

**SECTION 401(k) COMPLIANCE CHECK  
QUESTIONNAIRE**

**FINAL REPORT**

**March 2013**

**Internal Revenue Service  
TE/GE Employee Plans  
Employee Plans Compliance Unit (EPCU)**

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## SUMMARY

This Final Report was prepared by the Tax Exempt and Government Entities Division (TE/GE) of the Internal Revenue Service (IRS) to present results from the Section 401(k) Compliance Check Questionnaire (401(k) Questionnaire). Section 401(k) plans have become the most prevalent form of retirement plans in the United States. There are currently more than 500,000 section 401(k) plans covering approximately 60 million Americans. The 401(k) Questionnaire is a critical part of the Employee Plans (EP) 401(k) [Operating Priority](#) to:

- measure the health of section 401(k) plans in terms of compliance levels and risk factors;
- better understand compliance issues related to section 401(k) plans;
- evaluate the effectiveness of voluntary compliance programs and tools; and
- determine how the IRS can best foster compliance.

This Final Report includes results reported in the [Interim Report](#). The Interim Report projected 401(k) Questionnaire findings to the section 401(k) plan sponsor population that files Form 5500. The Final Report also includes:

- additional analysis of the 401(k) Questionnaire not included in the Interim Report;
- a new section on Automatic Contribution Arrangements;
- stratified data highlighting differences in the results based on plan size;
- updates to the data included in the Interim Report to address questions from the retirement plan community.

The 401(k) Questionnaire requested information from plan sponsors in the following areas: demographics, plan participation, employer and employee contributions, top-heavy and nondiscrimination rules, distributions and plan loans, other plan operations, automatic contribution arrangements, designated Roth features, IRS voluntary compliance and correction programs, and plan administration.

Twelve hundred section 401(k) plan sponsors were randomly selected to complete the 401(k) Questionnaire via a secure website. This was the first online compliance check questionnaire used by TE/GE and was administered by the Employee Plans Compliance Unit (EPCU). Ninety-eight percent of plans receiving the questionnaire responded.

A representative sample of the section 401(k) universe was selected and stratified based on plan size, as defined by number of participants. The four strata in the report include:

- Small Plans: 0-5 participants;
- Medium Plans: 6-100 participants;
- Large Plans: 101-2,500 participants; and
- Very Large Plans: more than 2,500 participants.

Responses to the 401(k) Questionnaire are self-reported. We have not compared responses to other sources to determine the correctness of the answers provided by individual plans.

## **Key Findings**<sup>1</sup>

### **Elective Deferrals**

- Fifty-four percent of section 401(k) plans provide a one-year-of-service requirement before allowing participation in the plan.
- Sixty-four percent of section 401(k) plans contain an age-21 eligibility requirement before allowing participation in the plan.
- As the strata size increases, from small to very large plans, the requirement that employees attain at least age 21 in order to participate in the elective deferral contribution feature of the section 401(k) plan decreases.
- Very large plans are more likely than small, medium, and large plans to have no age requirement for eligibility to make elective deferral contributions.
- Four percent of section 401(k) plans permit employee after-tax contributions.
- Very large plans are more likely than small, medium or large plans to permit employee after-tax contributions.

### **Employer Contributions**

- Sixty-eight percent of section 401(k) plans provide for matching contributions.
- Large and very large plans are more likely than small or medium plans to provide for a matching contribution.
- Twenty percent of section 401(k) plan sponsors identify their plans as top-heavy while an additional 25 percent state that the top-heavy rules are not applicable to them.
- Small and medium plans are more likely than large or very large plans to be top heavy or to not have the top heavy rules apply.
- Of the 20 percent of section 401(k) plans that are top-heavy, 79 percent provide non-key employees with a minimum contribution, 19 percent do not provide a minimum contribution, and two percent make the minimum contribution to another plan.

### **Changes in Elective Deferrals and Employee After-Tax Contributions**

- From 2006 to 2008, 58 percent of section 401(k) plans experienced a per-participant increase in the dollar amount of elective deferrals.
- From 2006 to 2008, 52 percent of section 401(k) plans experienced a per-participant decrease in the percentage of compensation deferred.

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<sup>1</sup> All analysis are for the 2008 plan year unless otherwise indicated. A 95% confidence level was used for all analysis. The margin of error for each Key Finding is reported in the corresponding section. A more detailed discussion of margin of error is presented on pages 14 and 15.

### **Changes in Employer Contributions**

- The percentage of section 401(k) plan sponsors that suspended or discontinued matching contributions in their plans increased from one percent in 2006 to four percent in 2008.
- The percentage of section 401(k) plan sponsors that suspended or discontinued the nonelective contribution in their plans increased from two percent in 2006 to five percent in 2008.
- Fifteen percent of section 401(k) plans reported a suspension, reduction or discontinuance of matching or nonelective contributions in the four years preceding the 401(k) Questionnaire.
- Very large plans were more likely than small or medium plans to have experienced such a suspension, discontinuance or reduction of such contributions during that time.

