

WORKING PAPER

Executive Summary

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CHOICES AND OTHER DETERMINANTS OF EMPLOYEE CONTRIBUTIONS TO DEFINED CONTRIBUTION PLANS

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Understanding the role that 401(k) plan characteristics – like investment choice and the ability to borrow – play in participation and employee contributions is important as more workers rely on this type of plan for their retirement income. Further, the degree of autonomy in investment decisions is an important issue in the design of private saving plans that are proposed as part of Social Security reform.

This paper, using the 1992 Health and Retirement Study (HRS), examines the individual and job characteristics that are associated with asset choice in defined contribution plans. The HRS is one of the few surveys that records whether participants have choice over their defined contribution assets. This survey shows that men and women are equally likely to have investment choice in their pension plan, and that choice does not vary by marital status. Ability to choose one's own investments does increase with education and family net worth. Workers in managerial positions are more likely to have choice than are workers in other occupations, and employees in larger establishments and in larger firms are also more likely to have investment choice.

A second question is whether having choice over pension investments increases contributions to defined contribution plans. As more workers rely on defined contribution plans, sufficient contributions is a key issue in retirement income security. (Often employee contributions are required before the employer will make a matching contribution.) One problem in estimating the effect of choice is the potential endogeneity; that is, do participants with some financial sophistication work at firms that offer plans with investment choice? If so, then it will be difficult to infer the effect of choice on the general population. This issue can be addressed econometrically in two different ways. My preferred estimates indicate that a participant with choice contributes over 8.5 percentage points more annually to their DC plan than a comparable randomly selected participant without choice. This effect is estimated fairly precisely, and it is the largest effect on contributions. Single and married women are estimated to contribute more (.83 and 1.03 percentage points, respectively) than married men. Older participants contribute more, but the effect is quite small economically.

From a policy perspective, it is important to understand what plan features encourage employee participation in defined contribution plans. This paper adds to a growing literature that suggests that plan attributes other than the employer match rate can play a role in increasing participant contributions. Loan provisions and asset choice may encourage contributions even as employers reduce or eliminate matching provisions in their 401(k) plans.

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