SAPERS & WALLACK

# Retirement Report

Volume 11, No. 9

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## To Loan or Not to Loan?

As you re-evaluate your retirement plan's design, consider asking yourself, "Should our plan continue allowing participants to take loans from their retirement accounts?"

If your retirement plan currently permits loans, you are not alone. According to the Profit Sharing Council of America's (PSCA) recently published 55th Annual Survey of Profit Sharing and 401(k) Plans, loans are permitted in 88 percent of profit sharing/401(k) plans.

Many mistakenly believe that the loan provision enhances the plan and encourages participation. On the contrary, participants utilizing the loan option substantially reduce their savings potential. And contrary to myth, loan elimination does not deter participation. This is why plan sponsors are increasingly embracing and adopting a "courageous" plan design philosophy to eliminate loans. There are many concerns:

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- As loan assets are removed (borrowed) from the plan, they are not invested in the plan's offerings and may result in a lost opportunity for asset growth.
- While it is true that the participant is repaying himself/herself, the after-tax interest paid on plan loans (which can be considerable) is added to the participant's account as a "pretax" deposit by the plan's record keeper, resulting in "double taxation" when the account is eventually paid out.
- Loan setup and maintenance fees may apply.
- Participants often elect to reduce or suspend contributions during the repayment period, resulting in diminished accumulation.
- Termination of participant employment most often triggers immediate and full loan repayment; participants unable to do so incur taxes and, in many cases, penalties.
- Loans require plan sponsor administration, which can be time-consuming, cumbersome and costly.

The continued allowance of loans should not be assumed or taken lightly. Consider adding it to the agenda of your next fiduciary committee meeting. Does the loan provision further your committee's efforts to maintain a successful plan? If the answer is not a resounding "yes," then consider taking action to eliminate it. As always, act in the best interests of your participants and their beneficiaries.

*— Charles Catagnus, Senior Plan Consultant, and Veronica Lee, Senior Vice President, Client Services*

## Understanding Plan Eligibility

Is your company's eligibility attracting and retaining quality employees? Is it competitive with other companies?

Eligibility is a waiting period and an age requirement for participants to meet in order to become eligible for a retirement plan. Some plans may also require an employee to work a certain number of hours to become eligible, and there may be ongoing requirements to receive company contributions.

The maximum waiting period that a company can choose is two years, and the age requirement cannot exceed 21. If a plan has a two-year waiting period, the employee must be 100 percent vested immediately in employer contributions. The maximum number of hours that an employee can be required to work to become eligible is 1,000. Immediate eligibility is permissible, and plans are not required to have a waiting period, age requirement or hours worked requirement. Most companies have a waiting period of one year or less and choose age 21 or age 18 as the age requirement. To align with other employee benefit plans, companies will commonly choose the same waiting period as they have for their other employee benefits. As an ongoing requirement, companies can require employees to be employed on the last day of the plan year and/or work at least 1,000 hours during the 12-month plan year to be eligible for a company contribution.

Plans can have different waiting periods for employee contributions and employer contributions. For example, companies can choose dual eligibility and allow employees to begin contributing their own contributions after three months of employment, but complete a year of service to be eligible for company matching contributions. Companies will consider this option if employer matching cost and employee turnover are a concern. Once an employee has met the eligibility requirements for the plan, they will enter the plan on established intervals. These entry dates can be anywhere from immediate entry (first pay period after meeting eligibility requirements) to an annual entry date, which is only available if the plan has immediate eligibility and no waiting period. Common entry dates are immediate, monthly and quarterly.

For plans that choose a waiting period of less than one year of service and less than age 21, annual ADP/ACP nondiscrimination testing rules allow plans to test the group of employees with less than a year of service and less than age 21 separately from those who have met one year of service and age 21. The annual ADP/ACP nondiscrimination testing compares the average contributions from highly compensated employees to non-highly compensated employees, and if the difference between the averages is above the permissible amount, a correction needs to be made to pass the test. This usually results in taxable refunds back to highly compensated employees. Generally speaking, plans have lower participation from shorter term employees, and companies can choose to use the test with the more favorable results: those with a year of service and age 21 or those without.

A company's eligibility requirements should be monitored to ensure that eligible employees have access to the plan. Also, companies should have automated processes in place to administer their eligibility requirements effectively.

