

PUBLICATION

How "Normal" is Your 401(k) Plan?

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In March 2013, the Internal Revenue Service (IRS) completed a design and administration survey of 1,200 different 401(k) plans and issued a summary of its findings. The survey primarily focused on the 2006 to 2008 period and included a review of common plan features and administrative practices by relative plan size. In addition to aggregate results, separate findings are provided for small plans (5 or fewer participants), medium plans (6 to 100 participants), large plans (101 to 2,500 participants) and very large plans (more than 2,500 participants). Many of the IRS "key findings" from the lengthy 91-page summary are outlined below.

Eligibility to Make Employee Contributions

- 54% of plans require one year of service. 13% have no service requirement.
- 64% of all plans require a participant to be at least age 21. The percentage decreases with plan size. 20% of plans impose no age restriction.
- 41% of plans allow election changes at any time, 22% allow changes quarterly and 13% allow changes by payroll period.
- 58% of plans had an increase in dollars deferred during the survey period. During the same time period, 52% had a decrease in the percentage of pay deferred.
- Only 4% of plans allow employee after-tax (non-Roth) contributions.
- 22% allow Roth contributions. About 2/3 of plans don't allow Roth contributions due to a lack sufficient participant interest.
- 96% allow catch-up contributions by participants who are age 50 or older.
- 6% of all plans need to make yearly corrective distributions of pay deferrals over the annual limit.

Employer Contributions

- Matching Contributions: 68% of plans provide some level of matching contributions, with higher percentages for large (81%) and very large (90%) plans. 32% have a fixed match rate, rather than a discretionary rate. Very large plans are much more prone to use a fixed match rate (61%).
- 61% of plans require a participant to be age 21 to be eligible for matching contributions and is much more prevalent in smaller plans. 23% have no age requirement, with much higher percentages in larger plans.
- 58% require one year of service for a match (much more prevalent in smaller plans), while 13% of all plans have no service requirement. 28% have an annual minimum service requirement to be eligible for a match that year, while 22% require employment at year-end and 17% have both service and year-end employment requirements.
- Employer "Profit Sharing" Contributions: 63% of all plans require a participant to be age 21, while 22% have no age requirement. An age 21 requirement decreases as plan size increases. 62% of all plans require one year of service before becoming eligible, while 11% have no service requirement. Again, a year of service requirement declines with plan size, and a zero service requirement increases with plan size.
- 20% of plans are "top heavy", with lower percentages for large and very large plans.
- 79% of top heavy plans provide the minimum contribution in the 401(k) plan.

Changes in Rates of Employer Contributions

- 1% of plans had suspended matching contributions in 2006, increasing to 4% in 2008.
- 2% of plans suspended "profit sharing" contributions in 2006, increasing to 5% in 2008.
- 1% of plans reduced profit sharing contributions in 2006, increasing to 5% in 2008.
- 15% reduced or suspended one or more employer contributions from 2006 to 2009.
- Large and very large plans were by far the most likely to reduce or suspend contributions.

Nondiscrimination Compliance

- Most plans correct excess employee contributions within two and a half months after year-end.
- More than 75% of plans distribute excess contributions as a correction method.
- 43% are safe harbor contribution plans, with higher percentages in small and medium plans.

Automatic Contributions by Participants

- 5% of plans have automatic participant contributions unless the employee elects otherwise.
- Large and very large plans are more likely to provide for automatic contributions.
- 43% of participants in automatic contribution plans contributed at the default rate.
- 29% contributed above the default rate, 21% contributed nothing and 7% contributed at a lower rate.

Distributions and Loans

- 72% of plans use involuntary cash-outs of post-termination balances, with more in larger plans.
- 62% allow some form of in-service withdrawals, with higher percentages in larger plans.
- 76% of plans allow hardship withdrawals, with more in larger plans.
- 65% of plans allow participant loans; with higher percentages in very large plans.
- 47% of plans had an increase in loans from 2006 to 2008.
- 60% of plans with loans had higher default rates from 2006 to 2008.

Other

- 1% of 401(k) plans allowed investment in employer stock, with higher percentages in very large plans.
- 86% of plans use some form of pre-approved plan document (which is not yet available for KSOPS).
- 6% of 401(k) sponsors also have a defined benefit plan.
- 7% terminated a defined benefit plan between 1995 and 2010.
- 53% of employers use a third-party administration firm.
- 83% of employers engage a third party to prepare Form 5500 Annual Returns.

Note that while employers are generally able to design or redesign a 401(k) plan, there are restrictions on the timing or permissibility of certain designs or amendments. For example, it is generally impermissible to eliminate the availability of age 59 1/2 in-service distributions, though the availability of hardship distributions and loans can be eliminated. Safe harbor contributions have more restrictions on change than do discretionary matching or profit sharing contributions. In general, it is easier to add flexibility to a participant's choices than to take away flexibility. Any employer designing or revising a 401(k) plan should understand the restrictions on future changes which may be inherent in any design.

If you would like to discuss any aspect of plan design or redesign, or should you have any other plan-related questions, please contact one of the attorneys in the Firm's Tax Department.

