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Does Autoenrollment Affect Employer Contributions?

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Low participation rates limit the effectiveness of 401(k) plans as a reliable source of retirement income. About one in five workers eligible to participate in their employer's 401(k) plans do not enroll (Munnell, Golub-Sass, and Muldoon 2009). Firms can raise participation rates by automatically enrolling employees as soon as they become eligible. However, higher participation rates increase costs for employers that match employee contributions, and firms appear to reduce the rate at which they contribute to 401(k) plans when they adopt autoenrollment. Autoenrollment, then, will not necessarily raise future incomes for all eligible employees.

Autoenrollment

Automatic enrollment is an increasingly popular 401(k) feature that enrolls employees as soon as they become eligible. Between 1999 and 2008, the percentage of 401(k) plans with automatic enrollment increased from 4.2 to 39.6 (PSCA 2008). Madrian and Shea (2001) found that automatic enrollment increased participation rates of new hires from 49 to 86 percent, leading academics, policymakers, and employers to embrace automatic enrollment as a solution to low plan participation and a way to increase retirement savings (U.S. GAO 2009). The 2006 Pension Protection Act (especially the release of related Internal Revenue Service rules in March 2009) will likely further boost the share of employers offering automatic enrollment.

Effects of Autoenrollment on an Employer Match

Most companies with automatic enrollment match their employees' contributions (Beshears et al. 2009), usually by contributing 50 cents for every dollar contributed by employees, up to 6 percent of salary. Unless employers cut costs in some way, the increase in pension participation generated by automatic enrollment will increase employers' cost of offering a match. In fact, companies often report that the cost of matching is the most important barrier to adding automatic enrollment (Bruno 2008).

We find evidence that firms reduce their match rate to offset the costs of automatic enrollment. Our statistical model shows that match rates are 7 percentage points lower among firms with automatic enrollment than among those without it, after we control for industry, plan size, and whether the firm also offers a defined benefit plan (figure 1). For firms with 60 percent or more participation before automatic enrollment, we estimate that a 7 percentage point reduction in match rates would offset at least 42 percent of the cost increase associated with autoenrollment.

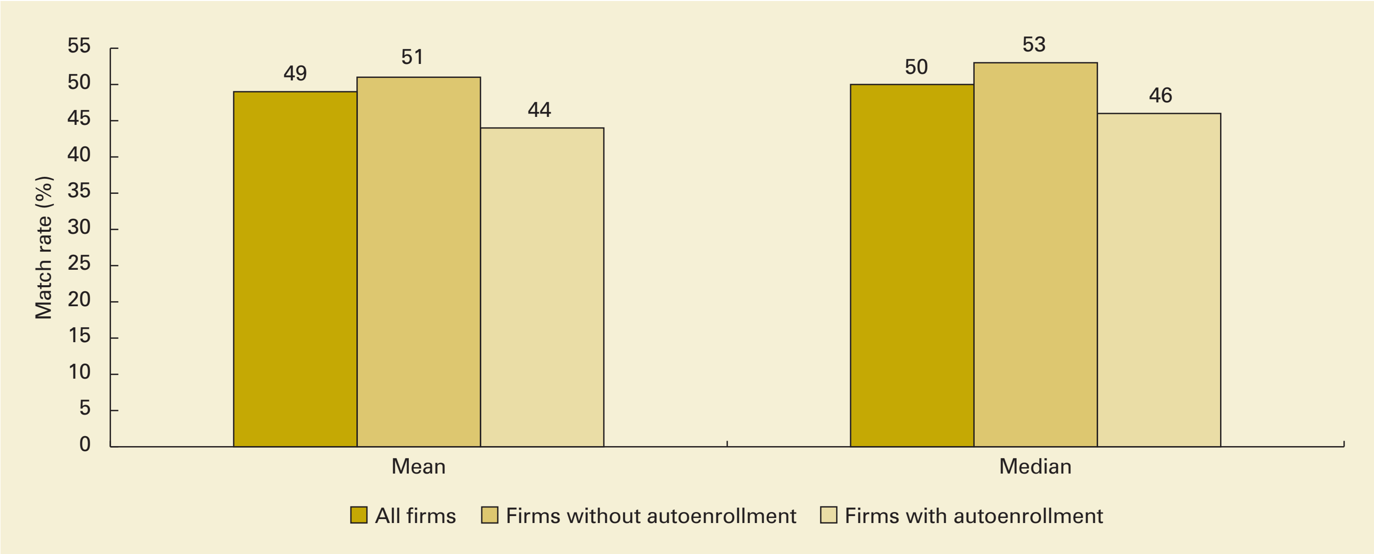
Of course, these results might indicate that firms with low match rates are more likely to adopt automatic enrollment because their matching expenses are already low, not that firms cut their match rates in response to autoenrollment. Either way, the results imply that autoenrollment may not promote retirement savings as effectively as some have claimed. We need additional research on how employers set their match level to better understand how they might respond to automatic enrollment.

Effects of Automatic Enrollment on Retirement Security

Most of the discussion surrounding automatic enrollment has focused on how it benefits employees by increasing pension coverage and retirement savings. However, it is not free for employers. While autoenrollment is likely to boost the retirement savings of workers who would not participate without it, our findings suggest it could lead to lower account balances at retirement for those who were already enrolled or would have enrolled anyway. The prospect of lower match rates may not only reduce employer contributions, but might also lower workers' contributions (Engelhardt and Kumar 2004; Even and Macpherson 2005).

Looking forward, a broader question is whether employers will continue offering matches after adopting automatic enrollment. In the past, the match was intended to increase employee participation and contributions (Choi et al. 2002). But research has shown that a match has only a modest impact on plan participation beyond that of automatic enrollment (Beshears et al. 2009). It will be important to monitor the effects of automatic enrollment on retirement contributions to assess the long-term effects of increasing enrollment.

FIGURE 1. Predicted Firm-Level 401(k) Match Rates, by Automatic Enrollment



Source: Authors' calculations using the Annual Return/Report Form 5500 Series for Plan Year 2007 and the Pensions & Investments database of the top 1,000 pension funds (P&I 1,000) as of September 30, 2008.

Notes: The Form 5500 contains information on the full universe of private sector employer-provided pension plans, including employer and employee contributions, number of participants, pension type, and employer industry. The P&I 1,000 contains information on the largest 1,000 private and public pension funds in the United States, including whether 401(k) plan sponsors offer automatic enrollment. The regression sample is constructed by merging data from the Form 5500 and the P&I. The final sample includes 532 firms with 100 or more plan participants (active and retired).

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