### **Nondiscrimination of Elective Deferrals**

- The majority of section 401(k) plan sponsors correct excess contributions within 2 ½ months following the end of the year of the excess.

### **Nondiscrimination of Employer Contributions**

- More than three-quarters of section 401(k) plan sponsors correct nondiscrimination testing failures by distributing excess aggregate contributions.

### **Safe Harbor**

- Forty-three percent of section 401(k) plans are safe harbor plans.
- Small plans are more likely than medium, large or very large plans to be safe harbor plans. Additionally, medium plans are more likely than large or very large plans to be safe harbor plans.

### **Automatic Contribution Arrangements**

- Five percent of all section 401(k) plans include an automatic contribution arrangement (ACA).
- Very large and large plans are more likely than medium or small plans to have an automatic contribution arrangement.
- Forty-three percent of participants subject to an automatic contribution arrangement deferred at the default rate while twenty-nine percent elected a rate higher than the default rate. Twenty-one percent elected not to make elective deferrals and seven percent elected a rate less than the default rate.
- Less than one quarter of plans with an ACA satisfy the qualified automatic contribution arrangement (QACA) requirements.
- Less than one half of plans with an ACA satisfy the eligible automatic contribution arrangement (EACA) requirements.
- Less than one fifth of plans with an ACA satisfy both the QACA and EACA requirements.

### **SIMPLE 401(k)**

- Five percent of section 401(k) plans are SIMPLE plans.

## **Distributions**

- Seventy-two percent of section 401(k) plans provide involuntary cash-outs.
- Very large plans are more likely than small or medium plans to allow involuntary cash-outs.
- Sixty-two percent of section 401(k) plans permit in-service withdrawals.
- Both very large and large plans are more likely than both small and medium plans to permit in-service withdrawals.

## **Hardship Distributions and Loans**

- Seventy-six percent of section 401(k) plans permit hardship distributions.
- Very large plans are more likely than small or medium plans to allow hardship distributions.
- Sixty-five percent of section 401(k) plans allow participant loans.
- Very large plans are more likely than small, medium or large plans to allow loans.
- Forty-seven percent of section 401(k) plans saw an increase in the number of outstanding participant loans from 2006 to 2008.
- Sixty percent of section 401(k) plans saw an increase in the number of defaulted participant loans from 2006 to 2008.

## **Trust Assets**

- One percent of section 401(k) plans have investments in assets held overseas.
- Our analysis found no difference by plan size in the likelihood that a plan has a direct foreign investment.
- One percent of section 401(k) plans allow investment in employer securities.
- Very large plans are more likely than small, medium or large plans to hold employer securities.

## **Employee Plans Compliance Resolution System**

- Sixty-five percent of all plan sponsors are aware of Employee Plans Compliance Resolution System (EPCRS).
- Sponsors of very large plans are more likely than small, medium or large plan sponsors to be aware of EPCRS.
- Six percent of all plan sponsors have used EPCRS.
- Sponsors of very large plans are more likely than sponsors of other size plans to have used EPCRS and large plan sponsors are more likely than small or medium plan sponsors to have used EPCRS.

## **Determinations**

- Eighty-six percent of section 401(k) plans are some form of pre-approved plan.
- Sponsors of very large plans are less likely than small, medium or large plans to use a pre-approved plan document.
- Twenty-three percent of plan sponsors have requested a determination letter from the IRS.
- Very large and large plans are more likely than small and medium plans to request a determination letter.
- Six percent of all section 401(k) plan sponsors also maintain a defined benefit plan.
- Between 1995 and 2010, seven percent of all section 401(k) plan sponsors terminated a defined benefit plan.

## **Customer Education and Outreach**

- Forty-one percent of all plan sponsors are aware of the 401(k) Fix-it Guide.
- Sponsors of very large plans are more likely than small, medium or large plan sponsors to be aware of the 401(k) Fix-it Guide.
- Seven percent of plan sponsors that are aware of the 401(k) Fix-it Guide have used it.
- Sponsors of very large plans that are aware of the 401(k) Fix-it Guide are more likely to have used it than small, medium or large plan sponsors that are aware of the 401(k) Fix-it Guide.
- Fifty-seven percent of section 401(k) plan sponsors have used the IRS website to obtain information about retirement plans.

## **Plan Administration**

- Fifty-three percent of section 401(k) plan sponsors use a third-party administrator for plan administration.
- Seventy-three percent of section 401(k) plans have designated a third-party administrator to be responsible for timely plan amendments.
- Third-party administrators are responsible for the annual preparation of the Form 5500 in 83 percent of section 401(k) plans.

