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RETIREMENT SAVINGS

Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges



GAO

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Highlights of [GAO-10-31](#), a report to the Chairman, Special Committee on Aging, U.S. Senate

Why GAO Did This Study

Although employer-sponsored retirement plans can be an important component of income security after retirement, only about half of all workers participate in such plans. To foster greater participation among workers who have access to such plans, Congress included provisions that facilitate plan sponsors' adoption of automatic enrollment policies in the Pension Protection Act of 2006. To foster greater retirement savings among workers who do not have access to an employer-sponsored plan, proposals have been made at the federal level for an "automatic IRA" and at the state level for state-based programs.

Because of questions about the extent of retirement savings and prospects for a sound retirement for all Americans, GAO was asked to determine (1) what is known about the effect of automatic enrollment policies among the nation's 401(k) plans, and the extent of and future prospect for such policies; and (2) the potential benefits and limitations of automatic IRA proposals and state-assisted retirement savings proposals. To answer these questions, GAO reviewed available reports and data, and interviewed plan sponsors, industry groups, investment professionals, and relevant federal agencies.

What GAO Recommends

This report makes no recommendations.

[View GAO-10-31 or key components.](#)
For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

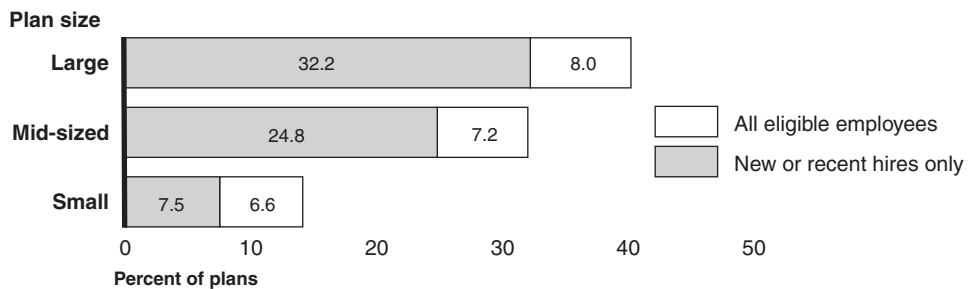
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What GAO Found

Automatic enrollment appears to significantly increase participation in 401(k) plans according to existing studies, but may not be suitable for all plan sponsors. Some studies found that participation rates can reach as high as 95 percent under automatic enrollment. Available data indicate that the percentage of plans with automatic enrollment policies increased from about 1 percent in 2004 to more than 16 percent in 2009, with higher rates of adoption among larger plan sponsors. In most cases, these plans automatically enroll only new employees, rather than all employees. We also found that automatic enrollment may not be suitable for all plan sponsors, such as those with a high-turnover workforce. Further, some data show that while automatic escalation policies—which automatically increase saving rates over time—are increasingly common, they lag behind adoption of automatic enrollment. In combination with low initial contribution rates, this could depress savings for some workers. Also, the emergence of target-date funds—funds that allocate investments among various asset classes and shift to lower-risk investments as a "target" retirement date approaches—as the typical default investment raises questions in light of the substantial losses such funds experienced in the past year.

Adoption and Scope of Automatic Enrollment by Plan Size, March 2009



Source: GAO presentation of Fidelity Investments data.

Other proposals could expand the portion of the workforce saving for retirement, but these proposals could face challenges. Under a federally mandated automatic IRA, certain employers could be required to enroll eligible employees in payroll-deduction IRAs, unless the worker specifically opted out. Such a proposal could broaden the population that saves for retirement at minimal cost to employers. However, this proposal faces a number of challenges, including uncertainty about the extent to which it would help low-income workers accumulate significant retirement savings. Proposals for state-assisted retirement savings programs could raise coverage and, ultimately, savings by involving state governments in facilitating retirement savings for workers without access to an employer-sponsored plan. However, such programs face uncertainty about employer and worker participation levels, as well as legal and regulatory issues.

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Abbreviations

| | |
|--------|---|
| ABC | American Benefits Council |
| ASPPA | American Society of Pension Professionals and Actuaries |
| CAP | Center for American Progress |
| CIEBA | The Committee on Investment of Employee Benefit Assets |
| EBRI | Employee Benefits Research Institute |
| ERISA | Employee Retirement Income Security Act of 1974 |
| ICI | Investment Company Institute |
| IRA | individual retirement account |
| IRS | Internal Revenue Service |
| PPA | Pension Protection Act of 2006 |
| PRC | Pension Rights Center |
| PSCA | Profit Sharing/401(k) Council of America |
| QDIA | Qualified Default Investment Alternative |
| SBCA | Small Business Council of America |
| SIMPLE | Savings Incentive Match Plan for Employees of Small Employers |
| SIPP | Survey of Income and Program Participation |
| TDF | target-date fund |

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United States Government Accountability Office
Washington, DC 20548

October 23, 2009

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

Dear Mr. Chairman:

Although employer-sponsored retirement plans can be an important component of retirement security for millions of American workers, only about half of all workers participate in such plans. Further, there has been little change in the percentage of workers covered by employer-sponsored plans in the last quarter century. While some working Americans choose not to participate in an employer-sponsored retirement savings plan, the large majority of uncovered workers do not have access to an employer-sponsored plan. Non-participation in employer-sponsored plans may have significant implications for future income, particularly for low-income workers. For example, as GAO reported in 2007, about 63 percent of workers in the lowest income quartile are projected to have no defined contribution plan savings at retirement.¹ Further, workers in this quartile are projected to have savings that would replace an average of about 10.3 percent of their annualized career earnings after retirement, compared to replacement rates of about 34 percent for the highest income quartile.

To foster retirement saving among the portion of the workforce that has been offered an employer-sponsored retirement savings plan but does not participate in it, some employers have adopted automatic enrollment policies for their defined contribution plans—retirement plans under which participants accumulate retirement savings in individual accounts, such as a 401(k). Under automatic enrollment, a worker is enrolled into the plan automatically, or by default, unless they explicitly choose to opt out. Employers who have adopted automatic enrollment must also establish default contribution rates and default investment vehicles for workers who do not specify these choices on their own. Employers may also adopt automatic escalation policies, which increase contribution rates

¹See GAO, *Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers*, [GAO-08-8](#) (Washington, D.C.: November 2007), p. 3.

automatically over time—typically up to a pre-defined maximum contribution rate per participant.

In addition, federal and state legislators have introduced proposals to foster retirement savings among those who work for employers that do not sponsor a plan. One group of proposals calls for establishing automatic individual retirement accounts (IRA) for workers not covered by another retirement plan. Under an automatic IRA, employers would be required to offer their employees the opportunity to make contributions through automatic payroll deduction, with an opt-out provision for participants. Another set of proposals calls for state governments to facilitate the establishment of retirement accounts for private-sector workers who are not covered by employer-sponsored plans. However, as of July 2009, no proposals for a federal automatic IRA or a state-assisted retirement savings plan had been passed into law.

In light of your interest in increasing retirement savings and ensuring a sound retirement for all Americans, you asked us to examine certain options for expanding retirement plan coverage. Specifically, we addressed the following two questions:

1. What is known about the effect of automatic enrollment policies among the nation's 401(k) plans, as well as the extent of and prospects for such policies?
2. What are the potential benefits and limitations of automatic IRA proposals and state-assisted retirement savings proposals?

To answer the first question, we obtained and reviewed data collected by large 401(k) plan administrators; reviewed studies on the impact of 401(k) automatic enrollment policies on participation rates and saving patterns; and conducted in-depth interviews with selected plan sponsors about their experience with and views of automatic enrollment. We found the data from these sources to be sufficiently reliable for our use. To answer the second question, we reviewed and analyzed existing proposals, as well as feasibility studies of these proposals, and interviewed pension industry experts in academia, representatives of employee benefit consulting firms, plan administrators, and state and federal government officials. Throughout this report, we considered a worker to be covered by an employer-sponsored plan if the employer offers such a plan, the worker is eligible to participate under the plan's rules, and the worker chooses to participate in it. For both objectives, we also reviewed relevant federal regulations.

We conducted this audit from August 2008 to October 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I of this report contains a detailed description of the methodology used in this review and its limitations.

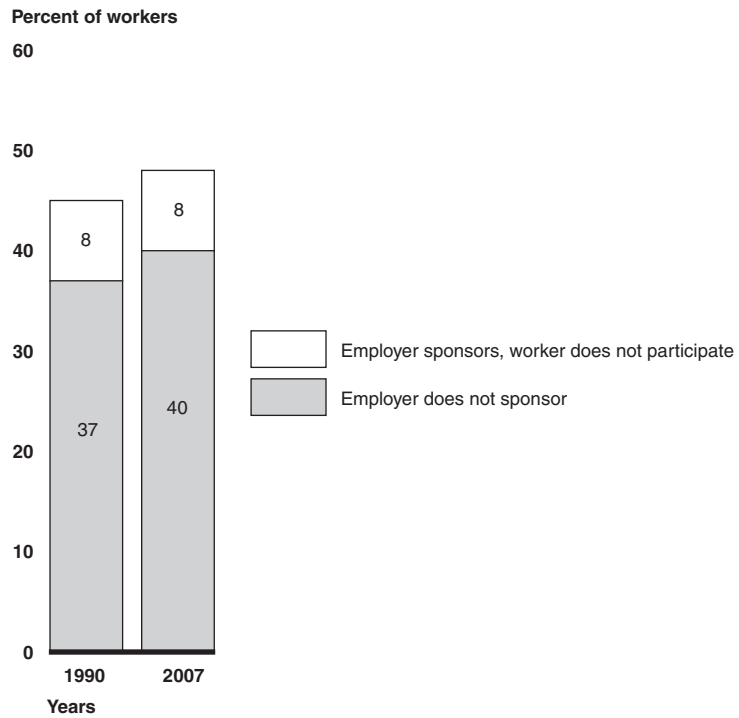
Background

Traditionally, employers that sponsored retirement plans generally established “defined benefit” plans. Under such plans, participation is generally automatic for eligible workers, and retirement benefits are established by a formula, often based on a worker’s salary and years of service. Since the 1980s, defined contribution plans—most prominently the 401(k) plan—have supplanted defined benefit plans as the dominant type of private-sector retirement plan. Under defined contribution plans, workers typically must decide whether or not to participate, how much to contribute, and how to invest plan assets from a range of options provided under the plan. Under a 401(k) plan, if the employee does not participate, if contributions made to an employee’s account are insufficient, or if the investments that an employee chooses yield an inadequate return, the employee may have retirement income that is insufficient to maintain his or her desired standard of living.

As defined contribution plans emerged as the dominant form of retirement plan, the percentage of the population covered by employer-sponsored plans changed very little—remaining at about half of the workforce. As figure 1 shows, Current Population Survey data reveal that about 48 percent of the total U.S. workforce was not covered by an employer-sponsored a plan in 2007.² About 40 percent worked for an employer that did not sponsor a plan, and about 8 percent did not participate in the plan that their employer sponsored.

²The Current Population Survey is a monthly survey conducted by the U.S. Census Bureau among a nationally representative sample of approximately 100,000 households, primarily in order to estimate the rates of employment and unemployment. During March of each year, the survey includes supplemental questions about retirement plan participation and other financial matters.

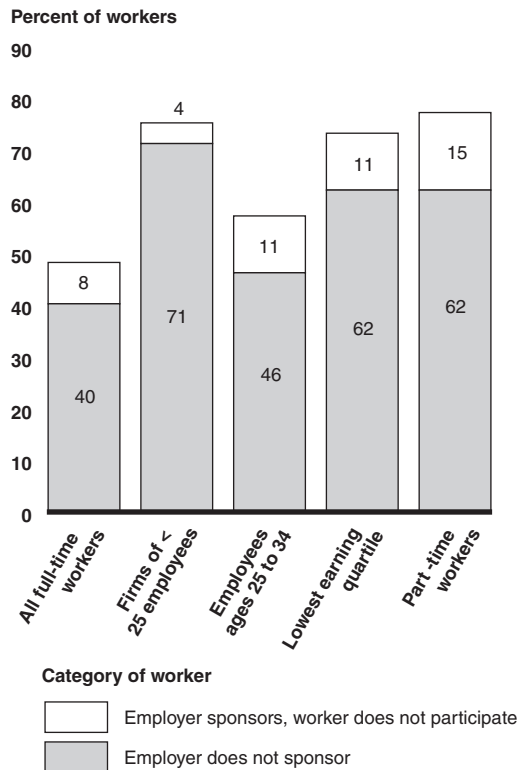
Figure 1: Proportion of Full-Time Workforce Lacking Retirement Plan Coverage, 1990 and 2007



Source: GAO presentation of data in Pension Sponsorship and Participation: Summary of Recent Trends, Congressional Research Service, September 2008.

