Issue Brief

Using Automatic Enrollment in Local Government Retirement Plans to Increase Savings

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Fiscal pressures have prompted many local governments to reduce retirement benefits for new hires, which raises the question: Will these new employees have sufficient retirement savings after a career in local government?

One way employees can increase their retirement security is to enroll in a supplemental savings plan. Unfortunately, while these plans are common in local governments, there are surprisingly few incentives for employees to enroll in them.

In this issue brief, University of Georgia Researcher Paula Sanford examines the role of automatic enrollment in local governments. She found many studies on the benefits and limitations of auto enrollment in the private sector but nothing about automatic enrollment in local governments.

Why have local governments been slow to adopt automatic enrollment practices?

1) Legal constraints. Only 11 states permit automatic enrollment for public defined contribution plans. In a few places, an exemption to anti-garnishment laws has been written into statute for a particular retirement system or plan.
2) Perception. Government leaders worry that automatic enrollment in a supplemental savings plan might overburden their employees, especially those who earn modest wages.
3) Labor questions. There is debate in the labor community about whether or not automatic enrollment should be supported.
4) Administrative challenges, such as multiple record keepers.

Even so, a number of local governments have successfully adopted automatic enrollment. This issue brief examines the experiences of Cobb County, Georgia; Multnomah County, Oregon; and the City of Los Angeles. It also describes the experience of the South Dakota Supplemental Retirement Plan, which serves more than 470 units of local governments. (For more information, see the Center's study on the South Dakota plan.) Working with employees and focusing on education were key factors to successful implementation. Having a single record keeper is considered a best practice, but it requires good planning to make a smooth transition.

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Introduction

The myriad of public sector retirement benefit reforms over the last several years has resulted in a greater sharing of financial responsibilities between the employer and the employee. This means that many employees will need to increase their level of personal savings to help fund their retirements. One of the best ways they can do so is through a supplemental savings plan. Yet, public employees have been reluctant to sign up for these plans even after receiving financial education about the importance of doing so. Economists have studied this phenomenon and developed a body of work referred to as "behavioral economics" that explains why people are lax about saving. On the basis of this information, the financial industry has developed savings tools, the most popular and successful being automatic enrollment. However, because of the public sector's use of defined benefits plans historically, there has been a perception that government employees do not require substantial additional savings for retirement, so automatic enrollment has not been widely adopted in the public sector. Several other legal, administrative, and perceptual challenges have also stymied the expansion of automatic enrollment. With the changing retirement environment, these concerns may need to be addressed in order to provide more financial options that encourage savings and financial security during retirement.

Because local governments differ significantly from states in terms of their legal status, service responsibilities, and cultures, this brief focuses on automatic enrollment in a local government context. Along with providing a primer for what automatic enrollment is, why it is needed, and what challenges have forestalled its adoption, the brief presents cases studies of local governments that have overcome those challenges as well as ideas for how other local governments can do the same.

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The information for this report comes from a review of written research and interviews with experts in the field of defined contribution retirement plans.[1] There is a growing body of work from both academic and practitioner sources on the benefits and limitations of automatic enrollment; however, these studies focus on private sector implementation, likely because public sector use of this feature is relatively new and less common. In fact, no research exists that exclusively considers automatic enrollment for local governments.[2] Thus, this study's findings and conclusions rely heavily on the insights from interviewees who have had experience with automatic enrollment in a local government context.

What Is Automatic Enrollment

Automatic enrollment is the best-known and most widely used feature from a suite of automatic options used to promote savings in defined contribution plans. With automatic enrollment, a plan sponsor or employer[3] automatically enrolls the employee in a defined contribution plan at a default employee contribution rate and default investment option. Employees can opt out of the plan if they choose. The purpose of automatic enrollment is to increase employee participation in the employer's defined contribution retirement plan and to increase the amount of individual savings. Because private sector experience has shown this feature to be very successful in achieving those goals,[4] automatic enrollment is generally considered best practice in defined contribution design.[5]

There are two main decisions that need to be made in establishing an automatic enrollment feature: the default employee contribution rate and the default investment option. The plan sponsor makes those decisions. The default employee contribution rate can be set at any amount, and the employer may or may not offer a matching contribution. In the private sector, the most common default employee contribution amount is 3 percent of salary, and there is often an employer

match.[6] For governments with automatic enrollment, the default contribution is lower typically—for example, 1 percent—because the defined contribution plan is most likely supplemental to a primary defined benefit retirement plan. Target date and other professionally managed funds have become the default investment option of choice because they offer a diversified investment portfolio that automatically adjusts investment risk according to a participant's age or years until retirement.[7]

The reason for automatic enrollment's success in increasing participation in retirement savings plans can be attributed to human behavior—specifically, our inertia with respect to decision making.[8] For many people, the decisions involved with saving for retirement, such as determining how much to save and what investments to choose, can be overwhelming; thus people simply don't act. Furthermore, many people value near-term consumption far more than saving for future consumption, which results in too little savings. Automatic enrollment works because individuals are not required to deliberately act to save, and with a target date fund default, they do not need to regularly adjust their investments. Inertia is also the biggest *limitation* with automatic enrollment because participants often stay with the default contribution rate, regardless of whether it is the most appropriate amount for that person to save.[9]

Another significant problem is that many participants perceive the default contribution rate as advice about how much they *should* be saving, and therefore they stay at that rate. This inertia becomes troubling when employers set the default contribution rate too low and participants who stay at that rate end up with too little income during retirement. Employers often set low default rates because of concerns that employees will opt out of the plan if rates are too high or because of guidelines set under the Pension Protection Act of 2006 (PPA). The PPA provides a safe harbor[10] for private sector employers who offer automatic enrollment in defined contribution plans that follow specific guidelines, such as a maximum initial employee contribution rate of 3 percent with the rate escalating up to 6 percent. Because of the combination of low default rates and inertia, automatic enrollment is often paired with automatic escalation. Under automatic escalation, participants' contributions are "increased at regular intervals, typically annually, until a predetermined contribution level or cap is reached."[11] Again owing to inertia, automatic escalation works because people do not have to actively decide to increase their contribution rates. As concerns for retirement income adequacy grow, so too does the push for higher default enrollment rates and escalation caps for primary defined contribution plans.[12]

