Research

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The changing workforce environment:

How employer plans can help attract and retain employees

- As large numbers of retirement plan participants change jobs, employers are reevaluating their retirement plan designs to make their benefits packages more attractive to potential employees.
- Employers have made it easier for employees to join plans and start saving. In 2021, 72% of plans allowed their participants to start contributing to the plan immediately upon hire, and 86% allowed for entry within three months of employment.
- Automatic enrollment has become more popular: 56% of plans had implemented an automatic enrollment design as of 2021, and 75% of plans with at least 1,000 participants had this design. The participation rate for plans that automatically enrolled participants was 93%, compared with only 66% for plans without an automatic enrollment feature.
- Recognizing the importance of employer contributions, 95% of retirement plans offered a matching contribution, a nonmatching contribution, or a combination.
- Forty-one percent of retirement plans offered managed account advice, with more than 8 in 10 large plans offering these services. Overall, 74% of participants had access to in-plan advice.

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Introduction

Since the outset of the COVID-19 pandemic, the U.S. workforce has been experiencing significant changes. In 2021, a record 47 million people voluntarily left their jobs.[1] The labor market remained tight throughout 2022, and as wages increased, employees continued to test it.

Employers are reevaluating their retirement plan designs to make their benefits packages more attractive to potential employees. Design changes include making it easier for employees to enroll and save in the plan and increasing employer contributions with faster vesting schedules. Additionally, in recognition that the pandemic may have put extra financial stress on their employees and in response to employee requests for guidance, more plan sponsors have begun to offer their participants financial advice.

This paper examines some of the plan design options that employers can use to attract and retain talent and to help employees save effectively for retirement.

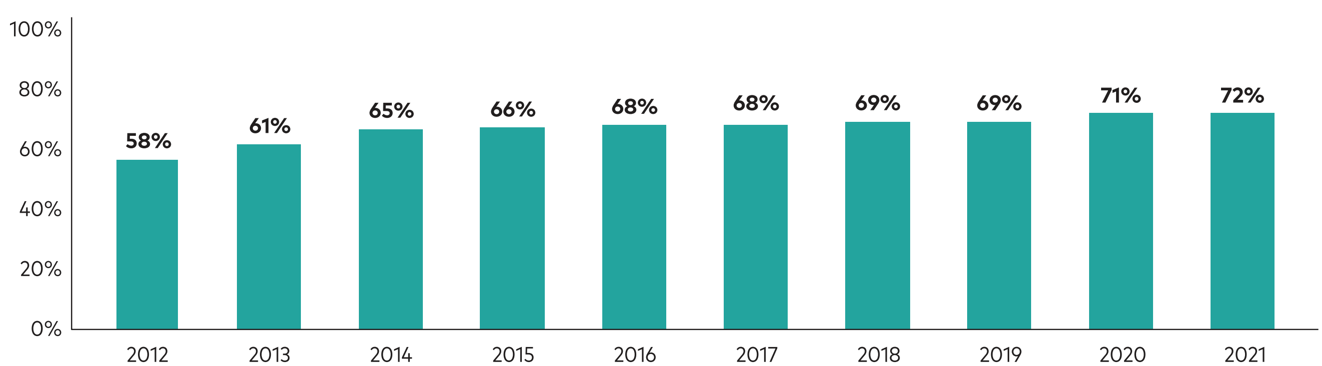
Eligibility

The first step in ensuring that participants have a chance to achieve retirement success is making iteasy to join the plan and start saving. Over the past 10 years, the trend has been toward allowing employees to join the plan immediately to encourage them to start saving. In 2021, as shown in **Figure 1**, 72% of plans allowed their participants to start contributing to the plan immediately upon hire, up from 58% in 2012. In fact, 86% of plans allowed for entry within three months of employment.

When participants are eligible to participate in a plan and contribute their own money, they may receive “free money” in the form of employer matching contributions. As of 2021, two thirds of plans with a matching contribution allowed participants to receive the matching contribution within the first month of an employee’s hire, up from 52% in 2012. Today, fewer than 20% of plans require an employee to wait a year before receiving a match.

