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New regulation expected to raise 401(k) participation

By Kathy Chu, USA TODAY

A final regulation to be issued by the Labor Department on Tuesday is expected to significantly boost employee participation in 401(k) retirement plans.

The regulation clarifies how employers can invest money from workers who were automatically enrolled in the plans rather than actively signing up.

One aspect of the regulation will also give companies a green light to automatically enroll existing employees. Many employers have been unsure about whether they faced legal liability if they automatically enrolled existing, rather than just new, workers.

The regulation will provide a "meaningful increase" in participation at a time when automatic enrollment is already gaining popularity, says Pamela Hess, director of retirement research at Hewitt Associates, a human-resources consulting firm. Automatic enrollment increases participation because instead of having to sign up, employees have to take action to opt out.

Since 2005, the percentage of employers that automatically enrolled workers in 401(k)s surged from 19% to 34%, according to Hewitt. During that time, though, average participation in 401(k)s only inched up, from 75% to 78%, because most employers automatically enrolled only new, not existing, workers, Hess says.

The finalized regulation will likely raise participation rates by as much as 8 percentage points by 2034, according to Bradford Campbell, an assistant labor secretary at the Employee Benefits Security Administration.

Overall, the Labor Department estimates that workers will add $70 billion to $134 billion to their retirement savings in the next 27 years because of automatic enrollment, which received a boost from last year's passage of the Pension Protection Act.

That law eased a key concern of automatic enrollment, by pre-empting state laws that bar withholding money from paychecks without employees' permission. The law also called for the Labor Department to spell out the default investment options for automatically enrolled workers.

After the law's passage, the Labor Department proposed a regulation that lets employers automatically enroll workers into balanced funds, which invest in both stocks and bonds, in professionally managed accounts or in target-date retirement funds, without facing lawsuits. The latter two options shift to more conservative allocations as workers age.

"Every new automatically enrolled plan is using one of (these) investment options," says David Wray of Profit Sharing/401(k) Council of America.

The final regulation allows these three investments but also says employers can ease workers into automatic enrollment by putting them in a money market account for the first 120 days.

The regulation also clarifies that employers that have previously put worker contributions in stable value funds — which guarantee a rate of return and have been the standard default investment for automatically enrolled employees — won't be subject to legal liability. The finalized regulation will take effect 60 days from Wednesday, when it's scheduled to be published in the Federal Register.

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