Stretching a Match

Revising matching contributions could encourage higher deferral rates.

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KEY INSIGHTS

- Restructuring employer matching contributions could encourage higher deferral rates and improve retirement outcomes for plan participants.
- It is important to evaluate potential changes to matching contributions as segments of the plan population could be negatively impacted.
- In addition to plan design, the adoption of auto-features can help nudge employees to save more and become better prepared for retirement.

For several years, retirement plan sponsors and plan service providers have been exploring plan design strategies that encourage participants to save more for retirement. One such strategy is restructuring employer matching contributions.

The concept of stretching a company match involves plan sponsors and consultants revising matching formulas with the goal of encouraging higher deferral rates, which may help participants become better prepared for retirement. While the strategy requires no additional employer matching contributions, it may limit the matching amounts received by highly compensated employees; however, there may be solutions to this issue.

Persuading plan participants to optimize the benefits of defined contribution plans is an ongoing challenge. Many plan sponsors have embraced communications strategies, education programs, and plan design solutions that encourage participants to save more—and those efforts have made a difference.

In Figure 1, we compare summary plan data from 2015 to 2021.[1] Except for the decline in plans suggesting a savings rate, these optimization efforts show that overall improvements and their potential long-term impacts on retirement outcomes could be meaningful. The total average retirement contribution in 2021 was 13.9% of pay (combined average deferral rate and company contributions). While this rate is still slightly short of the 15% combined contribution rate that T. Rowe Price suggests as a target, the positive trends in both the participant and company contribution are laudable.

[1] PSCA 65th 2021 Annual Survey of Profit Sharing and 401(k) Plans (reflecting 2021 plan experience)

Efforts to Optimize Benefits Show an Improving Trend Overall

(Fig. 1) A comparison of summary plan data from 2015 to 2021

	2015	2021	Difference
Eligible participants with a balance in the plan	87.6%	90.1%	**+2.85%**
Average participant deferral rate	6.8	8.3	**+22.06**
Average company contribution	4.7	5.6	**+19.15**
Plans that suggest a savings rate (usually 6%)	29.1	28.2	**-3.09**
Plans with auto-enrollment	57.5	58.8	**+2.26**
Plans with auto-escalation	68.3	78.4	**+14.79**

As of December 31, 2021.
PSCA 65th 2021 Annual Survey of Profit Sharing and 401(k) Plans.

Stretching the Match

One way that plan sponsors are motivating participants to save more is by stretching the match—revising matching contribution formulas so that participants have an incentive to increase their deferral rates. A plan sponsor can choose a variety of matching formulas without increasing the overall amount of the matching contribution. For example, some of the employer matching options are:

- 100% on the dollar, up to 3% of pay (a combined contribution of 6% for the full match)
- 50% on the dollar, up to 6% of pay (a combined contribution of 9% for the full match)
- 25% on the dollar, up to 12% of pay (a combined contribution of 15% for the full match)

A Word of Caution

While restructuring matching contribution formulas may encourage higher deferral rates for some participants, those participants who have a limited capacity to save could end up with lower overall contributions. This is because if they cannot increase their contributions, they will end up with fewer matching dollars. In fact, some research finds that higher match thresholds may be associated with lower plan participation and lower employee contribution rates.[2]

Further, stretching the match may also limit the matching contributions made to highly compensated employees. For example, the annual compensation limit for 2023 is $330,000 and the maximum deferral amount is $22,500. Consequently, a participant who is earning $330,000 can only contribute 6.82% of salary before reaching the $22,500 annual limit. If the plan matches 25% on the dollar, up to 12% of pay, then this participant would not receive the full matching contributions. He or she would only receive the match up to the 6.82% contributed.

There may, however, be a way to resolve this issue. Depending on your benefits program, you may consider offering true-up matching contributions in an excess benefit plan (nonqualified plan).

[2] Vanguard.com, “Stretching the match: Unintended effects on plan contributions,” December 2018. On the website at https://institutional.vanguard.com/iam/pdf/CIRSTM.pdf

Weighing the Decision

Before changing a plan's matching formula, it is vital to consider the ways in which it may affect your plan. Here are a few things to keep in mind:

Advantages

- **It's not expensive:** Changing a matching formula generally is cost-neutral, although there may be initial setup costs to amend the plan document, update the summary plan description, send communications to participants, or take other actions to support the change.
- **It may help most participants set higher savings goals:** Recent research suggests that active-choice frameworks are a cost-effective method to increase retirement program participation and contributions.[3]
- **It may change participants' behavior:** Raising the match threshold could push deferral rates higher.

Drawbacks

- **Participants may perceive the change as a takeaway:** Participants who must save more to receive the same matching contribution may be unhappy with the change unless it is communicated effectively.
- **It may not change participant behavior:** Because of inertia, few participants may increase their contribution amounts unless the plan requires that deferral rates be reset.
- **It may negatively affect highly compensated employees:** As discussed previously, restructuring the match may limit the matching contributions available to these participants.

As always, when considering a change to your plan or plan design, it may be helpful to discuss with an expert (such as a plan consultant or benefits attorney).

Aligning Plan Design and Employee Behavior

Stretching your company match is just one plan design option that may encourage plan participants to save more. You may also want to consider automatic services such as:

- Auto-enrollment for employees at higher initial default rates,
- Auto-enrollment for employees who are not currently enrolled,
- Auto-increases in deferral rates on an opt-out basis, and
- Auto-investing in a qualified default investment alternative.

> Simplifying options and communicating plan design choices effectively to employees can significantly influence their behavior.
>
> **— Kevin Collins**
>
> *Vice president and head of T. Rowe Price Retirement Plan Services, Inc.*

[3] NBER.org, "How do Behavioral Approaches to Increase Savings Compare? Evidence from Multiple Interventions in the U.S. Army," November 2022. On the website at https://www.nber.org/papers/w30697

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