Give Employees More Bang for Their Buck

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How to use default deferral rates and auto-escalation clauses

According to a Plan Sponsor Council of America survey, only 46% of defined contribution plans automatically enroll participants. The most common default deferral rate for those that do is 3%. Are you telling your employees that they can afford to retire by saving just 3% of their salary each year? Some participants may think so.

Avoiding Advice?
Studies by the Employee Benefit Research Institute suggest that, when plans default participants into a 3% deferral rate, participants stay at that level. This happens even when the participants were willing to defer more (typically 6%) to get the maximum employer match before the plan established its auto-enrollment feature. A slim majority (55%) of plans with a default participation feature automatically boost deferral rates annually, typically by one percentage point.

A Towers Watson survey of large employers found that fewer than 22% gave employees a specific suggestion of what a reasonable retirement savings rate might be. Of those that did, 39% suggested a figure of at least 10%.

For many participants, depending on the age at which they began saving for retirement, 15% might be more in order — although trying to default participants in at that rate likely would backfire. Yet employees often are less resistant to higher default rates than many plan sponsors believe. Doubling the auto-deferral rate from 3% to 6% seldom creates a participant backlash. In fact, a majority of employees in an OneAmerica online survey said they would appreciate being nudged into higher deferral levels through an auto-escalation feature.

What Does it Cost?
Company budgetary considerations sometimes can draw a veto to proposals to boost auto-enroll and auto-escalation default numbers. Naturally if you match, for example, 50 cents on the dollar up to a 6% deferral level, moving the default deferral from 3% to 6% will increase your plan's cost.

But offering a 33% match up to a 9% deferral rate would cost you the same 3% of pay for each participant going for the maximum match, and those participants would then be saving at a 12% of pay rate with the match added in. That's three points higher than the prior combined rate.

Also, the 33% match capped at 9%, in the case of some participants, might wind up costing you less, but still inspire employees to increase deferrals. For example, while it may not prompt a participant to increase his or her deferral all the way up to the 9% ceiling, that participant may choose to increase it instead to 7% or 8%.

With the 33% match, the participant would still wind up with a higher total deferral (9.31% and 10.64%, respectively). However, your cost would actually drop from the original 3% of payroll amount, to 2.33% and 2.66%, respectively.

The End Game
Encouraging participants to do more for themselves by deploying more aggressive plan designs can deliver better results for everyone. Contact your benefits advisor to see if you and your employees can profit from increased deferral rates and auto-escalation provisions.

For more information on BPM's Employee Benefit Plan services, please visit our website page or contact Jenise Gaskin at 925-296-1040 or Mike Spence at 408-961-6300.