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How High Can You Go? - Participants willing to accept higher default deferral rates

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It's generally accepted that 3% isn't a very ambitious 401(k) plan deferral rate, and won't get many employees where they need to be financially as they approach retirement unless they enjoy miraculously high average investment returns. Most employees will need a figure closer to 10%, or even more, depending on how old they are when they begin to get serious about retirement saving.

Yet 3% has traditionally been the most common default deferral rate used by plans that auto-enroll participants. That's changing, however.

No revolt

Many plan sponsors have feared that, if they get too ambitious with the auto-deferral rate, employees will balk, and simply opt out of the plan, leaving them worse off than they otherwise would have been. Anecdotal evidence, supplemented by survey data, suggests that this fear is overblown.

For example, according to the money-manager newspaper *Pensions & Investments*, an auto dealership in the Midwest that raised its auto-enroll default deferral to 6% from 3% at the beginning of 2016 reported that its employees didn't revolt. The company's maximum deferral rate eligible for a 50% match is 6%, a fact that might have kept some employees from objecting.

Number crunching

Large 401(k) recordkeepers regularly crunch the numbers on deferral rates and other data from all the accounts they service and publish them. They also look at the impact of raising the default deferral rates for auto-enrolled participants. Although their data don't always match, they tend to be similar, particularly with respect to trends.

For example, Wells Fargo's Institutional Retirement and Trust unit determined that there's no difference in auto-enrolled participant opt-out rates whether the deferral rate is 3% or 6%. (The opt-out rate for both was about 11%.)

Meanwhile, T. Rowe Price reports that in 2011 only 17% of the plans it administered with auto-enrollment had default deferral rates of 6% and above. By 2016, it had risen to 33%. That's just a hair under the 34% prevalence of the once dominant 3% default deferral rate (used by half of the firm's clients in 2011). In other words, if those trends have kept up, this year the most popular deferral rate among its clients will be 6%.

At Vanguard, the trends are the same, although in 2016 the percentage of plan sponsors using at least a 6% auto-enroll default deferral rate was only 20%, with 45% still using the traditional 3% rate. Fidelity has reported similar current rates: 18% use 6% deferral rates, and 48% use 3%.

More research

Companies that are fully comfortable with auto-enrollment don't limit the practice to new employees. Some extend auto-enrollment to eligible employees who aren't participating (such as if they were hired before auto-enrollment began or employees opted out after being auto-enrolled in the previous enrollment cycle). Others include auto-increases to deferral rates for active participants whose deferral rate is lower than the default rate.

Research also shows that employers that auto-enroll participants have better luck getting them to accept auto-increases in their deferral rates. Among T. Rowe Price clients, for example, two-thirds of participants in plans with an auto-enroll go along with auto-increases in deferral rates. But when auto-increase formulas are used for participants who weren't auto-enrolled, only 12% stick with that program.

What next

And remember: Auto-enrollment often helps plans pass average deferral percentage (ADP) testing because the average deferral rate for non-highly compensated employees will increase. Is a higher auto-enrollment deferral rate right for your plan and its participants? Discuss it with your benefits specialist and don't forget to sweeten the pot with matching contributions.

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