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INVEST WITH CONFIDENCE

Next generation thinking.

UNINTENDED CONSEQUENCES CAN RESULT FROM JOB-JUMPING MILLENNIALS.

Auto-services are widely touted as positive developments that drive better participant outcomes. Until now, however, they have been deployed on a very company-loyal demographic. How effective are those same services for a generation that changes jobs every few years?

4.2 years
As of Jan 2016, the MEDIAN tenure of American workers*

2.8 years
As of Jan 2016, the MEDIAN tenure of 25–34 year olds*

*U.S. Bureau of Labor Statistics

YOUNG EMPLOYEES FACE GREATEST IMPACT OF LOW DEFAULT RATES

Thanks to services such as auto-enrollment and auto-increase, more American workers are being given the opportunity to enroll and increase their savings levels than ever before.

However, when you consider the job-jumping tendencies of Millennials, the impact of these services can be less positive than anticipated. According to the Bureau of Labor Statistics, the median job tenure of Americans today is 4.2 years.

As the chart below shows, the default levels selected for auto-enrollment and auto-increase can be make-or-break decisions for younger workers who stick with those default levels.

			% OF GOAL MET AT AGE 65	
AUTO-INCREASE CAP %	AUTO-INCREASE %	# OF JOB CHANGES	AUTO-ENROLLMENT DEFAULT 6%	AUTO-ENROLLMENT DEFAULT 3%
15%	2%	3	108%	94%
15	2	6	96	76
10	2	3	89	76
10	1	6	81	58
6	1	6	67	51

Assumptions: Age 25, 3% annual salary increases, 7% investment return, and a 50% company match on the first 6% of pay. Job changes occur every three years after the initial year of hire at age 25. Upon changing jobs, the individual reverts to the default auto-enrollment contribution rate. The goal is defined as being able to replace 50% of final salary with a 4% initial withdrawal amount . That is based on a 75% income replacement rate intended to maintain the person's lifestyle (as FICA taxes and retirement contributions are no longer needed). Of that 75%, 25% is assumed to be replaced by Social Security and other sources (e.g., DB plan or wages). Initial salary does not affect the results above, but the income replacement assumptions may not be appropriate for all income levels. This chart is for illustrative purposes only. Individual results may vary.
Source: T. Rowe Price calculations, based on assumptions.

EMPLOYERS ALSO FACE NEGATIVE IMPACTS

Over the long term, inadequate retirement savings may lead to the unintended consequence of a workforce that cannot afford to retire. An older workforce, reluctant to leave the company, could negatively impact a company's:

- **Health care costs:** It's no secret that it costs more to cover and care for an older, perhaps less-healthy, population.
- **Payroll costs:** Older workers tend to earn more based on longevity with the company; if they are working past their retirement date this may be a negative.
- **Worker's compensation costs:** In manufacturing and other skilled labor industries, there could be a higher risk of job-related injuries.

DC IMPLICATIONS:

Broaden the view

DC plan providers and sponsors may be able to enhance participant retirement outcomes by ensuring that auto-service default rates are sufficient to prepare younger employees for retirement. Based on the PSCA's 59th Annual Survey of Profit Sharing and 401(k) Plans, there's plenty of room for improvement.

- 58% of plans have an automatic-enrollment feature.
- The most common default deferral is only 3% of pay (41% of plans).
- 40% of plans automatically increase deferral rates over time in conjunction with automatic enrollment.
- For plans with automatic increase on an opt-out basis, the majority have a cap below 10% (44% of plans).

STRATEGIES AND TACTICS:

Design a plan to create success

Avoid unintended consequences by considering how auto-service design can influence retirement outcomes.

SHORT-TERM TACTICS

1. **Help sponsors evaluate plan design choices relative to workplace demographics.**
Provide data on the potential impact of plan design decisions on short-tenure employees, particularly younger workers. Even better, structure benefits that could incentivize longer stays with the company.

2. **Structure company contributions to address cost considerations.**
Provide alternative ways a company match could be structured to temper the financial exposure associated with increasing the initial default rate. For example, stretch the match formula, add an eligibility or vesting provision, or all three.

3. **Help participants keep track of their accounts.**
With so many employees changing jobs, there are increased opportunities for orphaned retirement accounts. If these are automatically cashed out, participants may be creating earned income (and a tax event) they neither wanted nor needed. If they roll over old retirement accounts into their new employer's plan, participants can then keep better track of their total retirement picture, while sponsors can reap the potential benefits of increased plan assets.

LONGER-TERM CONSIDERATIONS

1. **Help sponsors see the long-term impact of their plan design decisions.**
Consider how strategic plan reviews and projected account balances at retirement can provide meaningful long-term views of the potential effects that plan design decisions could have on participants' retirement income.

2. **Help sponsors integrate their assessment of retirement preparedness and health care costs.**
Develop models that show the potential impact on an aging workforce. Squeezing costs from the retirement plan now may generate greater costs in health insurance premiums over the long term. Work with sponsors to request a look at their potential benefits costs from their health care provider. For example, the provider may be able to run projections based on a workforce that is 10 to 20 years older than it stands today. The projected increase in health care costs may motivate the sponsor to take action so that employees can retire on time.

To learn more about the benefits and best practices surrounding auto-services, contact your T. Rowe Price representative.

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