

WORKING PAPER

Executive Summary

DECEMBER 2009, WP# 2009-33

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WILL AUTOMATIC ENROLLMENT REDUCE EMPLOYER CONTRIBUTIONS TO 401(K) PLANS?

BY MAURICIO SOTO AND BARBARA A. BUTRICA

Employers have traditionally required workers to sign up for the company's 401(k) plan in order to participate. But many employers are now beginning to automatically enroll employees in the company's 401(k) plan at a default contribution rate and asset allocation. Yet, all else equal, an increase in pension participation due to automatic enrollment will increase employers' cost of offering a match because they will have to match contributions for those who would not contribute unless automatically enrolled. For this reason, it is unclear how the trend toward automatic enrollment will affect employer contributions to 401(k) plans and, ultimately, employees' retirement account accumulations and retirement security.

This paper uses the Form 5500 filings and the Pensions & Investment database of the top 1,000 pension funds (P&I 1,000) to examine the relationship between employer matching behavior and automatic enrollment. The Form 5500 contains information on the full universe of employer-provided pension plans in the private sector, including employer and employee contributions, number of active and total participants, pension type, and employer industry. The P&I 1,000 contains information on the largest 1,000 private and public pension funds in the United States, including a flag indicating whether plan administrators reported offering automatic enrollment in their defined contribution plans.

The analysis estimates a Probit model of the likelihood of offering a match, where the dependent variable is 1 if the plan offers a match and 0 otherwise. It also estimates a Tobit model with a lower bound of zero for the match rate, where the dependent variable is the value of the average match rate offered by the plan. The models control for automatic enrollment, industry, plan size, and whether the firm also offers a defined benefit plans, and are estimated separately for pension plans and firms.

Key findings include the following:

- The percentage of 401(k) plans with an employer match is correlated with both plan size and industry. In 2007, 94 percent of plans with 5,000 or more participants offered an employer match, compared with only 85 percent of plans with less than 500 participants. And 94 to 95 percent of 401(k) plans in the financial, insurance, real estate, wholesale trade, and manufacturing sectors offered an employer match, compared with only 81 percent of plans in the transportation and public utilities sector.

- Between 1993 and 2007, the percentage of 401(k) plans with an employer match increased modestly from 87 to 91 percent, but increased the most for plans with 2,500 or more participants and those in the agriculture, mining, and construction sector.
- While the prevalence of employer matching increased slightly between 1993 and 2007, the average match rate declined noticeably from 54 percent in 1993 to only 46 percent in 2007 almost entirely due to a decline in match rates at the top of the distribution.
- As with match offers, match rates are correlated with plan size and industry. However, differences in match rates by plan size are much less pronounced than differences in match offers. In 2007, the average match rate was 51 percent for plans with 2,500 to 4,999 participants and 46 percent for plans with less than 1,000 participants. In contrast, there are large differences in match rates by industry. Match rates average 73 percent for plans in the agriculture, mining, and construction sector, compared with only 42 percent for plans in the transportation and public utilities sector and the other services sector.
- In the sample of large 401(k) plans, autoenrollment appears correlated with employer match behavior. First, 93 percent of plans without automatic enrollment offer a match, compared with only 82 percent of plans with automatic enrollment. Second, the average match rate is 47 percent for plans without automatic enrollment, but only 34 percent for those with automatic enrollment.
- Regression models that control for industry, plan size, and whether the firm offers a defined benefit plan show that the likelihood of offering a match is uncorrelated with automatic enrollment. However, match rates are 7 percentage points lower among firms with automatic enrollment than among those without automatic enrollment.

Although these results suggest a relationship between automatic enrollment and match rates, data limitations prevent us from saying with certainty that autoenrollment causes lower match rates. For example, these results would also be consistent with a scenario in which firms with lower match rates are more likely to adopt automatic enrollment. However, if we were to assume that the estimated difference in match rates is in response to the higher costs associated with automatic enrollment, our calculations suggest that a 7 percentage point reduction in match rates would offset at least 42 percent of the increase in costs for firms with participation rates of 60 percent or more before automatic enrollment. So while autoenrollment increases the number of workers participating in the private pension plans, our findings suggest that it might also reduce the level of pension contributions.

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CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

Hovey House, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808
 phone 617.552.1762 fax 617.552.0191 crr@bc.edu www.bc.edu/crr