Automatic Enrollment: *Vanguard Client Experience*

THE VANGUARD CENTER FOR RETIREMENT RESEARCH

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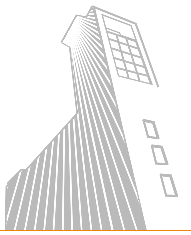

Executive Summary

This survey summarizes the experiences of 15 Vanguard clients who have introduced automatic enrollment (also called "negative elections") for their employee-contributory defined contribution plans. Among the findings:

- *Participation rates.* For plans automatically enrolling newly eligible employees, participation rates rose from 75% to 84%. For three plans that enrolled all eligible employees, the jump in participation rates was higher—from 73% to 90%.

- *Default savings rates.* Plan sponsors typically set low default deferral rates, with most choosing a default rate of 3% or less. Encouragingly, 25% of sponsors chose a default savings rate of 4% or more.

- *Default investment choices.* While 40% of plan sponsors chose balanced or life-cycle funds for their default investment option, 60% of clients made conservative choices—typically money market or stable value funds.

- *Implementation.* Nearly 9 out of 10 sponsors give participants a month or less to opt out of automatic enrollment. Communication of automatic enrollment typically occurs through enrollment kits and new-hire orientation.

This survey should be read in conjunction with our recent paper, *Automatic Enrollment: Benefits and Costs of Adoption, May 2001,* which summarized recent research, plan design and implementation issues, and Vanguard's recommendations for plan sponsors. It is available through a Vanguard marketing representative, your Vanguard relationship manager, or on the Web at institutional.vanguard.com in the news section.

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Background

As of April 2001, 15 defined contribution plans for which Vanguard provides recordkeeping services had introduced automatic enrollment. Virtually all had done so over the past two years. This survey summarizes the experiences of these plans as of April of this year. In general these results are similar to those reported by other observers, such as the Profit Sharing/401(k) Council of America.[1]

Caveat. A word of caution is in order about projecting the results from this and other surveys on automatic enrollment trends. Only a small percentage of plans have adopted the feature (e.g., the 15 plans in this survey represent about 1% of Vanguard recordkeeping clients). Moreover, many plans have introduced automatic enrollment in recent years, and then only to newly eligible participants—meaning that it will take time to impact aggregate participation rates. It will also take time to see how many participants choose to "opt out" of automatic enrollment. Thus, any reported results are necessarily preliminary.

The Vanguard plans offering automatic enrollment as of April 2001 varied widely in terms of size—ranging from as few as 200 participants to more than 20,000 participants (see Figure 1). That said, two-thirds of the plans had between 1,000 and 5,000 participants. When measured in terms of assets, plans ranged from about $16 million to $700 million, with 80% of plans having less than $250 million in assets.

Figure 1.

Survey Respondents by Plan Size and Assets

Plan Size (No. of participants)	**No. of plans**	**% of plans**
<1,000	2	13%
1,000–2,999	7	47%
3,000–4,999	3	20%
5,000–9,999	1	7%
10,000+	2	13%

Asset Size (in millions)	**No. of plans**	**% of plans**
<$50	4	27%
$50–$99	3	20%
$100–$249	5	33%
$250–$499	2	13%
$500+	1	7%

1 Profit Sharing/401(k) Council of America, "Automatic Enrollment 2001: A Study of Automatic Enrollment Features in 401(k) Plans," Chicago, IL, 2001. www.psca.org.

*Many plans have introduced **automatic enrollment** for newly eligible participants—thus the **impact** on participation rates will be seen slowly.*

More than half of the 15 plans in the survey provide an employer matching contribution of $0.50 on the dollar, and a majority provide for immediate eligibility (see Figure 2).

Figure 2.

Matching Contributions and Eligibility

Company Match	No. of plans	% of plans
$0.25 on the dollar	0	0%
$0.50 on the dollar	8	53%
$1.00 on the dollar	3	20%
Other	3	20%
None	1	7%

Eligibility Requirements	No. of plans	% of plans
Upon hire	8	54%
1 month	2	13%
3 months	2	13%
12 months	2	13%
Other	1	7%

Key Results

Automatic Enrollment Population. The majority of Vanguard plans automatically enroll only newly eligible employees (see Figure 3). As discussed in our automatic enrollment position paper, two factors are driving this trend:

- The desire for sponsors to minimize the cost of additional employer matching contributions.
- A concern that a rapid increase in the number of participant accounts, with little or no corresponding assets, will lead to increased costs or fees for the plan.

A related worry is that by automatically enrolling all eligible employees, sponsors may experience a high "opt out" rate, and they will then be left with the responsibility of administering many small inactive accounts.

Figure 3.

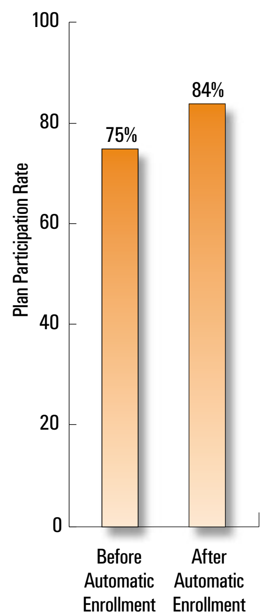
Automatic Enrollment Population

Employees Targeted	No. of plans	% of plans
All eligible employees	3	20%
Newly eligible employees only	11	73%
No response	1	7%

Participation Rates. Of the 11 plans enrolling newly eligible employees, 7 had sufficient data to report a change in participation rates. For these plans, participation rates rose from 75% to 84% (see Figure 4). These results understate the impact of automatic enrollment somewhat, as many of the plans in the survey introduced the feature within the past year. The impact of enrolling newly eligible employees on aggregate participation rates will only be seen over time.