Planning note: Although most plan sponsors provide immediate eligibility for employer matching contributions, plan sponsors with high employee turnover may consider attaching a vesting schedule or imposing an employment on the last-day rule (for example, the last day of the quarter or year) on the employer match.

Figure 1: Plans permitting immediate eligibility for employee deferrals



[1] U.S. Bureau of Labor Statistics.

Immediate eligibility helps encourage savings at the beginning of employment, and a last-day rule can help control employer costs.

Automatic enrollment

Data shows that merely offering a plan and allowing participants to decide to participate don't always ensure participation. In fact, the participation rate for plans without an automatic enrollment feature was only 66%, compared to 93% for plans that automatically enroll participants.[2] The differences are especially pronounced when we look at the rates of different income segments.

Unsurprisingly, workers with high earnings had a voluntary participation rate of 92% (98% when automatically enrolled). The participation rate in nonautomatic enrollment plans, however, was only 57% for those making between $30,000 and $49,999. With automatic enrollment, that group's participation rate jumped to 89%, an increase of more than 50%. Only one in three new employees (those with less than two years of service) voluntarily joined the plan. But with automatic enrollment, this number increased to 90%.

With outcomes like these, it is not surprising that 56% of plans had implemented an automatic enrollment design as of 2021, and 75% of large plans (those with at least 1,000 participants) had this design.

Planning note: Another potential benefit of automatic enrollment is its effect on the plan's annual nondiscrimination tests. Automatic enrollment, coupled with automatically increasing participants' deferral percentages each year, can raise the savings rates of non-highly compensated employees, which helps close the gap between highly and non-highly compensated employees and improves nondiscrimination testing results.

In addition to increasing a plan's participation rate, automatic enrollment has dramatically improved retirement saving behaviors. Employees who work for a company that offers automatic enrollment saved nearly 50% more than employees who work for a firm with voluntary enrollment (10.9% compared to 7.3%).

When a participant quits an automatic enrollment plan or fails to join a voluntary enrollment plan, it could signal a lack of commitment to the plan sponsor. Our research shows that nonparticipants were 63% more likely to leave within one year and 76% more likely to leave within three years.[3]

Default rates

A strong default rate, with annual increases, gradually moves participants to an optimal total savings rate, typically 12%–15% or more. With employees changing jobs more frequently, plans should set an automatic enrollment default rate that is equal to or greater than the deferral level to receive the full employer match. This rate helps employees maximize the employer match benefit and save at a strong level as soon as they enter the plan.

For example, assume that an employee is automatically enrolled at a 3% default rate with an automatic increase of 1% each year. A few years later the participant decides to change employment, and the new employer also defaults the employee at 3%. If this cycle continues, participants could find themselves in a perpetual state of undersaving for retirement.

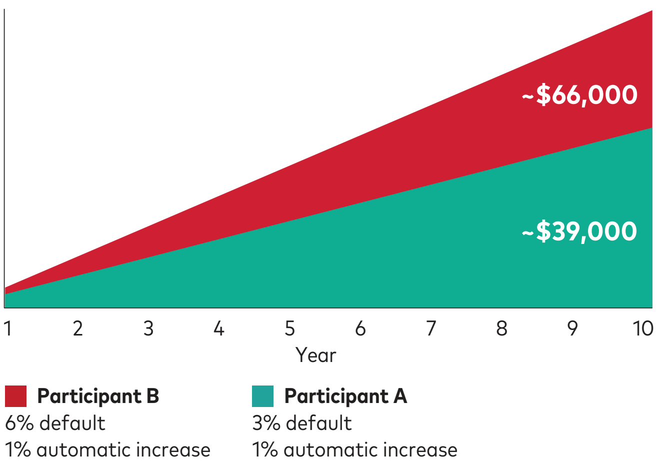
Consider the savings behavior of two employees who change jobs every three years and the stark differences in retirement readiness when different default rates are used. Participant A is automatically enrolled at a rate of 3% and receives an employer match of 50% on the first 6% of their deferral.[4] After two years of automatic increases, Participant A reaches a total savings rate of 7.5% (5% employee deferral plus 2.5% employer match), then changes jobs and is hired at a 3% deferral rate.