According to the Current Population Survey, certain segments of the working population have consistently had much lower rates of employment with employers sponsoring a plan, and lower participation rates than the working population overall. As figure 2 illustrates, larger portions of certain worker groups, such as lower-income workers, younger workers, workers employed by smaller companies, and part-time workers lack coverage compared to all full-time workers.

Figure 2: Proportion of Labor Force That Lacked Retirement Plan Coverage in 2007, by Selected Worker Characteristics



Source: GAO presentation of data in Pension Sponsorship and Participation: Summary of Recent Trends, Congressional Research Service, September 2008.

Note: Except where noted, all data are for full-time workers only.

Workers may choose not to enroll, or delay enrolling, in a retirement plan for a number of reasons. For example, according to a recent Congressional Research Service presentation of data from the Survey of Income and Program Participation, most non-participating workers whose employer sponsored a plan said they thought—in some cases, incorrectly—they were ineligible.³ The report also found that substantial numbers of

³Patrick Purcell, *Retirement Plan Participation and Contributions: Trends from 1998 to 2006*. (Washington, D.C.: Congressional Research Service, Jan. 30, 2009). This report is based on an analysis of the Survey of Income and Program Participation (SIPP), which is conducted by the U.S. Census Bureau and encompasses a nationally representative sample of the civilian, noninstitutionalized population of the United States. The SIPP is a longitudinal survey, which means that it measures changes pertaining to the same individuals and households over time.

employees fail to participate because they believe they cannot afford to contribute to the plan. For example, 19 percent of nonparticipating respondents cited this reason, and 10 percent said they did not want to tie up their money. In recent years, exponents of “behavioral economics” have noted that many non-participants may not have made a specific decision, but rather fail to participate because of a tendency to procrastinate and follow the path that does not require an active decision. Further, some workers may not participate because of more immediate savings objectives—such as saving for education or a home—and, in the case of lower income workers, the prospect that Social Security benefits will replace a relatively high percentage of income in their retirement years. For example, a recent analysis by the Investment Company Institute concluded that lower income workers are less likely to save for retirement in part because Social Security benefits replace a higher proportion of their pre-retirement earnings.⁴

In recent years, automatic enrollment has been advocated as a way to encourage greater participation in 401(k) plans among the portion of the workforce who have access to such plans but opt not to participate. Typically, under 401(k)s and some other types of defined contribution plans, workers have been required to decide whether or not to join a plan, to specify their saving contribution rates, and to select investments from the range of investment options offered by the plan.⁵ Under automatic enrollment, in contrast, a worker would be enrolled in a plan unless she or he explicitly opted-out of the plan. Plan sponsors that adopt automatic enrollment must specify a default contribution rate—the portion of an employee’s salary that will be deposited in the plan—that applies to employees who do not choose a different contribution rate. Also, plan sponsors must select a default investment—the fund or other vehicle into which deferred savings will be invested—unless the employee specifies an investment or investments from those available under the plan. Employers may also adopt an automatic escalation policy, under which an employee’s contribution rates would be automatically increased at periodic intervals, such as annually. For example, if the default contribution rate is 3 percent of pay, a plan sponsor may choose to increase an employee’s rate of saving

⁴Brady, Peter, and Stephen Sigrist, *Who Gets Retirement Plans and Why*, Investment Company Institute Perspective 14, no. 2 (Washington D.C.: September 2008).

⁵In some other types of defined contribution plans, such as profit-sharing and money-purchase plans, all workers are typically included in the plan, and the employer makes contributions and often invests the money in the employees’ account.

by 1 percent per year, up to some maximum, such as 6 percent. While a plan sponsor that adopts an automatic enrollment policy must specify a default contribution rate and a default investment, plan features such as these and automatic escalation may also be adopted in the absence of an automatic enrollment policy.

Automatic enrollment has not been a traditional feature of 401(k) plans and, prior to 1998, plan sponsors feared that adopting automatic enrollment could lead to plan disqualification.⁶ However, in 1998, the Internal Revenue Service (IRS) addressed this issue by stating that a plan sponsor could automatically enroll newly hired employees and, in 2000, clarified that automatic enrollment is permissible for current employees who have not enrolled.⁷ Nonetheless, a number of considerations inhibited widespread adoption of automatic enrollment, including remaining concerns such as liability in the event that the employee's investments under the plan did not perform satisfactorily, and concerns about state laws that prohibit withholding employee pay without written employee consent. More recently, provisions of the Pension Protection Act of 2006 (PPA) and subsequent regulations further facilitated the adoption of automatic enrollment by providing incentives for doing so and by protecting plans from fiduciary and legal liability if certain conditions are met.⁸ In September 2009, the Department of the Treasury announced IRS actions designed to further promote automatic enrollment and the use of automatic escalation policies.⁹

⁶A plan must be considered "qualified" to obtain favorable tax treatment under federal law. One requirement for a qualified 401(k) plan is that participants must elect to have the employer provide an amount of salary to the employee in cash, or to defer the amount of salary and deposit the amount in the employee's plan account.

⁷The 1998 IRS ruling—IRS Revenue Ruling 98-30—held that employer contributions made to a plan on an employee's behalf, in lieu of cash payment, are considered elective contributions, so long as the employee has an opportunity to receive cash instead, and has not affirmatively expressed a desire to do so. In a subsequent ruling—IRS Revenue Ruling 2000-8—the IRS determined that contributions made on behalf of either a newly hired or current employee in lieu of cash compensation were valid elective contributions.

⁸ Pub. L. No. 109-280 (2006) §902 of PPA added Code sections 401(k)(13), 401(m)(12) and 414(w). See final regulations of the Internal Revenue Service regarding "Automatic Contribution Arrangements" at 74 Fed. Reg. 8200 (Feb. 24, 2009).

⁹These IRS actions include Revenue Ruling 2009-30, which demonstrates ways a 401(k) plan sponsor can include automatic contribution increases in its plan, and Notice 2009-65, which includes sample automatic enrollment plan language that a 401(k) plan sponsor can adopt with automatic IRS approval.

PPA Provisions Facilitating Automatic Enrollment

Anti-Discrimination Safe Harbor 401(k) (13)

Plans that adopt automatic enrollment may be exempt from required annual testing to ensure that the plan does not discriminate in favor of highly compensated employees. To obtain safe harbor protection, plans must adopt automatic enrollment as well as other plan features and policies. For example, the plan must:

- Notify affected employees about automatic contributions
- Defer at least 3 percent of pay in the first year
- Automatically increase contribution by 1 percent each subsequent year, to a minimum of 6 percent and a maximum of 10 percent
- Invest savings in a type of investment vehicle identified in Department of Labor regulations as a Qualified Default Investment Alternative (QDIA)^a
- Match 100 percent of the first 1 percent of employee contributions, and 50 percent of contributions beyond 1 percent, up to 6 percent of wages

Protection from Employee Retirement Income Security Act of 1974 (ERISA) Fiduciary Liability

In the absence of direction from an employee, plans that automatically invest contributions in a QDIA are treated as if the employee exercised control over management of their savings in the plan. As a result, plans that comply with Department of Labor regulations pertaining to QDIAs will not be liable for any loss that occurs as a result of such investments.

90-Day Withdrawal Period

An automatically enrolled worker has 90 days to opt out and withdraw any contributions (including the earnings on those contributions.) These amounts will not be subject to the extra tax that normally applies to distributions received before age 59½. 414(w)(2)(B).

Protection from State Wage-Garnishment Laws

PPA preempts any state law that would directly or indirectly prohibit or restrict the inclusion of an automatic enrollment arrangement in a plan.

Source: GAO analysis of Pension Protection Act and related regulations.

^aFinal regulations issued by the U.S. Department of Labor specify four categories of QDIAs. They are (1) a product with a mix of investments that takes into account an individual's age (such as a target-date fund), (2) an investment service that allocates assets according to an individual's age (such as a managed account), or (3) a product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (such as a balanced fund). A sponsor may also use a capital preservation fund as a QDIA for the first 120 days of an individual's participation to simplify administration if the worker opts out of the plan. 29 C.F.R. §2550.404c-5(c)(4).

Other proposals have been put forth with the intent of broadening the practice of saving for retirement among workers whose employers do not

sponsor a retirement plan. One such proposal is the automatic IRA, which would require employers that do not sponsor a retirement plan to facilitate direct deposit or payroll-deduction savings for all employees.¹⁰ To maximize participation, employees would be automatically enrolled, but would be permitted to opt out. Legislative proposals to establish an automatic IRA requirement were introduced in Congress in 2006 and 2007, and the concept of an automatic IRA was also mentioned in the President's 2010 Budget proposal.¹¹ In addition, legislative proposals have been introduced in some states' legislatures that would involve state governments in facilitating payroll-deduction retirement plans or IRAs for employers that do not already offer them.¹² According to the architect of the state plan concept, a state could play an intermediary role to pool assets and share expenses among many plan sponsors, thus lowering costs.

Automatic Enrollment Raises Plan Participation, but Some Plan Sponsors Have Not Adopted Plan Features That Could Further Facilitate Retirement Savings

Existing studies show that automatic enrollment significantly increases participation rates in 401(k) plans, although beneficial effects of automatic enrollment may depend on accompanying policies designed to ensure adequate savings and appropriate investment. While defined contribution plan sponsors have increasingly adopted automatic enrollment in recent years, this approach may not be suitable for all plan sponsors, and available data show that some plan sponsors have not augmented automatic enrollment policies with other policies designed to ensure adequate savings.

¹⁰IRAs were established under the Employees Retirement Income Security Act of 1974. (Pub. L. 93-406, codified at 29 U.S.C. 1001 et seq.) IRAs are intended to provide individuals not covered by employer-sponsored retirement plans an opportunity to save for retirement in their own tax-deferred accounts, and to give retiring workers or those changing jobs a way to preserve assets in employer-sponsored plans by allowing them to transfer plan balances to an IRA. Over the past 30 years, Congress has created several types of IRAs with different features for individuals and small businesses.

¹¹The two legislative proposals were the Automatic IRA Act of 2007, S. 1141 and H.R. 2167, 110th Cong., 1st sess.; and the Automatic IRA Act of 2006, S. 3952 and H.R. 6210, 109th Cong., 2nd sess.

¹²For example, see Wash. Second Substitute Senate Bill 5791, 61st Legislature, 2009 Regular Session, and Md. Senate Bill 728, 2008 Regular Session.

Automatic Enrollment Increases Participation Rates, but Some Participants' Acceptance of the Default Contribution Rate and Investment Fund May Limit Savings Potential

According to analyses we reviewed, automatic enrollment policies result in considerably increased 401(k) participation rates for plans adopting them, with some participation rates reaching as high as 95 percent.¹³ For example, one study followed comparison groups hired before and after a company adopted automatic enrollment for new employees only and compared the participation rates of the two groups. The participation rate for those hired before automatic enrollment was adopted was 37 percent at 3 to 15 months of tenure, compared with an 86 percent participation rate for the group hired after automatic enrollment with a similar amount of tenure.¹⁴ According to the studies we reviewed, automatic enrollment has this effect because many people find it easier to delay the decision to enroll in a plan out of inertia, procrastination, feelings of intimidation about making savings and investment decisions, or other factors. Workers may intellectually understand the importance of saving for retirement but have trouble overcoming their own inertia to start saving or to save effectively.¹⁵ A team of researchers found that under automatic enrollment, workers' inertia works in favor of saving for retirement because workers need to do little or nothing to participate in their employers' plan.¹⁶ Further, workers may also decline to participate, in part, because they believe the decision to participate in a 401(k) plan requires time-consuming and complex decisions, such as choosing how much to contribute and how to invest their contributions. Automatic enrollment, through its default contribution rates and default investment vehicles,

¹³Four of the six analyses we reviewed were case studies that compared participation rates at companies before and after automatic enrollment was adopted, while two of the analyses were conducted by large plan administrators and analyzed the records of their respective defined contribution plan sponsors and participants. Because these analyses do not represent a random sample of 401(k) plan sponsors, their findings are not generalizable. For more information about the studies, see appendix I.