Adoption of Automatic Enrollment

Over the past 15 years, the private sector has significantly increased its support for automatic enrollment as a part of its defined contribution plan design. In 1999, only 4.2 percent of 401(k) plans had adopted automatic enrollment;[13] today that figure has grown to approximately 50 percent,[14] with higher percentages for larger plans. A 2012 survey of large-plan sponsors by the Defined Contribution Institutional Investment Association found that over half (56 percent) of the respondents used automatic enrollment in their defined contribution plans; and of those who did not yet have the feature, a third expected to add it within the next year.[15] The growth in private sector implementation of automatic enrollment has been driven by the PPA, which provides a safe harbor to employers who adopt automatic enrollment in their 401(k) plans, and by the increasing recognition of the importance of income adequacy in retirement. However, researchers in this area have noted that the adoption growth rates are likely to slow down in the future as those employers who support automatic enrollment have likely already implemented it.[16]

Private sector employers have embraced automatic enrollment because (1) the feature meets their objective of increasing employee plan participation, and (2) employees like the feature. A 2012 study by the Lincoln Financial Group found that 94 percent of employers recognize the success of automatic enrollment in driving higher participation and deferral rates in their retirement plans.[17] Studies repeatedly show that participation reaches over 80 percent for plans with automatic enrollment while plans without it achieve participation rates of only 55–65 percent.[18] The impact on younger workers—those in their early 20s—is especially significant as their participation rates reach in the mid-70 percent range for plans with automatic enrollment but are only in the low 20s for plans without it.[19] Employee support for automatic enrollment is expressed through low opt-out rates, typically around 10 percent, and supported by the results of attitudinal surveys. A nationwide survey of working adults found that 74 percent of respondents of all ages would rather be automatically enrolled in a workplace retirement plan than enroll in one themselves.[20]

In contrast, the public sector has been much slower to adopt automatic enrollment for its defined contribution plans.[21] In its 2014 annual survey, the National Association of Government Defined Contribution

Administrators (NAGDCA) found that for 87 percent of respondents, participation in their governmental defined contribution plans is optional; but for those with optional enrollment, only 2 percent use automatic enrollment.[22] However, 18 percent of the respondents who have not adopted automatic enrollment are considering doing so. Currently, five states have automatic enrollment for the defined contribution plans available for their workers: Georgia (ERSG) Missouri (MOSERS), South Dakota (SDRS), Texas (ERS), and Virginia (VRS). Of these plans, only SDRS and VRS allow local govern-ments to participate; to date, however, no local gov-ernments have chosen to adopt automatic enrollment through VRS while 22 have done so with SDRS.

No national surveys exist about the adoption of automatic enrollment by cities and counties. To attain a rough estimation of the use of automatic enrollment by local governments, several large record keepers were contacted.[23] Surprisingly, the results showed only nine local governments as currently having automatic enroll-ment. ICMA (the International City/County Manage-ment Association) conducted an automatic enrollment participation survey in its electronic newsletter during March 2014, and none of the respondents reported having adopted automatic enrollment. For the local governments that have adopted automatic enrollment, including those in South Dakota, all but three have applied the feature to a deferred compensation 457(b) plan. The absence of automatic enrollment at the local level is somewhat surprising in light of the larger public sector pension reform movement, which will require additional savings by many employees.

Other Automatic Investment Features

Prior to the widespread use of target date funds and other managed funds, plan participants had to select their own investments. Due to a lack of knowledge about investing and risk, many chose more extreme allocations, such as putting more than 90 percent of their assets in either very aggressive or very conservative asset classes, or investing inappropriately for their age. In order to address this situation and help participants with their asset allocations, some financial experts are now suggesting that all plan participants be automatically reenrolled in their plans on a periodic basis. Under reenrollment, participants who wish to maintain their current investment choices must actively reelect them. If they do not, all of the participant's current and future contributions would be automatically enrolled into a target date fund. Employers also use this opportunity to automatically enroll employees who do not already participate in the plan.

For a reenrollment effort to be successful, plan sponsors would need to spend considerable time educating employees about the default target date fund and its benefits. Plan sponsors should also provide extensive education about why reenrollment is necessary and ample opportunity for employees to reselect their options. Those employees who actively manage their accounts and have a diversified portfolio may resent having to select their choices again, so this process should be made as simple as possible, such as by checking a box. This concern may explain why this feature is not widely used. Another option could be to target only those employees with extreme allocations, which should lessen employee dissatisfaction with the feature.

Rather than making extreme allocations, many participants initially make relatively diverse investment choices; but due to a lack of active management, their asset distributions become skewed over time because of the proportionally higher growth rate of riskier assets. For this reason, financial consultants recommend that investors annually rebalance their investments to their initial allocations. To overcome the problems associated with investor inertia, plan sponsors can adopt automatic rebalancing. With automatic rebalancing, the record keeper adjusts an account's portfolio to an appropriate asset class mix annually or perhaps quarterly. The plan sponsor could use this opportunity to educate participants about the importance of diversified and age-appropriate investing as well as encourage participation in a target date fund.

Current Public Sector Retirement Environment

Since the Great Recession, states and local governments across the country have been amending their employee retirement benefit packages to decrease financial liabilities, reduce risk, and adjust to market demands for greater employee mobility. In a study of local government retirement benefits, it is important to include state plans because over 80 percent of state retirement systems have plans that permit local government participation.[24]

Reforms over the last several years have been widespread. From 2007 to 2014, 48 states have enacted

changes to one or more of their pension plans.[25] Likewise, in an annual survey of workforce trends, the Center for State and Local Government Excellence (SLGE) found that, between 2009 and 2013, 30 percent of local government respondents had changed the retirement benefits they offered employees. For both state and local governments, common changes to defined benefit plans included increasing employee contributions, age and service requirements, and the time required for new employees to vest, as well as reducing cost-of-living adjustments (COLAs). For example, during that time, 28 states increased employee contribution rates.[26] Likewise, between 2010 and 2013, 17 states reduced, suspended, or eliminated COLAs for one or more plans, which affects both employees and often current retirees.[27] Although these reforms have kept the defined benefit plans relatively intact, they do reduce employee benefits. Even seemingly small changes such as expanding the number of years used to calculate final average salary from three to five can reduce a retirement benefit by 2.4 percent.[28]

One of the more significant reforms in public retirement benefits has been the transition to hybrid plans. Sixteen states have either an optional or a mandatory hybrid plan for state and local government employees.[29] There are two types of plans: cash balance plans and combination plans. With cash balance plans, the plan's sponsor invests employee and employer contributions and guarantees a fairly conservative rate of return; at retirement, an employee's account balance is converted into an annuity. With a combination plan, employees participate in a defined benefit plan but with a service multiplier that is lower than that used in more traditional plans—that is, a benefit multiplier that is 1 to 1.5 percent times years of service rather than 2 to 2.5 percent. Because of the lower pension benefit, employees are required or strongly encouraged to participate in a supplemental defined contribution plan.