Figure 4.

Impact of Automatic Enrollment on Participation Rates *(for newly eligible participants)*



In the three plans enrolling all eligible employees, participation rates surged more dramatically—from an average of 73% to 90%.

Of course, increases in participation rates may be the result not just of automatic enrollment but of other changes made to a plan. Many plans in our survey undertook other plan improvements—in employer match, eligibility, education, or investments—parallel with introducing automatic enrollment. So participation rates reflect the cumulative impact of all these changes.

Default Deferral Rates. Nearly half of plans in our survey chose 3% as a default deferral rate on automatic enrollment (see Figure 5). A 3% rate is the default utilized by the Internal Revenue Service in its main revenue ruling on automatic enrollment.[2]

Figure 5.

Default Deferral Rates

% of pay	No. of plans	% of plans
1%	1	7%
2%	4	26%
3%	6	40%
4%	2	13%
5%	1	7%
6%	1	7%

Notably, a quarter of sponsors chose a deferral rate of 4% or greater. In our view, higher default rates send an important message to participants about the savings rate needed to fund a comfortable retirement.

2 IRS Revenue Ruling 2000-8, in *Internal Revenue Bulletin* No. 2000-7, February 14, 2000, p. 617.

*A quarter of sponsors chose a deferral rate of 4% or greater—sending an important message to participants about the **savings rate needed** to fund a comfortable **retirement.***

Default Investment Vehicle. Sixty percent of sponsors chose a conservative fixed income fund as the default investment option—a money market, bond, or stable value fund. Forty percent chose a balanced or life-cycle fund (see Figures 6 and 7). In our view, a balanced or life-cycle fund is more consistent with the long-term retirement savings purpose of most plans, and so is the more desirable choice. Yet many plan sponsors remain worried about employee reaction to a short-term decline in the value of their plan accounts—especially if the employees were enrolled automatically.

Figure 6.

Preference for Default Investments

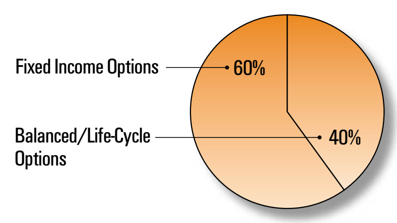


Figure 7.

Default Investment Choices

	No. of plans	% of plans
Money market fund	6	40%
Stable value fund	2	13%
Bond fund	1	7%
Balanced stock/bond fund	5	33%
Life-cycle fund	1	7%
Equity fund	0	0%

Implementation

Time Given to Opt Out. Virtually all the plans in our sample notify participants about automatic enrollment upon eligibility. Nearly 9 out of 10 require participants to "opt out" in less than one month—presumably as soon as possible before the first pay period following eligibility (see Figure 8). A handful of sponsors give participants two months or more to opt out.

Figure 8.

Time Given to Opt Out

	No. of plans	% of plans
Less than 1 month	13	86%
1 month	0	0%
2 months	1	7%
More than 2 months	1	7%

Responsibility for Communications. Under IRS rules, participants must be notified of automatic enrollment and be given instructions for opting out. Half of plan sponsors view it as their responsibility to notify participants of the automatic enrollment feature (see Figure 9). For the other half, it is a responsibility undertaken jointly with Vanguard or delegated to Vanguard.

Figure 9.

Responsibility for Communication

	No. of plans	% of plans
Recordkeeper	3	20%
Sponsor	8	53%
Recordkeeper and Sponsor	4	27%
Other	0	0%

Communication Methods. Most plans surveyed communicate automatic enrollment through enrollment kits (see Figure 10). Many plans also feature automatic enrollment during other communication events—the most popular being new-hire orientation.

Figure 10.

Methods for Communicating

	No. of plans	% of plans
Enrollment kit	11	100%
Orientation	6	54%
Meeting	1	9%
Separate Mailing	1	9%

Multiple responses allowed.

Methods for Opting Out. Employees typically fill out a form to opt out of automatic enrollment in the plan (see Figure 11). However, 20% of plans have employees opt out through a telephone associate.

Figure 11.

Methods for Opting Out

	No. of plans	% of plans
Telephone associate	3	20%
Paper form	12	80%

Conclusion

We encourage sponsors to review these survey results in conjunction with our recent position paper, *Automatic Enrollment: Benefits and Costs of Adoption.*

As noted in that paper, automatic enrollment should not be viewed as a "silver bullet" solution for alleviating sponsors' concerns with nondiscrimination testing or participant retirement security. While the initial results of automatic enrollment are indeed encouraging, plan sponsors seeking a long-term solution to the problem of low participation need to consider a multidisciplinary approach—one that integrates strategies for plan design, education, as well as administration.

As with any change in plan design, sponsors need to weigh the benefits of the higher participation and savings rates achieved through automatic enrollment against its costs. These include the cost of any employer match, the potential impact on plan fees due to a decline in average participant account balances, and the administrative headache of overseeing many small plan accounts if participants "opt out."

More important, whether or not plan sponsors elect to add an automatic enrollment feature, they must continue to reinforce basic education messages about the savings strategies needed to achieve retirement security.

*Sponsors seeking a **solution** to the problem of low participation need to adopt a **multidisciplinary approach**—combining plan design, education, and administration.*

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