Fidelity Benefits Consulting

Match True-Up Considerations

October 2017

Are your employees missing out on employer matching contributions because they don't fully understand how their plan works?

What should you, as plan sponsor, do to address the critical impact of the timing of their deferrals and help them realize the value of the matching benefits you have built into the plan?

This paper addresses these questions through an innovative approach.

What's Inside

- Are you empowering employees to maximize their match?
- Uneven deferrals may impact retirement readiness
- A true-up provision can support the spirit of your plan design
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Fidelity INVESTMENTS

Are you empowering employees to maximize their match?

We are all familiar with how 401(k) plans work. Employees defer a portion of their salary into the plan and employers typically provide a matching contribution based upon a set formula. For example, assume an employer makes a 50% matching contribution on the first 6% of employee deferrals, thereby encouraging employees to contribute at least 6%. This seems simple enough. But for many plans, "when" an employee defers over the course of the year is as important as "how much."

For many plans, **"when"** an employee defers compensation over the course of the year is as important as **"how much."** Employees who distribute their deferrals unevenly may miss out on the full benefit of the match.

The "when" matters because most plans calculate the match on a payroll-by-payroll basis. Employee deferrals in a pay cycle above the formula cap are not eligible for the match. More importantly, foregone matching contributions due to deferrals below the formula cap cannot be made up, even by higher deferrals in other pay cycles. The result: Employees who distribute their deferrals unevenly may miss out on the full benefit of the match.

If you want to make sure your employees get the full benefit of good savings behavior, consider adding a "true-up" provision to your plan match. A true-up contribution assures that all participants receive a matching contribution based on their annual deferrals in to the plan, regardless of timing. Good communication is also key. A strong communication and education program can help employees understand and appreciate the true value of the benefits they are offered, and how to make the most of them.

Meet Barbara & Harry

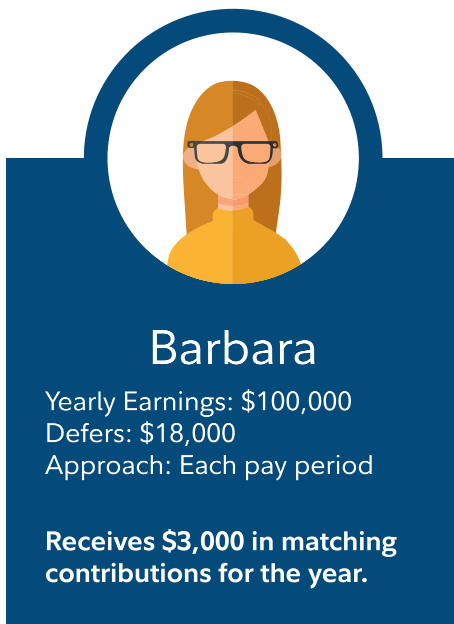
Both earn $100,000 per year and defer the maximum allowable amount for the year—$18,000.

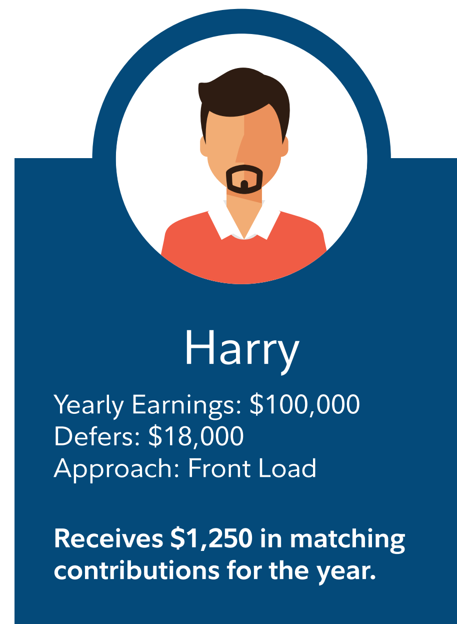
Barbara takes the conventional route and defers 18% of salary each pay period to spread her deferrals evenly throughout the course of the year. Barbara's deferrals exceed the 6% required to receive the maximum match, so she receives a 3% match each pay period. Over a full year, Barbara receives $3,000 in employer matching contributions.

Harry decides to "frontload" his deferrals, which is generally a reasonable strategy. He might want to accelerate his tax-favored investment return, or get his retirement savings done early in the year so he has extra money in his paycheck for summer vacations and Christmas shopping. Regardless of why Harry saves this way, notice what happens. In the first month, his $4,000 contribution represents a 48% deferral rate. The plan will only match 50% of the first 6% deferral, which is $250 each month. By May, Harry has met his savings goal and the IRS deferral limit and, as a result, he stops deferring for the remainder of the year. With no deferrals, no more employer match goes into the plan on his behalf. The total company match for the year is $1,250.

