

Effect of Automatic Enrollment on Retirement Savings

Testimony by
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Overview

- Overall effect of auto-enrollment on defined contribution (DC) plan participation rate
 - Madrian, Brigitte C., and Shea, Dennis F., 2001. “The power of suggestion: inertia in 401(k) participation and savings behavior.” *Quarterly Journal of Economics* 116 (4), 149–1187.
 - Butrica, B. A., and Karamcheva, N. S., 2015. “Automatic enrollment, employer match rates, and employee compensation in 401 (k) plans.” *Monthly Labor Review*, 138.
- Effect of the Pension Protection Act of 2006 on DC plan participation rate
 - Engelhardt, Gary V., 2011. “State wage-payment laws, the Pension Protection Act of 2006, and 401(k) saving behavior.” *Economic Letters*, 113, 237–240 .
 - Nessmith, William E., Utkus, Stephen P., and Young, Jean, 2007. “ the effectiveness of automatic enrollment. Vanguard Center for Retirement Research.” vol. 31. Philadelphia, PA.
 - VanDerhei, Jack, 2010. “The impact of automatic enrollment in 401(k) plans on future retirement accumulations.” Employee Benefit Research Institute. Washington.

Madrian and Shea (2001, *Quarterly Journal of Economics*)

- Sample:
 - One Fortune 500 company switched to auto-enrollment on April 1, 1998
 - 29,267 workers
- Findings:
 - Employees hired during the 1st year of auto-enrollment have the highest participation rate: 86%!
 - Auto-enrollment also equalizes the participation rates across various demographic groups: Black/Hispanic vs. White; Young vs. Old; Higher compensated workers vs. lower compensated workers.

Madrian and Shea (2001, *Quarterly Journal of Economics*)