[2] Vanguard, How America Saves 2022.
[3] Proctor, Daniel C., and Jean A. Young, 2021. Automatic Escalation and DC Saving Rates. Valley Forge, Pa.: Vanguard.
[4] 50% on 6% employer match is the most common matching formula across Vanguard's plans.

Participant B has the same workforce experience (and same employer match) but is reenrolled at a rate of 6%. As **Figure 2** shows, after two years of increases, Participant B saves a total of 11%.

After just 10 years, Participant B has an accumulated balance nearly 70% higher than Participant A.

Figure 2: Comparing 3% and 6% defaults



Notes: Participants A and B change jobs every three years and are automatically enrolled at either 3% or 6%. They are automatically increased and receive an employer match of 50% on 6% in each scenario. They have a starting salary of $50,000 with wage increases of 2% annually and a 4% real return.

Automatic enrollment serves as a widely successful design using the power of inertia to the participants' benefit. As employees increasingly change jobs, making it easy to save early becomes even more critical. The ability to start saving on day one will dramatically enhance participants' ability to retire comfortably.

Employer contributions

As employers focus on attracting and retaining talented employees, many firms are evaluating their overall benefits offer. Because employer contributions are a component of a total compensation package, employers are increasingly benchmarking their retirement benefits and ensuring that they are within range of what similar companies offer employees. In addition to providing future retirement benefits, generous employer contributions can help employees feel that their company is caring for and prioritizing their future well-being. Employer contributions can also offer employers tax savings because they are tax-deductible.

In recognition of the importance of employer contributions, 95% of retirement plans offered a matching contribution, a nonmatching contribution, or a combination. Eighty-five percent of plans offered an employer matching contribution, and 46% of plans offered a nonmatching contribution. More than a third (36%) of plans offered both types of employer contributions.

Participants deferred an average of 7.3% of their income, so employer contributions are necessary to help employees reach optimal total saving rates. Employer contributions make up about 40% of total retirement savings and can help workers save for retirement in two ways. First, when employer contributions are more generous, employees may find it easier to reach optimal total savings rates. In addition, employer contributions help higher paid workers save more for retirement because the employer contribution limits are separate from the regulatory limits on employee pretax and/or Roth contributions. Absent an employer contribution, participants who earn $250,000 would only be able to save about 9% of their pay due to the 402(g) elective deferral limit ($22,500 in 2023), which is probably not enough for retirement sufficiency. However, if they also received an employer match of 4%–5% in addition to the 9% deferral, they would be close to an optimal savings rate.

The average employer match value in 2021 was 4.4% of pay, and the average nonmatching value was 5.1%. Employer contributions averaged in the 4% to 5% range, but their values can vary significantly. For example, 18% of plans had an employer match value of 6% or more, and 15% of plans had a value of less than 3%. Employer contributions can vary greatly across companies and industries. Figure 3 shows employer contributions offered by industry and the median values of employer matching and nonmatching contributions.

Figure 3: Employer contributions by industry

Industry	Employer match only	Employer nonmatch only	Both match & nonmatch	No employer contribution	Median employer match value	Median employer nonmatch value
Ambulatory health care	28%	31%	34%	7%	4.0%	6.1%
Architecture & engineering	66%	9%	25%	0%	3.3%	5.0%
Construction	59%	0%	37%	4%	3.0%	5.9%
Finance	39%	14%	45%	2%	4.0%	5.0%
Information	51%	10%	26%	13%	3.3%	2.7%
Insurance	34%	7%	59%	0%	4.0%	4.0%
Legal services	18%	36%	34%	11%	3.0%	6.5%
Manufacturing	47%	5%	45%	3%	4.0%	3.4%
Mining, quarrying, & oil and gas extraction	50%	6%	44%	0%	6.0%	4.5%
Retail trade	77%	4%	19%	0%	4.4%	1.9%
Technology	57%	5%	34%	3%	4.0%	4.1%
Transportation and warehousing	48%	13%	38%	3%	4.0%	4.1%
Unions	45%	13%	40%	2%	3.0%	2.8%
Utilities	48%	0%	43%	9%	4.0%	3.9%
Wholesale trade	70%	5%	22%	3%	3.8%	4.5%
All plans	**49%**	**10%**	**36%**	**5%**	**4.0%**	**4.2%**