¹⁴Brigitte C. Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *The Quarterly Journal of Economics*, vol. CXVI, no. 4: 1149-1187.

¹⁵Olivia S. Mitchell and Stephen P. Utkus, "Lessons from Behavioral Finance for Retirement Plan Design." Chapter 1 in *Pension Design and Structure: New Lessons from Behavioral Finance*, eds. Olivia S. Mitchell and Stephen P. Utkus. (New York, N.Y.: Oxford University Press Inc., 2004).

¹⁶James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "Saving for Retirement on the Path of Least Resistance." Chapter 11 in *Behavioral Public Finance*, eds. Edward J. McCaffery and Joel Slemrod. New York: Russell Sage Foundation, 2006.

offers an easier way to start saving.¹⁷ Table 1 shows overall participation rate increases reported in the various studies we reviewed.

Table 1: Overall Participation Rate Effects of Automatic Enrollment

| Study | Authors (year of study) | Overall participation rate | |
|--|--|---|------------------------------------|
| | | Percent under voluntary enrollment only | Percent under automatic enrollment |
| The Power of Suggestion ^a | Madrian and Shea (2001) | 37 | 86 |
| For Better or For Worse ^a | Choi et al. (2001) | 26-43 ^b | 85 and above |
| Nationwide Savings Plan Automatic Enrollment Getting Associates PREPared for Retirement ^a | Swanson and Farnen (2008) | 77 | 95 |
| The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States ^a | Beshears et al. (2008) | 60 | 95 |
| Building Futures Volume VIII | Fidelity Investments (2007) | 53 | 81 |
| Measuring the Effectiveness of Automatic Enrollment | Vanguard Center for Retirement Research (2007) | 45 | 86 |

Source: GAO analysis.

^aThese studies are based on a small number of case studies.

^bAfter 6 months of tenure. This study reports separate results for three case-study companies.

Three of the studies also found that automatic enrollment has a significant effect on subgroups of workers with relatively low participation rates, such as lower-income and younger workers. For example, the Fidelity Investments study found that 30 percent of workers aged 20 to 29 were participating in plans without automatic enrollment. In plans with automatic enrollment, the participation rate for workers in that age range was 77 percent, an increase of 47 percentage points.¹⁸ In addition, four of the studies found that automatic enrollment policies reduced the disparities in participation rates between certain groups of workers. For example, the Madrian and Shea study examined participation rates by race and ethnicity and found that, among workers hired under a voluntary enrollment only policy, Hispanic workers had the lowest participation rate

¹⁷Madrian and Shea.

¹⁸Fidelity Investments, *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans* (Boston, Mass.: 2007). Fidelity compared the participation rate for automatic enrollment-eligible employees in plans with automatic enrollment with the participation rate for eligible employees in plans without automatic enrollment. The study analyzed the data of more than 10 million participants in nearly 13,000 Fidelity-administered plans, representing \$674 billion in assets.

at 19.0 percent, blacks had a slightly higher participation rate of 21.7 percent, and whites had the highest participation rate at 42.7 percent. Under automatic enrollment, however, the participation rates for Hispanic and black employees nearly quadrupled to 75.1 percent and 81.3 percent, respectively, narrowing the gap with white workers, whose participation rate more than doubled, increasing to 88.2 percent. The difference in participation rates between white and Hispanic employees fell from 23.7 to 13.1 percentage points.¹⁹

The high level of participation rates under automatic enrollment appears to persist after such policies are adopted, according to two of the studies in our review.²⁰ Both studies observed participation rates at specific companies for about 3 years after an automatic enrollment policy was adopted. The studies found that for employees hired under automatic enrollment, participation jumped almost immediately and then increased slightly over the 3-year period, but remained relatively stable. The Vanguard study modeled the participation rate over time and found a decline in the participation rate over a 3-year period, with the participation rate falling by about 10 percentage points from its peak of 91 percent but remaining high relative to participation rates for plans without automatic enrollment.²¹ Consistent with these results, plan sponsors who had adopted automatic enrollment stated that their experience also indicated that higher participation rates were sustained. One plan sponsor, a large manufacturer, reported that after 2 years of automatic enrollment, 95

¹⁹Madrian and Shea.

²⁰James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "For Better or For Worse: Default Effects and 401(k) Savings Behavior." Chapter 2 in *Perspectives on the Economics of Aging*, ed. David A. Wise. Chicago: University of Chicago Press, June 2004.

John Beshears, James J. Choi, David Laibson, and Brigitte C. Madrian, "The Importance of Default Options for Retirement Saving Outcomes: Evidence from the USA." Chapter 3 in *Lessons from Pension Reform in the Americas*, eds. Stephen J. Kay and Tapen Sinha. (New York: Oxford University Press Inc., 2008)

²¹William E. Nessmith, Stephen P. Utkus, and Jean A. Young, *Measuring the Effectiveness of Automatic Enrollment* (Valley Forge, Pa.: Vanguard Center for Retirement Research, December 2007). Vanguard reported predicted effects from a logistic regression modeling comparing 527 plans with voluntary enrollment and 48 plans that implemented automatic enrollment for new hires only. Plans introducing automatic enrollment during the analysis period have employees hired under both voluntary and automatic enrollment. As of December 31, 2007, Vanguard administered over 2,200 defined contribution plans with more than 3 million participants. A Vanguard official reported that total plan assets at the end of 2008 were approximately \$194 billion.

percent of employees who had been automatically enrolled had stayed in the plan.²²

Although automatic enrollment can increase participation and saving rates for most workers, it may have an adverse effect on saving rates and investment choices for other workers, depending on the nature of default contribution rates and default investment funds used, according to some of the studies in our review. Four of the six studies we reviewed found that automatically enrolled participants are likely to accept the plan's default contribution rate. Three of the studies found that some participants would have selected a contribution rate higher than the default rate had they not been subject to automatic enrollment and had they chosen to enroll in the plan voluntarily. Further, two of the three studies also found that some participants were likely to accept a default investment fund with relatively low future prospects for return on investment, such as money-market or stable-value funds, compared to the investment fund they would have selected if they had voluntarily enrolled.²³ Thus, these studies concluded that overall savings for these particular participants were lower under automatic enrollment.²⁴ Further, the Beshears et al. study calculated participation rates for a company that doubled its default contribution rate from 3 percent to 6 percent and found that the participation rates were virtually identical before and after the policy change. In addition, Fidelity Investments reported that employees accept the default contribution rate the majority of the time, regardless of how high it is. Studies have found that default policies have these effects,

²²It should be noted that rates of participation in employer-sponsored plans without automatic enrollment tend to increase with the length of employee tenure. For this reason, the impact of automatic enrollment on participation rates may be significantly less pronounced as length of tenure increases.

²³A money market fund is a type of mutual fund that is required by law to invest in low-risk securities. These funds have relatively low risks compared to other mutual funds. A stable-value fund typically invests in bonds and achieves rates of return 2 to 3 percentage points higher than money market funds. The fund manager guarantees the investors a certain rate of return.

²⁴Choi et al. and Madrian and Shea. While particular types of assets, such as money-market and stable-value funds, may result in lower asset accumulations for some participants, they must also consider market risk when assessing their asset allocations. Market risk is the possibility of an overall decline in a broad class of assets, such as stocks. In 2008, stock values fell across the board and even well-diversified portfolios could not protect participants' portfolios from depreciating. Most investment advisors recommend diversifying across asset classes as well as within a particular asset class. For example, bond prices have historically been less volatile than stock prices, and there have been long periods when returns on bonds and stocks have not been closely correlated.

in part, for the same reasons that automatic enrollment increases participation rates—accepting the defaults is the path of least resistance and requires no action on the part of the worker. In addition, some studies found that some employees see default policies as implicit advice from the plan sponsor and that they imply optimal saving rates and investment choices.

Adoption of Automatic Enrollment Has Grown Considerably in Recent Years, but Many Plan Sponsors Have Not Adopted Policies to Ensure Adequate Long-Term Savings

Automatic enrollment policies have been increasingly adopted by defined contribution plan sponsors in recent years as a result of several factors. Nonetheless, a number of considerations may limit adoption of automatic enrollment over the long term. Low default contribution rates and an apparent lag in the adoption of automatic escalation policies raise questions about the adequacy of long-term saving rates under automatic enrollment. Further, the widespread adoption of target-date funds (TDF)—funds that allocate investments among various asset classes and automatically shift to lower-risk, income-producing investments as a “target” retirement date approaches—as default investments for plans with automatic enrollment has raised concerns about investment risk and transparency of investments of TDFs for participants nearing retirement.

Greater Adoption of Automatic Enrollment and Factors Driving Trend

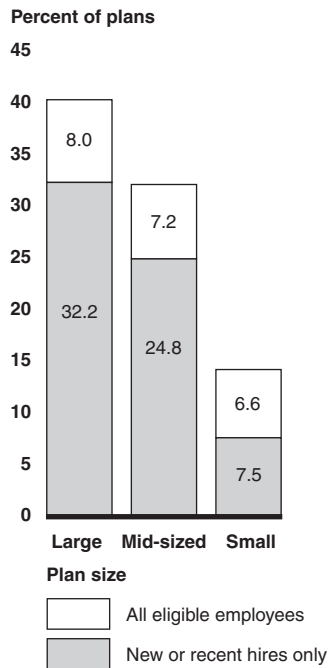
Data from two large plan administrators, as well as discussion with retirement plan experts, indicate that plan sponsors’ adoption of such policies has grown considerably in recent years. Data from Fidelity Investments show that the percentage of defined contribution plans adopting automatic enrollment grew from about 1 percent in December 2004 to about 16 percent in March of 2009. Comparable data from Vanguard show that about 19 percent of plans had adopted automatic enrollment as of December 2008, up from 8 percent in June 2006.

Data from one plan administrator show that large plan sponsors—sponsors of plans with \$500 million or more in assets—have adopted automatic enrollment policies more often than smaller plans. As figure 3 illustrates, Fidelity Investments data show that about 40 percent of large plans had adopted automatic enrollment by March 2009, while only about 14 percent of small plans had done so.²⁵ According to Fidelity’s data, about

²⁵For purposes of this data, Fidelity defines large plans as those with more than \$500 million in assets, mid-sized plans as those with between \$35 million and \$500 million, and small plans as those with less than \$35 million in assets.

47 percent of all plan participants are included in plans that offer automatic enrollment.

Figure 3: Adoption and Scope of Automatic Enrollment by Plan Size, March 2009



Source: GAO presentation of Fidelity Investments data.

Plan sponsors can choose to apply automatic enrollment “broadly” to all employees, or more narrowly to include only newly hired employees. Data from Fidelity Investments indicate that automatic enrollment policies are typically applied only to new or recently hired employees, but a growing percentage of plan sponsors extended automatic enrollment to existing employees as well. Among plans with automatic enrollment policies, about 58 percent of plans apply such policies to new and recently hired employees only, while about 42 percent apply automatic enrollment to existing eligible employees as well.²⁶ There is considerable variation in this pattern by plan size—as figure 3 illustrates, the majority of large plans had adopted automatic enrollment only for new or recently hired

²⁶Fidelity Investments, *Building Futures: Auto Solutions Data* (Boston, Mass.: September 2008).

employees, while nearly half of small plans applied the policy to all eligible employees.

According to plan sponsors, retirement plan experts, and others we contacted, several considerations have been driving the increase in automatic enrollment. These considerations include: (1) plan sponsors' desire to increase participation rates, (2) plan administrators' marketing of automatic enrollment, and (3) aspects of the Pension Protection Act that facilitate and encourage the adoption of automatic enrollment.

