Provisions That Make Your 401(k) Plan A Bigger Employee Benefit

By Ary Rosenbaum, Esq.

I worked for about 12 years for employers and had enough. I was a malcontent. That being said, most employees never want to start their own practice and like the workplace environment. While they may like working for you, you need to have empathy and understand that workplace benefits are a good tool to recruit and retain employees. Your 401(k) plan is an employee benefit and you need to treat it as such. You need a cost-effective plan that engages your employees so they will participate and some features are nicer than others. This article is all about plan provisions that could make your 401(k) plan more attractive to employees and potential employees.

Eligibility

In the days when I was a malcontent and looking for the next place to work, a big strike was any potential employer that required a full year of service before I could defer in the 401(k) plan. I understand why any employer would want you to complete a full year to get an employer contribution. As a 401(k) plan sponsor, you may not want to give an employer contribution to a part-time employee or an employee who flamed out in 3 months. In this day and age, I think you should have immediate eligibility or something as little as 3 months for new employees to become eligible for salary deferrals. For discrimination testing on deferrals, you can still test the plan as if you still had an age 21 and One Year of Service eligibility. People caution on a small or no eligibility requirement for deferrals because that would lead to a small account balance because of high turnover. I believe that high turnover is a problem you should tackle first. Small account balances may be fixed through the exercise of the involuntary cash-out rule where you can cash out participants without their consent if it falls below the cash-out limit (being increased to $7,000). Thanks to the implementation of the Long Time Part Time rule for salary deferrals (where you can no longer exclude long-term, part-time employees from deferrals), the reasons for not having very liberal eligibility for deferrals Peter out. My wife and I have turned down job opportunities and each turned down opportunity required a full year, just to defer in the 401(k) plan. You can lose on some great candidates if you require a year for eligibility for salary deferrals.

Employer contributions

The major reason that businesses switched from pension plans to 401(k) plans is because it cut down on costs. The burden on funding retirement went from the employer to the employee since most contributions to a 401(k) plan are participant salary deferrals. So while your employees will fund their retirement, employer contributions go a long way. They go a long way because it's an attractive benefit to recruit and retain employees. Whether it's a non-elective (profit sharing) or matching contribution, employees and potential employees will see this as an attractive employee benefit. In addition, contributions you make are tax deductions on your business return. Some plan design formulas such as cross-tested non-elective and/or safe harbor contributions, can produce a better benefit for highly compensated employees, which would include owners of your business. Safe harbor contributions will help satisfy the contribution testing issues of your plan while providing a fully vested contribution to your employees. Obviously, not every plan sponsor can afford to make employer contributions, but any chance you can make one can help you with providing a substantive and attractive employee benefit.

Hardship distributions

The wisest person I know, my Grandmother Rose said that life never goes to plan. She never participated in a 401(k) plan (she had a union pension plan as a seamstress), but she would probably approve of the idea of a hardship provision. Hardships allow participants to withdraw money from

their 401(k) plan based on a definition of what constitutes a hardship. Whether it's for medical expenses, stave off an eviction or foreclosure, or funeral expenses, it's an option that most 401(k) plans offer. There are many plans out there that don't want to offer it because of the belief that retirement savings are for retirement. As someone who had 5 feet of water in my house because of Hurricane Sandy, I would like the hardship provision of my plan that allowed for one because of a casualty loss. That wasn't the plan when I started saving for retirement back in 2000 (after I had to complete that Year of Service), but climate change, changed things. In the end, it's the participants' money and if they really and truly need it, don't be the gatekeeper that could cause them financial ruin if they can't access their 401(k) account in case of an emergency.

Loans

Like with hardship distributions, I think allowing loans is beneficial for participants. It's their money and if your plan allows for participant-directed investments, the loan is their directed investment because any interest they pay is added to their 401(k) account balance. Again, like with hardship distributions, life doesn't go to plan. There are many reasons why people take out loans and many of the reasons are because they don't have an allowable basis for a hardship distribution. It's not wise to use your 401(k) plan to fund current needs, but there are times when people really need to take out a loan. To avoid administrative headaches, I suggest allowing a loan provision but allowing only one loan outstanding at a time with a $1,000 minimum.

In-Service distributions

In the days of pension plans, distributions were usually not allowed until actual retirement. 401(k) plans can allow an in-service distribution for employees, even if they still work for you. With salary deferrals, there can be no regular in-service distributions before the attainment of age 59 ½. I think allowing older employees to tap into their 401(k) plan while still working is an attractive benefit. It's attractive because it allows them to plan for retirement. They can take a distribution in cash or move the money out to an Individual Retirement Account. I can't recall the last time I drafted a plan without an in-service distribution at age 59 ½ and/or attainment of Normal Retirement Age. It makes no sense, not to offer it.

Vesting

In the days of pension plans and ERISA, employees might have needed 20 to 30 years in order to achieve 100% vesting in their employer contributions. Since ERISA went into effect in 1976, the number of years required to achieve full vesting has been shrunken to a maximum of 6 years. While I'm not suggesting that you offer full and immediate vesting, a schedule that is more liberal than a 6 years graded schedule (0% vesting until 2 years, then 20% a year until 100% full vesting after 6 years) will be seen as an attractive recruitment and retention tool.

Investment Advice

If you offer participant-directed investments in your 401(k) plan as almost all daily valued plans do, you will try to seek liability protection under ERISA §404(c) for losses sustained by plan participants in their account. To achieve that protection, you need to give enough information for participants to make informed investment decisions. That is general investment education, provided by your financial advisor. That also means you have to meet with your advisor, create an investment policy statement, and make fund changes and choices when needed. Investment education is general principles, not based on specific investment advice. Investment advice is specific investment choice guidance, tailored to the current and future needs of the individual participant. Participants who get investment advice do better in their returns than a participant who just gets general investment education. To engage your participants, and get better participation, and outcomes, I recommend you work with your financial advisor to offer investment advice. That could be one-on-one meetings or the use of a web interface. Regardless of the delivery, I recommend offering it.

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