Vesting

In the past, to mitigate the cost of employer contributions and to encourage employees not to leave their employment, employers attached vesting schedules to matching and nonmatching contributions. But with employees now changing jobs more frequently and the talent pool becoming more competitive, prospective employees can see a lengthy vesting schedule as a detriment. As of 2021, almost half (49%) of plan sponsors offered immediate vesting for matching contributions, and only one quarter of all plans had a five- or six-year vesting schedule for matching contributions.

While employers have accelerated vesting, nonmatching contributions are more likely to have longer vesting schedules. Forty percent of plans had immediate vesting for nonelective contributions, with 34% having a five- or six-year vesting schedule.

Planning note: Although employees are leaving jobs at high rates, many are also returning to their former employers. These "boomerang employees" can present special challenges for plan sponsors. For example, unless a plan document contains a break-in-service rule for participants, the plan must account for all of an employee's years of service with an employer. In determining the vested percentage of the participant's account balance attributable to contributions allocated before a break in service, plan documents may include a five-year break-in-service rule by which the plan can disregard years of service completed after a participant has five consecutive one-year breaks when determining the vested percentage of the pre-break account balance.

Auto portability

As millions of employees change jobs, leakage from the retirement system—the spending of plan savings before retirement—is a concern for the future retirement security of participants. Currently, defined contribution plan rules permit sponsors to cash out a terminated participant's low balance (if under $1,000) or transfer it to a safe harbor individual retirement account (IRA) (if under $5,000). When this occurs, participants often do not transfer these savings to their new plan or tax-advantaged vehicle, resulting in stranded small-balance IRAs and potential participant forfeiture of future savings and returns. Retirement leakage can be reduced by moving participants' small-balance retirement savings to their new employer plans.

Auto portability seeks to minimize lost or abandoned retirement savings by automatically searching for and transferring participants' small-balance accounts to their new employer plans. It is similar to other automatic default provisions in that it defines a default that, without an action from the participant, takes the action most likely to benefit the participant's retirement outcome. Specifically, auto portability makes 401(k) portability a new plan distribution default for all balances less than $5,000, automatically moving a terminated participant's account from a former employer's retirement plan to an active account at a new employer's plan when the participant changes jobs.

Auto portability can lower plan administration expenses and burdens for plan sponsors, a benefit achieved through both a reduction in the number of small, inactive accounts and an increase in active account balances as auto portability transfers new employees' savings to their current employer plans. Expenses are also reduced as the incidence of lost and missing accounts and uncashed checks is mitigated.

Planning note: Participants can be advantaged by staying in an employer's plan through retirement because they can benefit from fiduciary oversight, institutional pricing, and the availability of cost-effective financial advice. As employers enhance their plans to accommodate retirees, they may want to consider allowing all participants (including terminated, deferred participants) to roll money into the plan.

The value of advice

Competitive retirement benefits offer a broad array of solutions to help employees address their financial challenges. Plan sponsors are increasingly choosing to offer in-plan advice services to help participants invest, plan, and balance competing goals. Forty-one percent of retirement plans offered managed account advice, with more than 8 in 10 large plans offering these services. Overall, 74% of participants had access to in-plan advice.[5]

Some plan sponsors express concern about the legal consequences of offering advice programs, but the Pension Protection Act of 2006 (PPA) and related Department of Labor (DOL) guidance supports advice programs. Under PPA, the plan sponsor (or other plan fiduciary) is subject to general fiduciary requirements on the prudent selection and periodic review of the advice provider but does not have fiduciary responsibility under the Employee Retirement Income Security Act of 1974 (ERISA) to monitor the specific advice given by the affiliated advisor to participants.

