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WEB EXCLUSIVES

Automatic contribution arrangements can be one step in a sound retirement plan. How does one know if an automatic contribution arrangement is right for a particular plan? This article explains automatic contribution arrangements and offers key points to consider when determining if such an arrangement is the right way to go.

Automatic Contribution Arrangements in Government DC Plans

by Jamie Kalamarides, Prudential Financial

Faced with low participation rates, inadequate salary deferral percentages and inappropriate asset allocation despite the efforts of traditional education, marketing and one-on-one counseling methods, government plan sponsors are looking to "automatic contribution arrangements" as a potential solution to improve the likelihood that their employees achieve a secure retirement. To adopt these arrangements, governments may need to revise legislation and state wage laws.

This article:

- Defines automatic contribution arrangements
- Explores the reasons why employers are considering automatic enrollment
- Reviews the impact of the Pension Protection Act of 2006
- Offers a simple assessment to determine whether an automatic contribution arrangement may be right for your plan
- Identifies the key decisions necessary to set up such arrangements in government plans (See sidebar on page 3.)
- Discusses critical implementation considerations.

What Is an "Automatic Contribution Arrangement"?

While there are many variations of automatic contribution arrangements, most experts agree that these arrangements have the following features:

- **Automatic Enrollment**—Employees are automatically enrolled in the defined contribution plan on their eligibility date. Employees are given the option to opt-out.
- **Automatic Contribution Rate**—Participants' contributions are automatically started at a meaningful level.
- **Automatic Escalation**—Participants' contributions are automatically increased annually to a specified maximum amount.
- **Default and Balanced Investments**—Participants' contributions are automatically invested in a prudent fund and rebalanced on a periodic basis.

Why Consider Automatic Contribution Arrangements?

Whether you are contemplating your fiduciary responsibilities, troubled by the future liabilities attributable to today's workers or just altruistic, you have to be concerned about the retirement security of government employees.

The facts are startling:

- The U.S. personal savings rate as a percentage of disposable income is near 100-year lows.[1]
- Most workers (52%) have less than $25,000 saved, not including their primary residence.[2]
- 59% of all workers feel as though they are behind schedule in saving toward retirement.[3]
- 52% of Americans in their 30s are saying "just tell me what to do."[4]
- 80% of participants are not engaged or involved in retirement planning.[5]
- 46% of participants never change their asset allocation.[6]

You may have tried a variety of traditional approaches to change participants'

Is an Automatic Contribution Arrangement Appropriate for Your Government DC Plan?

While there are a number of considerations often unique to each situation, ask yourself the following questions and count the number of "yes" answers.

1. Is your organization's primary retirement plan a defined contribution plan?
2. Does your defined contribution plan have lower participation than desired?
3. Is the eligible workforce not contributing enough to get a match (if applicable)?
4. Do fewer than 10% of participants increase their contributions over time?
5. Are assets concentrated in just a few investments for many age cohorts?
6. Do fewer than 10% of participants rebalance their assets periodically?
7. Is the eligible workforce younger and likely to vest?
8. Can your organization afford to pay a match (if applicable) to more participants?
9. Is it impractical or too expensive to increase participation, contributions or diversification through traditional techniques such as one-on-one counseling or targeted marketing?
10. Is your enrollment process currently paperless?
11. Do you have benefits and an investment philosophy that is altruistic or paternalistic?

If you answered "yes" to 7-11 questions, you may want to seriously consider adopting an automatic contribution arrangement. If you answered "yes" to 4-6 questions, some of your employees may realize real benefits from automatic contribution.

If you answered "yes" to fewer than 3 questions, you may want to consider more focused solutions—rather than automatic contribution arrangements—to achieve your goals. For example:

- Lifecycle funds
- Simplified enrollment methods like postcards and using electronic signatures or
- Starting a match.

behavior—like one-on-one counseling, direct marketing and signature-only enrollment cards—only to be frustrated by participants' unwillingness to change due to inertia.

Academics and industry experts have found that for many employees, it is primarily inertia that has caused a failure to save.[7] Under automatic enrollment arrangements, inertia works in favor of savings for those employees who want to save. The data indicates that automatic contribution arrangements materially increase the savings levels among low- and middle-income employees.[8]

What Is the Impact of the Pension Protection Act of 2006?

