

## Rethinking the Company Match

A recent paper outlines potential reasons that companies may want to rethink offering a 401(k) match.

By Lori Lucas

New research from Harvard and Yale universities provides defined-contribution plan sponsors with more food for thought.

A paper titled “The Impact of Employer Matching on Savings Plan Participation Under Automatic Enrollment” contends that the success of automatic enrollment in increasing employee participation in defined-contribution plans is only marginally dependent upon whether the company makes a matching contribution.

In the paper, researchers John Beshears, David Laibson and Brigitte Madrian, all from Harvard, and James J. Choi from Yale conclude that “participation rates under automatic enrollment decline only modestly when the employer match is eliminated or reduced.”

The report finds 401(k) plans with automatic enrollment that move from offering employees the typical match of 50 percent on the first 6 percent of pay to offering no match at all reduces savings-plan participation by 5 percent to 11 percent.

Plan sponsors may argue over whether that percentage-point decline is indeed modest. This type of reduction in participation could mean the difference between passing and failing nondiscrimination testing.

Nonetheless, the findings should give plan sponsors pause: If defined-contribution plans can obtain significant participation rates under automatic enrollment with-

out a company match, is it really necessary?

The possibilities extend much further than saving companies the cost of the matching contributions. After all, there are a number of other productive ways that funds currently dedicated to the company match could be employed:

- **Create an employer-sponsored retirement “floor” for all employees.** Instead of a matching contribution, 401(k) plans with automatic enrollment could switch to non-contingent company contributions—as did one of the plans in the study. Under such a structure, even employees who don’t participate in the defined-contribution plan would still receive some defined-contribution-related retirement benefit from the employer.

Instead of matching 50 percent of participants’ contributions up to 6 percent of pay, the company could simply provide a contribution equal to 3 percent of pay, whether or not participants contribute to the plan.

This could be a very important goal for companies whose only retirement benefit is the defined-contribution plan. It would assure that all employees, including those who have opted out of the plan that had a match, would have some level of employer-sponsored retirement benefit.

Plan sponsors might wonder whether non-contingent contributions would further exacerbate automatic enrollment opt-outs. The concern would be that employees might feel so “wealthy” in retirement funding as a result of receiving the company’s contribution that they would believe

there was no need to contribute to the defined-contribution plan. That reaction is known as an “income effect.”

In the analysis, a plan that switched from a match to a non-contingent company contribution was estimated to experience a 6 percent to 6.7 percent decrease in participation because of an uptick in opt-outs under automatic enrollment as well as the income effect of the company’s contribution.

- **Reduce or eliminate participant-paid defined-contribution fees.** A somewhat more controversial alternative for plan sponsors with automatic enrollment plans is to redirect some or all of the funds that would normally go to matching contributions to the payment of plan expenses. Unlike the first solution, participants in defined-contribution plans might view the decrease in matching contribution as something being taken away from them—even if the effect is economically neutral. Nonetheless, in an environment where the burden of monitoring and disclosing fees appears to be increasing, as are the number of fee-related lawsuits, this approach is still worth considering.

- **Enhance other benefits.** From a total benefits perspective, plan sponsors may also view a move away from matching contributions as a way to enhance other benefits—such as health care. Again, the message to employees would have to be carefully crafted. However, in situations where health care subsidies are more greatly valued than defined-contribution match-

ing contributions, this may be a winning strategy for employers.

Of course, the reality is that the existing matching structure will probably remain the logical approach for most plan sponsors. The majority of companies offer defined-contribution plans not only to create an effective benefit, but to compete in an environment where talent is difficult to attract and retain.

For most plans in most industries, that means offering a match. Further, many plan sponsors will likely remain more comfortable with the collaborative approach to saving that results from matching contributions, rather than the gift-giving approach represented by non-contingent company contributions.

Plan sponsors will also likely find the challenge of communicating a change to

the matching program more onerous than it might be worth. Even if the change has no true negative economic impact (such as using the funds to pay for plan expenses), it may be too difficult to offset the negative perception by participants.

Finally, even a small increase in opt-out rates that would likely come from decreasing or eliminating the company match may be too much of a sacrifice for plan sponsors.

The point is this: As plan sponsors consider the options presented by the 2006 Pension Protection Act, such as adding automatic enrollment, they can choose to act tactically or strategically. The tactical approach is to address specific plan issues, such as participation. The strategic opportunity is to rethink the goals of the defined-contribution plan in particular and benefits overall.

Even if the outcome is embracing the status quo, it can be an important exercise for plan sponsors to consider all of the strategic possibilities and re-evaluate why they are offering their defined-contribution plans, what they hope to achieve and whether they can reach their goals more effectively in the current environment.

By thinking differently, plan sponsors may even come to question legacy decision-making and realign their retirement programs with new business realities and workforce needs.

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