Sponsor Desire to Increase Participation Rates: Officials of each of the six plan sponsors we contacted that had adopted automatic enrollment highlighted the desire to better ensure adequate retirement savings for employees. Some plan sponsors noted that automatic enrollment was considered necessary because other methods of increasing plan participation had not been effective. For example, one plan sponsor had sent e-mails and educational materials reminding employees of the plan's availability and provided them with analyses of the matching funds they had lost by not contributing. While these methods raised contribution rates from the 50 percent range to the 65 percent range, the company could not further increase contribution rates. However, after instituting an automatic enrollment policy, the plan's participation rates increased to 93 percent. An official of another plan sponsor noted that an automatic enrollment policy was necessary because the company had a very young workforce, and the company believed that retirement savings was a very low priority and a distant, "abstract" benefit for these workers. Some plan sponsors also noted that adoption of an automatic enrollment policy may be particularly urgent in the case of plans that discontinue other benefits. For example, representatives of two plan sponsors stated that automatic enrollment was adopted at about the time that an existing defined benefit plan was frozen—that is, closed to new entrants. A representative of a large plan consulting firm noted that sponsors may do this with the long term in view; they want their employees to be able to retire at retirement age, partly to ensure that as productivity drops off, these workers do not have a reason to stay on indefinitely. This plan consultant also said that

some plans may adopt automatic enrollment to help ensure that the sponsor can pass nondiscrimination testing.²⁷

Plan Administrator Marketing: 401(k) plan administrators—firms that provide and manage retirement plans for plan sponsors—have been actively marketing and promoting adoption of automatic enrollment, according to plan administrators and others. One large plan administrator stated that it encourages automatic enrollment by conducting analyses of the effects of automatic enrollment tailored to individual plan sponsor clients. The official stated that when plan sponsors see the potential benefits to employees of automatic enrollment compared to the status quo, about 25 percent of them have adopted automatic enrollment.

The Pension Protection Act: Finally, various aspects of the PPA have facilitated the trend toward automatic enrollment. An official of one of the nation’s largest 401(k) plan administrators noted that the criteria and guidelines established in the PPA streamlined and simplified the decision-making process about automatic enrollment and the related plan design features. One consultant noted that the deliberations about the PPA involved considerable industry input and had an “announcement effect” that generated considerable publicity regarding automatic enrollment. Representatives of two plan sponsors said that the PPA safe harbor protection was a consideration in adopting automatic enrollment.²⁸ One plan had not adopted all of the PPA safe harbor provisions. Instead, it used the safe harbor specifications as a guide in setting features such as a matching contributions and the 3 percent default contribution rate. The other plan sponsor adopted all of the PPA safe harbor provisions.

Factors Limiting the Adoption of Automatic Enrollment

Various factors, including higher costs, management views, concerns about legal and regulatory challenges, and lack of awareness may delay or prevent the adoption of automatic enrollment policies by some plan sponsors.

²⁷To maintain their 401(k) plans’ qualified status, employers must perform tests to ensure that their plans comply with federal tax nondiscrimination rules (26 U.S.C. §401). These rules seek to balance benefit accruals of highly paid participants with those of non-highly paid participants.

²⁸The plan sponsor may utilize a “safe harbor” to avoid otherwise required ADP and ACP antidiscrimination testing of these plans. Specifically, in exchange for utilizing the safe harbor, the employer is required to make certain contributions to plan participants and use an accelerated vesting schedule.

Greater Costs: Automatic enrollment implies greater costs for plan sponsors, including higher matching costs and greater fees paid to plan administrators. One plan administrator stated that automatic enrollment could be particularly unattractive to cost-sensitive companies that have narrow profit margins. This concern was reflected by a plan sponsor who noted that the adoption of automatic enrollment would be difficult for one of the company's subsidiaries, which operated in a very cost-competitive environment and would therefore have difficulty passing on costs to customers. The subsidiary would probably have to absorb the additional costs through reduced profit margins. Plan consultants and plan administrators noted that the costs of automatic enrollment may be a particular concern in the current economic environment. One large plan administrator noted that the current state of the economy will slow down adoption of automatic enrollment, as many companies try to minimize additional costs. While some noted that this should be a transient consideration, one expert we contacted said that the recession would be a memorable event for some plan sponsors, which could have longer-term implications.

Certain types of plan sponsors may be especially concerned about the cost impact of automatic enrollment. For example, plan sponsors that employ a low-wage and high-turnover workforce—such as retail establishments and restaurant chains—may be especially reluctant to adopt automatic enrollment because of the additional cost, administrative burden, and prospect of limited benefits for employees. One such plan sponsor we contacted explained that adopting automatic enrollment would result in a five-fold increase in the number of plan participants and associated administrative costs and that the company might lower the employer match to mitigate the associated cost increases. In addition, the plan would have greater administrative burdens related to the need for employee communication and to handle inquiries from the much larger pool of participants. A representative of this plan sponsor also explained that, even with contribution rates of 6 percent, low-wage and short-tenure staff would accumulate very small balances and likely abandon them or take a lump-sum distribution upon separation.²⁹

²⁹A recent GAO report discusses the impact of lump sum distributions—that is, cashouts of account balances at job separation that are not rolled over into another retirement plan—and other forms of 401(k) account “leakage”: *401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers’ Retirement Savings* [GAO-09-715](#) (Washington, D.C.: Aug. 28, 2009).

Management Views: Apart from costs, experts noted that some plan sponsors may be reluctant to adopt automatic enrollment due to certain management views or out of concern about employee reaction or welfare. Some experts told us that some managers view automatic enrollment as overly paternalistic or do not wish to reward passivity in employees who do not voluntarily join a plan. For example, a representative of one plan sponsor told us that the company wanted all employees to participate in the plan but wanted active participation and conscientious saving. A representative of a small manufacturing company stated that management believes that the workforce would be highly distressed if the company began summarily taking 401(k) contributions from their pay, even with a well-communicated opt-out feature. The representative further noted that the sponsor believes the recent declines in the equity markets also weigh against adoption of automatic enrollment, in light of the firm's fiduciary responsibility for the plan.

Legal and Regulatory Challenges: Some experts noted that some plan sponsors may be reluctant to adopt automatic enrollment due to legal and regulatory concerns. One expert noted that small plans see the legal and regulatory environment surrounding 401(k)s as complex and may see a switch to automatic enrollment as overly risky. Another expert noted that, unlike larger plan sponsors, small plans without well-staffed legal and compliance departments may be risk-averse and slow to adopt new policies.

Lack of Employer Awareness: Some smaller employers may not be aware that automatic enrollment is a plan feature available to them. Representatives of two small plan sponsors said that they were generally unaware of automatic enrollment as a plan option. For example, one small plan sponsor stated that neither she nor the organization's 401(k) employee advisory committee was familiar with the concept of automatic enrollment. Further, the local service provider that provides the organization with plan guidance and management assistance had not suggested such a policy. Relatedly, representatives of one large plan administrator told us that small plan sponsors generally lag behind large plan sponsors in adopting innovative services, tools, and plan design features, including automatic enrollment.

Impact of Automatic Features
on Saving Rates and
Investment Risk and
Transparency

Available data show that many plans with automatic enrollment have not adopted default automatic escalation policies, which, in combination with low default contribution rates, could result in low saving rates for participants who do not increase contribution rates over time. Also, experts noted that a trend toward TDFs as default investments, while

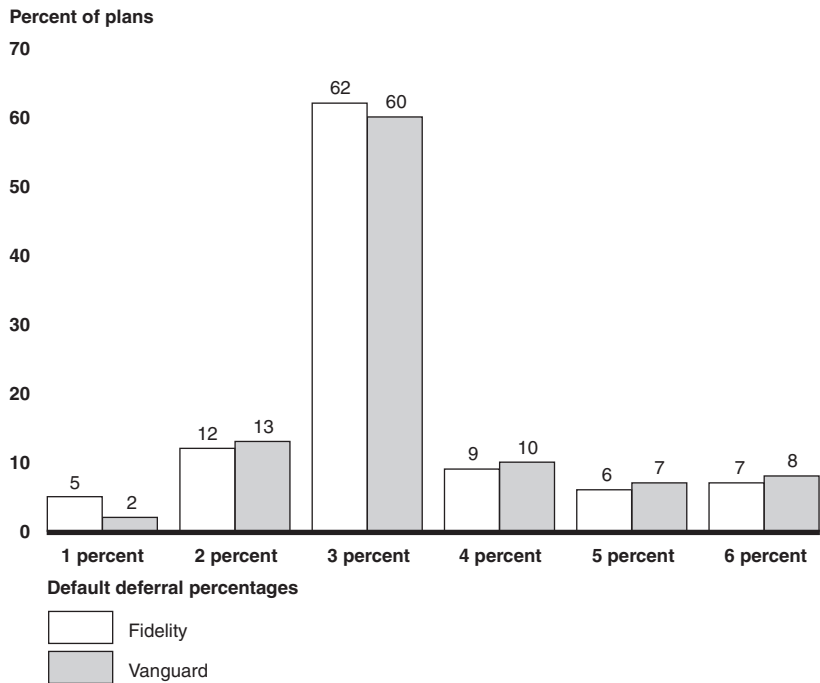
potentially beneficial in important respects, also raises questions about the investment risks and transparency for those close to retirement.

As figure 4 illustrates, data from two large plan sponsors indicate that the majority of plans with automatic enrollment have adopted initial default contribution rates of 3 percent. Between 15 to 17 percent of plans have a default contribution rate of less than 3 percent, and between 22 and 25 percent of plans have a default contribution rate of more than 3 percent.³⁰ Data from Fidelity showed that the average default contribution rate grew modestly, from about 3.0 percent in March 2005 to about 3.2 percent in March 2009. According to a Vanguard official, the average default contribution rate was 3.3 percent at the end of 2008.³¹

³⁰While there is no consensus about what constitutes an adequate contribution rate, some pension experts have cited combined contribution rates—including employer and employee contributions—of between 12 and 20 percent of pay.

³¹Interviews with plans sponsors and others revealed a number of reasons for the predominance of the 3 percent default rate. For example, a representative of a firm that consults with many retirement plans stated that plan sponsors do not want a high default contribution rate that would risk causing automatically enrolled participants to drop out of the plan. A large plan administrator noted that the Pension Protection Act's specification of a 3 percent minimum default rate for safe harbor plans was seen by many as implied advice to start at 3 percent.

Figure 4: Default Contribution Rates for Plans with Automatic Enrollment



Source: GAO presentation of data from Fidelity Investments and Vanguard Group.

Note: Fidelity data are as of March 2009. Vanguard data are as of December 2008. Vanguard data indicate that 8 percent of plans had default deferral rates of 6 percent or more.

Available data is mixed with regard to the extent to which plan sponsors with automatic enrollment have also adopted automatic escalation policies. According to one plan administrator’s data, about 45 percent of plans with automatic enrollment had adopted a default automatic escalation feature as of March 2009, up from zero in 2005.³² Further, this administrator’s data shows that adoption of default automatic escalation policies are much less prevalent among large plans than small plans—about 24 percent of large plans with automatic enrollment policies have adopted such a policy, while about 51 percent of small plans have done so. Data from another plan administrator show a much greater rate of adoption of default automatic escalation policies—77 percent of all plans

³²According to data from Fidelity, another 46 percent of automatic enrollment plans have adopted optional automatic escalation, which means that participants have the option of increasing their contribution rate automatically at periodic intervals, such as once per year.

with automatic enrollment had adopted default automatic escalation policies in 2008, up from 31 percent in 2005.³³

Available data indicate that plans with automatic enrollment policies overwhelmingly adopted TDFs as a default investment. TDFs allocate their investments among various asset classes and shift that allocation from equity investments to fixed income and money market investments as a “target” retirement date approaches.³⁴ Eighty-seven percent of Vanguard Group plans with automatic enrollment had adopted TDFs as a default investment at the end of 2008, compared to 42 percent in 2005. Conversely, the use of balanced funds, money market funds, and stable value funds as default investments have declined significantly.³⁵ This trend toward TDFs as a default investment vehicle is corroborated by data from Fidelity Investments, which shows that 96 percent of plans with an automatic enrollment policy used TDFs as of March 2009, up from 57 percent at the end of 2005.³⁶

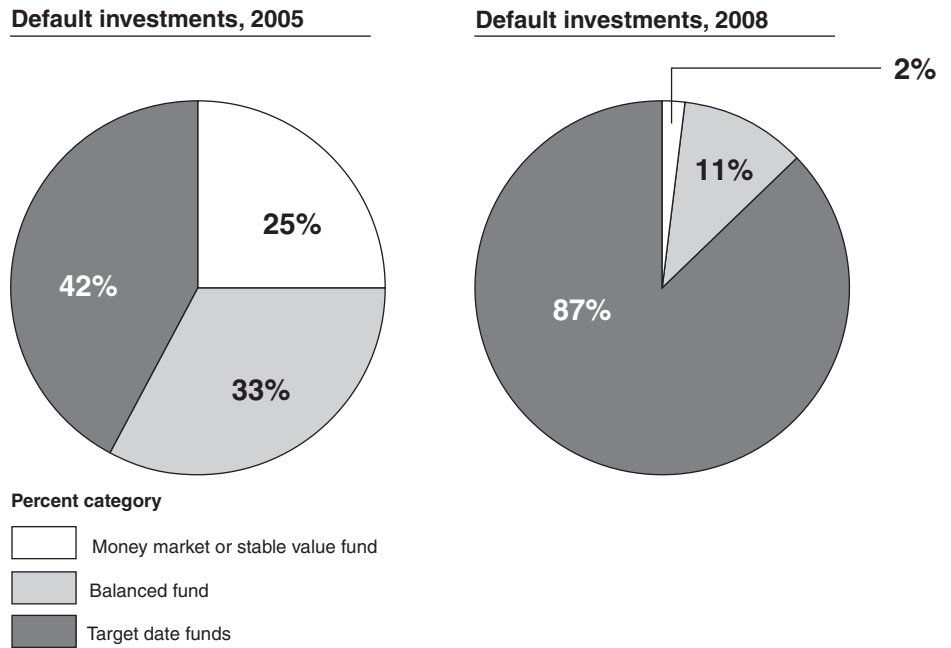
³³According to a representative of a plan administrator, a number of factors could explain this difference. For example, one plan administrator may have actively promoted default automatic escalation.

