

PART 1: IMPROVING RETIREMENT OUTCOMES

THINK FURTHER FOR RETIREMENT



Auto Plan Features May Help Plan Sponsors Improve Retirement Readiness

Personal retirement savings plans are crucial vehicles for workers to meet their retirement income needs. Implementing plan features such as auto enrollment and auto escalation can improve retirement readiness by encouraging participants to save as early and as much as possible.

HELPING **PLAN SPONSORS** THINK FURTHER FOR THEIR RETIREMENT PLAN



This is Part 1 of a two-part series focusing on steps that plan sponsors can take to promote retirement readiness and structure investments to improve retirement outcomes. This paper discusses retirement readiness concerns and explores ways plan sponsors can **Think Further** by designing 401(k) plans to address those concerns.

1 STATE OF RETIREMENT READINESS

The U.S. is suffering a retirement savings deficit—many are outliving their retirement savings because of low savings rates, late starts to savings, or assets that do not grow as much as anticipated. The average American has just 9.7 years of retirement savings, which means the average man will live 8.3 years beyond his retirement savings and the average woman 10.9 years beyond hers.¹

Defined benefit plans were the historic savings vehicles for most Americans; however, their use has been steadily declining. Today, more people rely on individual savings to meet their retirement needs, and defined contribution plans, particularly employer-sponsored 401(k) plans, have become the dominant savings vehicle.²

2 CREATING RETIREMENT READINESS

There are two fundamental factors necessary to create adequate retirement savings:

- Putting money aside in a savings vehicle
- Growing that money to provide a large enough balance to provide income throughout retirement.

A third factor, seeking expert investment advice, has been shown to enhance the impact of the first two factors.

Investing in an employer sponsored retirement plan promotes long-term savings and helps participants stay invested during all market cycles, which is a key to maximizing savings. For example, if \$10,000 was invested in the S&P 500 Index on January 1, 2000, it would be worth more than \$49,400 at the end of 2021; however, if the ten best trading days during that period were missed, the investment would have grown less than half that amount to roughly \$22,600 according to Alger’s calculations. Moreover, staying fully invested for the long term allows participants to maximize the benefits of compounding interest.

Keys to Retirement Readiness

- Begin saving early in career
- Invest savings for growth
- Seek professional advice

3 AUTOMATIC FEATURES INCREASE CHANCE OF RETIREMENT SUCCESS

Obviously, the earlier a person begins to save, the more time they have to experience the upward movement of markets and the benefits of compounding.

Automatic enrollment (also known as auto enroll or an automatic contribution arrangement) and **automatic escalation** are retirement plan features plan sponsors can use to promote savings among their employees. When coupled with appropriate investment options and professional advice, these features may improve employees’ chances of meeting long-term retirement needs.

Automatic Enrollment

With automatic enrollment, employers automatically enroll eligible employees and contribute a default percentage of the employees’ wages (typically 3-5% initially) to the retirement plan, unless an employee affirmatively elects not to participate.³ Such features encourage employees to contribute to plans as soon as they’re eligible and save more for retirement (see Exhibit 1).

Exhibit 1: GROWTH OF SAVINGS



Assumes bi-weekly contributions and a 6% rate of return, compounded bi-weekly. There is no guarantee that investors will experience the type of performance reflected above.

Automatic Escalation

Some employers also encourage employees to increase their savings by implementing automatic contribution increases, known as auto escalation. Automatic escalation is a feature that automatically increases an employee's contribution rate at set intervals. For instance, employers can set the feature to increase employee contributions by 1% each year up to 10%, 15% or more of compensation. Such small yearly escalations can increase balances without significantly impacting take-home pay (see Exhibit 2).

Exhibit 2: THE 1% DIFFERENCE

After 40 years, a savings rate increase of 1% could be worth almost \$100,000 but additional increases can potentially drive retirement plan balances even higher.



Assumes \$40,000 annual salary and increases of 3.6% rate of return compounded annually, and annual contribution amounts. There is no guarantee that investors will experience the type of performance reflected above.

Automatic plan features can help increase the amount of money available for employees at retirement. Part 2 of our series explores how a properly structured Qualified Default Investment Alternative (QDIA), coupled with professional investment advice, can further promote retirement readiness and improve outcomes.



To learn more about the steps you can take to promote retirement readiness with your employees, reach out to your Alger contact, email us at retirement@alger.com or visit us at www.alger.com.

¹ Gandhi, Amish, *Investing in (and for) Our Future*, World Economic Forum (June 2019)

² *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2018* (July 2021) (“with \$6.7 trillion in assets at the end of 2020, 401(k) plans have become one of the largest components of U.S. retirement assets”).

³ IRS, FAQs – Auto Enrollment – What is an automatic contribution arrangement in a retirement plan? (Sept. 8, 2021) <https://www.irs.gov/retirement-plans/faqs-auto-enrollment-what-is-an-automatic-contribution-arrangement>)

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