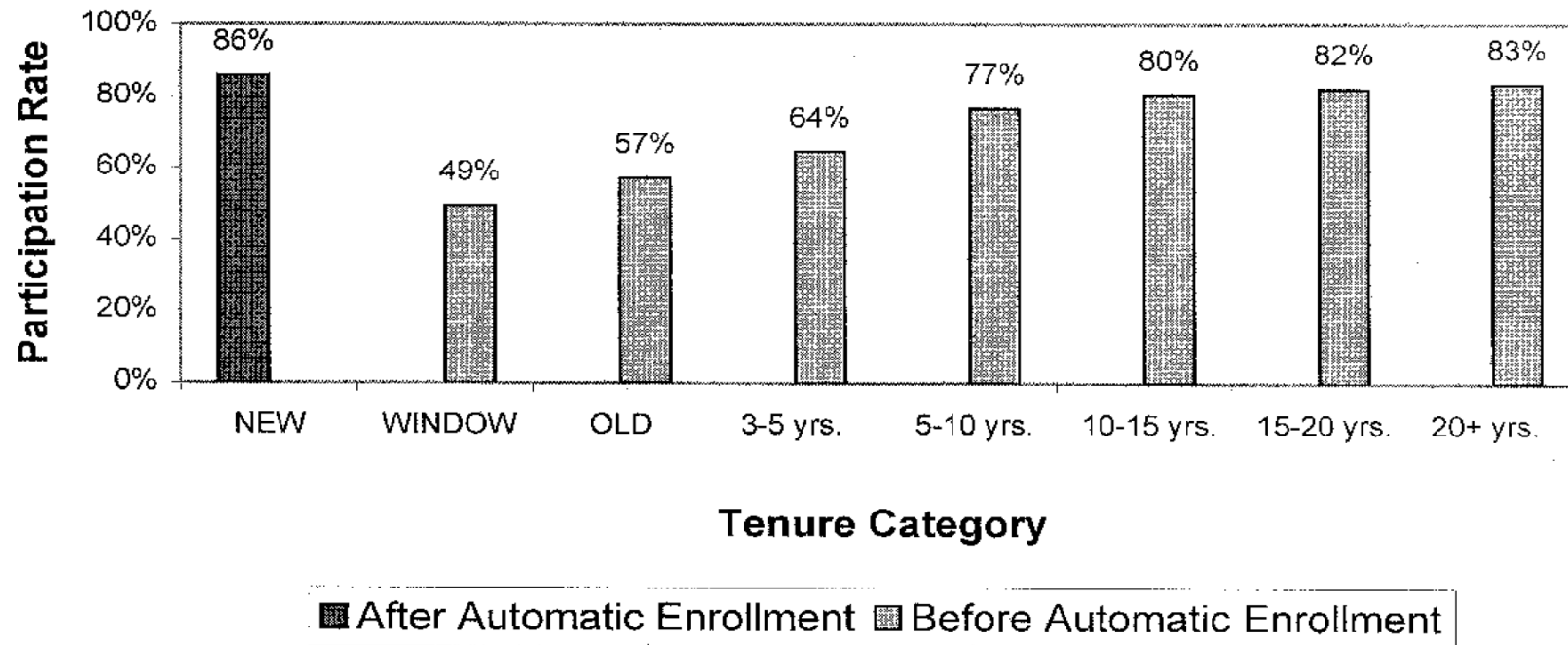


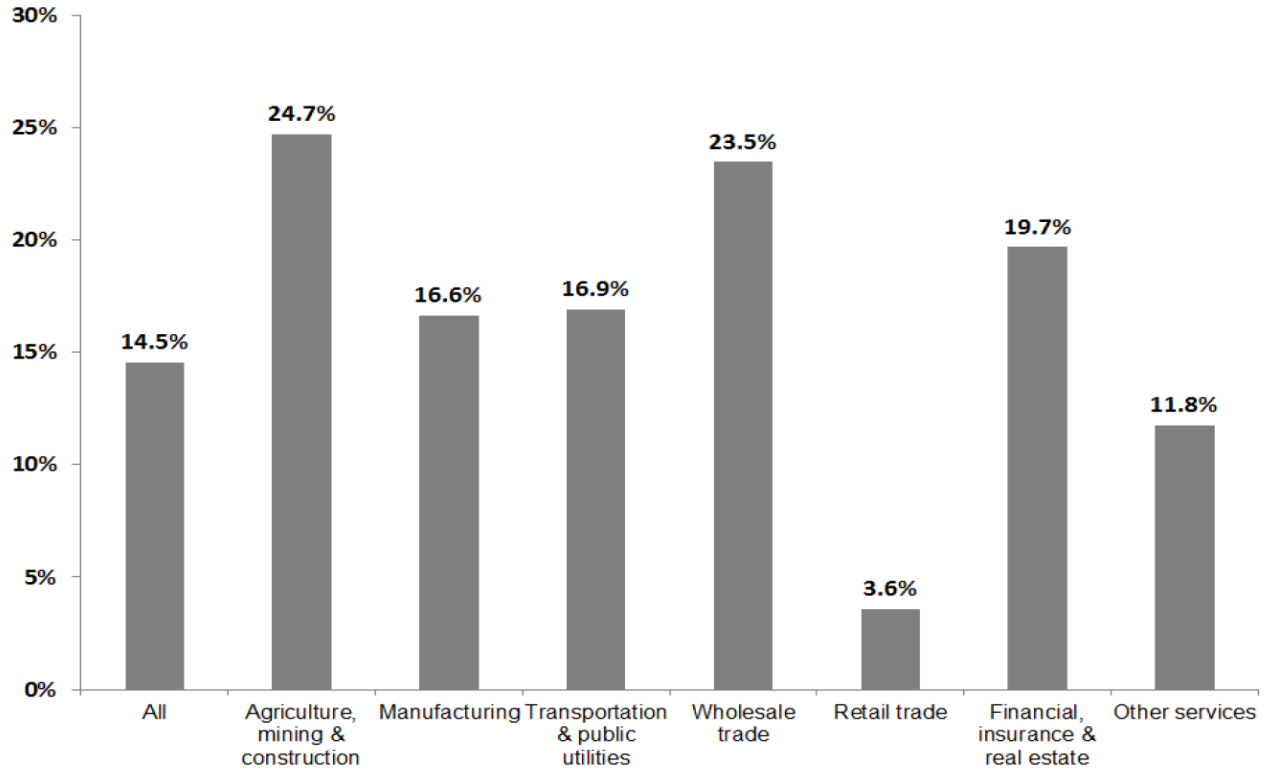
FIGURE I
401(k) Participation by Tenure

Butrica and Karamcheva (2015).

- Data sample:
 - Restricted micro data from the National Compensation Survey conducted by the U.S. Bureau of Labor Statistics (BLS).
 - Comprehensive survey covering civilian workers in private industry and state and local governments.
- Findings:
 - Less than 15% of workers have auto-enrollment plan feature.
 - Plans with automatic enrollment have higher participation rates than those without this plan feature –77.1 versus 67.3 percent.

Butrica and Karamcheva (2015 cont.)

Fig. 1. Prevalence of Automatic Enrollment by Industry



Pension Protection Act of 2006

- Before 2006, 26 states had wage-payment laws prohibiting wage deductions without the written permission of the employee.
- The Pension Protection Act of 2006 (PPA2006) set forth federal rules for the legality of auto-enrolled plans that superseded any state wage-payment laws.
- Impact of PPA2006 on DC plan participant rate?

Engelhardt (2011, *Economic Letters*)

- Data sample:
 - 703 mid-career workers for non-federal employers eligible to participate in 401K plans
 - Compare the 401K participation rate for workers residing in states with wage-payment laws against workers residing in states without such laws before vs. after the passage of PPA2006.
- Findings:
 - Before PPA2006, participation rate was higher in states not requiring written permission.
 - After PPA2006, participation rate grew 9.5% points more in states requiring written permission.

Engelhardt (2011, *Economic Letters* cont.)

Table 3

Difference-in-difference estimate of impact of PPA2006 on 401(k) participation, standard errors in parentheses.

Group/Year	(1) Before PPA2006	(2) After PPA2006	(3) Time difference for groups
State requires written permission	0.583 (0.024)	0.785 (0.021)	0.201 (0.032)
State does not require written permission	0.614 (0.028)	0.750 (0.025)	0.136 (0.038)
Difference-in-difference			0.095 (0.040)

Conclusion

- The extant empirical research has produced convincing evidence that automatic enrollment is highly effective in promoting employee retirement savings.