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AUTO-ENROLL 401(K)s

More companies are offering them. Will they fix our retirement savings blues?

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The trend could become the norm. Human resources firm Aon Hewitt surveyed 120 large U.S. companies in 2010 and found that 60% of them automatically enrolled workers in defined contribution retirement plans such as 401(k)s. In Aon Hewitt's 2006 survey, only 24% of companies had bothered to do so.¹

Does automatic enrollment lead to plan participation? It seems to greatly encourage it. The Aon Hewitt study found that 85.3% of auto-enrolled workers were participating in the retirement plans, bringing overall defined contribution retirement plan participation to 75.8% of the workforce.¹

It may encourage growth investing. When you auto-enroll in a 401(k), you are often presented with a suggested asset allocation including target-date funds. Younger plan participants seem to be embracing this choice and ramping up their ownership of equities. A new Vanguard study shows that equity allocations for the typical 20-year old plan participant went from 40.7% to 84.7% between 2003 and 2010, and there was also a notable increase in equity ownership for plan participants aged 20-30 in that period. Last year, 61% of Vanguard plans offered workers default investment choices; 89% of these plan sponsors picked target-date funds as the default choice.²

Are the set contribution rates too low? Aon Hewitt found that 76% of auto-enroll plans had set contribution rates of 4% or less. This automation might be a hindrance: while employees in the auto-enroll plans deferred an average of 6.8% of their pay, workers who had actively enrolled in their company retirement plans put 7.8% of their salaries away.²

Will we see auto-IRAs? In 2010, President Obama proposed requiring any employer in business for more than two years with 10 or more employees to sponsor direct-deposit Roth IRAs, with 3% of employee salaries going into the accounts. The National Small Business Association (NSBA) called the idea "unfair" to small businesses and "very problematic". No momentum seems to be building for its revival.³

Is automatic enrollment "the answer"? Since few and fewer employers offer pensions, employees need to save more for retirement, and auto-enroll 401(k)s helps those who wouldn't normally participate in a retirement plan to become acquainted with the awesome potential of these retirement savings vehicles. The Aon Hewitt study seems to show a path from enrollment to interest to investment.

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Citations.

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