## OVERVIEW

This Final Report summarizes the results obtained from the Internal Revenue Service's (IRS) Section 401(k) Compliance Check Questionnaire Project. A key focus for IRS Employee Plans (EP) is looking at compliance issues in section 401(k) plans.<sup>2</sup> The electronic online questionnaire project gathered information that will help the IRS gain a better understanding of the health and compliance behaviors of section 401(k) plans. This information will also assist the IRS in determining how best to allocate its resources to foster voluntary compliance in section 401(k) plans that serve as qualified retirement vehicles for approximately 60 million Americans.<sup>3</sup> Promoting section 401(k) plan compliance is a continuing EP Operating Priority in FY 2013 and will continue to be a critical focus area in the future.

This Final Report includes results from the Interim Report<sup>4</sup>, along with additional findings and analysis. The Interim Report projected 401(k) Questionnaire findings to the section 401(k) plan sponsor population that files Form 5500. The additional findings included in this report help to provide a clearer picture of the 401(k) population. For example, this report includes stratified results that highlight differences between plan sizes. It also includes a new section relating to Automatic Contribution Arrangements.

### **Background Information about Section 401(k) Plans**

A section 401(k) plan is a type of tax-qualified deferred compensation plan that permits employees to save for retirement on a tax-favored basis. If an employer sponsors a section 401(k) plan, a covered employee can elect to have the employer contribute a portion of an employee's cash wages to the plan on a pretax basis. Generally, these deferred wages (commonly referred to as "elective contributions," "salary deferrals" or "elective deferrals") are not included as taxable wages for income tax purposes on an employee's Form W-2 and are not included in an employee's income until distributed from the plan. However, these deferred wages are subject to Social Security, Medicare, and federal unemployment taxes.

The dollar amount that an employee may elect to defer to a section 401(k) plan is limited by the Internal Revenue Code (Code). An employee's elective deferrals also may be limited by the terms of the section 401(k) plan. A section 401(k) plan is generally subject to requirements to ensure that higher-paid employees do not defer amounts to the plan that are significantly more than amounts deferred by lower-paid employees. These requirements are generally referred to as "nondiscrimination requirements." (An employer may adopt a more simplified plan, known as a safe harbor plan, which automatically meets the nondiscrimination requirements and does not require the employer to conduct nondiscrimination testing.)

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<sup>2</sup> A section 401(k) plan is a defined contribution plan that includes a cash or deferred arrangement as described in section 401(k) of the Internal Revenue Code.

<sup>3</sup> *Private Pension Plan Bulletin, Abstract of 2009 Form 5500 Annual Reports*, US Department of Labor, Employee Benefits Security Administration, December 2011.

<sup>4</sup> The Interim Report was issued February 3, 2011. To obtain a copy of the report, visit [www.irs.gov](http://www.irs.gov).

Employers may offer employees an opportunity to make after-tax salary deferral contributions (known as “designated Roth contributions”) to a separate designated Roth account in an employer’s section 401(k) plan. Unlike other elective deferrals, the amount an employee contributes to a designated Roth account is includible in gross income when contributed. Qualified distributions from the Roth account, including previously untaxed earnings, are tax-free.

For more information on section 401(k) plans, go to our website at [www.irs.gov/ep](http://www.irs.gov/ep).

### **The Focus on Section 401(k) Plans**

Until the mid 1980’s, defined benefit pension plans were the predominant type of pension arrangement in the United States. A defined benefit plan provides for a specified benefit upon the employee’s retirement. Although many Americans continue to be covered under defined benefit pension plans, the use of defined contribution plans, particularly section 401(k) plans, has become more common. Beginning in 1989, participation in defined contribution plans exceeded participation in defined benefit plans.<sup>5</sup> As of 2009, Form 5500 filings reported 47 thousand defined benefit plans with approximately 42 million participants while there were over 659 thousand defined contribution plans with over 87 million participants.<sup>6</sup> Many Americans rely on section 401(k) plans as the sole private pension vehicle to fund their retirement. Most private retirement programs in the United States now include a section 401(k) arrangement. There are currently more than 500,000 section 401(k) plans covering approximately 60 million Americans.<sup>7</sup>

### **About the Section 401(k) Compliance Check Questionnaire**

The Section 401(k) Compliance Check Questionnaire (401(k) Questionnaire) is the result of a collaborative project with representatives from the Tax Exempt and Government Entities Division (TE/GE), including TE/GE Research and Analysis, Employee Plans Examinations, EP Rulings and Agreements, EP Customer Education and Outreach, and the Employee Plans Compliance Unit (EPCU). The 401(k) Questionnaire was designed to gather information regarding the form, features, and operation of existing section 401(k) plans. The EPCU sent the 401(k) Questionnaire to 1,200 plan sponsors in May 2010. As explained below, the 1,200 plan sponsors were selected from those plan sponsors who indicated on their 2007 Form 5500 filing that they had a section 401(k) feature in their plans. The 401(k) Questionnaire requested information pertaining to plan years 2006 through 2008. Plan sponsors were able to complete the 401(k) Questionnaire either by accessing a website or by submitting the 401(k) Questionnaire in paper form

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<sup>5</sup> Based on U.S. Department of Labor Form 5500 Summaries for 1979-1998.  
<http://www.ebri.org/publications/benfaq/index.cfm?fa=retfaqt14fig2>.

