

# EBRI 401(k) Accumulation Projection Model

*May 2005*

# Analytical Enhancements of Accumulation Projection Study

- ✓ Breaks in 401(k) coverage
- ✓ Catch-up contributions
- ✓ IRA utilization
- ✓ Automatic enrollment

# Accumulation Projection Study Findings

## Automatic Enrollment's Impact

- Opt out rates in auto enrollment are low across all demographics.
- Workers stick with default options for long periods of time.
  - After 46 months of tenure, the percentage of participants still at the defaults was approximately 30 percent, according to Choi et al study.
- Due to inertia, while the bottom two income quartiles benefit from increased participation, higher income employees (who tend to participate at high rates without automatic enrollment) don't tend to benefit for automatic enrollment.

***What should plan sponsors take away from this?***

# 2005 Automatic Enrollment Defaults

## Default Investment Option

## Default Before-Tax Contrib. Rate

<b>Money Market/Stable Value</b>	<b>56%</b>
<b>Asset Allocation/Balanced</b>	<b>39%</b>
<b>Other</b>	<b>5%</b>

<b>1%</b>	<b>=</b>	<b>6%</b>
<b>2%</b>	<b>=</b>	<b>28%</b>
<b>3%</b>	<b>=</b>	<b>49%</b>
<b>4%</b>	<b>=</b>	<b>9%</b>
<b>5%</b>	<b>=</b>	<b>3%</b>
<b>6%</b>	<b>=</b>	<b>5%</b>

*Hewitt's 2005 Trends and Experience in 401(k) Plans Survey*

# Can American Workers Afford to Retire?

## Hewitt's Total Retirement Income Replacement At Large Companies Study: The Real Deal

- The 401(k) is projected to represent a significant portion of retirement income even for those with DB plans.
- 30 percent of workers do not participate in their 401(k).
- Retiree medical costs can add 5 percent to 20 percent to the annual cost of retirement depending on coverage—or more.
- Workers with only DC plans do not participate in a way that compensates for the lack of a DB plan: *For workers who have only DC retirement benefits—taking into account the impact of retiree medical—income replacement (including SS) is projected to be only 57.2 percent.*

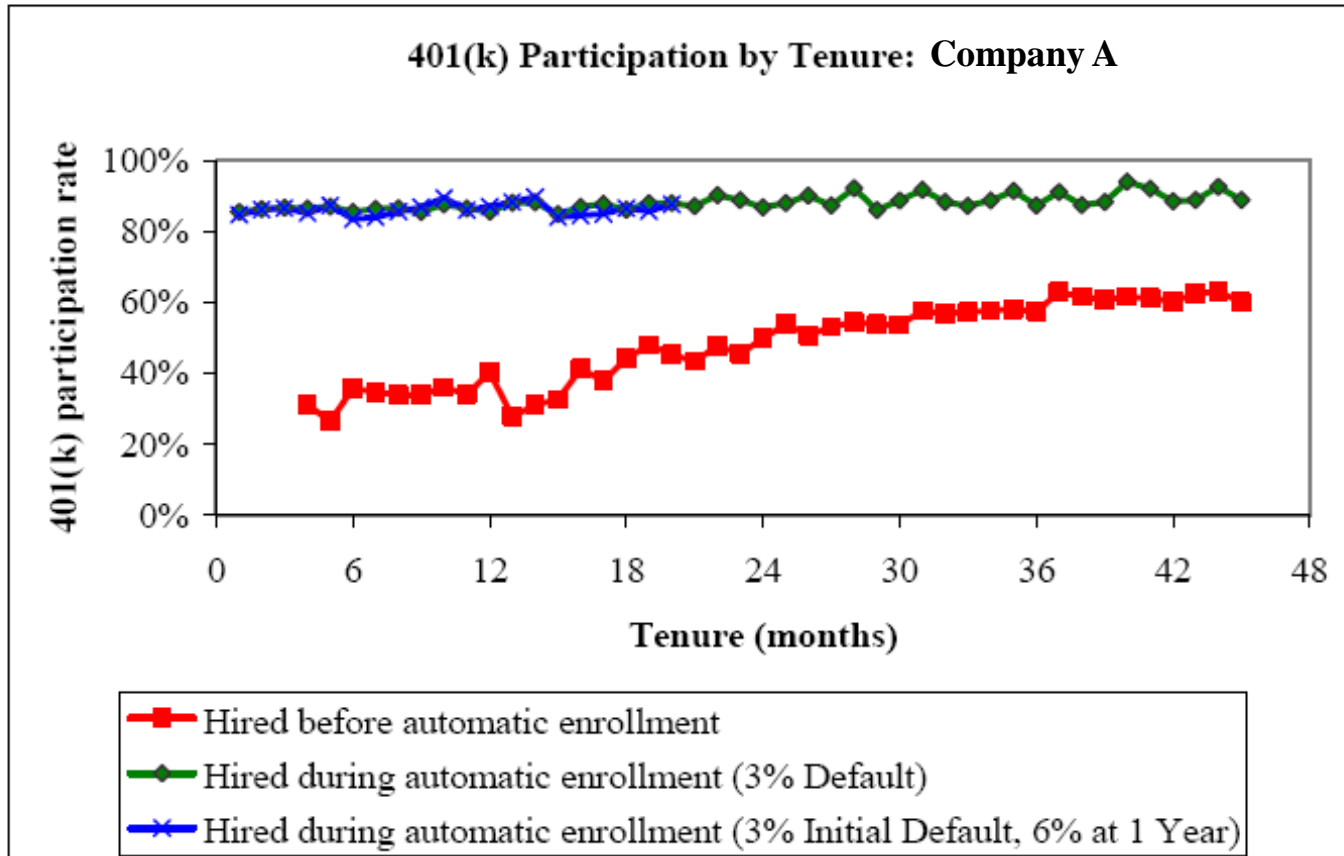
*The Real Deal: Total Retirement Income Replacement At Large Companies.* July 2004. Hewitt Associates.

# Impact of Changes in Opt Out Rates

- Increasing the default contribution rate from 3 percent to 4 percent doesn't change opt out rates.
- Increasing default contribution rate from 3 percent to 6 percent doesn't reduce opt out rates.
- Defaulting contribution rate to 6 percent and fund to balanced fund still results in high participation rates under automatic enrollment.

*Saving for Retirement on the Path of Least Resistance. Choi et al. 2001.*

# Defaults' Impact on Opt Out Rates



*Saving for Retirement on the Path of Least Resistance. Choi et al. 2001.*

# Conclusions

- **Traditional automatic enrollment appears to augment the retirement income adequacy of certain workers.**
- **However, traditional automatic enrollment may lead participants and plan sponsors into a false sense of security. *True retirement income adequacy may still not be achieved.***
  - **Consider workers' tendency to cash out small balances at termination.**
  - **Provide baseline non-participants' accumulation projection.**
  - **Evaluate improvement over baseline relative to adequacy needs.**
  - **Provide what if analysis of more robust defaults.**
  - **Provide what if analysis of features such as contribution escalation.**



# Appendix

# Retirement Income Adequacy— The Real Deal

## The Analysis

- 62 Fortune 500-type companies studied
- 960,000 eligible employees considered
- Examined retirement income adequacy on average, by age, by salary, and by tenure
- Considered DB, DC, Social Security, and Retiree Medical
  - Actual DC data used
  - DB projections from Spec Book
  - Three retiree medical scenarios