Another important environmental change for retirement benefits is the evolving workforce. Younger employees are expected to be more mobile than has historically been the case, while certain classes of workers, such as information technology specialists, are known to move regularly between the public and private sectors. These workers are less likely to stay with a public employer long enough to reap the full rewards offered through a defined benefit plan. Younger employees must work many years to accrue benefits equal to what they could earn under a defined contribution plan with the same contribution rate.[30] Because a mobile workforce is less likely to receive a full pension benefit, these employees will need more personal savings, which can be encouraged through automatic enrollment in a supplemental retirement plan.

Researchers who have reviewed these changes generally come to same conclusion: current and future public employees will need to work longer or save more to have an adequate income in retirement.[31] A 2014 study by the SLGE and the National Association of State Retirement Administrators found that the expected average retirement income for future retirees will be approximately 92 percent of pre-reform benefits for the 24 states analyzed.[32] Yet we know from behavioral economics and actual plan participation figures that financial education may not be enough to increase employee savings. The aforementioned 2014 national survey by NAGDCA found that the average employee participation in 457(b) plans was just 49 percent.[33] This figure includes governments that do not participate in Social Security, so savings beyond the defined benefit plan is often critical. Workforce trends and the current state of public retirement benefits strongly suggest that defined contribution features that encourage savings, such as automatic enrollment, can play an important role in the retirement income security of many public employees.

Public Sector Challenges with Automatic Enrollment

Even though automatic enrollment is considered best practice and there may be real benefits to adopting it for supplemental plans, there exist challenges to doing so. Both the nature of these challenges and the degree of difficulty in overcoming them vary greatly. This research groups these challenges into three general categories: legal, administrative, and perceptual.

Legal

By far the greatest hindrance to the adoption of automatic enrollment for local governments is anti-garnishment laws. These laws prohibit employers, including governments, from garnishing wages without the employee's express consent, typically through written acknowledgment. Specific exceptions are written into law for union dues, withholding taxes, defined benefit contributions, other benefits, and court orders. In only 11 states is automatic enrollment permitted for public defined contribution plans, because payroll deductions for retirement benefits do not require an employee's

signature.[34] In a handful of cases, general anti-garnishment laws exist, but an exemption has been written into statute for a particular retirement system or plan. For example, the Missouri State Deferred Compensation plan uses automatic enrollment for state employees hired after July 1, 2012.[35] This allowance does not extend to defined contribution plans that serve employees of cities, counties, or other political subdivisions. For the remaining states, the anti-garnishment provisions vary from a likelihood that automatic enrollment may be permitted to a very explicit mandate for an employee's written authorization to withhold wages as deferred compensation.

Some labor and political organizations have expressed concerns over the adoption of automatic enrollment because they fear that reformed defined contribution plans could lead to replacing public defined benefit plans. To the extent that these concerns result in political activism, public employers' ability to change anti-garnishment laws could be blocked. In "right-to-work" states, this challenge is far less of an issue, if at all. However, this research found a few public sector labor groups supporting automatic enrollment as a means to encourage savings after the government's defined benefit plan had been reformed. If union leadership believes elected officials and management will not try to erode benefits further, they may be more supportive of including automatic features in supplemental defined compensation plans for their members.

Administrative

Administrative barriers are considered to be those that are caused by management practices or due to widespread administrative conditions. A substantial but fixable challenge with adopting automatic enrollment for deferred compensation [i.e., 457(b)] plans arises when a local government uses multiple record keepers. In this scenario, the local government would likely have a primary defined benefit plan and, to encourage further employee savings, also offers a 457(b) plan. When the 457(b) plan was initiated, there was one record keeper; but for some reason, such as employees wanting different investment options, the government added a second record keeper with which employees could invest their contributions. The challenge, as it relates to automatic enrollment, occurs when two or more record keepers offer a target date fund or the type of fund wanted as the default investment option. The government must select a record keeper that will get all the automatic enrollees and therefore more business, which could make relations with the other record keeper(s) more difficult. Best practice recommends a single record keeper in order to improve coordination of employee investments and to provide better financial consultation.[36]

Some governments may be concerned about the cost of automatic enrollment. Because of the high participation rates with this feature, local governments that match employee contributions into a defined contribution plan may have to pay more after adopting automatic enrollment. According to NAGDCA's 2014 survey, 32 percent of single-employer defined contribution plans do not offer an employer matching contribution.[37] One solution to cost concerns would be for governments to select a matching formula that accounts for the high participation rates that come with automatic enrollment and is therefore budget neutral for the government. Individually, employees would receive a smaller match, but more employees would be receiving the benefit.

Keeping informed of best practice in the area of employee benefits takes time and energy, and most small local governments do not have the staff to dedicate substantial resources to learning about it. They employ only one or two human resource (HR) personnel, who spend their time on daily program administration such as hiring personnel. Actively reviewing the design of the government's deferred compensation plan is not a high priority as senior administrators often see it as just an additional service for employees and not a core component of employee retirement income. Unless employees push for plan redesign, it is unlikely to happen; yet we know from behavioral economics that employees won't push for redesign because of inertia. They need the external encouragement to save, which may come through plan features such as automatic enrollment.

Perceptual

Perceptual barriers to automatic enrollment are likely more common in local governments than in state governments because of the culture, size, and generally more limited resources of local governments. These challenges may be the most easily overcome because it just takes education to do so; yet they can also be some of the most intractable challenges if policy makers do not want to accept the information given to them.

