How 401(k) Plan Sponsors Can Encourage Their Employees to Defer $$$$$

By Ary Rosenbaum, Esq.

For some reason when I was growing up, my mother decided to make the living room a no man's land (only for parties and special occasions) because it needed to be the perfect room. I never understood that because things that serve a purpose are meant to be used. The same can be said about 401(k) plans. They are adopted by employers to encourage retirement savings by their employees by providing this wonderful employee benefit. The problem is that participant deferral rates are still mediocre and employers don't do a whole lot to encourage their employees to contribute on their own. This article is why you should encourage your employees to save for retirement and the ways you can encourage them to do so which benefits them and more importantly, benefits you as an employer/plan sponsor.

Why you should encourage your employees to contribute to a 401(k) Plan

A 401(k) plan is considered as an employee benefit, but too many employers fail to stress that point. The plan was supposed to be implemented so employees can save for retirement. Since the 401(k) plan is probably the only retirement plan you sponsor, it's important to encourage your employees to contribute on their own to a 401(k) plan because you want your employees to save for their retirement. You also want to encourage your employees to participate in the plan because it's supposed to be an employee benefit. Having them actively deferring money in the plan will make them acknowledge that you have provided them with a benefit that can help in your efforts to retain the employees you value. In addition, having your rank and file employees defer into the plan also helps with the discrimination and compliance tests that help your highly compensated employees (including the owners) to maximize their contributions under the plan. Plans with low deferral percentage rates by the rank and file employees may be required to either make employer funded contributions to them or a refund of salary deferrals to your highly compensated employees. So there are many reasons why you should encourage your employees to defer. How to encourage deferring? Well, that's the hard part.

Automatic Enrollment

Instead of encouraging people to voluntarily defer into the 401(k) plan, you can have them involuntarily defer. Automatic enrollment allows you to automatically deduct elective deferrals from your employees' wages unless they make an election not to contribute or to contribute a different amount. You must give your employee the option, before any deferrals are withheld from their wages, to have none withheld or to have a different amount withheld. Employees may also have the option to withdraw their money within 90 days of the date that the first automatic contribution was made. When it was initially created, thanks to some Internal Revenue Service guidance in the late 1990's, it wasn't popular because it offered employer no fiduciary liability relief on plan investments since a participant who automatically deferred did not direct their own investments if the plan allowed them to. Thanks to the Pension Protection Act of 2006, your liability is limited if you offer automatic enrollment and deferrals from that would be deposited into an investment option that would be designated as a Qualified Default Investment Alternative. Many employers shy away from automatic enrollment because they feel that employees would be upset once they saw their paychecks after they were automatically enrolled, but the rate should be set low. Since the automatic percentage limit could be as high as the salary deferral limit for those who contribute voluntarily, the limit should be placed at the 3% to 7% range to be effective. While some people scoff at Automatic Enrollment as a cheap gimmick to inflate the deferral percentage rate of the rank and file employees, it can be used as an effective means of increasing that deferral rate as well as increasing the size of assets in your plan, which decreases the percentage of assets that are used to pay administrative fees. In addition, if you have some effective ways of communicating about the plan (as this article will discuss) to your employees, you may be able to convert those who automatically defer to those participants who actively defer.

Curtailing Salary Deferral Eligibility from less 1 Year

While I understand why employers require a participant to complete a Year of Service in order for participants to be eligible to receive a profit sharing or matching contribution, there is very little reason why plan sponsors should require a Year of Service for participants to be able to make salary deferral contributions in a 401(k) plan. The reason is because even if a plan sponsor would require no service or six months of service as an eligibility requirement for deferrals, the otherwise excludible rule would allow salary deferral testing (the ADP test) to be conducted as if the salary deferral eligibility was age 21 and a Year of Service (by segregating those who have less than a Year of Service). The only down- sides are that administrative costs would be increased because third party administration firms typically have a per participant charge and there is a concern with employee turnover that there will be many small account balances of former participants in the plan. The reasons those downsides can be dismissed is because most 401(k) plans have their administration fees paid by the participants' account balances and there are mechanisms to rid 401(k) plans of small account balances of $5,000 or less belonging to plan participants who are former employees. In addition, allowing participants to start deferring income from their date of hire will increase plan assets, which may lower costs as a percentage of assets because of the economies of scale. The ability to allow participants to defer quickly is a statement that the employer is encouraging retirement savings and it becomes a rather attractive benefit to entice potential employees and to retain current employees.

Matching Contributions

This is the one idea that will encourage plan participants to defer money into the plan, but will actually cost you money. A matching contribution is what it says it is, it a is a contribution made by employer that is tied to participants making salary deferral contributions. This contribution can be mandatory (through a stated formula) or discretionary. Matching contributions for a participant can be like a carrot to a bunny, it can entice them to change their behavior. Matching contributions are a great inventive way for plan participants to defer their salary into their 401(k) plan. While matching contributions are costly, they can be an effective means to increasing the participant deferrals into your plan.

Education and Investment Advice

Too often plan participants don't defer because they are overwhelmed by the information provided for the 401(k) plan. For example, studies have shown that plans with more investment options have depressed deferral rates because it increases confusion for plan participants, so they don't defer. The cure for that is investment education and/or investment advice. Education is about basic investment principals and is not tailored to the specific retirement needs of participants. Investment advice is specific investment advice, tailored to the needs of the participants. Advice can only be offer by plan providers that serve in a fiduciary role and go through a process to ensure that such advice is neutral. It is paramount to offer some sort of education because it will help plan participants eliminate some of the confusion that participating in a 401(k) plan entails. In addition, try to liven up the plan enrollment meetings. I've been to too many and with many of them, I can't tell whether I'm at a funeral or an enrollment meeting. Considering offering gift cards raffles to spur attendance or serve food (free food goes a long way) at the meeting If you show excitement and interest in your 401(k) plan, it's likely to spur interest as well.

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