³⁴This shift in TDF asset allocation is commonly referred to as the fund’s “glide path.” Sometimes TDFs have significant equity components at the retirement date and even at the endpoint of the glide path.

³⁵Both money market and stable value funds were often used as default investments before the PPA because employers were concerned about legal liability if investments they had chosen declined in value as a result of market fluctuations. As a result, they were led to invest workers contributions in such low-risk, low-return default investments.

³⁶Target-date funds are also sometimes referred to as “lifecycle funds.” The two are generally synonymous in that they both adjust the proportion of different asset classes over time so that the investor has lower risk as they approach retirement.

Figure 5: Default Fund Types Used by Plans with Automatic Enrollment Policies in 2005 and 2008



Source: GAO presentation of data from Vanguard Group.

TARGET-DATE FUNDS

Target-date funds (TDF) offer investors certain advantages generally not offered by other types of investment vehicles. TDFs allocate their investments among various asset classes and shift that allocation to more conservative investments as a “target” date approaches. For example, a TDF could be designed for workers expecting to retire many years in the future and would typically have a much greater allocation to equities and a lesser allocation to fixed-income investments. Conversely, a fund designed for workers nearing retirement age would tend to have a greater allocation to fixed-income investments. TDFs thus offer participants a potentially beneficial long-term asset allocation strategy while lowering risks as the participant approaches retirement age.

Source: GAO synthesis of various descriptive literature.

This trend is important in part because recent evidence suggests that participants who are automatically enrolled in plans with target-date fund defaults tend to have a high concentration of their savings in these funds. A recent analysis by the Employee Benefit Research Institute found that workers who were considered to be automatically enrolled in a 401(k)

plan were more likely than those who voluntarily joined to invest all their assets in a TDF.³⁷ The study found that, except for participants in plans with more than 10,000 participants, more than 90 percent of those automatically enrolled in TDFs had all of their allocation in such funds.

While TDFs may help ensure that workers have a more age-appropriate mix of investments, some experts have stated that TDFs may pose certain challenges, as recent events in the financial markets have illustrated. As a result of the 2008 stock market decline, some TDFs designed for those expecting to retire in or around 2010 lost 25 percent or more in value. In light of concerns about a number of issues, including how plan sponsors evaluate, monitor, and use TDFs, in 2008 the Advisory Council on Employee Welfare and Pension Benefit Plans recommended that the U.S. Department of Labor provide more specific guidance regarding the complex nature of TDFs, and outline the methodology that plan fiduciaries should follow in selecting and monitoring them. The Advisory Council also stated that additional education materials would help plan participants become aware of the value and risks of TDFs.³⁸

³⁷Craig Copeland, *Use of Target-Date Funds in 401(k) Plans, 2007*, Issue Brief 327 (Washington, D.C.: Employee Benefit Research Institute, March 2009). This analysis was based on the Employee Benefit Research Institute/Investment Company Institute database, which contains data on nearly 22 million participants in participant-directed retirement plans. Although this database does not include information on plans' use of automatic enrollment, the author of the study developed a proxy to identify participants who were considered to have been automatically enrolled.

³⁸The Department of Labor and the Securities and Exchange Commission held a joint public hearing in June 2009 on TDFs and are currently reviewing the testimony presented at the hearing and supplemental materials submitted for the public record. (*Hearing on Target Date Funds and Similar Investment Options*, 74 Fed. Register 24052.)

Automatic IRA and State-Assisted Retirement Savings Plan Proposals Could Improve Access to Retirement Savings Vehicles for Uncovered Workers, but Each Proposal Faces Challenges

In order to promote retirement savings among the 40 percent of the workforce whose employer does not sponsor a plan, members of Congress, in recent years, have introduced bills for federally required “automatic IRAs” that would be implemented nationwide. Automatic IRAs offer the potential benefit of expanding retirement coverage but some have expressed concerns that automatic IRAs may not result in significant retirement savings, and raised questions about the costs of such a program for employers and the federal government. There have also been proposals for state-supported retirement savings programs over the past several years. These state proposals also have the potential to expand retirement coverage, but on a state-by-state basis. Concerns have been expressed regarding the cost of these state proposals, as well as employer and employee interest in such plans, and potential legal barriers.

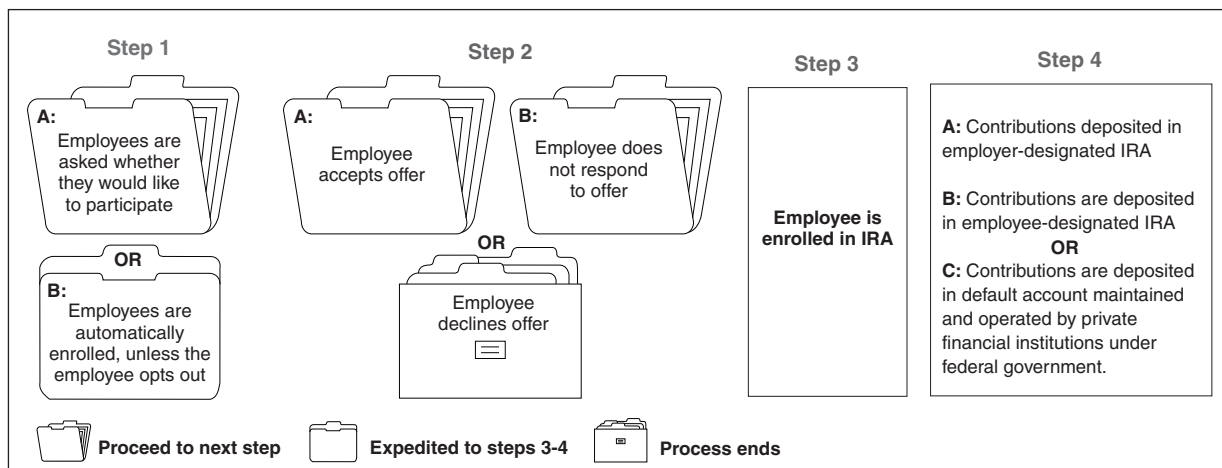
Automatic IRAs Could Provide Benefits to More Workers, but Its Impact Is Uncertain

A number of existing proposals have described in general terms the concept of an automatic IRA, and they contain common elements.³⁹ Under the 2006 and 2007 congressional bills for automatic IRAs, employers that do not sponsor a retirement plan would be required to defer a percentage of an employee’s pay to an IRA through payroll deduction, unless the employee opts out. The requirement would apply to all employers with more than 10 employees and who had been in business for at least 2 years, or employers with 100 or more employees regardless of the length of time the employer has been in business. Eligible workers would be those who had worked for an employer for a specified period, were at least 18 years old, and were not eligible to participate in any other qualified retirement plan the employer sponsors. Affected employers could either (1) automatically enroll eligible workers, although employees would be offered the option to affirmatively opt out or (2) require that employees

³⁹S. 1141 and H.R. 2167, 110th Cong., 1st sess.; S. 3952 and H.R. 6210, 109th Cong., 2nd sess.; David C. John and J. Mark Iwry, *Pursuing Universal Retirement Security Through Automatic IRAs*, Joint Written Statement before Subcommittee on Long-Term Growth and Debt Reduction Committee on Finance, United States Senate. Washington, D.C.: June 29, 2006. The White House’s FY 2010 Budget Proposal also called for an automatic workplace pension program. Further, in its August 2009 proposals for financial regulatory reform, the Department of the Treasury called for the enactment of the automatic IRA (The Department of the Treasury, *Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: Aug. 11, 2009)). At this writing, no bill for an automatic IRA had been introduced before the 111th (current) Congress.

make an explicit yes or no decision on whether to participate; workers not making such a decision would be automatically enrolled (see fig. 6). Employers would then transfer a portion of employees' pay to either a traditional IRA or a Roth IRA through payroll deduction.⁴⁰ Employers could elect to send contributions to IRAs of an employer-designated issuer, unless the employee selects his own IRA provider. If neither the employer nor the employee designates a specific IRA provider, the contributions would be deposited into federally designated default accounts.

Figure 6: Steps Involved with Establishing an Automatic IRA



Source: GAO, Adobe systems incorporated.

The automatic IRA is intended to help address the retirement security needs of those not already covered by an employer-sponsored retirement plan. Further, the automatic IRA is designed to extend the benefits of

⁴⁰A traditional IRA allows individuals to defer taxes on investment earnings accumulated in these accounts until distribution at retirement. A Roth IRA, in contrast, allows employees to make after-tax contributions to an IRA and, after age 59½, take tax-free distributions of their investment earnings. Account owners can also make tax-free withdrawals of their contributions after age 59½, as long as they have held the account for 5 years.

Impact on Employees and Retirement Savings

payroll-deduction savings and automatic features of 401(k)s.⁴¹ According to some experts, requiring employers to offer automatic IRAs is necessary for a number of reasons. First, employers have had the option to establish payroll-deduction IRAs for over 10 years, and for a number of reasons, very few employers have done so. As we previously reported,⁴² IRA providers have told us some employers may be reluctant to adopt a payroll-deduction IRA because they believe that their publicizing the payroll-deduction IRAs may be construed as an endorsement of the policy, which could potentially violate ERISA.⁴³ Further, employers may not be aware of how payroll-deduction IRAs work and some small employers may not be aware that this option exists. The automatic enrollment component is necessary, according to designers of the automatic IRA, because various impediments would prevent many eligible employees from taking advantage of an available payroll-deduction IRA. For example, employees would have to decide whether to participate, select an IRA provider, select investment vehicles, and determine how much to contribute. These officials note that many workers may have difficulty overcoming inertia, and automatic enrollment would help them overcome this difficulty.

Advocates for automatic IRAs and some pension industry experts reported that the automatic IRA could have a positive effect on retirement savings. According to the architects of the approach, automatic IRAs offer a powerful mechanism for accumulating retirement savings through regular payroll deposits that continue automatically. In light of the impact of

⁴¹We first reported on the potential benefits of automatic IRAs in our 2007 report *Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers*, [GAO-08-8](#) (Washington, D.C.: Nov. 29, 2007). We projected DC plan savings assuming that all employees participate immediately, rather than waiting for eligibility or opting not to participate. We found that instant and universal participation not only raised average savings for the sample as a whole, but had a relatively strong impact on workers in the lowest income quartile. Although our projections were for DC plans, they suggested that automatic features intended to increase participation can have a strong impact on retirement savings levels.

⁴²See GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, [GAO-08-590](#) (Washington, D.C.: June 4, 2008).

