

Automatic enrollment: No retirement security guarantee

By Ron Froeschle, Qualified 401(k) Administrator - QKA at F&M Trust

Automatic enrollment has become an increasingly popular option for employers looking to boost participation rates in their retirement plans. With automatic enrollment, employees are signed up for their 401(k) plan by default and must opt out of the plan if they don't want to take part.

Automatic enrollment is beneficial for employees who have put off enrolling in their employer's 401(k) plan, but it can provide participants with a false sense of security that they're prepared for retirement.

Automatic risks

This first issue with automatic enrollment is that the contribution defaults are almost always too low — often just 2% or 3% of pretax salary. In many cases, that's not even enough to take full advantage of matching employer contributions. It's also not enough for most people to accomplish even modest retirement goals.

To address this concern, some employers have implemented automatic increases to the default employee contribution levels — typically up to 6% — but even that amount is insufficient for many people.

The other drawback of automatic enrollment is that employee contributions have traditionally gone into low-risk funds, such as money market or stable value funds. Again, these options may be better than nothing, but they generally aren't appropriate for younger investors — or even many investors close to retirement — because of their limited income and capital appreciation potential.

To address this concern, some automatic enrollment plans have begun to default contributions into target-date funds. They start out with a greater equity allocation that becomes steadily more conservative as retirement approaches. Even though they're a significant improvement over money market funds, target-date products aren't right for everyone, particularly individuals with plans to retire earlier or later than their fund's target date.

Take the next step

If your employer has automatically enrolled you in its 401(k) plan, take the next step toward retirement security by discussing both your contribution level and your investment options with your financial advisor. He or she can help you determine whether you're saving enough and in the right places.