Employer Match Strikes a Hot Debate

By Editor Test *Wed, Jan 27, 2010*

Academic and industry researchers clashed over methodology, but they appear to agree that auto-enrollment in 401(k) plans might have unintended consequences on the employer matching contribution.

The topic of auto-enrollment in 401(k) plans and its potential impact on the employer matching contribution has sparked a scholarly rhubarb between the Urban Institute and the Employee Benefit Research Institute.

In December, researchers at the liberal Urban Institute reported evidence that the match at large firms with auto-enrollment is lower than at those without it. They warned that auto-enrollment, by lifting participation rates, could raise costs for employers and trigger cutbacks in the match or in other compensation.

"While auto-enrollment increases the number of workers participating in private pensions, our findings suggest it might also reduce the level of pension contributions," wrote Barbara Butrica and Mauricio Soto in their report "Will Automatic Enrollment Reduce Employer Contributions to 401(k) Plans?." RIJ reported their findings January 13, "Will "Auto-Enrollment" Kill the Employer Match?"

National newspapers publicized that story, prompting the EBRI, which is non-partisan but whose membership list is a Who's Who of the retirement savings industry, to fire back with a statement refuting the Urban Institute's assertion and questioning its data.

"Our recent analysis of plan-specific data shows that, at least among large 401(k) plans, plan sponsors actually increased the generosity of their contribution rates," said Jack VanDerhei, EBRI research director and author of the analysis, in a statement released last week.

That was not the end of it. On Monday, Butrica e-mailed reporters a response to the EBRI report. It said that the EBRI's data largely supported her findings, and reiterated that auto-enrollment—a key plank of the Pension Protection Act of 2006—could backfire.

"We think auto-enrollment is a good thing," Butrica told RIJ. "But if employers do in fact lower their match rates to offset some of the higher costs, then auto-enrollment may have some unintended consequences."

Vanderhei told RIJ he will release a full study of the impact of auto-enrollment and other pension innovations in a February EBRI Issue Brief.

If untold billions or even trillions of dollars were not at stake here—both in terms of Americans' retirement savings and financial service company revenues—this point-counterpoint exercise would be purely academic. But billions are at stake.

This debate also comes at a time when academics have criticized the 401(k) system and when employers have shown a readiness to suspend matches during tough economic times. The financial industry is unsurprisingly sensitive to any news that might further erode consumer faith in defined contribution pensions as the primary path to retirement security.

EBRI's rebuttal

The EBRI challenged the Urban Institute's methodology and its inference that match rates are already about seven percentage points lower among large plan sponsors that use automatic enrollment than among those that don't.

In rebuttal, EBRI cited its recent study showing that 42.5% of the defined benefit plan sponsors it surveyed had already increased or planned to increase their direct "first tier" match and/or their "second tier" non-matching contribution to their defined contribution plans.

EBRI also noted that "225 large defined contribution plans that had adopted automatic enrollment 401(k) plans by 2009, but did not have them in 2005." The study showed that:

- The average 2009 first-tier match rate was 87.78%, up from 81.26% in 2005. [Note: An employer who matched an employee's 3% deferral with a 3% contribution would have a 100% first-tier match rate.]
- The average effective match rate for 2009 was 4.32% of compensation, up from 4% in 2005.
- The average total employer contribution rate for 2009 was 6.35% of compensation, up from 5.46% in 2005.

But, while showing that match rates are higher at firms with auto-enrollment, EBRI also suggested that it wasn't because they had adopted auto-enrollment. It was because they had recently closed or frozen their defined benefit plans.

The improvements in the match "were much higher for sponsors that had frozen/closed their defined benefit plans than for the overall average," the report said. Those companies could offer higher 401(k) match rates because they were saving money on the conversion and because they wanted to ease the sting of losing the defined benefit plan, Vanderhei told RIJ.

Points of agreement

The Urban Institute researchers, whose study was published by the Center for Retirement Research at Boston College, don't disagree with that assessment.

"We do not believe the EBRI results necessarily contradict our results. In fact, their findings with regard to DB plans are consistent with our conclusions. And, as we have shown, the first-tier match rates and EBRI effective match rates could increase with automatic enrollment, at the same time that our match rates decline," Butrica wrote in her response to the EBRI assertions.

"Ultimately, the main point of our paper is that automatic enrollment is not free for employers and that profit-maximizing firms might look for ways to offset the higher costs of auto-enrollment. How they will do that is still up for debate, but our results suggest that some employers *may* reduce their match rates," she added.

On Monday, Vanderhei conceded that he also believed that auto-enrollment could have unplanned and unwelcome consequences.

"I don't disagree that there will be modifications seeking a long-run equilibrium [in the match]. Other papers have already said that auto-enrollment could cost employees in terms of match rates," he told RIJ.

"My 2005 study showed that, all else being equal, auto-enrollment would work to the benefit of low-income participants but to the detriment of the highest quartile, because they may get anchored at the default rate," he said.

"There's no doubt that basic back-of-the-envelope math will show that, all else being equal, something will have to give. I took exception to the Urban Institute's argument that this has already happened.

"The most important thing is that this is one input to a full study to be released [as an EBRI Issue Brief] in February looking at the overall impact of auto-enrollment on participants," Vanderhei added. "It will cover much more than what happens to match rates, and will include auto-escalation and other things."