ADVISER TOOLBOX

401(K) PLAN DESIGN

A Q & A FOR ADVISERS

Q **What are the 2009 contribution limits of a 401(k)?**

A For 2009, participants in a 401(k) can defer up to $16,500 of their salary into a 401(k). Those over the age of 50 can make catch-up contributions up to $5,500.

The company can make a contribution on an employee's behalf in the form of a match or profit sharing. The combination of the employee contribution and the employer contributions can not exceed $49,000 for those under 50 and $54,500 for those 50 and older.

Q **Why is the Roth feature attractive as a 401(k) plan design option and what types of firms and plan sponsors use it?**

A The Roth feature has become an appealing option for many plan sponsors over the past year. Recent studies indicate that almost 40% of plan sponsors have, or are planning to add, a Roth feature to their 401(k) plan. A positive aspect of the Roth feature is that high income individuals, who are otherwise ineligible for a Roth IRA, can share the benefits of the Roth feature – something that professional service firms such as law firms, medical practices, accounting firms and consulting practices find attractive.

Q **What are the benefits of using automatic enrollment?**

A The automatic enrollment feature has been especially popular with employers who want to increase their plans' participation and savings rates. By increasing the participation, the plan is much more likely to pass testing thus allowing higher compensated employees and owners the ability to contribute more. Additionally, if the plan utilizes the new guidelines for default investments, the plan trustee will receive fiduciary protection from participants who fail to designate their investment options.

Q **What makes safe harbor an attractive provision to a 401(k) plan and what types of employers should consider it?**

A A safe harbor 401(k) plan is not subject to many of the complex nondiscrimination tests that apply to a traditional 401(k) plan. These tests limit the amount of employee contributions and employer matching contributions that may be made on behalf of highly compensated employees (HCEs). The limit is based on the level of contributions made or received by the nonhighly compensated employees (NHCEs). Thus, in a traditional 401(k) plan, low levels of participation by NHCEs generally reduce the benefits that can be provided to HCEs. A Safe Harbor 401(k) plan is not subject to these limits. In a safe harbor 401(k) plan, the amount of employee pre-tax and employer matching contributions is not affected by the level of participation of the NHCEs.

The requirements of a safe harbor plan are for the employer to match the participants at 100% of the first 3% and 50% of the next 2% of NHCE deferrals, which matching must be 100% vested. Certain available contribution alternatives provide additional employer flexibility. A safe harbor plan is appealing to sponsors of smaller companies where you have one or a few HCEs with a majority of lower wage earners – such as doctors, lawyers, engineers, accountants and other professional practice groups.

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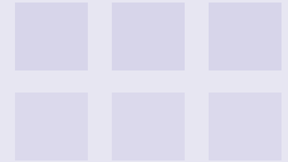

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STERLING TRUST

ADVISER TOOLBOX

401(K) PLAN DESIGN

A Q & A FOR ADVISERS

Q **What are the different types of profit sharing and what types of firms and employers find them appealing?**

A Adding a profit sharing feature to a 401(k) plan is a plan design technique that produces a larger contribution amount and it can be the ideal plan design for many employers.

This formula is what defines the different types of profit sharing plans:

- **Traditional**

  In a traditional allocation, employers will give the same percentages to all employees. For example, they might choose to give 5% of pay to each eligible participant.

  Best for: Employers who wish to benefit all participants equally.

- **Age Weighted**

  An age-weighted profit sharing plan uses both age and compensation as a basis for allocating employer contributions among plan participants. Because age is a factor, this type of plan favors older employees who have fewer years to accumulate sufficient funds for retirement.

  Best for: An age weighted plan is typically used when all of your key employees are much older than the non-key employees.

- **Integrated**

  This type of allocation method is integrated with an overall retirement scenario that includes Social Security; this combination is called "permitted disparity." By providing for permitted disparity in a qualified retirement plan, the employer gets the benefit of its Social Security tax payments.

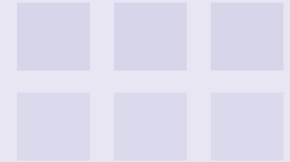
  Employees with compensation above the Social Security wage base are allowed an additional contribution on that amount. This shifts the allocation toward the higher paid employees. It favors higher paid employees by providing an additional share of the contribution to be based on compensation that would otherwise accrue minimal Social Security benefits or none at all.

  Best for: Employers that wish to benefit higher paid employees who are the same age or younger than other employees.

- **New Comparability/Cross Tested**

  In this type of plan, the employer segregates the eligible employees into "non-discriminatory" categories (i.e., job description, title, hourly vs. salaried, etc.) and designates different contribution rates for each group. This type of plan is normally designed to favor the HCEs or older employees. However, it can be designed to favor any group of employees assuming the annual non-discrimination requirements are satisfied.

  Best for: Employers who want to give different amounts to different classes of employees, typically the higher amounts given to owners or key employees. This type of profit sharing appeals to the same plan sponsors that would like to have Roth contributions or safe harbor plans - doctors, lawyers, engineers, accountants and other professional practice groups.



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