Saving for Retirement

Make it automatic

The percentage of employer-sponsored 401(k) plans using automatic enrollment continues to climb, with 43% of plan sponsors now adopting this feature, including 62% of large-sized plans having at least $250 million in assets.[1] While these numbers are an encouraging sign that more employees are saving at least a portion of their income for retirement, we believe automatic enrollment is only one ingredient in a well-designed retirement savings plan. Another method to increase the likelihood that participants will reach adequate deferral levels over time is to combine automatic enrollment with automatic contribution escalation.

Build savings automatically

While most plans using automatic enrollment typically set 3% as their default contribution rate, many plan sponsors believe employees need to save 10% or more to reach their goals. But, of those companies using automatic enrollment, only 21% also use automatic contribution escalation.[1]

While this feature helps participants save more, while also overcoming their tendency to stick with the original contribution rate, many employers are reluctant to use it as a default option for fear of an employee backlash. These concerns appear unfounded, however. A study by J.P. Morgan shows that 60% of participants are either in favor of or neutral on the use of both automatic enrollment and automatic contribution escalation.[2]

In addition, industry experience shows that employees rarely choose to opt out of these features, and generally do not increase their initial contribution rates unless automatic contribution escalation is in place. As a result, those who are automatically enrolled without automatic contribution escalation tend to save less (an average of 4%) than those who participate in 401(k) plans at a level of their own choosing. In 2011, for example, the average savings rate of those who voluntarily enrolled in plans administered by J.P. Morgan Retirement Plan Services was 7.7%.

As the chart illustrates, the value of assets accumulated by individuals who save more than the default contribution rate of 3% can be substantial. For example, a person earning a median income of $56,000 in 2012 who contributed 6% over 35 years could retire with roughly $302,000. That's $128,000 more than the $174,000 an individual would have accumulated who saved at the default contribution rate of 3% over 35 years. The difference would be much larger, of course, for someone with a voluntary savings rate of 7.7% and higher still for those who saved 10%. And this doesn't even consider the positive impact on retirement assets of an employer match.

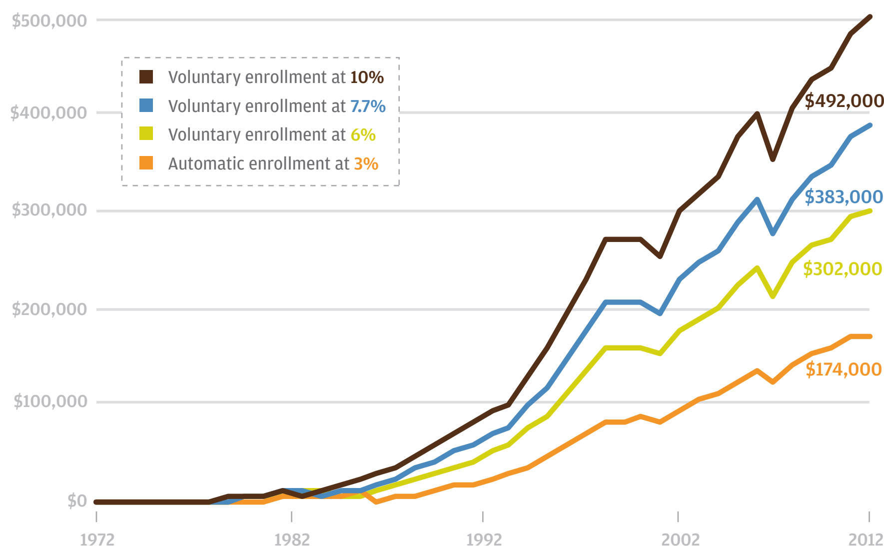
Put these ideas to use

Plan sponsors may want to rethink setting the bar too low. When adopted effectively, higher default contribution rates, along with automatic contribution escalation, can help plan sponsors better assist their employees to achieve their retirement goals.

[1] J.P. Morgan *2013 Defined Contribution Plan Sponsor Survey Findings.*

[2] J.P. Morgan *2013 Plan Participant Survey.*

The Impact of Higher Contribution Rates
Value of financial assets



Source: Tax Policy Center, Bureau of Economic Analysis, Bureau of Labor Statistics, J.P. Morgan Asset Management, U.S. Census Bureau, Bloomberg.
This example assumes that one family member has earned a median income since 1972, which in 2012 was $56,000. At age 30, the family begins saving, with an equity allocation of 65%, which gradually decreases to 40% by age 65. The rest of its portfolio is allocated to fixed income. Other estimates include applicable federal and state tax rates for each scenario. Estimates for annual equity returns, T-bill rates and inflation are 7.0%, 2.5% and 2.0%, respectively. For tax purposes, 80% of equity gains in after-tax savings accounts are assumed to be realized each year. The example is for illustration purposes only and does not represent any particular investment product. This information is also for educational purposes only and is not meant to provide tax or investment advice.

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