

Reviewing Your 401(k) Plan Design

A 401(k) plan's design can have a significant influence on both participation and contributions. One way you can evaluate the effectiveness of your plan's features is to use a benchmark, such as the Profit Sharing/401(k) Council of America's (PSCA) *Annual Survey of Profit Sharing and 401(k) Plans*.^{*} Here are some of the PSCA's most recent findings.

Look at Contributions and Participation

The first things an employer should consider are the plan's participation and participant deferral rates. The PSCA survey's average participation rate for all 401(k) plans is 82.7%. Participation is greatest in plans that offer both a safe harbor and discretionary match (90.1% average participation rate) and — not surprisingly — lowest in plans with no employer contribution (67.2%). The average deferral of lower paid participants, as the ADP tests define them, is 5.5% of pretax pay, while higher paid participants defer an average of 6.6%.

Employer 401(k) contributions average 3% of pay for companies that do not also offer a defined benefit plan (5.6% in combination profit sharing/401(k) plans). The most common matching formula is a fixed match only. The most common fixed-match contribution (29%) is 50 cents per dollar of the first 6% of pay deferred. A



“The first things an employer should consider are the plan’s participation and participant deferral rates.”

50-cents-per-dollar match of up to 3% of pay is the choice for 7.6% of plans, and 7% offer a dollar-for-dollar match of the first 6% deferred.

If you find your participation and participant deferral rates vary significantly from other similarly sized 401(k) plans, you may want to investigate why. A good place to start is by looking at the rates and plan features offered by similarly sized plans (see the table on page three).

Review Plan Investments

The number of funds that plans offer appears to be leveling out after many years of steady increase. Plans offer an average of 18 funds for both participant and company contributions. Among all plans, the

most common investment option offered for participant contributions is actively managed domestic equity funds (81.3%). Actively managed international equity funds are second (78.5%), and indexed domestic equity funds (70.2%) are third. Actively managed domestic bond funds are a close fourth at 70% of plans.

For plans surveyed that offer automatic enrollment, the most popular default investment choice is a target retirement date fund (59.7%), followed by lifestyle funds (17.9%), balanced funds (13%), and professionally managed accounts (2.9%).

Examine Plan Loan Policies

The vast majority of 401(k) plans (87.7%) allow loans. Most charge some type of loan fee to participants — loan origination fees being the most common. Slightly fewer than half of all plans allow multiple loans, and nearly all have a minimum loan amount. In 84.4% of plans, the minimum is between \$500 and \$1,000.

While different employers have different plan objectives, and employee demographics vary, a look at the PSCA's survey results can give employers a good idea of what similar plans offer.

* 52nd Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing/401(k) Council of America; copies available online at www.pasca.org

(continued on page 3)

Inside

HEART Act Clarifications

2

Plan Automation: One, Two, Three

3

Safe Harbor Plan Notice — Watch the Timing

4

Recent Development

4

HEART Act Clarifications

The IRS recently provided guidance (IRS Notice 2010-15) on the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), which affects qualified plan rules for individuals called into qualified military service (QMS). The guidance clarifies certain HEART provisions and reinforces others.

The HEART Act created a new tax code section (IRC Section 401(a)(37)). It provides that survivors of a plan participant who dies on QMS will be entitled to any additional benefits — other than benefit accruals relating to the participant's period of qualified military service — that would have been provided had the participant resumed employment and then terminated on account of death. Benefits include service credit, ancillary life insurance benefits, and other survivor benefits that are contingent upon a participant's death and vesting.

Vesting Service

HEART requires that participants killed on QMS be treated as having returned to employment the day before their death and that vesting be provided accordingly; just as if the individual had died while he or she was employed. In almost all defined contribution (DC) plans, this will result in 100% vesting. However, that may not be the case in defined benefit (DB) plans, which often do not fully vest upon death. Although credit will be given as if the employee had died while employed for the purpose of vesting percentages, the plan is not required to include the participant's period of QMS when determining the amount of death benefits for either a DB or a DC plan. However, the plan may opt to do so.

If a participant is not entitled to reemployment rights under USERRA, then the survivor benefits under the HEART Act do not apply.

The Notice also clarifies that the plan does not have to provide 100% vesting for service members who become disabled on QMS, although it may choose to do so.

Differential Wage Payments

Under the HEART Act, differential pay is considered compensation. Any individual receiving differential wage payments will be treated as an employee of the employer making the payment. Thus, if an employee on QMS is already a plan participant, his or her differential wage



“Under the HEART Act, differential pay is considered compensation.”

payments are considered compensation for qualified plan purposes, such as employer allocations and elective deferrals. (Note: Differential pay was an option in the final 415 regulations plan amendment and, thus, has already been either included or excluded in the plan's definition of compensation.)