## Health Care Reform Overview and Retirement Plan Implications

**Pre-2014 Outlook**

Balance Competitive Advantage and Cost Management

- Current benchmark: competitive offering and cost management techniques.

**2014 and Beyond Development**

New Options and New Benchmarks

- Availability of individual coverage through public exchanges.
- The Affordable Care Act sets new floor (now effective in 2015) and ceiling (effective in 2018) for large employer-sponsored health coverage.

**Impact**

Cost Impact for Some, Consulting Opportunity for All

- Predictable financial impact of employer mandate.
- Key to consulting is demonstrating the variety of options available.

**Opportunity**

Call to Action

- Plan sponsors must partner with brokers and consultants who will guide them through the uncertainty.
- Begin talking about employer's health plan strategies now to learn about retirement opportunities.

**Three important questions for retirement plan sponsors:**

1. Do you plan to offer health coverage in 2014?
   There is a lot of speculation about how many employers will stop offering health plans because of health care reform, particularly now that the employer mandate provisions are postponed until 2015. As employers think more strategically about whether and why they offer health benefits, the retirement plan can be an increasingly important component to an employer's total rewards package.
2. Are you planning to make changes to your workforce?
   One of the most talked about strategies to minimize health care reform costs is workforce management. Since health care reform's employer penalties are based on the number of full-time employees, many employers have or are considering cutting hours below 30 hours a week. That change could affect the number of employees eligible to participate in the retirement plan.
3. Are health benefits part of your executive compensation package?
   Health care reform imposes new nondiscrimination requirements for some health plans, making it more difficult for employers to use executive health plans as part of the executive compensation package. As a result, there is a growing interest in tax preferred retirement benefits for key employees and executives.

This information was originally published by Manning & Napier in their *2013 Health & Wealth Resources for Retirement Plan Advisors.*

## Are You Excluding Part-timers from the 401(k) Plan?

Many plan sponsors mistakenly believe that they are not required to offer the retirement plan to part-time employees. Regardless of what type of retirement plan you have, all part-time employees must be offered the retirement benefit. Though your plan may contain a service requirement that essentially prevents "part-timers" from ever becoming eligible (such as a one-year and/or 1,000 hours requirement), part-time employees may not be excluded as a class of employees.

If you have not informed your part-time employees that they are eligible to participate in the retirement plan, please contact your plan consultant to discuss immediate corrective measures.

## Communication Corner: Capital Preservation Funds

This month's sample employee memo is Part Three of our six-part series in which we answer common participant questions. In part three, we answer the question, "Our plan offers a capital preservation fund. What is its purpose and how can I best use it?"

Call or email your plan consultant if you have questions or need assistance.

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SAPERS & WALLACK

# We're Listening to You!

We are pleased to present the third installment in our six-part series, answering the most common questions we receive from you, our participants, on the path to becoming retirement ready.

We are committed to helping you retire on time and to keeping you informed. The more questions you ask and the more active you are in your retirement plan, the more we can focus on what is important to you. Let's keep this communication going!

## Question:

Our plan offers a capital preservation fund. What is its purpose and how can I best use it?

## Answer:

Your plan probably offers one of three types of capital preservation funds: a money market fund, a guaranteed or fixed-interest fund, or a stable value fund.

The primary purpose of capital preservation funds is to hold cash for a short time or to comprise a portion of your total account. Here are examples of when it may be appropriate to utilize this option:

- Enrolling during a particularly volatile time in the market and you want the market to settle down before selecting your investments.
- Enrolling in the plan and you want to obtain advice or do additional research into where to allocate your assets.
- Close to or in retirement and you want to maintain your account balance (ideally when your retirement accumulation goal has been met).

**Note:** If you are considering the capital preservation fund because your risk level is conservative, your plan's conservative asset allocation fund may be the better option, as it will maintain your risk level while helping you reach your retirement goal.

Capital preservation funds are not intended as exclusive long-term investments, because they may not provide a sufficient return. As a result, the purchasing value of your investment may actually reduce over time, which is not desirable when trying to accumulate money for retirement. They are better utilized to keep pace with inflation.

For questions, please see the plan administrator or contact our retirement plan consultant.

**Be on the lookout for installment four of our six-part series where we answer the following question:**

**"Why does it seem so difficult to make saving and investment decisions in our retirement plan?"**

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