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Plan Design:
STRETCHING A MATCH

In recent years, retirement plan sponsors and plan providers have been evaluating the effects of a low interest rate environment on participants' retirement income adequacy. In many cases, sponsors have begun exploring plan design strategies that encourage participants to save more for retirement. One of the strategies being discussed is restructuring employer matching contributions. Read on to learn more and stay informed....

The concept of stretching a company match is gaining attention in the industry. Plan sponsors and consultants are exploring whether revising matching formulas has the potential to help participants become better prepared for retirement by encouraging higher deferral rates. 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. During 2013:[1]

- 88.6% of eligible participants had balances in their employers' plans
- 6.7% was the average participant deferral rate
- 43% of employees said they participated in the plan to get the company match
- 4.7% of pay was the average company contribution during 2013 (up from 4.5%)
- 21.8% of plans provided a suggested savings rate to employees; most suggest a rate above 6%
- 50.2% of plan sponsors had adopted automatic enrollment
- 24.6% of all plans had automatic increase

While these improvements are laudable, 2013's 11.4% of pay (combined average deferral rate and company contribution) is still short of the 15% combined contribution rate that T. Rowe Price and others in the industry recommend as a target.

STRETCHING THE MATCH

One way that plan sponsors are motivating participants to save more is by stretching the match—**revising matching contribution formulas so 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%)
- 50% on the dollar, up to 6% of pay (a combined contribution of 9%)
- 25% on the dollar, up to 12% of pay (a combined contribution of 15%)

A recent analysis of matching formulas showed that stretching the match encouraged slightly higher deferral rates and, in some cases, had the potential to lower employers' matching costs.[2]

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[1]PSCA 57th 2014 Annual Survey of Profit Sharing and 401(k) Plans (reflecting 2013 plan-year experience)
[2]Principal.com, *How Plan Design May Impact Participant Behavior*, June 2014 (http://www.principal.com/businesses/planningcenter/employeebenefits/bestpractices/plan-design-impact-behavior.htm#5)

A WORD OF CAUTION

While restructuring matching contribution formulas will encourage higher deferral rates for some participants, it may limit the matching contributions made to highly compensated employees. For example, the annual compensation limit for 2015 is $265,000 and the maximum deferral amount is $18,000. Consequently, a participant who is earning $265,000 can only contribute 6.79% of salary before reaching the $18,000 annual limit. If the plan matches 25% on the dollar, up to 12% of pay, then this participant would not receive full matching contributions. He or she would receive the match up to the 6.79% contributed.

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

WEIGHING THE DECISION

Before changing a plan's matching formula, it's 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:** It appears that about one-third of participants save at a level equal to the maximum employer matching contribution. This supports research showing that participants take cues from plan sponsors about how much to save.[3]
- **It may change participants' behavior:** Analysis shows that raising the match threshold can push deferral rates higher.[2]

Considerations

- **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, consult with your ERISA 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.

"Plan design choices, and the ways in which they are communicated to employees, can have a powerful influence on employees' behavior," said Aimee DeCamillo, vice president and head of T. Rowe Price Retirement Plan Services, Inc.

Learn more about auto-service plan design options by visiting the Retirement For All website at **troweprice.com/retirementforall**.

Your T. Rowe Price representative can work with you to evaluate plan design choices and develop a plan that helps participants achieve their goals.

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[3]NBER.org, *Small Cues Change Savings Choices*, February 2012 (http://www.nber.org/papers/w17843)