By frontloading contributions, Harry missed out on $1,750 of company money for the year.

Barbara and Harry deferred the same percentage of their salaries but received dramatically different employer dollars. The "when" really mattered.





By frontloading his contributions, **Harry missed out on $1,750 of company matching contributions** for the year.

Examples

Barbara

– Annual Salary $100,000, Match of 50% on 6%:

Month	Monthly Pay	Deferral %	Deferral ($)	Cumulative Deferral ($)	Match ($)	Cumulative Match ($)
January	$8,333	18%	$1,500	$1,500	$250	$250
February	$8,333	18%	$1,500	$3,000	$250	$500
March	$8,333	18%	$1,500	$4,500	$250	$750
April	$8,333	18%	$1,500	$6,000	$250	$1,000
May	$8,333	18%	$1,500	$7,500	$250	$1,250
June	$8,333	18%	$1,500	$9,000	$250	$1,500
July	$8,333	18%	$1,500	$10,500	$250	$1,750
August	$8,333	18%	$1,500	$12,000	$250	$2,000
September	$8,333	18%	$1,500	$13,500	$250	$2,250
October	$8,333	18%	$1,500	$15,000	$250	$2,500
November	$8,333	18%	$1,500	$16,500	$250	$2,750
December	$8,333	18%	$1,500	$18,000	$250	$3,000

The maximum annual match Barbara could receive is **$3,000** ($100,000 x 50% x 6%), and because she spread her deferrals evenly throughout the year she was able to receive the maximum match available.

Harry

– Annual Salary $100,000, Match of 50% on 6%:

Month	Monthly Pay	Deferral %	Deferral ($)	Cumulative Deferral ($)	Match ($)	Cumulative Match ($)
January	$8,333	48%	$4,000	$4,000	$250	$250
February	$8,333	48%	$4,000	$8,000	$250	$500
March	$8,333	48%	$4,000	$12,000	$250	$750
April	$8,333	48%	$4,000	$16,000	$250	$1,000
May	$8,333	24%	$2,000	$18,000	$250	$1,250
June	$8,333	0%	$0	$18,000	$0	$1,250
July	$8,333	0%	$0	$18,000	$0	$1,250
August	$8,333	0%	$0	$18,000	$0	$1,250
September	$8,333	0%	$0	$18,000	$0	$1,250
October	$8,333	0%	$0	$18,000	$0	$1,250
November	$8,333	0%	$0	$18,000	$0	$1,250
December	$8,333	0%	$0	$18,000	$0	$1,250
					Missed Match and Possible True-Up Opportunity	***$1,750***

Harry is saving well above the 6% match level on an annualized basis ($18,000 / $100,000 = 18% annualized deferral rate), so he should be eligible to receive the maximum annual match of **$3,000** ($100,000 x 50% x 6%). However, by frontloading his contributions, Harry missed out on **$1,750** in company matching contributions.

Uneven deferrals may impact retirement readiness

This example was constructed to provide an obvious illustration of how this dynamic can impact a participant. But there are many more subtle ways in which an employee's uneven deferral pattern can impact the match they receive. For any given year, the dollar value of this missed opportunity could be minimal. However, over the course of a career, consecutive years of inconsistent deferral behavior can become significant and have an unintended negative impact on an employee's overall retirement readiness.

A true-up provision can support the spirit of your plan design

To remedy this problem, many plan sponsors have adopted a "true-up" provision in their plan. Essentially, a true-up provision defines the company matching formula in terms of an annual amount. At the end of each year, a calculation is performed looking at actual earnings, deferrals, and match for the year. Returning to our hypothetical employees, only Harry would need a "true-up" employer contribution. When calculated on an annual basis, the full $3,000 match would be earned which would result in a $1,750 true-up some time after the end of the year ($3,000 minus $1,250).

More and more companies are adopting true-up provisions and many others are considering a true-up to determine if it aligns with their benefit philosophy. We see the "when" can have a dramatic impact, but many employers struggle with whether it is their responsibility to make a participant "whole" for their mistimed deferrals or not. After all, there is no compliance requirement to have a true-up. Additionally, year-end processing and reporting tasks are already fairly onerous and adding yet another project might not be high on the list of priorities.

Effective communication counts, too

Alternatives to implementing a true-up include tools, resources and communication to help employees understand the importance of "when." Effective communication is key to helping employees understand and value the benefits you provide and optimize their saving potential. Regularly evaluate your savings plans within the context of your Total Rewards strategy and employee value proposition to determine whether your plans are meeting desired objectives. If your plans are falling short, perhaps it's time to reevaluate your plan design, consider your options, and put a new strategy in place for 2018.

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