Lawley | RETIREMENT ADVISORS

The Retirement Times

JULY 2022

Safe Harbor Options

401(k) plans are intended to provide comparable advantages for all employees, and there are numerous safeguards in place to make sure their benefits are allocated equitably. U.S. regulatory measures ensure that a company's plan does not disproportionately benefit some employees over others, regardless of their income or ownership status. To evaluate whether the plan is administered in an even-handed manner, the IRS conducts annual nondiscrimination tests. Failure of any of these tests can result in significant — and costly — additional contributions or required corrective distributions to some employees.

Nondiscrimination Testing

There are three primary tests most people think of when they hear "nondiscrimination tests:" the Actual Deferral Percentage test, the Top-Heavy test, and the Actual Contribution Percentage test. All three tests judge a plan's overall fairness toward the employees served, but they use different metrics, and measure different plan items (different types of contributions or account balances) to make these determinations. By comparing deferral rates, contributions and asset balances among highly compensated and non-highly compensated employees, they assess whether plans disproportionately benefit higher paid employees, such as management and owners.

Safe Harbor Plans

Failure of nondiscrimination testing can result in the plan having to make qualified nonelective contributions for employees that are not highly compensated. Your plan might even lose its qualified status — and the tax benefits that go along with it if rules are not met in terms of passing testing or taking proper corrective actions. Fortunately, safe harbor plans can help you avoid these tests by preemptively meeting requirements for fairness through the plan design itself. There are four different types of deferrals that employers can make through safe harbor plans: nonelective, basic, enhanced and qualified automatic contribution agreement (QACA). Adopting safe harbor design results in less administrative burdens, and as a result often results with lower administrative costs for the plan.

Nonelective. A nonelective safe harbor plan requires employers to make automatic contributions to their employees' plans that are equal to or greater than 3% of annual compensation for every employee eligible to participate. This type of plan benefits employees whether they choose to defer or not. If a plan sponsor wants to adopt a safe harbor design retroactively they can do so after the plan year (within certain parameters) if they raise the nonelective contribution to 4% of annual compensation for all eligible employees.

Basic. A basic safe harbor plan features what's known as a basic match. This means that employers simply match 100% of their employees' contributions, up to 3% of their annual compensation plus 50% match on employee contributions on the next 2% of pay (for a total potential match of 4% on 5% of pay).

Enhanced. An enhanced contribution is any contribution that's greater than those offered by a basic safe harbor plan. This is typically a 100% match of up to 4% of an employee's contribution. For growing businesses, these types of plans can be especially attractive to new talent with several competitive job offers under consideration. Vesting is immediate for nonelective, basic and enhanced match plans.

Qualified Automatic Contribution Arrangement. QACA plans automatically enroll eligible workers (who can opt out) and employ an auto-escalation feature that increases employee contributions by 1% annually until they reach 6%. To qualify for this type of plan — and avoid nondiscrimination tests — employers must select one of two options. The first is for employers to match 100% of an employee's contribution of the first 1% of their annual compensation, plus 50% of the employee's contributions on the next 5% of compensation (for a potential total of a 3.5% match on 5% of compensation). The second option is to provide a nonelective contribution of 3% of annual compensation to all eligible employees, including employees who do not contribute. Vesting must take place within two years of employee service.

Why You Should Consider Safe Harbor

In addition to potentially saving you administrative work and your plan participants some administrative cost, safe harbor can also unlock savings opportunities for your highly compensated employees that may be presently limited while concurrently helping all of your employees save for retirement. For employees, most types of safe harbor plans guarantee fast or immediate vesting and allow them to potentially grow their nest eggs more quickly due to the provision of matching contributions. For employers, these attractive plans can fuel recruitment initiatives and boost employee morale by empowering workers with more robust tools to improve their financial wellness. Sponsors must weigh the tradeoff of increased payroll costs in light of lower administrative burdens and the eliminated risk of penalties resulting from failed nondiscrimination testing. Especially if you're planning on offering a match anyway, you should consider the advantages a safe harbor plan offers.