Perhaps the biggest attitudinal barrier to automatic enrollment is the perception that it is not needed. Policy makers, either elected or appointed, often believe that with a defined benefit plan, employees should have sufficient income in retirement, especially if the

benefit is coupled with Social Security. By far the vast majority of local government employees (82 percent) have access to a defined benefit plan, and the participation rate is 78 percent.[38] A public defined contribution plan in systems with a defined benefit plan is seen as a supplement, not as a significant source of income. However, as discussed in the previous section on the current environment, pension reforms over the last several years have made many of the defined benefit plans less generous. Instead of defined contribution plans being used to pay for unanticipated expenses such as home repairs or lifestyle choices such as travel, for many retirees the plans will be used to offset lost buying power due to inflation, rising health costs, or other daily expenses.

For local governments that have primary defined contribution plans, mandatory employee contributions are more prevalent. Most experts view mandatory employee retirement contributions as best practice, and therefore it would be the preferred option over automatic enrollment.[39] More often, the concern with employee contributions rates in this context is that they are too low, which may call for an automatic escalation plan feature instead of automatic enrollment.

Local governments that participate in state defined benefit plans that have undergone legislative reforms may not fully understand how the changes financially affect their future retirees. Furthermore, the financial impact of defined benefit reforms such as COLA reductions or of increasing the years to retirement is not easily calculated.

Even with retirement plans that have not undergone substantial changes, local governments may not fully know the projected retirement income of their employees and how much their employees will need in the future. The amount of retirement income workers will need is increasing,[40] yet that message—and how it may necessitate a review of retirement benefits—has not been shared with all local officials. Too often these officials base decisions about employee benefits and retirement security on what an employee with 30 years of service *could* earn rather than considering employee turnover and what the average employee *will actually* earn. Using the former perspective could result in an overly optimistic view of retirees' financial conditions. Exacerbating the problem is that local governments may not have all the data or staff resources they need to undertake a thorough retirement income gap analysis of their workforce. On a more basic level, local officials may not even fully understand how automatic enrollment works—for example, that it allows employees to opt out and thus differs from mandatory participation—or that employees, once signed up in a defined contribution plan through automatic enrollment, really like it.

A frequently cited challenge to automatic enrollment is the notion that it will overburden employees, particularly lower-paid employees, since they are likely already contributing to a defined benefit plan. Nearly all local government employees with defined benefit plans contribute to them (85 percent), and the average contribution rate is 6.6 percent of salary.[41] Since 2009, 28 states have raised employee contribution rates in at least one of their public pension plans.[42] Further stressing employees is that they have experienced either no or limited pay raises for the last several years. Although this problem does appear to be ending as the economy and housing markets have rebounded and tax bases have improved, it does not change the reality that many local public employees will need personal savings beyond their defined benefit plan and Social Security in retirement and will likely be better served with small savings now that can provide improved financial security later.

The retirement benefits committee or deferred compensation committee may be hesitant to take on the additional fiduciary responsibility that comes with automatic enrollment: the selection of a default investment option, which is very important and requires research to ensure that a sound choice has been made for enrollees. The widespread use of target date funds as the default enrollment option can boost confidence in the appropriateness of this investment vehicle, but it has its own fiduciary issues. As a fee-based investment, target date funds require more attention and oversight than some other funds, such as an index fund. Target date funds also vary substantially in their glide paths (i.e., the formula for adjusting the mix of assets in a fund as it reaches its target date) because of the investment assumptions that underlie them.

Owing to their size and limited resources, small and medium-sized local governments will often wait for their states and large cities and counties to implement reforms and best practice first. Reasonably, many local officials wonder about the efficacy of a policy if larger governments have not yet adopted it. Smaller governments typically do not have the resources to research and develop implementation strategies for cutting-edge policy design. Instead, they learn lessons from larger governments, seeing what worked well and what did not and then adapt policies to fit their circumstances. This conservative approach is often less resource

intensive and avoids costly policy design mistakes. Of course, not all small and mid-sized governments adhere to this policy implementation model, but it is reasonable to predict that widespread local adoption of automatic enrollment will not occur until more states and large cities and counties do so. Likewise, many local governments participate in their states' defined contribution plans; so until their states adopt automatic enrollment, they won't either.

Some local government officials are apprehensive about the perceived paternalism associated with automatic enrollment and other automatic features for defined contribution plans. Their apprehension stems not from a lack of knowledge or from legal or resource constraints but from concerns about the employer's relationship with and responsibility for the employee. Some officials believe that employees are best able to make retirement savings and investment decisions for themselves. Yet behavioral economics has repeatedly shown that individuals struggle with these decisions and need and usually value strong incentives to save. Furthermore, this apprehension about perceived paternalism is incongruent with defined benefit plans, which mandate contributions, manage investments, and provide a lifetime annuity for the employee.

Successful Automatic Enrollment Efforts

The discussion on challenges with automatic enrollment helps to explain why so few local governments have adopted the feature for their defined contribution plans. This section reviews four governments that have overcome those challenges to successfully adopt automatic enrollment for the betterment of their employees' retirement income security.

Cobb County, Georgia[43]

Located in the Atlanta metropolitan area, Cobb County provides a full range of services to its 717,910 residents.[44] In line with its very strong reputation for sound administration and implementation of best administrative practices, the county undertook pension reform in 2009, establishing a hybrid retirement plan that went into effect on January 1, 2010, for new employees. The defined benefit multiplier was decreased from 2.5 percent of salary to 1 percent, and the county instituted a "Rule of 80" for normal retirement for general employees. Employees contribute 3 percent[45] of salary to the defined benefit plan while the employer contribution is 16.4 percent. Employees participate in Social Security.

Originally, employees hired under the hybrid plan had to opt into the deferred compensation [457(b)] plan. To encourage participation in the 457(b) plan, the county matches employee contributions at 50 percent, up to a maximum of 2 percent of salary (4 percent employee contribution). The county's contribution is invested in a 401(a) plan. However when the hybrid plan was adopted, employee participation in the 457(b) plan was lower than was hoped, so the county's retirement board began advocating for automatic enrollment.

