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USING AUTOMATIC FEATURES TO DRIVE SUCCESSFUL RETIREMENT OUTCOMES

Fewer decisions can lead to more savings.

Since employees were first allowed to defer a portion of their pay to a workplace retirement plan, there was a problem: People weren't saving enough to ensure a secure retirement.

Maybe employees simply didn't understand the importance of saving on their own. Or maybe there was something else at play. Whatever the reasons, more needed to be done.

In this paper, we'll examine how automatic retirement plan features can address the lack of savings and improve retirement security. We'll cover:

- **Why financial education alone isn't enough**
- **How automatic features can help**
- **Recommendations for brighter retirements**

WHY FINANCIAL EDUCATION ALONE ISN'T ENOUGH

Defined contribution (DC) plans that allow participants to save on their own — such as 401(k) and 403(b) plans — are vital to the retirement security of Americans. The concept is subtly brilliant because it counters the feeling that employees are "losing" part of their pay by offering something in return: a reduction in taxable income (within defined limits). Ideally, everyone would have access to a retirement savings plan and everyone would take advantage of it.

So why don't enough people adequately contribute to their workplace retirement plan? At first, the solution seemed to be a lack of understanding. Education surely would help employees appreciate the importance of making good financial decisions. Plan sponsors and service providers produced eloquently written and beautifully designed flyers, brochures, and videos that clearly explained the importance of saving for retirement, and how to do it.

When the problem continued, it became apparent something else was standing in the way: us. According to researchers who study human behavior, our nature often gets in the way of making good financial decisions. Despite our best intentions, our decisions aren't always in our best interests. For example, we may avoid complicated issues (especially those involving finances) and procrastinate — tendencies that can hinder even the most determined savers.

What if employers and service providers could make a difference by working *with* these tendencies instead of *against* them? Experts call it *behavioral finance*. It seeks to understand and address how to overcome the deeply rooted tendencies that keep us from acting in our own best financial interests — in short, to beat these behaviors at their own game.

With that, things start to get interesting in the design of retirement plans.

Of course, many people respond to well-written and well-designed participant communications. For some, that's all it takes. But there are tendencies that can impact our decision-making without our being aware of it. For example:

- **Inertia.** Once we've made a decision (or a decision has been made for us), we tend to leave it alone. This "set it and forget it" thinking can keep us from increasing retirement contributions over time.
- **Anchoring.** We tend to make comparisons to something familiar. For example, we may think of the historically low mortgage interest rates available a few years ago as "correct," causing us to avoid taking out a new loan at the current, higher rate.
- **Loss aversion.** People react more strongly to a loss than to a gain. Think about losing your wallet and the $200 it contains, compared to discovering $200 in your coat pocket. Finding money feels great, but most people feel far more pain from the loss than the pleasure they get from the gain.
- **Decision paralysis.** It's easy to be overwhelmed when facing a long list of choices. That's often how people feel when it's time to review their retirement plan materials, including investment options.
- **Herd mentality.** If everyone else is doing something, I'd better jump in, too! Herd mentality helps explain why a stock might increase sharply even though its underlying value doesn't support the rise. People invest when they see others investing, sometimes even going against their own research and viewpoint.

HOW AUTOMATIC FEATURES CAN HELP

As researchers began to explain the basics of behavioral finance, retirement plan sponsors and industry experts listened. With techniques ranging from subtle encouragement to psychological sleight of hand, they realized employees can be coaxed into joining, contributing, and contributing more to their retirement plan.

Initially, enrollment in a retirement plan was voluntary. Employees were given the opportunity to opt in, but the default option was not to participate. Experts wondered what would happen if joining the plan was the default option and employees had to opt out.

The theory was put into practice when the Pension Protection Act of 2006 allowed plans to incorporate automatic features. Employees would have the right to decline, but the law allowed plans to automatically enroll employees in their employer-sponsored plan. It also allowed plans to periodically increase participant deferrals.