Contributions resulting from differential wage payments may be included in nondiscrimination testing. However, this is not permitted — nor desired — if the amounts will cause the testing to fail. If these amounts are included in testing, they must be included for all employees receiving differential wage payments.

Qualified Reservist Distributions

The qualified reservist distribution (QRD) was created by the Pension Protection Act of 2006 (PPA) and made permanent by the HEART Act. It is a distribution from an IRA or of deferrals from a 401(k) or

403(b) plan to a member of a military reserve unit that was ordered or called to active duty for a period in excess of 179 days (or for an indefinite period). The QRD must be made between the date of the order or call to active duty and the date the active duty period ends. There is no 10% penalty on QRDs for participants under age 59½.

A QRD or any portion of a QRD may be repaid up until two years after the day the active duty period ends. Whether the QRD is from a 401(k), 403(b), or IRA, repayment may only be made to an IRA as after-tax amounts. Thus, there is no deduction for the repayment (unless it is made within the normal 60-day period allowed for rollovers). Since this is a rollover, it has no impact on the annual IRA contribution limit.

Deemed Severance Distribution

For distribution purposes, an individual called into active duty is deemed to be severed from employment after 30 days of active duty and may request a distribution of deferrals after that 30-day period. Deferrals are suspended for six months after such a distribution. Deemed severance distributions are eligible rollover distributions subject to the 20% mandatory income-tax withholding. A plan is not required to allow deemed severance distributions. If an individual has a real severance from employment and then returns to the job within six months of taking a distribution of deferrals, he or she can begin making elective deferrals immediately.

If an individual on active duty is eligible for both a deemed severance distribution and a QRD (after 179 days on active duty), the distribution will be treated as a QRD. Thus, there will be no six-month suspension of deferrals or 10% premature distribution penalty.

Remedial Amendment Period

Plans must be amended for the HEART Act by the last day of the first plan year beginning on or after January 1, 2010. (The deadline for amending governmental plans is January 1, 2012.)

Plan Automation: One, Two, Three

About a fifth of employees who are eligible to participate in an employer-sponsored retirement savings plan don't contribute. Workers who don't participate in an employer-sponsored plan are much less likely than those who do to have total savings and investments of at least \$50,000 (56% versus 13%).* And among those employees who do participate, a relatively small fraction regularly rebalance their accounts — one reason so many participant accounts were hit hard by the 2008 stock market crash.

What can plan sponsors do to increase plan participation and help participants increase their plan account balances? Automate their plans.

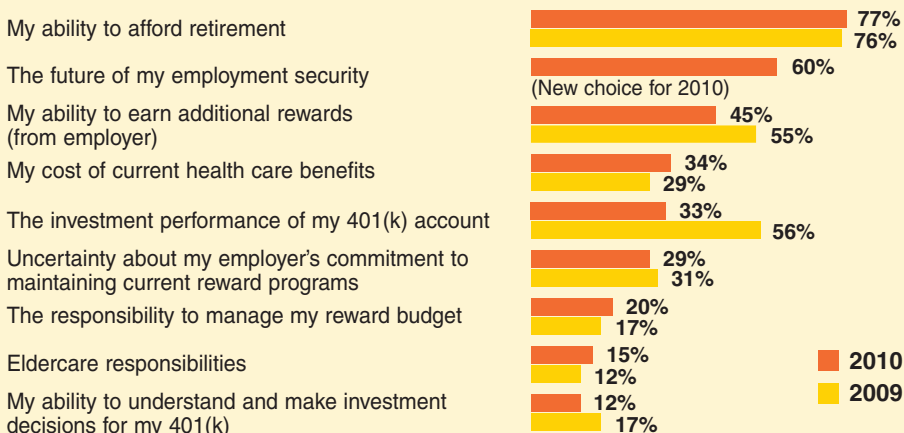
Automatic Enrollment. With automatic enrollment, when an employee becomes eligible to participate in the plan, a set percentage of the employee's compensation is withheld (often 3%) and deposited in a 401(k) plan account for the employee. Some employers apply automatic enrollment only to new employees, but you could choose to automatically enroll all of your eligible employees. All employees must be given the option to decline participation.

Automatic Contribution Escalation. Along with automatic enrollment, consider automatic contribution escalation. You can increase the automatic deferral percentage over time as long as the increases are made in accordance with a specified schedule. You must notify employees of the amount of the deferral increases and when increases will occur. Employees must be given the option to opt out of increases.