The board was well aware of behavioral economics literature and of automatic enrollment's success in the private sector. In contrast, county staff were somewhat reluctant to adopt automatic enrollment, concerned that employees would not want additional pay deducted from their salaries given limited wage increases over the previous few years and the relatively low pay compared to that in neighboring governments. An opportunity to adopt automatic enrollment arose when the grandfathered defined benefit plan participants had their contributions slightly increased. With that increase, hybrid plan members would have an equal pay deduction when 1 percent of employee pay was transferred to a 457(b) account. This alleviated concerns that employees in the hybrid plan would resent having more pay deducted than their longer-tenured counterparts, who are under the grandfathered plan.

The county started automatic enrollment for new employees in January 2013, and the feature has been very successful at increasing participation in the 457(b) plan. Prior to automatic enrollment, countywide participation in the 457(b) plan was only at about 33 percent; yet in just a little over a year, it has increased to 57.5 percent.[46] This increase is striking considering that approximately two-thirds of the employees still participate in the original defined benefit plan. The initial employee contribution under automatic enrollment is 1 percent of salary, and the county has kept its matching formula for all hybrid plan participants. The default investment option is a target date fund.

Tony Hagler, HR director for Cobb County, attributes a large part of automatic enrollment's success to the financial education and information new employees receive at orientation. With the adoption of automatic enrollment, the county worked with its record keeper to revamp the financial education presentation at employee orientation. Now employees are given lunch while a financial consultant fully explains the benefits to saving in the 457(b) plan and how automatic enroll-

ment works. Employees are also given an opportunity to amend their contributions or even opt out of the plan. As a testament to the quality of the education, some employees actually increase their contributions during the orientation. The county has not heard any complaints from automatically enrolled employees, eliminating staff's concerns about the feature.

The administrative implementation of automatic enrollment went very smoothly for county employees. They worked with the record keeper on amending the plan, and staff were able to easily adjust the payroll system, even though they had to account for two types of deductions: dollar amount for existing 457(b) plan participants, and a percentage of salary for automatically enrolled participants. Fortunately, the payroll system can accommodate multiple deduction formats, and new codes were added to it. Budgeting for the match has also been straightforward with automatic enrollment. The HR office has a good estimate for employee turnover rates, so staff can calculate the money needed for the 457(b) plan match because participation with automatic enrollment is so steady.

The county would still like to enroll hybrid plan participants who were hired between 2010 and 2013 but have not yet joined the 457(b) plan. This summer the county plans to start an enrollment campaign that includes financial incentives. The difference in 457(b) plan participation rates between employees hired before and after automatic enrollment is striking and tends to support the argument that adding automatic features like automatic enrollment should be done concomitantly with other major retirement benefit reforms.

Multnomah County, Oregon, and the City of Los Angeles, California[47]

Multnomah County, Oregon, and the City of Los Angeles, California, are discussed together because these two governments are using the same approach to adopting automatic enrollment for their deferred compensation [457(b)] plans even when anti-garnishment laws would appear to prohibit it.

Multnomah County Multnomah County's population is 766,135[48] and includes the state's largest city, Portland. The county provides mostly traditional county services such as courts, human services, elections, and public works; and its workforce totals 5,600. In 2003 the Oregon Public Employees Retirement System, of which Multnomah County is a member, underwent significant reform, which included moving to a hybrid plan for new employees. Under the hybrid plan, general employees receive a defined benefit with a multiplier of 1.5 times years of service, and the employer fully pays the necessary contributions. Employees are required to contribute 6 percent of their salaries into defined contribution-type accounts, with the money being invested by the Oregon Investment Council. The total estimated retirement income from these sources is approximately 65 percent of final salary. County employees also participate in Social Security.

Knowing that employees need to save for retirement, the county encourages all employees to participate in its 457(b) plan. A big boost came, however, when the president of the county's largest union realized that his members' participation rates were very low and wanted to do something about it. County staff researched the state's anti-garnishment statutes and determined that Multnomah could have automatic enrollment through labor contracts. Together, the union president and the county's chief financial officer agreed to propose adding automatic enrollment language into the union's next bargaining agreement. Multnomah developed an automatic enrollment feature that would be used for this union and others that may choose to join in the future. The feature applies to new employees of the union, has an initial contribution rate of 1 percent of employee salary, and has an "opt out" provision, with the default investment option being a target date fund. There is no employer match. Union leadership felt comfortable that the defined benefit plan would not be further reduced and that the county would not seek additional defined benefit plan changes for the foreseeable future. With this trust, the union voted in favor of the contract in 2012; so far, the program has gone very well with no complaints and very few employees opting out.

Even though the county has two record keepers, which are very different in size and have distinct investment options, program implementation went very smoothly. One of the county's record keepers is a local credit union, which offers only fixed-rate certificates of deposit and is used by about 7 percent of plan participants. In contrast, the other record keeper is a national firm with a wide array of investment options. When the county decided to use a target date fund as the default investment option for automatic enrollment, the national firm was not a difficult or controversial choice.

In the upcoming years, the county anticipates that other bargaining units will add the automatic enrollment feature to their contracts as well. Of course, that decision will depend on contract votes by each of the unions. Ironically, personnel classified as management

are unable to have automatic enrollment because they are not unionized.

City of Los Angeles The City of Los Angeles has 3,857,799 residents and employs approximately 44,900 people to serve them.[49] The city's Deferred Compensation Plan has $4.4 billion in assets with 40,000 total participants. Because the city does not participate in Social Security, participation in the 457(b) plan is important for employees' financial security in retirement. Currently, about 68 percent of all eligible employees participate in the plan.

The city has three defined benefit plans: one for sworn officers and public safety personnel, one for employees of the water and power utilities, and one for general employees. To improve the financial stability of the plans, the city undertook pension reform in 2013, creating new tiers of benefits for new employees. Though the changes were not drastic (e.g., benefit multipliers remain unchanged), contribution levels increased, and the cumulative changes will require new employees to work longer to receive the same benefits as tenured employees.

