THE EMPLOYEE BENEFIT
Forum
current issues in retirement benefit planning

qualified PLANS LLC

Catch-up Contributions Defined

SITUATION: In 2011, our 401(k) plan began allowing catch-up contributions. Several employees who are age 50 or older deferred $5,500 (the maximum catch-up contribution amount) more to the plan in 2011 than they had in previous years.

QUESTION: How should we treat these contributions for purposes of the dollar limit on annual additions and our annual nondiscrimination testing and top-heavy plan determination?

ANSWER: Catch-up contributions are not subject to the dollar limit on annual additions to an employee's plan account. Nor do these contributions have to be counted in your actual deferral percentage (ADP) nondiscrimination testing. In addition, catch-up contributions by key employees are not included as part of the threshold amount that triggers required minimum contributions in a top-heavy plan.

DISCUSSION: To gain these advantages, you must take care not to misclassify an elective deferral as a catch-up contribution. For example, an employee who simply contributes $5,500 more than in past years cannot choose to have that amount classified as a catch-up contribution. Rather, the tax law defines when a participant contribution becomes a catch-up contribution. To qualify, a deferral must be made by an employee age 50 or older by the end of the year *and* must exceed the maximum allowed deferral to the plan as determined by the plan document limits or by tax law restrictions.

A plan determines whether elective deferrals are catch-up contributions by comparing the total amount deferred by an employee during the year to the applicable tax law and plan limits. Here are some examples. All of the employees were age 50 or older in 2011.

- Employee #1 defers $20,000 to the plan. The $3,500 in excess of the $16,500 (in 2011) dollar limit on elective deferrals is treated as a catch-up contribution. If the plan had a lower elective deferral limit, a deferral in excess of that limit would be considered a catch-up contribution.
- Employee #2 defers $22,000 to his employer's safe harbor 401(k) plan, and his employer makes a 3% nonelective contribution of $2,000 to his account, for a total contribution of $24,000. $5,500 is considered a catch-up contribution because the employee exceeded the tax law's elective deferral limit by that amount. The nonelective employer contribution doesn't factor into the determination.

Plan Limitations Increase for 2012

The 2012 retirement plan limitations are in. And in contrast to the past two years, many limits have increased:

- Maximum annual additions to a defined contribution plan account from $49,000 to $50,000
- Maximum annual benefit from a defined benefit pension plan from $195,000 to $200,000
- Maximum annual compensation used to determine qualified plan benefits or contributions from $245,000 to $250,000
- 401(k), 403(b), and most 457 plan deferrals from $16,500 to $17,000 (catch-up contributions remain $5,500)
- Dollar limit used in the definition of highly compensated employee from $110,000 to $115,000
- Compensation limit for determining whether officers are key employees for top-heavy plan purposes from $160,000 to $165,000
- Social Security taxable wage base from $106,800 to $110,100

SIMPLE deferrals and catch-up contributions are unchanged at $11,500/$2,500.

Stop Plan Leaks

Knowing that they can dip into their plan accounts before retirement if necessary — either through a plan loan or a hardship withdrawal — can be the reassurance some employees need to join and contribute to your 401(k) plan. But you don't want your plan participants to view your plan as a household emergency fund to be used for any unexpected expense. Here are some ways you can slow the leakage of retirement assets from your plan.

Reduce Excessive Plan Loans

When they take a plan loan, many participants reduce contributions to the plan or stop them altogether. You may be able to decrease requests for plan loans by limiting the number of loans a participant can have outstanding at one time and/or the amount a participant can borrow. Educating participants on the pitfalls of taking a plan loan can also be helpful.

Restart Contributions After a Hardship Withdrawal

The problem with hardship withdrawals often isn't the effect of the distribution but, rather, participant inertia about restarting contributions. Plans generally must suspend employee contributions for six months after the withdrawal. As a matter of plan design, you can address this problem by automatically restarting the employee's elective deferrals when the suspension period ends. You might also send messages to employees who made hardship withdrawals that encourage them to restart contributions.

