



401(k) Plan Enrollment – Making it Automatic

Approximately 47 million Americans actively participate in 401(k) retirement savings plans. Despite their popularity, however, 401(k) plan participation rates aren't what they should be at some companies. Be it for lack of motivation, lack of understanding, or other reasons, some employees who are eligible to join a 401(k) plan simply don't.

Low participation among a company's non-highly compensated employees can make it difficult for a plan to pass the tax law's nondiscrimination tests, forcing the company to restrict deferrals by highly compensated employees. Increasing overall participation can make it possible for highly paid employees to take full advantage of the 401(k) plan, in addition to improving the retirement outlook for all employees. Automatic enrollment is one approach employers are using to boost participation.

How It Works

With automatic enrollment, pre-set elective deferrals to the 401(k) plan begin as soon as an employee becomes eligible to participate, unless the employee elects to opt out or have another amount contributed. The set percentage is withheld from the employee's pay and deposited in the plan.

Example. Acme's 401(k) plan provides for an automatic enrollment contribution of 3% of eligible compensation. Jason begins working for Acme and is immediately eligible to participate in the plan. He does not opt out of making a plan contribution or choose to contribute a different amount. As a result, Acme begins to withhold 3% of Jason's compensation, contributing the money to his plan account.

To implement automatic enrollment, the employer notifies each eligible employee of the arrangement and of the employee's right to choose not to make contributions. Employees must be given sufficient time after receiving the notice to elect not to participate in the plan and have the option of changing their elections in the future.

Pension Protection Act Incentives

The 2006 pension law provides several incentives for employers to adopt automatic enrollment.

Prohibitions on withholding.

Conflicts with state laws on wage withholding without employee consent have been eliminated.

Default investments.

Employers will be protected from fiduciary liability for the investment of contributions made to the plan through automatic enrollment, provided the plan follows U.S. Department of Labor guidelines regarding default investments.

Non-discrimination safe harbor.

401(k) plans have the option of following certain safe harbor rules that will allow them to avoid the tax law's top-heavy rules and bypass actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination testing. The safe harbor requires:

- First-year automatic contributions of no more than 10%, with a minimum contribution of 3% of pay, increasing by 1% annually up to 6% of pay in the fourth year;
- Mandatory employer contributions, either in the form of matching contributions on up to 3.5% of compensation or non-elective contributions of at least 3% of compensation;
- 100% vesting of these employer contributions after two years of service; and
- Compliance with certain notice requirements.

Inside this issue:

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Choosing a default investment for your 401(k) plan

Evaluating your plans features

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Choosing a Default Investment for your 401(k) Plan

Traditionally, many 401(k) plans have had a default investment — an investment that is used when employees neglect to make a decision about how to invest their plan accounts. Now, with the trend toward automatic enrollment, government regulators are focusing more attention on the types of investments that plans are using as a default. If you sponsor a 401(k) plan or a similar retirement plan, new guidance from the U.S. Department of Labor (DOL) will be of interest to you. Contributions and Participation

Liability Relief

When a plan invests an employee's contributions in a default investment, the employer may be liable for investment losses if the investment doesn't perform well. But now there's a qualified default investment alternative (QDIA). As long as a plan meets all of the DOL's requirements, a QDIA provides relief from fiduciary liability (though the employer must still prudently select the default investment).

Qualified Investments

In its regulations, the DOL spells out the categories of investments that qualify as QDIAs. They include lifecycle and targeted retirement date funds that take into account an individual's age or retirement date, as well as funds that take into account the group of employees as a whole, such as balanced funds. Professionally managed accounts that take an individual participant's characteristics into consideration also qualify. Stable value and money market funds, which frequently have been used as default investments in the past, can be QDIAs only for the first 120 days after the employee's first elective contribution. A QDIA generally cannot hold securities issued by the employer.

Other Requirements

To qualify for fiduciary relief, certain requirements must be met. Before investing your employees' contributions in a QDIA, your plan must give the

employees the chance to direct their own investments. And the plan must permit employees to transfer out of the QDIA and into the other investments your plan offers with the same frequency available for the other plan investments (at least quarterly). You also must provide plan participants with certain notices and investment information.

2008 Pension Plan Contribution Limits

401(k) Elective Deferrals
\$15,500

Catch-up Contributions
(*must be age 50 or over by 12/31*)
\$5,000

Defined Contribution Plans
\$46,000

Annual Compensation Limit
\$230,000

Highly Compensated Employee ("HCEs")
\$105,000

Retirement Plan Update

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Evaluating Your Plan's Features

Studies show that 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 design is to compare the plan's features to a benchmark, such as the Profit Sharing/401(k) Council of America's (PSCA) Annual Survey of Profit Sharing and 401(k) Plans. The most recent survey published reflects 2006 plan year experience*

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 78.9%. Participation is greatest in plans that offer both a fixed and discretionary match (87.9% average participation rate) and — not surprisingly — lowest in plans with no employer match (65.3%). The average deferral of lower paid participants, as the ADP tests define them, is 5.4% of pretax pay, while higher paid participants defer 6.9%.

Company 401(k) contributions average 3.0% of pay (5.7% in combination profit sharing/401(k) plans). The most common matching formula is a fixed match (29.5% of plans). Among plans with company matches, 18.1% offer a graded match based on the percentage of pay deferred. The most common fixed-match contribution (32.2%) is 50 cents per dollar of the first 6% of pay deferred. A dollar-for-dollar match of up to 4% of pay is the choice for 9.8% of plans, and 6.4% offer a 50-cents-per-dollar match of the first 4% deferred.

If you find that 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 five).

Plan Investments

The vast majority of 401(k) plans (87.5%) allow loans. Most charge some type of loan fee to participants — loan origination fees being the most common. Fewer than half of the plans allow multiple loans, and nearly all have a minimum loan amount.

In 84.2% of the plans surveyed, this minimum loan amount 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.

** 50th Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing/401(k) Council of America; copies available online at www.pasca.org.*

How Does Your 401(k) Plan Compare?

Rates and Features Offered	Plan Size by Number of Participants			
	1-49	50-199	200-999	All Plans*
Average employee participation rate	85%	85%	78.8%	78.9%
Average pretax deferral for nondiscrimination testing				
Higher paid employees	7.3%	7.1%	6.7%	6.9%
Lower paid employees	6.1%	5.9%	5.1%	5.4%
Type of match (where offered)				
Fixed	96.7%	85.5%	84.2%	78.5%
Graded	3.3%	14.5%	15.8%	19.7%
Plans permitting catch-up contributions for participants age 50 and older	94.6%	100%	96.9%	97.4%
Plans matching catch-up contributions (when permitted)	48.6%	44.3%	28.0%	30.0%
Participants making catch-up contributions	34.1%	30.3%	13.7%	21.2%
Plans permitting loans	77.2%	71.6%	91.1%	85.2%
Plans allowing multiple loans	34.9%	38.6%	44.9%	45.9%

* Includes larger sized plans