The city's Deferred Compensation Plan is administered separately from the pension plan and has long taken a position supporting automatic enrollment. As the new pension tiers were being implemented, the plan's governing board renewed its study of automatic enrollment and began looking for ways to pursue it. The plan has already developed a sophisticated retirement planning calculator and communications program; the program is geared toward encouraging city employees to fully replace their net "lifestyle" income upon retirement using a combination of their defined contribution and defined benefit retirement plans over the course of a full career in city government.

Like those in Multnomah County, the city's board and HR staff recognized the state's anti-garnishment law as an obstacle to adopting automatic enrollment. Officials had hoped that the California legislature would pass legislation explicitly allowing the feature for local governments, but that never happened even though the private sector's success seemed to be a good example. Then, upon closer examination of state laws, HR staff determined that the law does permit the adoption of automatic enrollment programs provided they are negotiated and included in collective bargaining agreements.

Staff are currently in the process of designing the automatic enrollment program feature that they will present to the unions as an option for the bargaining agreements. The plan's board and HR staff see the automatic enrollment/escalation program as guiding employees to meet their full lifestyle income replacement objectives. As part of the feature, the city is also seriously considering adopting automatic escalation into its 457(b) plan. Right now, the biggest obstacle for automatic enrollment appears to be integrating a new deduction format into the payroll system. Employees currently in the 457(b) plan have deductions made by a designated dollar amount; under automatic enrollment, the city would want the deductions to be a percentage of salary.

The city currently has 30 unions, and several of their contracts will soon be up for renegotiation. Plan staff are optimistic that the automatic enrollment program will be attractive to many of the city's unions once its features and benefits are thoroughly understood. The city expects to have a design ready before the end of the calendar year. When finished, Los Angeles plans to work closely with its unions and the general employee population to explain the feature's design and purpose. The union representative and three elected employees on the plan's board can also help promote automatic enrollment after the board has approved it.

South Dakota Retirement System[50]

The South Dakota Retirement System (SDRS) has over 77,000 members from state government, the South Dakota Board of Regents, municipalities, counties, and local school systems. In total, over 470 units of government participate in SDRS, which offers a defined benefit plan and a deferred compensation plan. After employees complete 30 years of the service, the defined benefit plan replaces approximately 50 percent of their final average salaries. Employees also participate in Social Security. However, employees on average retire from the system after 20 to 25 years of service.

Though SDRS has had a deferred compensation [457(b)] plan for many years, the participation rate was only about 20 percent. To help employees fill any income gap needed for a secure retirement, the system's Board of Trustees promoted personal saving through SDRS into its mission statement and began working with the legislature to adopt automatic enrollment for the 457(b) plan.

Automatic enrollment started July 1, 2009, for new employees. The minimum contribution is $25 per month, and the default investment option is a target date fund. Automatic enrollment is required for all state and Board of Regents employees, but local government units can choose to participate in the feature. The

initial education effort to encourage participation in automatic enrollment was robust. Six months prior to its rollout, SDRS sent out letters and postcards to cities and counties explaining the feature and even providing model resolution wording and reference materials.

Even with these efforts, the participation rate of local governments is not as strong as SDRS would like. Of the 122 cities and counties that participate in the 457(b) plan, 22 have included automatic enrollment. Reasons offered for the lower adoption rate are employer concerns about overtaxing employees since local pay is often lower than state government pay and the need to restructure payroll systems. For those that do participate, the employers and employees are satisfied with the feature as evidenced by the very low opt-out rate of employees—just 3.1 percent. Rob Wylie, executive director of SDRS, says that the system plans to reignite the automatic enrollment participation effort now that SDRS has five years of savings and participation data to show the positive impact the feature has on saving rates.

Overcoming Challenges and Lessons Learned

The ease in overcoming challenges with the adoption of automatic enrollment varies substantially by the type of challenge. Yet lessons and ideas from the cases studies and the interviewees demonstrate that many of the barriers to automatic enrollment can be addressed although it will require financial resources, political resources, and time.

Union Cooperation

Multnomah County and the City of Los Angeles provide excellent examples of local governments that have managed to work around legal barriers by partnering with unions to adopt automatic enrollment. In both cases, the governments had already undergone pension reform, so union leadership did or hopefully will view automatic enrollment as a positive supplement to a new retirement benefit package. Automatic enrollment is a response, not a precursor, to defined benefit plan changes.

The cases also show that automatic enrollment does not have to be government wide. Multnomah County started the feature with one union and plans to include more. Los Angeles is designing an automatic enrollment feature and will communicate with unions about it; however, the city's HR staff do not consider universal adoption necessary for success.

Securing support for automatic enrollment from union leadership and eventually in a collective bargaining agreement requires a certain level of trust by the parties and a decent working relationship. Unfortunately, these conditions are not always present. If a local government believes automatic enrollment is important and would help employees, management can begin working with union leadership on the issue. One place to start may be educating union leaders about their members' expected income at retirement, level of participation in the supplemental retirement plan, and ways in which automatic enrollment can improve the financial condition of their members at retirement.

Education

Educating local government officials has the potential to overcome many of the perceptual challenges with automatic enrollment. Many local officials are likely unaware of the feature's design and implementation flexibility. Employers who are apprehensive that existing employees would balk at having their take-home pay reduced could apply the feature to only new employees, a common practice. This was the approach used in Cobb County, in Multnomah County, and by the SDRS. Concerns about whether employees can afford the deductions can be minimized by using small default amounts. For example, Ohio Deferred Compensation's pilot automatic enrollment plan uses an initial contribution amount of only $15 per pay period/$30 per month.[51] Of course, employers and plan sponsors need to consider the long-term savings needs of employees when selecting a default contribution rate.

Local governments may also need help appreciating how important it is for their employees to save. Small local governments may not have the time or expertise to undertake a thorough analysis of their employees' projected retirement incomes and therefore cannot easily determine whether additional savings enhancements like automatic enrollment are necessary. Information tools such as basic primers that explain the importance of income gap analysis and templates that provide step-by-step instruction on completing an income gap analysis could be helpful. Regardless of whether the incomes of current retirees are sufficient, simply having that information can help local governments in deciding upon current and future employee benefits.