As more plans adopt advice, more participants are taking advantage of its benefits. Vanguard research has found that participant investment advice provides meaningful portfolio, financial, and emotional value to participants. Advice can help investors prioritize their financial goals, then help improve their chances of reaching them. One 2019 study found that 8 in 10 advised investors with a retirement goal had an 80% or greater probability of achieving their objective.[6]

Financial wellness

Strong plan designs help participants achieve optimal saving and investment behaviors, but financial challenges can hinder participants' ability to save for retirement. Many participants have questions about managing debt or saving for an emergency, and these types of financial wellness concerns should be addressed so that participants can save sufficiently for retirement.

[5] Vanguard, 2021.
[6] Vanguard, Assessing the value of advice, September 2019.

In a recent survey, 63% of Americans polled said they have been living paycheck to paycheck since the pandemic started.[7] In addition, 56% couldn't cover an unexpected $1,000 bill,[8] and over 70% ranked finances as their number one source of stress.[9]

Financial well-being means the ability to meet today's financial needs while continuing to build toward long-term retirement goals. It's also the feeling of optimism that employees experience when they understand their finances and are confident in their ability to pay bills, weather financial shocks, and live the lives they love today without jeopardizing their long-term security. Plan sponsors are increasingly focused on delivering integrated financial wellness programs that meet participants' needs, surrounding them with the tools, education, and services that will guide them to better outcomes and financial well-being. These integrated experiences support participants as they get their finances under control, protect against the unexpected, and make progress toward their retirement goals. After all, improving employees' overall financial wellness is the top priority for 401(k) plan sponsors.[10]

Conclusion

A strong, participant-focused retirement plan can be a differentiator for employers interested in attracting and retaining talent. As the post-pandemic workforce shifts, data can help inform plan design choices such as eligibility, employer contributions, automatic solutions, and the availability of participant financial advice. An effective plan design may attract talent while also serving as a powerful tool to help employees save for their future.

Among the most popular and effective retirement plan features are these:

- The trend has been toward allowing employees to join the plan immediately to encourage them to start saving. In 2021, 72% of plans allowed their participants to start contributing to the plan immediately upon hire.
- The participation rate for plans with an automatic enrollment feature was significantly higher than the rate for plans without automatic enrollment.
- A strong default rate, with annual increases, gradually moves participants to a total savings rate of 12%–15% or more. Plans should set an automatic enrollment default rate that is equal to or greater than the deferral level to receive the full employer match.
- Generous employer contributions, in addition to providing retirement benefits, can help employees feel that their company is caring for and prioritizing their future well-being. Tax-deductible employer contributions can also offer employers tax savings.
- With employees changing jobs more frequently and the talent pool becoming more competitive, prospective employees can see a lengthy vesting schedule as a detriment. Almost half of plan sponsors offered immediate vesting for matching contributions.
- Auto portability seeks to minimize lost or abandoned retirement savings by automatically searching for and transferring participants' small-balance accounts to their new employer plans.
- Plan sponsors are increasingly offering in-plan advice services to help participants invest, plan, and balance competing goals.
- Plan sponsors are also focused on delivering integrated financial wellness programs that meet participants' needs, surrounding them with the tools, education, and services that will guide them to better outcomes and financial well-being. These integrated experiences support participants as they get their finances under control, protect against the unexpected, and make progress toward their retirement goals.

7 Spending Habits During COVID-19 Survey. Highland, November 2020.
8 Survey: Less than half of Americans have savings to cover a $1,000 surprise expense, Bankrate, January 2022.
9 Capital one CreditWise survey, 2021.
10 The Cerulli Report, U.S. Retirement Markets, 2021.

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