Encourage Rollovers

The most harm to future retirement security may come from the failure to roll over cash distributions. Use your employee education program to encourage new employees to transfer balances directly from their former employers' plans to your plan (if it accepts rollovers). And encourage retiring employees and other employees leaving your company to directly transfer or roll over their account balances to an IRA or another employer's plan.

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Educate Them and They Will Come

No matter how many automatic features your plan adopts, your employees will always have a choice: to join or not to join the plan. Providing them with financial education may help them make the right choice. Knowledgeable employees are more likely to see the value of participating in your plan and feel empowered to make the most of the benefit you're providing. Below, we answer questions you may have about the need to provide employees with retirement education.

Why do other employers offer retirement and financial education to their employees? The majority of plan sponsors look at employee education as a way to improve overall plan participation. In the Profit Sharing/401(k) Council of America's (PSCA) most recent annual survey,* 78.6% of plan sponsors surveyed said one of the reasons they offer employee education is to increase participation. About 30% said increasing participation is the primary reason they offer educational information. Some of the other reasons employers give for employee education: to increase appreciation for the plan, to increase deferrals, to improve asset allocation, to introduce plan changes, and to reduce fiduciary liability.

What types of educational materials do plan sponsors use? According to the PSCA study, the most commonly used types of educational materials are enrollment kits, in-person seminars/workshops, Internet/intranet sites, e-mail, newsletters, fund performance sheets, and individually targeted communication (see chart).

* *PSCA's 54th Annual Survey of Profit Sharing and 401(k) Plans* (for the 2010 plan year)

Types of Educational Materials Plan Sponsors Use

	(% of sponsors)
Individually targeted communication	40.4%
Fund performance sheets	44.0%
Newsletters	48.9%
E-mail	52.5%
Internet/intranet sites	59.3%
In-person seminars/workshops	63.5%
Enrollment kits	70.2%

Source: *PSCA's 54th Annual Survey of Profit Sharing and 401(k) Plans*

What educational materials do participants prefer? Another study by the Spectrem Group asked a group of 401(k) plan participants how they decide how to invest their retirement plan assets. The accompanying chart shows their responses.

How Participants Decide How To Invest Retirement Plan Assets

	(% of participants)
An interactive module on the plan website that provides investment advice	18.0%
One-on-one meetings	27.0%
Group meetings	31.0%
Hard copy written materials	56.0%
Information that can be read or downloaded from the plan website	58.0%

Source: Spectrem Group, 2011

Where do plan sponsors turn for employee retirement planning education? Most of the sponsors responding to the PSCA's survey (66.4%) rely on their current plan providers for employee retirement education. Other sources used by the sponsors surveyed include third-party education (20.7%) and advice (35.0%) firms. Slightly more than a third of plan sponsors create their own education programs.

RECENT DEVELOPMENTS
In Benefit Plans

Automatic Enrollment Update. From the recently released Profit Sharing/401(k) Council of America's *54th Annual Survey of Profit Sharing and 401(k) Plans*: 41.8% of the plans responding to the survey had an automatic enrollment feature in 2010, up from 38.4% in 2009. (The survey uses 2010 plan year experience.) Of those plans, 82.3% use the feature with new hires only, and 17.7% use it for all non-participants. The most common default deferral rate was 3%, and target retirement date funds were the most common default investment option used.

Favorable View of 401(k) Plans. An Investment Company Institute (ICI) report, *Commitment to Retirement Security: Investor Attitudes and Actions*, contains news employers should find heartening. For starters, 91% of the households responding to an ICI survey that expressed an opinion had favorable impressions of 401(k) plans, and 41% said they had a "very favorable" impression. Among respondents who had a 401(k) or other defined contribution plan:

- 92% agreed that employer-sponsored retirement accounts helped them "think about the long term, not just my current needs."
- 90% said that payroll deduction "makes it easier for me to save."
- 83% indicated that their employer's plan offered a good lineup of investment options.
- 82% agreed that the "immediate tax savings from my retirement plan are a big incentive to contribute."
- 44% admitted "I probably wouldn't save for retirement if I didn't have a retirement plan at work."

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