Auto-enrollment promotes debt as well as savings, study shows

By Editorial Staff *Thu, Mar 30, 2017*

Lower-income employees had the biggest wealth increases from auto-enrollment, but they offset their gains—by as much as 75%—with new installment debt and credit card debt, according to a four-year study of participants in the federal Thrift Savings Plan.

Has auto-enrollment been successful in raising the financial wellness of the participants who are at greatest risk of not saving enough for retirement? A decade after the Pension Protection Act began allowing plan sponsor to "nudge" employees into defined-contribution plans, the answer appears to be yes—but with an asterisk.

According to an unpublished research paper, auto-enrollment may also be driving them deeper into debt. Low-income workers could be living so close to subsistence that DC participation may be a mixed blessing. An increase in debt appears to offset as much as 73% of the gains of low-income participants, the research showed.

The researchers analysed savings data on civilian employees of the U.S. Army who contributed to the federal defined-contribution Thrift Savings Plan. Automatic enrollment into the plan was associated with an increase inbut the average wealth of participants, more than a third of the average gain was offset by new consumer debt.

The authors compared the 32,088 civilian U.S. Army employees hired in the year prior to the implementation of auto-enrollment change with the 26,826 employees hired in the year after. The researchers also studied 2,345 employees hired in the month prior to the implementation to the 3,414 hired in the month after the change and got similar results.

During a four-year period after they were hired, auto-enrolled employees saw their wealth go up (as a result of employer and employee contributions, and as a percentage of their first-year salaries) by 5.2% on average, by 13.9% at the 25th percentile of income, and by 21.5% at the 10th percentile of income, the study showed. Auto-enrollment had no effect at the 75th and 90th percentiles.

But, when the employees' new assumption of installment and credit card debt was factored in, automatic enrollment increased net wealth over the same period by an average of only 3.3% (a 37% "crowding out" effect), by 8.6% (38% crowd-out) at the 25th percentile, and by 5.8% (73% crowd-out) at the 10th percentile. There was no effect on net wealth at the 75th and 90th percentiles.

Brigitte Madrian, David Laibson and John Beshears of Harvard, James Choi of Yale, and William Skimmyhorn of the U.S. Military Academy were the authors of the study. Several of the authors have as a team been studying behavioral efforts to lift U.S. savings rates for a decade or more.