The Pension Protection Act of 2006 (PPA) defines "automatic contribution arrangements" for ERISA plans in §902.

The PPA gives ERISA plan sponsors the choice to adopt qualified automatic contribution arrangements to avoid nondiscrimination testing and enable employees to reap the benefits of behavioral economics. The PPA provides for the preemption of state wage laws that currently prohibit employers from automatically enrolling eligible employees in ERISA-covered defined contribution plans. Automatically enrolled participants must contribute at least 3% in the first year, 4% in their second, 5% in the third and 6% thereafter, but not to exceed 10%. To qualify, employers must provide 100% match up to 1% of compensation and 50% match on elective contributions from 1% to 6% of employee contributions. Plan sponsors are not to be required to retroactively enroll non-participants. Also, under §624, ERISA sponsors have fiduciary protection for default investments whose objectives may include capital preservation and long-term capital appreciation.

However, the PPA does not address automatic contribution arrangements for Section 457 government deferred compensation plans and other non-ERISA plans. Why? Some say Congress was reluctant to consider legislation that states can create themselves. Others did not want Congress to preempt states' wage law for their own employees. Still others wanted to avoid defining fiduciary protection for default investments in non-ERISA plans based on ERISA.

What does this all mean to government plan sponsors? To enable automatic contribution arrangements for government plans, each plan must adopt its own "automatic contribution arrangement" and modify, if necessary, any wage laws that restrict employers from withholding wages without the employee's written consent. **B&C**

Endnotes

1. U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts of the US.
2. Retirement Confidence Survey conducted by Employee Benefit Research Institute (EBRI), American Savings Council (ASEC), and Matthew Greenwald & Associates (Greenwald), 2005.
3. Prudential's Four Pillars of Retirement Series, 2005.
4. Ibid.
5. Retirement Services Roundtable, 2006.
6. Ibid.
7. Retirement Confidence Survey.
8. "The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States" by Boshears, Choi, Laibson, and Madrian, 2006.

What Are the Key Decisions Required to Implement Automatic Contribution Arrangements in Government DC Plans?

To implement an automatic contribution arrangement, a plan needs to determine its approach to the following implementation choices. Seek early assistance on these topics from the plan administrator and recordkeeper to understand any implementation constraints and additional costs.

Implementation Decision	Considerations
• What are your goals from automatic contribution arrangements?	• Write them down before you answer the rest of these questions as they will guide your decision making.
• What percentage or dollar amount should eligible participants automatically contribute?	• Three percent of wages may become the market standard based on the Pension Protection Act of 2006.
• What time of year should the arrangement automatically increase salary deferral?	• Your employees won't miss the increase if you match the timing with annual salary increases.
• By what amount should salary deferrals be increased?	• One percent of wages or 50% of negotiated dollar wage increases are common.
• What is the maximum amount that should be deferred?	• Many employers are deciding between 10% and 15% of wages.
• Should non-participating employees be enrolled retroactively?	• Retroactive enrollment will increase participation faster for older and longer-tenured workers.
• Will you provide a match or base contribution?	• Matches give tangible incentives to stay enrolled.
• In what investments will you invest automatic contributions?	• Use your written goals and investment policy to determine the appropriate solution for your plan. Typical alternatives include stable value funds, target maturity funds, lifecycle funds and balanced funds.
• How will funds be rebalanced?	• Rebalancing is often done quarterly or annually.
• What will be the form and frequency of opt-out notification?	• Opt-out notification should occur before automatic contributions start and at least annually thereafter.
• Will you market to those who have opted-out to reconsider?	• Non-participants' situations may change in future years.
• Will you re-examine the default payout vehicle for retirees and terminations?	• To create a retirement paycheck for life from participants' DC balances, some sponsors are considering moving the default payout away from lump-sum toward annuitization or guaranteed withdrawal provisions.
• If you currently have multiple retirement plan providers/administrators, which will keep records and invest the automatic contributions?	• Your plan may want to consider consolidating providers first and/or issuing an RFP to determine the most competitive offer for automatic contributions.

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John J. (Jamie) Kalamarides is senior vice president of the Tax-Exempt Segment for Prudential Retirement, a unit of Prudential Financial, Hartford, Connecticut. He chaired the 2006 NAGDCA Taskforce on Automatic Enrollment.