Opt-in or Opt-out?

Connecticut will have to decide how to design the State's proposed defined contribution (DC) plan to achieve high participation rates. In the absence of a mandatory participation requirement, automatic enrollment will be fundamental to attaining this goal, particularly among the poor, minorities, and women.

Prior to 1998, private-sector DC plans required workers to actively elect to participate, or "opt-in" to the plan. In other words, the default option was "no participation." At the time, average participation in DC plans hovered around 40 percent during the first few years of tenure, although it increased thereafter. In 1998, the government changed the rule that required employees to opt-in to one that allowed plans to automatically enroll employees, leaving employees the option to opt-out. After this rule change, a handful of plans automatically enrolled new workers at default contribution levels and investment allocations. After adopting this feature, plans with automatic enrollment reported dramatically higher participation rates among newly-hired employees. Automatic enrollment is now considered an industry standard for DC plans, and about half of all DC plans have adopted this feature – at least for new hires.[1]

A number of academic studies since 2000 have documented the effect of automatic enrollment and explained why this relatively simple plan feature is so powerful. The most widely cited of these studies, published in 2001 by economists Brigitte Madrian and Dennis Shea, found that automatic enrollment increased participation among newly-hired employees from 49 percent to 86 percent. Even after three years of service, participation with automatic enrollment was a third higher than before the feature was adopted. In addition to increasing participation, automatic enrollment also led to a large proportion of participants sticking with default contribution rates and investment options. Numerous other studies have confirmed this finding and shown that automatic enrollment boosts participation among the groups least likely to save for retirement under traditional opt-in plans, including lower-income workers, minorities, and women (see Bibliography).

Analysts attribute the success of automatic enrollment to a number of factors, including inertia (a tendency to follow the path of least resistance), employer endorsement (of enrollment in the plan), and control (ability to reverse the enrollment decision). Underlying many of these factors is the widespread phenomenon of present bias – the tendency to place a far greater importance on the immediate present compared to the future. Present bias limits take-up in opt-in plans because the immediate pain of signing up for a 401(k) (due to the complexity of the decision) is greater than the pleasure of more expected money in the distant future (even if a worker knows that saving is important). Not knowing how much to contribute or how to invest in a plan increases the pain of enrolling, and the net result is procrastination, or putting off the immediate pain of enrolling until tomorrow. By eliminating decision-making for workers altogether and setting a contribution rate and investment option where most are clearly better off than not participating, defaults make participation the "painless" option or "path of least resistance."

Under automatic enrollment only workers with a strong incentive to opt-out will do so, a prediction supported by Beshears et al. (2010), who reported a 75-percent opt-out rate in a plan

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[1] PSCA's Annual Survey of Profit Sharing and 401(k) Plans, 2012.

with a default contribution rate of 12 percent (which was suboptimal for most participants). In other words, automatic enrollment does not work when it puts workers in a situation where they do not want to be; they must think they are better off participating under plan defaults.

International experience with automatic enrollment also supports its importance in achieving meaningful participation in voluntary savings plans. In 2001, the United Kingdom made it mandatory for employers to offer a voluntary workplace saving plan. However, few workers participated because workers were required to opt-in and fees were high. A sweeping report on rebuilding the U.K. pension system, commissioned in 2001 and produced in 2005 and 2006, concluded that education alone could not raise participation rates in DC plans and recommended introducing a new national savings plan with automatic enrollment (and lower administrative fees). The United Kingdom rolled out such a plan – the National Employer Savings Trust (NEST) – in 2012. Opt-out rates reported by NEST in 2013 were dramatically low: only 9 percent of employees in the initial roll-out of the program opted out of the plan.[2]

Most proposals for State-administered DC plans in the United States include a provision for automatic enrollment. Of the 17 States that have introduced bills to set up or study state-run DC plans, 6 include a provision for automatic enrollment, 2 are opt-in plans, and the remainder do not specify whether workers will be automatically enrolled or not. Illinois' Secure Choice Savings program, signed into law in January 2015, automatically enrolls employees at a 3-percent contribution rate. California's "Secure Choice" plan, which is currently undergoing a financial feasibility assessment, would also automatically enroll participants if implemented. Maryland, Minnesota, New Hampshire, and Arizona all introduced bills proposing state-administered DC plans with automatic enrollment. The only state DC initiatives that explicitly do not include automatic enrollment are Massachusetts's state sponsored retirement plan for non-profits, North Dakota's proposed voluntary retirement investment program, and Indiana's proposed Hoosier Employee Retirement Option that would create IRAs for employees of employers who do not provide a DC plan. At the federal level, the Treasury set up MyRA as an opt-in plan because creating an opt-out plan would require legislation. The Administration's Auto-IRA proposal (H.R.2035 - Automatic IRA Act of 2013), which provides an outline for a more robust workplace IRA, includes provisions for automatic enrollment.

In short, more than a decade of evidence confirms that only automatic enrollment can achieve the level of participation required to make Connecticut's initiative a success.

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[2] NEST was initially rolled out to large employers which tend to pay higher-than-average wages, thus the opt out rates will likely increase as smaller employers with lower-wage workers are automatically enrolled into the plan in the future.

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