One idea worth considering is whether automatic enrollment is truly paternalistic if employees want it. Research has shown that given the choice, employees opt to save through automatic enrollment, particularly if given quality financial education. In Cobb County,

the low opt-out rate by employees even when given a withdrawal form is testament to the effectiveness of integrating automatic enrollment with quality financial education during employee orientation. If automatic enrollment advocates can explain employees' support for the feature, perhaps local government officials will be more open to it.

Although education may help reduce challenges to automatic enrollment, the question remains as to who will provide it. The various stakeholders each have different roles and responsibilities, and all have limited resources. Universities and private think tanks have undertaken important research in the areas of personal savings and retirement income, but their role is a relatively passive one. They provide quality information to those who seek it, but they do not lobby for legislative change. Government associations exist to serve the interests of members who drive the associations' activities, and they cannot spend limited resources on nonmembers or activities not deemed a priority by members. Record keepers are also in a difficult position. Although many already devote substantial resources to financial education for both their clients and non-clients, it may be unfair to expect this group to pay for large-scale education efforts. In the future, one or more stakeholders in the public retirement arena may decide to undertake this challenge. If so, it would be very interesting to learn the impact.

Record Keepers

One of the precursors to automatic enrollment is having a single record keeper. As a first step for local governments adopting automatic enrollment, interested groups could educate local governments about the benefits of having a single record keeper and why it is considered best practice. Local governments with multiple record keepers likely would also need advice on how best to make a transition to a single record keeper.

Legislative Reform

Because of the nature of politics and how issues come to the forefront of the political agenda, perhaps the most difficult challenge to overcome will be the legislative barriers caused by anti-garnishment laws. Experts agree that a federal law permitting automatic enrollment by governments will not happen; even though adding 457(b) plans to the Pension Protection Act could be considered a technical amendment to the law, ideological differences and stakeholder interests would make it politically impossible for the foreseeable future. Thus, legal change will need to occur at the state level.

Five states have passed laws permitting automatic enrollment for public defined contribution plans; however, for three of these states, automatic enrollment applies to the state-only retirement system. In cases where local governments cannot or choose not to participate in the state retirement system, their officials would need to work with their statewide (e.g., city or county) associations to pass legislation that allows automatic enrollment for defined contribution plans—a task that is much easier said than done.

First, local government associations' legislative priorities are driven by membership concerns, legislator-initiated bills, and other current realities, such as the state of the economy. Yet perceptual challenges may keep automatic enrollment from being a legislative priority, so educational efforts would need to be undertaken to create an employer demand for the feature that would turn it into a legislative priority.

Second, even if it is determined that local governments need automatic enrollment authority, actually passing legislation can be very difficult. The association's advocates need to know far in advance of the legislative session that the reform is on the agenda in order to develop a strategy for getting it passed. Such a strategy would typically include knowing which committees the bill will be coming before, getting to know the committee members and their staffs, determining which legislator would be the best sponsor, and getting his or her support. Even if automatic enrollment would not be controversial, it may still be difficult to gain allies for the bill because they would not want to expend their resources supporting it. The bill may be passed over because of more pressing issues as well. Bills that would otherwise pass easily can get caught up in political gamesmanship. Because automatic enrollment would likely be initiated by an association, legislators could very well use the bill as leverage to lessen opposition or gain support from the association for other legislation.

In states where the majority of local governments are under a state retirement plan, local governments would need to work with the plan's executive staff and board and try to convince them that the time is right for automatic enrollment. The state retirement system would have many different issues to consider, including whether state employees should have or would want automatic enrollment, the organization's relationships with the governor and the legislature, likely opposition from interest groups, timing in relation to other possible retirement plan reforms, and

legislative priorities. Any time legislation is introduced, political capital is used; so a state retirement system would be very judicious in using it, working with legislators to pass automatic enrollment legislation only if its board strongly believes that the feature is needed and the political timing is right. While five states have passed automatic enrollment, the impetus was from either the retirement system or legislators who wanted automatic enrollment as part of a larger retirement reform effort.

Conclusion

Fiscal stress and changing employee work patterns have necessitated reforms to public sector retirement plans. Defined benefit plans still serve as the primary retirement benefit, but they are less generous than in the past, so employees need to save more for retirement. Yet we know from behavioral economics and the private sector that employees need encouragement to save. One proven successful savings feature is automatic enrollment. Local governments have been reluctant to adopt automatic enrollment for several reasons: legal prohibitions through anti-garnishment laws, administrative hurdles such as having multiple record keepers, and perceptions that employees are opposed to the feature. The most difficult of these challenges to overcome is the legal barrier, but this report has shown how this can be achieved by working with unions and including automatic enrollment in collective bargaining agreements. Several of the other challenges can be met through education and technical assistance. The question remains, though: who will provide the resources to assist local governments?

Endnotes

1 These experts are Chris Baker, ICMA-RC; Steven Durden, Georgia Municipal Association; Thomas Gehl, Georgia Municipal Association; Tony Hagler, Cobb County, Georgia; Mindy Harris, Multnomah County (retired), Oregon; David John, Security Project, Brookings Institution; Julie Klassen, Prudential Trust Company; Dan Kohler, ICMA-RC; Steve Montagna, City of Los Angeles; Timothy Rouse, ING Financial Services; Robert Wylie, South Dakota Retirement System.

2 Research organizations and governmental associations such as the National Association of Defined Contribution Administrators have conducted surveys on state and local adoption of automatic enrollment. However, if states are excluded from these surveys, the number of participants will be too small to be statistically valid.

3 The terms *employer* and *plan sponsor* are used interchangeably. *Plan sponsor* would be appropriate for a retirement system or plan that includes multiple employers.

4 For example, J. Choi et al., "Saving for Retirement on a Path of Least Resistance," in *Behavioral Public Finance: Toward a New Agenda*, ed. E. McCaffrey and J. Slemrod (New York: Russell Sage Foundation, 2006), 304–351; B. Madrian and D. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116, no. 4 (2001): 573–598; A. Rappaport, S. Schaus, and J. Clymer, "Improving Retirement Security in a Heavily DC World," *Benefits Quarterly*, no. 3 (2011): 34–44.

5 P. Sanford and J. Franzel, *The Evolving Role of Defined Contribution Plans in the Public Sector* (September 2012), found at www.slge.org.

6 The Pension Protection Act of 2006 provides a default contribution rate of 3 percent of gross pay unless the employer sets a higher rate.