⁴³Employers may establish payroll-deduction IRAs and are not subject to ERISA fiduciary requirements so long as they follow regulations set by the Department of Labor. Further, the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, established SIMPLE IRAs specifically for the purpose of encouraging more employers to sponsor IRAs. SIMPLE IRAs were designed to encourage employers with 100 or fewer employees to assist workers with retirement savings. Under a SIMPLE IRA, an employer can both direct a portion of an employee's salary to an IRA and offer a matching contribution.

automatic enrollment policies on participation in 401(k)s, an automatic IRA program that features default automatic enrollment could have a positive impact on participation rates. One study estimated that likely automatic IRA participants include younger, part-time, and lower- or moderate-income workers, as well as workers subject to higher than average job turnover. Advocates stated that automatic IRAs could help these employees overcome inertia since they would no longer need to take the initiative in order to save. Further, two pension industry experts told us that the payroll-deduction nature of automatic IRAs would ensure that employees of affected companies are saving on a regular basis. However, some experts agree that the automatic enrollment component of automatic IRAs has the potential to significantly increase the number of workers saving for retirement by including workers that currently do not have access to an employer-sponsored plan.

Some caution, however, that the benefits resulting from the automatic IRA could be relatively small. A 2009 preliminary analysis funded by the Department of Labor illustrates potential outcomes of two automatic IRA scenarios using specific behavioral assumptions about participation and contribution rates, among other things.⁴⁴ The analysis found that the resulting increase in average retirement benefits at age 70 is small (even when ignoring account fees and offsetting reductions in other savings) and is weighted toward the third of the population with the highest lifetime earnings. If actual participation rates in the automatic IRA are higher than the analysis assumes—and the experience of automatic enrollment in 401(k)s indicates this is a possibility—the resulting increase in average retirement benefits could be higher. The Department of Labor is undertaking additional analysis to illustrate the effects of participation rates similar to those achieved in 401(k) plans with automatic enrollment.

Participants may also not fully benefit from the tax incentives provided by automatic IRAs. According to analysis sponsored by AARP, 50 percent of automatic IRA participants would be lower-income. Therefore, with the exception of Social Security and Medicare taxes, they would pay little, if any, income tax and may not benefit from the tax incentives traditional

⁴⁴This analysis was conducted by the Policy Simulation Group at the request of the Department of Labor. The analysis considers the impact of an automatic IRA fully implemented in 2010 on the annual retirement benefits of individuals aged 70 in the year 2065. The analysis creates a hypothetical birth cohort and models the cohort's lives from birth to death, including all life events such as marriages, births, education and job decisions, pension coverage and behavior, and retirement.

IRAs offer. Further, while some participants would be eligible for the Saver's Credit, one analysis estimated that the benefit of the credit could be limited. Because the credit is nonrefundable, it can only be used to offset income tax liability. If the participant does not have income tax liability up to the full amount of the credit, the full value of the credit can not be used. For example, the study concluded that if participants made the maximum permitted contributions to an automatic IRA, then nearly 90 percent would not receive the full credit. In part to improve the tax incentive of automatic IRAs, the Department of Treasury, in August of 2009, proposed making the Saver's Credit fully refundable and depositing it automatically into IRAs.⁴⁵

Finally, proper administration of accounts, including record keeping, will be important for managing and maintaining the retirement savings accumulated through the IRAs, according to some analyses and experts. For example, workers would be responsible for ensuring that they do not exceed applicable limits on annual contributions to an automatic IRA. An analysis sponsored by AARP and pension industry officials noted that it might be difficult for some workers to keep track of their accounts when they move from job to job or if their employer goes out of business.⁴⁶ A 2007 study noted that automatic IRA proposals do not impose record-keeping responsibilities on employers, beyond withholding and transmitting IRA contributions. Because of this, the report noted that other entities must assume these responsibilities, and a companion report recommended a centralized administrator be responsible for record keeping. For example, the first report found that a central administrator could help prevent lost accounts by providing participants with annual reports including their contributions and investment earnings for the year, as well as the total account balance. In addition, the architects of the automatic IRA proposed that the federal government set up a standard default account and contract with private financial institutions for record-keeping services, among other things, to make managing the IRAs easier.

⁴⁵The Department of the Treasury, *Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation* (Washington, D.C.: Aug. 11, 2009).

⁴⁶Mary M. Schmitt and Judy Xanthopoulos, *Automatic IRAs: Are They Administratively Feasible, What Are the Costs to Employers and the Federal Government, and Will They Increase Retirement Savings?*, Preliminary Report Prepared for AARP (Optimal Benefit Strategies, LLC, Mar. 8, 2007).

Impact on Employers

A variety of views exist regarding the cost and administrative burden that an automatic IRA would place on affected small employers. As one analysis of the automatic IRA concept noted, an automatic IRA has the potential to result in some costs and administrative burdens on small employers. The analysis noted that employers would need to provide employees with election forms and process paperwork with respect to employee elections or non-elections, choose an IRA provider or opt for the federally designated default investment, and withhold contributions from employees' pay. Pension industry officials also stated that some small employers do not have payroll deduction systems and send paper or spreadsheet files to their record keepers and brokers. They told us that these employers may choose to invest in new infrastructure in order to remit automatic IRA contributions through payroll deduction.

Recent legislative proposals for an automatic IRA have recognized the potential challenges for small employers and contain provisions to mitigate their impacts. For example, the 2007 bills to authorize automatic IRAs would have exempted employers with fewer than 10 employees as well as those that had been in business for less than 2 years. According to some advocates, the proposals would have therefore avoided placing additional requirements on the smallest companies, which may not have electronic payroll-deduction systems. It would also relieve employers starting a new business from additional costs and administrative burdens. In addition, the proposals would establish a tax credit in the early years for participating employers with fewer than 100 employees to mitigate some administrative and startup costs.

In light of these automatic IRA features, some experts and a recent analysis have found that additional costs may be small for most small employers. The architects of the automatic IRA concept have stated that because many employers already make deductions for federal income tax and payroll tax withholdings, making IRA payroll deductions would impose little, if any, new administrative costs. Further, they said these employers would not have to bear the costs involved in maintaining a retirement plan, such as matching employee contributions. These views were supported by a 2009 report sponsored by AARP, which found that most small employers would face low costs to implement the automatic IRA.⁴⁷ This study noted, for example, that about 97 percent of employers

⁴⁷*Most Small Employers Face Low Costs to Implement Automatic IRAs*, a report prepared for AARP (Optimal Benefit Strategies, LLC, Aug. 19, 2009).

with 10 or more employees had automated payroll systems, and such employers would face relatively few burdens implementing the automatic IRA. The report also found that payroll software companies and payroll service providers are likely to adopt automatic IRA requirements in their services to small employers. For the estimated 3 percent of affected employers that process payroll manually, the automatic IRA would also have to be implemented manually.

Impact on the Federal Government

Past proposals have described a federal role that could mitigate some of the difficulties and risks of implementing an automatic IRA. For example, the proposals would have created a new federal entity that would, among other things, establish low-cost default investments.⁴⁸ According to experts we contacted and analyses we reviewed, establishing an automatic IRA policy would require tax incentives to make it more affordable to some employers and federal expenditures to establish and govern the program, among other things.⁴⁹ However, analyses sponsored by AARP found that it is not possible to determine what the costs would be to the federal government without a more detailed proposal. Further, these studies reported that the establishment of an automatic IRA would reduce federal tax revenues as a result of the tax credit available to small employers, individual tax benefits from deferred employee income, and greater use of the Saver's Credit. Two analyses estimated that the revenue losses could amount to somewhere between \$2 billion and \$19 billion over 10 years.

Impact on 401(k) Plans

Industry officials and some experts we contacted also noted that establishment of an automatic IRA could affect the market for 401(k) plans. For example, some pension industry experts and representatives of two national organizations representing large plan sponsors noted that if automatic IRAs are made too attractive, they might displace 401(k)s and Savings Incentive Match Plan for Employees of Small Employers

⁴⁸Although the 2007 House and Senate bills for an automatic IRA included establishment of a governing board modeled on the Federal Thrift Investment Board—a so-called TSP II Board—the bill did not, as the AARP-sponsored analysis noted, clearly delineate the amount of reporting and record keeping that would be required.

⁴⁹For example, the Department of Labor's enforcement activities currently include pursuing 401(k) plan payroll deductions that are not remitted to employees' accounts in a timely manner. Department of Labor officials stated that the government would have to undertake similar activities in instances where automatic IRA payroll deductions are not timely remitted.

(SIMPLE) plans.⁵⁰ These officials said that an employer might forego adopting a 401(k) plan if they have already been required to facilitate an automatic IRA, and that this would be unfortunate because an IRA is in many ways an inferior option for workers. The officials told us that a 401(k) plan can offer workers better benefits, such as an employer match and higher contribution rates.⁵¹ In addition, some of the officials reported that the existence of a 401(k) creates a workplace culture that encourages participation in retirement saving. Further, an AARP-sponsored analysis noted that small businesses will weigh the costs of establishing or maintaining a qualified retirement plan against the costs of complying with the automatic IRA requirements. To the extent that the automatic IRA approach offers significantly lower costs—including the relative costs of fiduciary liability—employers may decide against adopting a 401(k) plan or may eliminate an existing one.⁵² In light of concerns such as these, officials of one large financial services firm said that, if implemented, the automatic IRA program should be evaluated to determine if it led to a shift away from 401(k) plans.

Others, however, have stated that the automatic IRA is not likely to erode the popularity of 401(k) plans, and may even promote greater adoption of such retirement vehicles. Some experts noted that the potential for automatic IRAs to supplant 401(k)s can be minimized by careful design of the program. Perhaps most importantly, they said that the maximum annual savings for an automatic IRA should be designed so that it is less attractive to a small business employer than a 401(k). Specifically, they noted that it is important that the automatic IRA not permit contributions above the current IRA dollar limits to avoid competing with qualified plans. These advocates reason that the potential tax advantage of a 401(k) enables a small business owner—who, along with his employees, may choose to participate in the 401(k) or IRA plan his business sponsors—to save a much higher percentage of his tax-deferred income than does an automatic IRA, making the 401(k) plan a more attractive option. Further, some industry experts told us that an automatic IRA would likely be a stepping stone toward adopting a 401(k) for some small employers. For

⁵⁰An employer with 100 or fewer employees may establish a SIMPLE plan. A SIMPLE plan is a simplified retirement plan for small employers that is not subject to some of the same requirements that the Internal Revenue Code imposes on qualified pension plans.

⁵¹The 2009 maximum annual tax-favored contribution levels are as follows: \$5,000 for a traditional or Roth IRA, \$11,500 for a SIMPLE IRA, and \$16,500 for a 401(k).

⁵²Schmitt and Xanthopoulos 2007.

example, according to an official of one large organization representing pension professionals stated that payroll deduction automatic IRA arrangements will ultimately encourage more employers to sponsor 401(k) plans, and contribute on their employees' behalf.

State-Assisted Retirement Savings Proposals Intend to Increase Retirement Plan Savings but Raise Questions Regarding Participation, Program Design, and Legal Barriers

In recent years, 10 states have considered proposals that would involve state governments in facilitating retirement savings plans for workers whose employer does not sponsor a plan.⁵³ One study on such state proposals reported that employers would like to provide a retirement savings vehicle for their employees, but are inhibited by the cost, complexity, and time that would be required to do so.

Under the proposals, state governments could take a number of actions to help address some of these issues and facilitate the use of payroll-deduction or SIMPLE IRAs or the adoption of 401(k) plans. For example, a state would promote private pension coverage and facilitate retirement savings for small business, moderate-income, and lower-income workers—who are less likely to be covered by an employer-sponsored plan—by acting as an intermediary between employers and financial institutions. In addition, a state could help small employers pool their investments and administrative activities.

The type of retirement plans that would be established by the programs varies. For example, California's proposal would establish a payroll-deduction, traditional, or SIMPLE IRA, or a combination of these options; Connecticut's proposal would establish a 401(k) or other type of defined contribution plan; and proposals in Maryland and Washington would establish a defined contribution plan and IRA options.⁵⁴ Regardless, the state would initiate and oversee the programs, while private-sector companies under contract to the state would manage the investment vehicles and day-to-day administration. For example, a Washington study

⁵³The 10 states are California, Connecticut, Maryland, Massachusetts, Michigan, Pennsylvania, Rhode Island, Vermont, Virginia, and Washington. We focused our analysis on proposals in four states—California, Connecticut, Maryland, and Washington—because these proposals cover a range of retirement plan options, among other criteria (for more on selection criteria, see app. D).

