



Automatic Enrollment IRAs - Coming to a Business Near You?

While much of the debate on Capital Hill in recent months has focused on deficit reduction and entitlement reform, retirement has not been completely relegated to the back burner. When President Barack Obama released his 2012 Budget, many retirement industry observers were pleased to see that the President's proposed budget includes a renewed call for "Automatic Workplace Pensions" (a fancy name for an IRA-based automatic enrollment program that would be made available through the workplace). While some industry observers were heartened by the fact that the auto-enrollment IRA program received mention in the 2012 budget proposal, others have been quick to point out that a similar program was included—even more prominently—in the President's 2011 budget proposal, to no avail.

While the likelihood of the President's auto-enrollment IRA proposal finding its way into law between now and year end is admittedly moderate, the inclusion of the auto-enrollment IRA provision in the budget proposal serves to draw attention to the explicit need for meaningful retirement reform to address the nation's looming retirement crisis.

What is automatic enrollment?

The concept of automatic enrollment has its origin in research that was conducted within the 401(k) arena. Leveraging concepts from the field of behavioral finance, researchers in the mid-to-late 1990s began experimenting with various 401(k) plan design alternatives in an attempt to determine the extent to which employee behavior could be impacted by plan design. One of the most striking discoveries made by this research was the extent to which plan participation rates could be significantly increased by simply changing the plan enrollment paradigm from one of elective enrollment (opt-in) to one of negative consent (opt-out).

Whereas under the traditional "opt-in" paradigm, employees were given the option to enroll in their company's 401(k) plan after meeting certain eligibility criteria, in the new experimental model, employees were automatically enrolled in their company's 401(k) plan unless they affirmatively elected not to participate in the plan. While the difference may seem to be one of form, the results were telling. In one case, researchers found that participation rates among new employees more than doubled (37% versus 86%) following the implementation of an automatic enrollment feature within the company's 401(k) plan*. When similar results emerged from other experimental programs, the employer community took notice. By 2006, Aon Hewitt was projecting that approximately 24% of defined contribution plan sponsors had incorporated automatic enrollment**.

Automatic enrollment received its next major boost with the passage of the Pension Protection Act of 2006 (PPA). PPA created a new 401(k) safe harbor plan design alternative to incent the business community to expand its use of automatic enrollment within 401(k) plans. Thanks to PPA as well as positive response from the employer community, adoption of automatic enrollment within 401(k) plans continues to rise. As of 2010, according to a study released by Aon Hewitt, approximately 57% of defined contribution plans now incorporate automatic enrollment**.

While the results of the past ten years are promising, there is nearly universal consensus that much remains to be done if future generations of U.S. retirees—most of whom will be without traditional pension coverage—are to have the level of discretionary retirement savings needed for a financially secure retirement. For companies that sponsor 401(k) plans, a promising next step appears to be the use of automatic escalation programs under which an employee's deferral rate is automatically increased on an annual basis (e.g., 5% in year one, 6% in year two, 7% in year three, etc.) unless the employee makes an affirmative election to the contrary. Based on early results, indications are that automatic escalation (paired with automatic enrollment) may, indeed, represent a key element in the search for a viable, long-range solution.

Why automatic-enrollment IRAs?

But what about those workers not covered by a 401(k) or similar type of employer-sponsored retirement plan? According to the federal government, there are approximately 78 million U.S. workers who are not covered by an employer-sponsored retirement plan. For these workers, traditional IRAs and Roth IRAs represent the primary retirement savings option. While the IRA market is booming, the overwhelming majority of the assets currently flowing into IRAs each year come in the form of rollover contributions from employer-sponsored plans, and not from regular IRA contributions. Simply put, the 78 million workers who are not covered by an employer-sponsored plan are—for the most part—setting aside little or nothing for their retirement. To many, this situation does not come as a surprise given the fact that traditional and Roth IRAs represent a conventional “opt-in” form of retirement savings coupled with the fact that many of the 78 million uncovered employees are in the lower income brackets.

On one end of the spectrum, there are individuals who would advocate a federal mandate under which all businesses would be required to sponsor a retirement plan that would provide a minimal level of retirement plan coverage and funding. On the other end of the spectrum are individuals who would argue that it is up to each worker to personally take the steps necessary to ensure that he or she is able to support him or herself financially in retirement. Automatic enrollment IRA programs represent a middle-of-the road approach designed to leverage what we have learned within the 401(k) market over the past decade to increase retirement savings without placing an undue burden on the nation's small business community. Under the President's proposed approach, most businesses that do not sponsor a retirement plan such as a 401(k) would be required to facilitate an automatic enrollment IRA program. Under such a program, employers would be required to directly deposit a set percentage of each employee's pay into an IRA program unless the employee makes an affirmative election to the contrary. Once funded, the IRA would be owned and controlled by the employee, thereby sidestepping many of the conventional cost and liability concerns surrounding any type of mandate that would require employer plan sponsorship.

In addition to the inclusion of automatic enrollment IRAs within the President's 2012 budget proposal, activity is also brewing in both the House and the Senate. On April 14, 2011, Representative Ronald Kind (D-WI) introduced an automatic enrollment IRA bill to the House of Representatives (H.R. 1534) which is co-sponsored by Representative Dave Reichert (R-WA). And on the Senate side, Senator Jeff Bingaman's (D-NM) office has indicated that the Senator expects to reintroduce an automatic IRA bill similar to one that he and Senator John Kerry (D-MA) co-sponsored in 2010.

If Not Auto-Enrollment IRAs, then What?

While one can legitimately argue—for a number of reasons—that the 401(k) automatic enrollment results of the past decade are not necessarily indicative of the results that would be achieved through a nationwide automatic enrollment IRA program, it's difficult to argue that a nationwide IRA-based automatic enrollment program would not result in an appreciable increase in the overall number of U.S. workers actively saving for retirement. And, while the automatic enrollment IRA approach may draw limited criticism from both ends of the political spectrum, given the scope of the looming retirement savings challenge coupled with the apparent lack of any broadly embraced, viable alternative, it may well be that a nationwide automatic enrollment IRA is in our nation's future—if not this year, perhaps in the near future.



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