That said, it is important to also consider alternative ways to meet your organizations' goals. Safe harbor plan design can be a blunt, and sometimes limited, instrument that's more expensive than necessary if the organization's goals is really to ensure compensation replacement for a class of highly compensated employees. In many instances creation of a non-qualified plan may be a more precise tool to accomplish your organizational goals . . . and many times it's much less expensive than the safe harbor design options. Regardless, it's worthwhile to explore all of your options with your plan advisor.

Sources:
https://money.usnews.com/money/retirement/401ks/articles/what-you-need-to-know-about-a-safe-harbor-401-k
https://www.napa-net.org/news-info/daily-news/case-week-401k-after-tax-contributions-are-%E2%80%98testy%E2%80%99
https://www.employeefiduciary.com/blog/traditional-safe-harbor-401k-plan-vs.-qaca-how-to-choose
https://www.investopedia.com/terms/q/qualified-automatic-contribution-arrangements-qacas.asp
https://www.irs.gov/retirement-plans/faqs-auto-enrollment-are-there-different-types-of-automatic-contribution-arrangements-for-retirement-plans
https://www.irs.gov/retirement-plans/401k-plan-fix-it-guide-the-plan-failed-the-401k-adp-and-acp-nondiscrimination-tests
https://www.irs.gov/retirement-plans/faqs-auto-enrollment-are-there-different-types-of-automatic-contribution-arrangements-for-retirement-plans

5 Ways You Can Benefit from Partnering with a Retirement Plan Advisor

From decoding key ERISA regulations to keeping abreast of fees and providing educational support to workers, there are many responsibilities that sponsors possess. Some business owners even forgo offering a 401(k) to their employees because they fear they don't have the time or expertise to manage a plan.

However, whether it's helping to attract and retain top talent or providing valuable tax advantages, a robust retirement offering is a major asset to an organization. To take advantage of these benefits, but still have time to run day-to-day operations, sponsors can avail themselves of an invaluable resource — a retirement plan advisor. Here are a few reasons to consider bringing in an expert.

Plan Design and Upkeep

There isn't (or shouldn't be) a one-size-fits-all approach to plan design. Factors such as business size, participant needs, and employee pay levels can all affect what kind of plan might be optimal for you. An advisor can design a plan that meets your business goals and customize your fund lineup, set vesting schedules and procedures, incorporate or omit revenue sharing features, determine qualified default investment alternatives and more.

Plans can also be tailored to meet the needs of your employees. For example, new hires who have recently graduated with high student loan debt may have different objectives and concerns than highly tenured individuals. Growing businesses can also benefit from an advisor because they can find options that will keep fees reasonable and help prevent your plan from running afoul of ERISA regulations.

Participant Outreach

One of the key steps to promote positive plan outcomes is by encouraging a high participation rate. This helps your plan avoid becoming top-heavy and assists with passing required nondiscrimination testing. Skilled and experienced advisors leverage plan design features and multiple outreach methods to encourage employee participation. Seminars, one-on-one consultations, and educational content can help them feel motivated to contribute and empowered to save for retirement.

Reduced Fiduciary Risk

An advisor can help mitigate fiduciary risk by assuming some of the responsibility. A 3(21) fiduciary will share fiduciary responsibility and make recommendations for selecting and replacing investment options, while a 3(38) fiduciary is delegated the actual responsibility to manage plan assets. However, the sponsor is ultimately responsible for ensuring that the fiduciary is properly appointed and monitored. Which type of fiduciary you choose to work with will depend on your needs, but either way, hiring an advisor can help you keep your fees transparent and reasonable — and ensure investments perform well enough to merit continued inclusion in the fund lineup. Excessive

fee litigation is becoming more commonplace, and it can be costly. You want to do all you can to avoid finding yourself in the crosshairs of a 401(k) lawsuit, and in the unhappy circumstance that you do find yourself there, you want the confidence that you understood prudent processes and have the proper documentation of same.