⁵⁴See Cal. Assembly Bill No. 125, 2009-10 Regular Session; Conn. General Assembly Raised Bill No. 971, January Session, 2009; Md. Senate Bill 728 and House Bill 1228, 2008 Regular Session; Wash. Second Substitute Senate Bill 5791 and House Bill 1893, 61st Legislature, 2009 Regular Session.

outlined an option under which the state would design the basic features of a 401(k) plan and market the plan to private-sector employers who do not currently offer a plan. The state would then contract with a private-sector plan administrator to provide access to investment funds, direct customer service, Web-based account access, and to distribute account statements and other communications. Table 2 shows examples of state roles and the intended impact of automatic IRAs under existing proposals.

Table 2: Examples of State Roles and Intended Impact under Existing Proposals

| Potential state role | Intended impact |
|--|---|
| Publicize program and provide information to employers | Through outreach and marketing, the state could inform smaller employers about the availability and benefits of 401(k) plans or payroll-deduction IRAs. As a result, small employers would become aware of the state program and the benefits their employees would derive from participation. |
| Develop, approve, and help market a prototype 401(k) plan | A prototype plan document would facilitate employer participation by eliminating a potentially high up-front cost. Such a document could be developed using in-house expertise in coordination with private-sector financial firms. |
| Negotiate on behalf of small employers and contract with service providers | The state would have bargaining power with financial service providers in light of the prospect that the program could grow to large scale. For example, through competitive bidding the state could negotiate for services that are low in cost and incorporate best practices. |
| Pool savings of employees of small employers | By facilitating the pooled savings of numerous small accounts, the state would obtain lower-cost retirement plans. Small employers are less likely to sponsor retirement plans in part because of higher per capita costs and because financial service providers are less likely to be interested in serving small accounts. |
| Assist employers with plan administration and compliance | By providing participating small employers with convenient and professional assistance with plan investments, administrative tasks, and compliance, the state would further encourage small employers to adopt a plan or facilitate a payroll-deduction IRA. |

Source: GAO analysis.

Challenges States Would Face

Program Participation: Little is known about the extent to which employers and employees would participate in a state-assisted retirement savings program. According to representatives of two organizations in favor of state-assisted retirement savings plans, employer and employee interest in such a program could be considerable. Moreover, one of the representatives noted that proposals in Washington and other states have been specifically designed to address small companies' concerns that the cost of setting up payroll deduction prevents them from adopting a 401(k) plan or a payroll-deduction IRA. However, no known rigorous assessment

exists of the extent to which small employers or employees would opt to participate in such a program. We obtained state-sponsored studies from three of the four states we examined, and while none of the studies included an analysis measuring the magnitude of the market demand for such a program, two noted concerns regarding the potential demand for a state program. For example, a study prepared for the Maryland legislature compared a Maryland proposal to a number of other state financial programs, such as a state-sponsored college savings program.⁵⁵ In comparing the two, the report noted that the college savings program offers distinctive tax and pre-payment guarantee advantages that are not otherwise available in the private market. However, the study noted that this distinction, which helps ensure a market demand for the college savings plans, would not exist for the state-assisted retirement program. The report noted that there will be no additional employee tax benefit for participants in the proposed state-assisted retirement savings program and, for that reason, the program would have to compete on an equal footing with plans in the marketplace. The Maryland analysis concluded that the program might be difficult to establish or market in the absence of a federal requirement that all employers have a retirement savings plan.

Representatives of the financial services industry also indicated that state-assisted programs to some extent could have a “zero-sum” effect. In commentary on the Connecticut proposal in March of 2008, the Small Business Council of America (SBCA) and American Society of Pension Professionals and Actuaries (ASPPA) stated that low-cost retirement options exist now, and the state-assisted program would result in little difference in cost. The SBCA and ASPPA added that state government should not compete with small private businesses unless there is a clear market failure or some inherent unfairness that disadvantages its citizens. Representatives of the Connecticut Bankers Association were concerned that rather than expand retirement savings vehicles to new employees, the state program would attract the “already served market” with initial low costs. Similarly, an SBCA representative stated that providing retirement services to small employers is not very profitable for financial services firms, and if such a proposal resulted in the state obtaining half of the small business market, for example, it is conceivable that large plan administrators would exit the business since they only profit in this sector though large volume. Further, a fiscal analysis of a Washington state

⁵⁵Michael Rubenstein, *Maryland Voluntary Employee Accounts Program Study* (Annapolis: January 2008).

proposal noted that the program would have no initial plan assets and uncertain levels of participation and, as a result, vendors may have difficulty estimating the total cost of record-keeping services. This, in turn, could affect vendor interest in providing services for the program.

Program Design and Costs to State: Studies from California, Maryland, and Washington about the feasibility of state-assisted retirement savings programs identified important questions about program design and related costs. For example, state governments will need to determine the extent to which administrative and management responsibilities will be borne by the state, and how much will be contracted out to financial services providers. States would also need to determine what types of investment funds will be used, including any default funds. Further, analyses from the three states showed they would face initial and ongoing costs. In addition, a fiscal analysis of the Washington proposal identified three major costs categories—including program development and administration, communications and marketing, and record keeping. As table 3 illustrates, the Washington analysis estimated a total cost of about \$4.4 million to implement and operate the program in the first 2 years.

Table 3: Estimated Program Development and Operation Costs in Washington State

| Cost category | Examples | Estimated costs ^a |
|--|--|------------------------------|
| Program development and ongoing administration | <ul style="list-style-type: none"> • Working with a contracted defined contribution consultant: <ul style="list-style-type: none"> • Develop program design • Conduct procurement process for obtaining record keeper and vendors • Create communication plans • Test systems, processes, and communications materials • Provide oversight of program, including legal support and analysis, contract management, and financial reporting | \$2,224,000 |
| Communication and marketing | <ul style="list-style-type: none"> • Develop statewide marketing and communication program targeted toward employers and employees • Publish and disseminate participant and employer communications through mailings and other media such as TV, radio, and Web | \$1,606,000 |
| Record keeping | <ul style="list-style-type: none"> • Contract with third-party record keeper to provide record-keeping service, including: <ul style="list-style-type: none"> • Daily valuations of participant accounts • Quarterly statements • Customized Web site • Internet account access | \$575,000 |
| Total | | \$4,405,500 |

Source: Fiscal Note to Washington Senate Bill 5791.

^aCost estimates are for 2009-2011. The estimate indicated that comparable total costs would also be incurred in future years.

Lack of startup funding may be a significant barrier in some states. While the Maryland and Connecticut proposals allow for state budget appropriations (which may later be recovered through participant fees), the California proposal stated that initial funding could come from a state budget appropriation or a non-profit or private entity. However, state budget appropriations may be difficult to obtain given these states' current budget shortfalls. The Washington proposal stated that its program could not be started until the state had obtained federal and/or philanthropic funds sufficient to support the first 3 years of the program. According to an advocate for the Washington proposal, his organization recognized that, due to the current economy, the states are not in a position to self-fund state-assisted retirement savings programs. He reported that his organization has been working on obtaining federal funds to cover the startup costs of such programs.

Legal and Regulatory Challenges: State-assisted savings programs would also have to comply with both federal and state law that, according to the state analyses, could provide additional challenges. One analysis noted that states would need to obtain requisite federal approvals to ensure that the programs adhere to all federal requirements governing the operation of retirement plans. For example, if the program establishes 401(k) accounts, the state would need to submit plan documents to the IRS and Department of Labor for approval. Further, the Maryland and Washington analyses found that if a state sponsored the establishment of a 401(k) plan, such plans would be subject to ERISA's fiduciary requirements and expose either the state or the employer to potential liability in the event that participants suffer financial losses. According to the Maryland analysis, participants may try to hold the state or the employer liable if they incur investment losses after being sold an investment unsuitable for their needs or if they received misleading communications about investments. However, both analyses noted that there are steps the states can take to minimize their liability. For example, according to the Maryland study, the state could limit investment options to reduce the possibility of unsuitable choices or miscommunication.

The Washington and Maryland analyses discussed a number of other potential liabilities that states could face. For example, the Maryland analysis noted that a failure to file required forms and conduct transactions under applicable standards could subject the state or employers to significant penalties imposed by IRS or the Department of Labor. Officials from Washington noted that a 401(k) option could create a new and complex compliance and monitoring role for the state retirement agency and that it could be administratively difficult for the state to

assume this role. They added that the state would face a steep learning curve in addressing ERISA and liability issues, and might have to contract with outside expertise to deal with compliance and oversight issues.

The state role envisioned in the proposals may be precluded by some states' constitutions. Analyses of proposals in California and Washington specifically cited aspects of the state constitutions that could affect the states' ability to operate a plan. For example, California's constitution prohibits the gift or loan of state credit to associations, companies or corporations, and prohibits the state from loaning its credit, subscribing to, or being interested in the stock of any company, association, or corporation.⁵⁶ According to the California study, although California's constitution specifically exempts the retirement board of a public retirement system from this prohibition, it is not clear whether the exemption would extend to a program for private-sector employees. The California study noted that if the program is structured in such a way that the state internally manages funds associated with the program, this could be seen as the state having a financial interest outside the limits of the public employees' retirement fund. The California study also observed that a constitutional amendment may be needed to address this issue. Washington's constitution has a similar prohibition.⁵⁷ The Washington report noted that the proposed retirement savings program may be permissible because it serves a public purpose by helping individuals save for retirement and reducing the risk that individuals will rely on state assistance in the absence of adequate retirement savings. However, the report also noted that no Washington case has considered proposals similar to those discussed in the report. The report concluded that it was not possible to predict how a court would rule should the program be challenged. In addition, because no other states have enacted such programs, there is no guidance available from other courts.

Concluding Observations

Automatic enrollment of workers in 401(k) plans has proven to be an effective means of increasing plan participation rates. Because such policies are being increasingly adopted by defined contribution plan sponsors in the wake of the Pension Protection Act of 2006, many additional workers will be brought into plans who might not otherwise have participated. Nonetheless, a number of considerations could

⁵⁶CA Const. art. XVI, § 17.

⁵⁷WA Const. art. VIII, § 5 and art. XII, § 9.

potentially limit the extent or impact of such policies. First, the benefits of automatic enrollment are inherently limited to workers that have access to an employer-sponsored plan but do not participate. Second, some types of employers, such as employers with high-turnover workforces and small employers, may find automatic enrollment too costly or inappropriate for their workforce. Third, initially low default contribution rates and the absence of default automatic escalation policies at some plans may result in inadequate long-term savings for some workers.

Automatic IRAs may hold promise for workers who do not have access to an employer-sponsored plan. The proposal has potential in that it could foster retirement savings among the roughly 40 percent of the workforce whose employers do not sponsor a plan. As such a policy is designed, however, a number of important issues remain to be considered. For example, it is not clear that an automatic IRA will offer low-income workers a significant benefit. Further, in order to ensure that the intended beneficiaries accumulate and retain savings, some central administration—possibly by the federal government—may be required to assume significant and long-term involvement for record keeping and administration. The nature and costs of such a role have not yet been publicly assessed or compared against the potential benefits and limitations of an automatic IRA. In addition, while state-assisted retirement savings plans may also hold some promise for expanding retirement coverage for workers, none of these proposals has been enacted and they could face significant legal barriers to implementation.

Both the growth of automatic enrollment and the introduction of automatic IRA proposals have brought renewed attention to the question of how to extend retirement coverage to the half of the workforce not covered by an employer-sponsored plan. This is an important step forward, as past debate over retirement security has largely focused on increasing retirement savings for those already participating in retirement plans. As plan sponsors and participants gain more experience with automatic enrollment, it will be helpful to learn from these experiences, especially in light of the recent recession. The lessons learned may have important implications for related 401(k) plan features, such as automatic escalation, and for the potential feasibility and usefulness of automatic IRA and state-assisted retirement savings proposals. Further, it would also be helpful to carefully consider the various concerns raised in the automatic IRA debate to increase the likelihood that, if such a proposal becomes law, it is administered in an efficient and effective way. Finally, while state efforts could be helpful in increasing the number of workers saving for retirement, these efforts may not be necessary depending on the potential implementation of automatic

IRAs. Further, fiscal difficulties in some states may make such proposals difficult to implement in the near future.