In the early days, auto-enrollment deferral rates tended to be around 2% or 3% of pay. While it increased the number of participants, it wasn't effective at increasing the average account balance and thus, improving prospects for fully funded retirements. It would take automatic deferral increases to start to move the needle.

Although many plans incorporated automatic features by the early 2020s, some had not. Perhaps that's why the very first provision of the SECURE 2.0 Act, Section 101, addressed automatic features. With this legislation, all 401(k) and 403(b) plans established after SECURE 2.0's December 29, 2022 enactment date must include automatic features, no later than January 1, 2025.

In spite of generally high implementation of automatic features, there is still work to do:

ON AVERAGE

75% of 401(k) plans offer auto-enrollment[1]

PLAN ASSETS	$50M - $200M	$200M - $1B	$1B+	AVERAGE
% OF 401(k) PLANS	70.1%	72.5%	81.3%	75%

ON AVERAGE

74% of 403(b) plans offer auto-enrollment[2]

PLAN ASSETS	$50M - $200M	$200M - $1B	$1B+	AVERAGE
% OF 401(b) PLANS	75%	85.7%	60%	74%

RECOMMENDATIONS FOR BRIGHTER RETIREMENTS

Adding automatic features to employer-sponsored retirement plans can help employees achieve brighter retirement outcomes. Transamerica's best practice recommendations include:

AUTOMATIC ENROLLMENT AT 5% - 7% OF COMPENSATION

Automatically enrolling employees in the plan eliminates the tendency to procrastinate and takes advantage of inertia. Often, employees appreciate the nudge toward plan participation; 83% of plan sponsors adopting auto-enrollment indicate employee response has been positive.[3]

SECURE 2.0 requires automatic enrollment between 3% and 10% of pay. Currently, the default deferral rate is 6% (median).[3]

AUTOMATIC DEFERRAL INCREASES OF 2% PER YEAR, CAPPED AT 15% OF COMPENSATION

Most (71%) automatic enrollment plans also automatically increase employee deferrals each year.[3]

As is the case for auto-enrollment, automatically increasing participant deferrals each year helps overcome procrastination and inertia. Well-meaning participants may intend to increase their contribution percentage at their work anniversary date, when they receive a pay increase, or the first of the year, but they often fail to follow through. By removing the need to opt in to a higher deferral rate, automatic increases remove a roadblock to saving enough.

SECURE 2.0 requires automatic deferral increases of 1% per year, up to a minimum of 10% and maximum of 15% of compensation.

ANNUAL RE-ENROLLMENT OF EMPLOYEES WHO HAVE OPTED OUT AND THOSE CONTRIBUTING LESS THAN THE AUTOMATIC ENROLLMENT PERCENTAGE

Circumstances change, so it's important to regularly give employees more opportunities to join the retirement plan. By requiring them to revisit their decision to opt out, they must take action — and this time, it could be a positive move.

Employees who are in the plan but making minimal contributions should also be given another opportunity by automatically re-enrolling them at the plan's initial deferral rate.

CONCLUSION

Auto-enrollment, auto-escalation, and re-enrollment are no longer emerging trends. They are established strategies that can help boost retirement plan participation and savings rates. Adding them to a retirement plan is another way employers can help employees live their best lives.

Contact your Transamerica representative for more information about adding automatic features to your retirement plan.

Get in touch:

CALL
800-755-5801

VISIT
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[1] "2024 PLANSPONSOR Defined Contribution Plan Industry Report, 401(k) Plans," 2024

[2] "2024 PLANSPONSOR Defined Contribution Plan Industry Report, 403(b) Plans," 2024

[3] "Workplace Transformations: Employer Business Practices and Benefit Offerings," nonprofit Transamerica Institute, March 2024

Information regarding retirement plans is general and is not intended as legal or tax advice. Retirement plans are complex, and the federal and state laws or regulations on which they are based vary for each type of plan and are subject to change. In addition, some products, investment vehicles, and services may not be available or appropriate in all workplace retirement plans. Plan sponsors and plan administrators may wish to seek the advice of legal counsel or a tax professional to address their specific situations.

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