Compliance Support
Sponsors who run their own plans have their work cut out for them to maintain compliance. By working in conjunction with your other service providers and retirement plan committee, advisors can help ease administrative burdens. Market changes, mergers and acquisitions, and regulatory changes could affect plan design and investment lineup decisions. A retirement plan advisor can help you stay abreast of any developments that may affect your organization.

The Advisor Advantage
The upkeep of a retirement plan can feel overwhelming at times. Though some sponsors attempt to run their plans on their own, those who hire advisors have a built-in support system that can help ensure their retirement plan is a net benefit, instead of a burden.

Have You Met Your Match?

Just how important is a 401(k) match to your employees? It appears to be top of mind, according to Principal's 2021 Retirement Security Survey. The study's results show that the match matters most, as the top retirement plan considerations of survey participants when considering a new job are as follows: employer match (91%), eligibility requirements (80%), vesting requirements (74%), investment options (73%) and withdrawal options at job change or retirement (70%).

Moreover, one in four respondents indicated that they were considering retiring from their job or looking for a new one over the next 12 to 18 months. In an especially tight labor market, this means employers need to do all they can to attract top talent to their organizations.

How Do You Stack Up?
With employer match on the minds of workers, and many considering making a career move in the near future, it makes the following question all the more important: "What are your competitors doing to assist their workers in planning for retirement?" Here's a roundup of some recent data on employer trends.

Employer contributions. According to U.S. News & World Report, the average 401(k) employee contributions for Vanguard retirement plans in 2020 was 7%, with employers contributing an additional 4% to their accounts. Still, total contributions continue to fall short of the goal of 15% of annual income frequently recommended by many financial advisors.

Match formulas. T. Rowe Price's Reference Point benchmarking report of 674 retirement plans, published in June 2021 details the top five employer-match formulas for their defined contribution plans in 2020:

50% up to 5% (20%)
100% up to 3% + 50% up to the next 2% (19%)
100% up to 4% (12%)
100% up to 6% (11%)
100% up to 5% (9%)

Vesting schedules. XpertHr's 2021 Employee Benefit Survey, as reported by CNBC, asked 452 U.S. employers how long their matches take to vest. Results were as follows: immediate (28%), one year (13%), two years (7%), three years (14%), four years (6%), five years (17%), six years (10%) and unknown (5%).

Show Them the Money

According to CNBC, more than 40% of workers say it would take "a miracle" for them to be financially prepared for retirement. At this time, it's advisable to look at your retention numbers and peruse your exit interviews. Are many human resource losses likely related to a perceived weakness in your retirement plan? Compare your defined contribution offering, especially in the above spheres, to what other organizations in your industry and area are doing. Because it's more than likely that, if you don't, at least some of your current employees will be in the near future.

Sources:
https://www.troweprice.com/content/dam/ide/articles/pdfs/2021/q2/reference-point.pdf
https://www.cnbc.com/2021/09/14/36percent-of-americans-say-they-wont-have-enough-to-retire-report-finds.html
https://money.usnews.com/money/retirement/401ks/articles/how-much-should-you-contribute-to-a-401-k#:~:text=The%20average%20401(k)%20contribution,of%20their%20salary%20for%20r
https://www.cnbc.com/2021/06/17/most-workers-wait-years-for-company-401k-matches-to-vest.html
https://businessrecord.com/Content/Insurance-Investments/Insurance-Investments/Article/-span-style-font-weight-bold-Principal-span-Retirement-Security-Survey-Tight-labor-market-talent-competition-will-drive-2022/171/833/95977?s=1
https://landing.principal.com/financial-wellness/4-insights-consumer-financial-behavior
https://smartasset.com/retirement/how-much-in-401k-to-retire

For more information, please contact your financial professional at 1.844.4Lawley

To remove yourself from this list, or to add a colleague, please email us at info@lawleyinsurance.com.
www.lawelyretirement.com

*Securities and investment advisory services offered through **Royal Alliance Associates, Inc. (RAA)** member FINRA/SIPC. Additional advisory services offered through Lawley Retirement Advisors. **RAA** is separately owned and other entities and/or marketing names, products or services referenced here are independent of **RAA.*** ACR# 4777692 06/22