Agency Comments

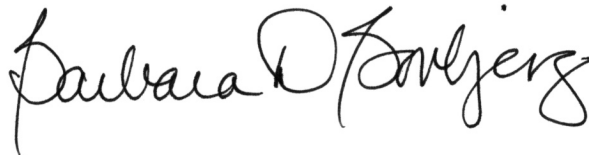
We provided a draft of this report to the Department of Labor and the Department of the Treasury for review and comment. The Department of Labor generally agreed with our findings. With regard to the potential impacts of an automatic IRA on retirement benefits, Labor said that the Employee Benefits Security Administration is undertaking additional analysis to illustrate the effect of higher participation rates, similar to those achieved in 401(k) plans. The Department of Labor provided technical comments, which we incorporated as appropriate. The Department of Labor's formal comments are reproduced in appendix II.

The Department of the Treasury also generally agreed with our findings, and provided technical comments, which we incorporated as appropriate. The Department of the Treasury's formal comments are reproduced in appendix III.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution until 30 days after the date of this letter. At that time, we will send copies of this report to the Secretary of Labor, the Secretary of the Treasury, appropriate congressional committees, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you have any questions concerning this report, please contact Barbara Bovbjerg at (202) 512-7215. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix II.

Sincerely yours,



Barbara D. Bovbjerg
Director, Education, Workforce,
and Income Security Issues

Appendix I: Scope and Methodology

To determine what is known about the effect of automatic enrollment policies among the nation's defined contribution plans, as well as the extent of and prospects for such policies, we first reviewed reports examining the impact of automatic enrollment, default contribution rates, and default investment funds on participation rates and saving patterns. Table 4 shows the six reports presenting original research that we reviewed.

Table 4: Six Studies We Reviewed on the Impact of Automatic Enrollment and Related Policies

| Study | Authors (year of study) |
|---|--|
| Measuring the Effectiveness of Automatic Enrollment | Vanguard Center for Retirement Research (2007) |
| For Better or For Worse | Choi et al. (2001) |
| Nationwide Savings Plan Automatic Enrollment Getting Associates PREPared for Retirement | Swanson and Farnen (2008) |
| The Power of Suggestion | Madrian and Shea (2001) |
| Building Futures Volume VIII | Fidelity Investments (2007) |
| The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States | Beshears et al. (2008) |

Source: GAO.

Officials at the Department of Labor, as well as other pension industry experts, verified our selections. The six reports include two conducted by large plan administrators that analyzed the records of their respective defined contribution plan sponsors and participants. The remaining four reports conducted case studies of companies that adopted automatic enrollment and analyzed participation rates, contribution rates, and investment fund allocations before and after the policy was implemented. For each study, we analyzed available evidence on: (1) the impact of automatic enrollment on participation rates and the durability of any increases in participation, (2) the characteristics of the workers whose participation rates are affected by automatic enrollment, (3) the impact of automatic enrollment on contribution rates, and (4) the impact of automatic enrollment on selection of investment funds. However, the findings of these case studies may not be generalizable for three reasons. First, each study examined the experience of only one to three companies. Second, many of the companies in the four case studies seem to have been facing difficulty meeting nondiscrimination testing requirements. Third, some offered matching contributions to their employees and it is unclear

whether the presence of a match affects automatic enrollment participation rates. Therefore, the experiences of these companies may not be representative of all 401(k) sponsors.

To determine the extent to which plans had adopted automatic enrollment policies, we obtained data from two large plan administrators—Fidelity Investment and Vanguard Investments. Data from Fidelity represents the 18,100 qualified defined contribution plans Fidelity administers, encompassing about 14 million plan participants and over \$600 billion in assets. Data from Vanguard is drawn from Vanguard’s universe of defined contribution plans—more than 2,200 qualified plans that encompass more than 3 million participants and almost \$200 billion in assets. We determined that these data accurately reflect the experience of Fidelity and Vanguard, but are not necessarily representative of the universe of defined contribution plans.

We conducted in-depth interviews with 12 plan sponsors to obtain their perspectives on their experiences with automatic enrollment and related policies, as well as prospects for the policies. We used Form 5500 data from the Department of Labor to select a sample that included plan sponsors from a variety of industries including those that may be considered to have low wages and high turnover, and vice-versa, and small, medium, and large plans, as measured by number of participants. Six of the plan sponsors had adopted automatic enrollment, including one that had significantly narrowed the scope of its automatic enrollment policy, two that had adopted a 401(k) plan within the past 5 years, and 10 that have sponsored a 401(k) plan for more than 5 years. The remaining six plan sponsors have not adopted automatic enrollment. Table 5 shows the industries and plan sponsor sizes for the 12 sponsors that we contacted.

Table 5: Industries and Plan Sponsor Sizes

| Industry | Number of plan sponsors |
|-------------------------------------|-------------------------|
| Professional and business services | 1 |
| Utilities | 1 |
| Manufacturing | 2 |
| Accommodation and food services | 1 |
| Arts, entertainment, and recreation | 1 |
| Transportation and warehousing | 1 |
| Information | 1 |
| Finance and insurance | 2 |
| Retail trade | 2 |
| Plan size | |
| Small (<150 employees) | 3 |
| Medium (150-4,999 employees) | 3 |
| Large (>5,000 employees) | 6 |

Source: GAO analysis of Form 5500 data from the Department of Labor.

In addition, we conducted interviews with officials at the Departments of the Treasury and Labor, as well as academic experts from the Employee Benefits Research Institute (EBRI), Brookings, The Heritage Foundation, Harvard University, and the New School of Social Research. We also interviewed 401(k) plan administrators, providers, and consultants including Deloitte, Fidelity Investments, Vanguard, Mercer, Watson Wyatt, T. Rowe Price, ADP, State Street Global Advisors, and Renaissance Institutional Management. Finally, we interviewed industry and research organizations such as the Investment Company Institute (ICI), the Pension Rights Center (PRC), AARP, the Profit Sharing/401(k) Council of America (PSCA), the American Benefits Council (ABC), American Society for Pension Professionals and Actuaries (ASPPA), the Center for American Progress (CAP), the AFL-CIO, the Small Business Council of America (SBCA), and the Committee on Investment of Employee Benefit Assets (CIEBA).

To determine the potential benefits and limitations of automatic IRA proposals and state-assisted retirement savings plan proposals, we analyzed the Automatic IRA Acts of 2006 and 2007 as well as state-assisted retirement savings proposals from four states. The Economic Opportunity Institute identified nine states that have introduced state-assisted retirement savings proposals: California, Connecticut, Maryland, Massachusetts, Michigan, Pennsylvania, Rhode Island, Vermont, Virginia,

and Washington.¹ In addition, the architect of the state-assisted retirement savings concept identified Vermont as having introduced a proposal. We selected four—California, Connecticut, Maryland, and Washington—for an in-depth review because these states covered a range of plan type offerings and we were able to obtain feasibility studies or testimony prepared for state congressional hearings on their proposals. We did not conduct an independent legal review of these proposals. We analyzed the work of two researchers from Brookings and The Heritage Foundation that have developed proposals for the automatic IRA and state-assisted retirement savings plans. We then reviewed four studies sponsored by AARP examining the feasibility of automatic IRAs; survey reports by AARP and Prudential on employee and employer attitudes toward automatic IRAs; a microsimulation analysis of the impact of automatic IRAs on workers' savings accumulations and retirement security; and three feasibility studies on California, Maryland, and Washington states' proposals. In addition, we reviewed testimony and written materials from hearings held in Connecticut and Washington to obtain the perspectives of state officials, small business representatives, and pension industry representatives on state-assisted retirement savings proposals. We also reviewed relevant federal laws and regulations.

We interviewed researchers who have focused on the topic, including those from Brookings, The Heritage Foundation, EBRI, the Economic Opportunity Institute, Harvard University, and the New School for Social Research as well as officials from AARP, PSCA, ASPPA, CIEBA, ABC, ICI, CAP, and PRC. In addition, we interviewed state officials from Washington, Maryland, and California as well as officials from pension plan administrators and consultants, including Mercer, Watson Wyatt, T. Rowe Price, ADP, State Street Global Advisors, and Renaissance Institutional Management. Finally, we interviewed a 401(k) consultant for small businesses and an official from SBCA to obtain the perspective of representatives of the small business community.

¹The Economic Opportunity Institute is a non-profit public policy organization located in Washington state that focuses on retirement security and several other issues.

Appendix II: Comments from the Department of Labor

U.S. Department of Labor

Employee Benefits Security Administration
Washington, D.C. 20210



October 5, 2009

Ms. Barbara D. Bovbjerg
Director, Education, Workforce, and
Income Security Issues
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Bovbjerg:

We have reviewed the Government Accountability Office's (GAO) draft report entitled "Retirement Savings: Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Face Challenges" (GAO-10-31).

GAO is to be commended for this thoughtful report. Automatic enrollment has proven to be an important policy and market tool for promoting retirement saving. Its positive impact in 401(k) plans has been well documented. Its promise for individual retirement accounts (IRAs) is considerable but not yet demonstrated. With respect to the latter, the Employee Benefits Security Administration (EBSA) would like to highlight two open questions that GAO's report considers but does not fully explore.

The first such question relates to the potential impact of automatic IRA proposals on retirement savings of lower-paid workers. According to the report, "it is not clear that an automatic IRA would help low-income workers" save. GAO cites a "preliminary analysis" from the Policy Simulation Group (PSG) which finds little positive impact. This analysis, which EBSA funded, illustrates the effect on future retirement income of automatic IRA participation rates similar to those posited by some of the proposals' advocates. EBSA is undertaking additional analysis that is intended to illustrate the effect of higher participation rates similar to those achieved in automatic 401(k) plans.

The second such question relates to government oversight of an automatic IRA program. GAO's report notes that EBSA's "enforcement activities currently include pursuing 401(k) plan payroll deductions that are not timely remitted to employees' accounts. The government would have to undertake similar activities in instances where automatic IRA payroll deductions are not timely remitted." Given the large number of affected small employers, the large volume of small transactions, and the risk that workers saving by default might be inattentive, EBSA believes that the level of effort required to detect and correct such lapses, as well as to keep accounts linked to their owners as they move from job to job, could be large.

EBSA is committed to protecting the employer-sponsored benefits of American workers, retirees, and their families. We appreciate having had the opportunity to review and comment on

**Appendix II: Comments from the Department
of Labor**

the draft report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,



Michael L. Davis
Deputy Assistant Secretary

Appendix III: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 15, 2009

Ms. Barbara D. Bovbjerg
Director, Education, Workforce, and Income Security Issues
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Bovbjerg:

We appreciate the excellent work that you and your colleagues at GAO do to help improve the performance and accountability of the federal government for the benefit of the American people. We particularly appreciate your work in the area of retirement security and retirement savings, and are writing to comment briefly on your draft report GAO-10-31 to the Chairman, Special Committee on Aging, U.S. Senate, regarding the opportunities and challenges of expanding the benefits of retirement savings to additional American workers through automatic enrollment in 401(k) plans and automatic IRAs.

GAO's report issued in November 2007 titled "Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers" decried low participation rates in defined contribution plans, particularly for low-income workers who have less opportunity to participate in such plans than the average worker. The automatic IRA proposal (first introduced as proposed legislation in 2006) was one of only a few options discussed in the report that seek to increase retirement savings coverage and participation.

The President proposed the automatic IRA in his FY 2010 budget to expand retirement savings and help address our nation's low personal saving rate. Since then, many stakeholders representing the interests of workers, employers, and service providers have expressed an interest in this important effort. We appreciate the enthusiasm shown by various stakeholders and the fact that they have suggested a number of ideas in discussions with us and the congressional sponsors of the legislation. Our and the congressional sponsors' outreach to stakeholders has helped inform the thinking on how best to structure an automatic IRA program in order to make this expansion of retirement savings as effective and efficient as possible. Your work will also be helpful to us as we work to flesh out the proposal with a view to maximizing participation in automatic IRAs; maximizing the formation of new 401(k) and other plans as employers "graduate" from automatic IRAs to sponsorship of retirement plans; and minimizing any costs to employers and employees.

**Appendix III: Comments from the Department
of the Treasury**

Thank you for the opportunity to review the draft of your report. We are optimistic that automatic IRAs will go far toward making the benefits of tax-favored retirement saving easily available to the tens of millions of working families who do not yet participate in those benefits.

Yours sincerely,



J. Mark Iwry
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Appendix IV: GAO Contact and Staff Acknowledgments

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Staff Acknowledgments

David Lehrer, Assistant Director, and Michael Hartnett, Analyst-in-Charge, managed this review. Jennifer Gregory also led portions of the research and made significant contributions to this report in all aspects of the work.

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