7 In the private sector, target date funds are the designated Qualified Investment Alternative (QDIA) set by the Department of Labor. Upon the initial participation in the DC plan, contributions are typically invested in a risk-free instrument such as a money market fund. If the employee has not opted out of the plan after a designated period of time (60–90 days), the contributions are then transferred to the target date fund.

8 Examples of important research in behavioral economics in regard to retirement savings include J. Beshears et al., *Defined Contribution Plans in the Public Sector: Lessons from Behavioral Economics*, NBER State and Local Pensions Conference, August 19–20, 2010; Choi et al., "Saving for Retirement"; Madrian and Shea, "Power of Suggestion"; O. Mitchell and S. Utkus, *Pension Design and Structure* (New York: Oxford University Press, 2004).

9 J. Choi et al., *Saving for Retirement on the Path of Least Resistance* (2004; updated paper originally prepared in 2001), found at www.hks.harvard.edu/fs/bmadria/Documents/Madrian%20Papers/Saving%20for%20Retirement%20on%20the%20Path%20of%20Least%20Resistance.pdf; L. Lucas, "The Next DC Frontier: An Outcomes-Based Approach to DC Plan Management," *Benefits Quarterly*, no. 4 (2010): 15–20.

10 Provision in an agreement, law, or regulation that provides protection from liability or penalties if certain conditions are met.

11 P. Sanford, *Using Automatic Escalation in Public Sector Retirement Plans to Increase Savings*. (Washington, DC: Center for State and Local Government Excellence [SLGE], March 2014), 4, found at www.slge.org.

12 For example, L. Lucas and M. Kreindler. 2013. *Best Practices When Implementing Auto Features in DC Plans* (Washington, DC: Defined Contribution Institutional Investors Association [DCIIA], 2013), found at dciia.org; P. Sanford, *Using Automatic Escalation*; J. VanDerhei and L. Lucas, *The Impact of Auto-Enrollment and Automatic Contribution Escalation on Retirement Income Adequacy*, Employee Benefits Retirement Institute, no. 349 (2010).

13 M. Soto and B. Butrica, *Will Automatic Enrollment Reduce Employer Contributions to 401(k) Plans?*, Center for Retirement Research, Working Paper 2009–33 (2009), found at http://crr.bc.edu/working-papers/will-automatic-enrollment-reduce-employer-contributions-to-401k-plans/.

14 L. Lucas and C. Peterson. *Plan Sponsor Survey 2012: Action Needed to Drive Better Participation Outcomes* (Washington, DC: DCIIA, 2012), found at www.dciia.org; R. Steyer, *Adoption of Auto Enrollment Slows Down* (February 12, 2014), found at www.pionline.com/article/2014022012/ONLINE/140219961/adoption-of-auto-enrollment-slows-down; R. Steyer, *Vanguard: Automatic Enrollment Reaching Plateau* (June 11, 2013), found at www.pionline.com/article/20130611/ONLINE/130619968/vanguard-auto-enrollment-reaching-plateau. Data represent plans for which Vanguard is the record keeper. Current automatic enrollment participation rates vary since surveys typically are based on data from a single record keeper.

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16 Steyer, *Adoption of Auto Enrollment*; E. Rosenbaum, *The Psychology of Retirement Saving*. (March 18, 2014), found at http://www.cnbc.com/id/101480388.

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15 Lucas and Peterson, *Plan Sponsor Survey 2012*.

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19 Ebeling, *Some Employees Short-Shrifted*.

20 *The New Economic Reality and the Workplace Retirement Plan* (Prudential Retirement, January 2010), found at http://retirementmadesimpler.org/Library/New_Economy_WorkPlace_Retirement.pdf.

21 This brief focuses on deferred compensation plans; i.e., 457(b) plans. 457(b) Plan: "Plans of deferred compensation described in [Internal Revenue Code (IRC)] section 457 are available for certain state and local governments and non-governmental entities tax exempt under IRC 501….Plans eligible under 457(b) allow employees of sponsoring organizations to defer income taxation on retirement savings into future years." Source: http://www.irs.gov/Retirement-Plans/IRC-457(b)-Deferred-Compensation-Plans.

22 National Association of Government Defined Contribution Administrators (NAGDCA), *Public Sector Defined Contribution Plan Survey Report* (March 2014).

23 Participating record keepers are the Florida Municipal Association, Georgia Municipal Association, ICMA-RC, ING, Nationwide Retirement Solutions, and Prudential Retirement.

24 *Local governments* refers to cities, counties, schools, and in some instances special districts. Often teachers will have their own statewide plans. In the remaining states, either there are statewide plans specifically for local governments or the local governments independently develop their own plans.

25 National Association of State Retirement Administrators (NASRA), *2014 Facts: State and Municipal Bankruptcy–Municipal Bonds–State and Local Pensions* (February 2014), found at www.nasra.org/files/JointPublications/FactsYouShouldKnow.pdf.

26 NASRA. *NASRA Issue Brief: Employee Contributions to Public Pension Funds* (January 2013), found at www.nasra.org.

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34 Based on author analysis of unpublished data sets received during expert interviews.

35 Missouri Revised Statute § 105.915.2

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40 Ibid.

41 As of 2013, the median contribution rate is 6.5% of salary, found at www.bls.gov/ncs/ebs/benefits/2013.

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43 Information for this case study came from a phone interview on April 23, 2014, with Tony Hagler, Cobb County Department of Human Resources, and the Cobb County website.

44 U.S. Census Bureau, 2013 population estimate.

45 Originally, the employee contribution under the hybrid plans was 5 percent, but it was reduced to 3 percent after an actuarial review effective January 1, 2014.

46 Participation prior to automatic enrollment as of December 2012 and current enrollment as of May 2014.

47 Information for these case studies came from a phone interview with Mindy Harris, retired chief financial officer for Multnomah County, on April 10, 2014; a phone interview with Steve Montagna, City of Los Angeles Department of Human Resources, on April 10, 2014; the websites for Multnomah County and Los Angeles; and *Strengthening State and Local Government Finances: Lessons for Negotiating Public Pension Plan Reform* by the SLGE (2011), which can be found at www.slge.org.

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