Automatic Rebalancing. You may have several options for offering participants automatic rebalancing: Make automatic rebalancing an optional feature of your plan and encourage participants to use it; offer managed accounts; or choose a default investment option for your plan, such as a life-cycle or target-date fund, that automatically rebalances.

* 2010 Retirement Confidence Survey, Employee Benefit Research Institute, www.ebri.org

Top Personal Challenges to Employees



Source: 2010 Top Five Total Rewards Priorities Survey, Deloitte Development, LLC

Reviewing Your 401(k) Plan Design *(continued from page 1)*

How Does Your 401(k) Plan Compare?

Plan Rates and Features	Plan Size by Number of Participants			
	1-49	50-199	200-999	All Plans*
Average employee participation rate	91.4%	84.2%	82.1%	82.7%
Average pretax deferral for ADP-ACP nondiscrimination testing				
Higher paid employees	6.9%	6.7%	6.6%	6.6%
Lower paid employees	6.4%	5.7%	5.5%	5.5%
Average after-tax (Roth) deferral for nondiscrimination testing				
Higher paid employees	4.2%	3.8%	4.0%	3.9%
Lower paid employees	4.7%	3.7%	3.5%	3.7%
Type of match (where offered)				
Fixed	36.6%	69.1%	60.2%	57.1%
Graded	63.4%	30.9%	39.8%	42.9%
Plans permitting catch-up contributions for participants age 50 and older	100%	99.0%	99.0%	98.9%
Plans matching catch-up contributions (when permitted)	39.4%	49.4%	29.0%	36.5%
Participants making catch-up contributions	44.9%	27.5%	14.4%	24.0%
Plans permitting loans	80.2%	82.2%	87.9%	87.7%
Plans allowing multiple loans	43.3%	32.6%	54.3%	47.6%

* Includes larger sized plans

Source: 52nd Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing/401(k) Council of America; copies available online at www.psc.org

Safe Harbor Plan Notice — Watch the Timing

401(k) plans that have a safe harbor design must provide eligible employees with a safe harbor notice not earlier than 90 days and not less than 30 days before the beginning of each plan year the safe harbor is in effect. Special rules apply for new plans and new participants.

With a safe harbor plan design, an employer can avoid annual nondiscrimination testing by making minimum nonelective contributions or minimum matching contributions to the plan.

New Plans

If a new 401(k) plan is established with safe harbor provisions, and the plan design provides immediate eligibility for deferrals and employer contributions (as of the effective date of the plan), a safe harbor notice must be provided anytime between 90 days before the plan's effective date and the plan's effective date.

Example: An employer adopts a safe harbor 401(k) plan effective September 1,

“The annual safe harbor notice (generally sent between October 3 and December 2 each year by calendar-year plans) covers all ongoing participants.”

2010. The plan design allows employees immediate eligibility and permits them to make deferrals and receive safe harbor matching contributions as of September 1, 2010. The employer must provide the safe harbor notice between June 3, 2010, and September 1, 2010.

Newly Eligible Participants

The same notice time frame applies to a newly eligible participant in an existing safe harbor 401(k).

Example: A safe harbor 401(k) plan has a six-months-of-service eligibility requirement. A new employee hired on March 31, 2010, will be eligible to enter the plan on October 1, 2010. The employer must provide the safe harbor notice no earlier

than July 3, 2010, but no later than October 1, 2010.

The annual safe harbor notice (generally sent between October 3 and December 2 each year by calendar-year plans) covers all ongoing participants. The same notice will cover employees who become newly eligible through the date the notice is provided.



Recent Development

The Department of Labor (DOL) has stated that an overwhelming number of filings in the Voluntary Fiduciary Compliance Program (VFCP) involve late deposits of elective deferrals and loan repayments.

Self-correction for these errors is very possible. Between the calculator on the DOL website that allows plans to compute earnings due to the plan on late deposits and the recently finalized rules for the seven-business-day safe harbor for

depositing deferrals/loan repayments for small plans,* the correction process has been greatly simplified. Hopefully, a future VFCP update will include criteria permitting self-correction methods for late deferrals and/or loan repayments.

For a number of years, Form 5500 has asked plan sponsors to disclose if any deferrals were deposited late during the year. The 2009 Form 5500 also asks if late deposits were corrected, thus allowing plan sponsors to indicate that the

plan has been made whole. This should prevent a common scenario where a plan sponsor reports a late deposit and makes the correction, only to then receive a letter from the IRS and/or the DOL about the need to make a correction.

* Note that if a small plan misses the safe harbor, interest and penalties are calculated from the benchmarked deposit date (usually three to five business days) and not from the end of the seven-day safe harbor period.

Can We Help?

Our firm offers a broad range of employee benefit plan services. If we can be of service to you, please call.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.