<sup>6</sup> *Private Pension Plan Bulletin, Abstract of 2009 Form 5500 Annual Reports*, US Department of Labor, Employee Benefits Security Administration, December 2011, Table A1, p.3.

<sup>7</sup> *Ibid.*

The information requested in the 401(k) Questionnaire is divided into major subject areas, including:

- Demographics: The types of plans sponsored by the employer, and whether the employer's section 401(k) plan is ongoing, frozen or terminated.
- Plan Participation: The number and categories of employees eligible to participate in the plan, the number of employees excluded, the number of employees making elective deferral contributions, and the bases upon which employer contributions are allocated to participant accounts.
- Employer and Employee Contributions: The nature, amount and frequency of employer and employee contributions to the section 401(k) plan.
- Top-Heavy and Nondiscrimination Rules: The degree to which the plan sponsor is able to demonstrate that the section 401(k) plan benefits rank-and-file employees as compared to highly compensated employees and owners, and whether appropriate corrective actions are taken to the extent required under the nondiscrimination rules of the Code.
- Distributions and Plan Loans: The circumstances under which funds are distributed or withdrawn from the plan, the forms of benefit available under the plan, and the amounts of such distributions or withdrawals.
- Other Plan Operations: The effect of recent financial conditions on the contribution levels and investment behavior of employers and participants.
- Automatic Contribution Arrangement: Whether the plan contains an automatic contribution arrangement and, if so, information about its design and use.
- Designated Roth Features: Whether the plan offers participants the opportunity to elect designated Roth contributions and, if so, the amounts contributed.
- IRS Voluntary Compliance Programs: The extent to which plan sponsors are aware of, and use, the IRS's voluntary compliance programs and tools, such as the Employee Plans Compliance Resolution System and the 401(k) Fix-It Guide. The 401(k) Questionnaire also asked how these programs and tools can be improved.
- Plan Administration: The plan sponsor's administrative policies and procedures, and the persons responsible for different aspects of the day-to-day operations of the section 401(k) plan.

# **SAMPLE SELECTION AND ANALYSIS METHODS**

The IRS selected a representative sample of plan sponsors that was sufficient to provide a valid analysis of the section 401(k) plan population. The process used to select plan sponsors to participate in the 401(k) Questionnaire is described below.

## **Identifying Section 401(k) Plan Sponsors**

Since most section 401(k) plan sponsors are required to file a Form 5500-series annual return, Form 5500 filings were used to identify section 401(k) plan sponsors.<sup>8</sup> Subject to the exceptions described immediately below, all Form 5500 filers that indicated they had a section 401(k) feature in their filing for their 2007 plan year were included in the initial sample frame. The 2007 plan year was selected for analysis because 2007 included the most complete and current data at the time of sample selection. In total, 455,880 section 401(k) plans were included in the sampling frame.<sup>9</sup>

## **Certain Section 401(k) Plans Excluded**

Plans under IRS examination after December 2008 were excluded from the final sampling frame. Additionally, final- and short-plan year Form 5500 returns were excluded from the final sampling frame. Section 401(k) plan sponsors that file a Form 5500-EZ (Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan) were also not included in the final sampling frame. Unlike the Form 5500, the Form 5500-EZ does not require the identification of a section 401(k) feature.

## **Sample Method**

The IRS contacted 1,200 section 401(k) plan sponsors and requested they complete the 401(k) Questionnaire. The sample population was divided into four strata based on plan size, as defined by the number of participants. Figure 1 sets forth the names of each stratum, the number of plans in each stratum, the proportion of the section 401(k) plan population represented by that stratum, the number of plans randomly sampled for each stratum, and the strata weights used to generalize the findings to the population. The strata weights are calculated by dividing the total number of plans in each stratum by the number of plans randomly sampled for that stratum.

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<sup>8</sup> The presence of a section 401(k) feature is identified on the Form 5500 by a “2J” Plan Characteristics Code in response to Question 8a of Part II of the form.

<sup>9</sup> The sampling frame is a list of units from which a sample is drawn. All members of the sampling frame have a chance of being selected for the sample.

**Figure 1: The Four Strata of Plans Based on Number of Participants**

	Reported Number of Plans	Proportion in the Section 401(k) Segment	Number of Plans Selected	Stratum Weight
Stratum 1: Small Plans (0-5 participants)	77,154	17%	170	453.85
Stratum 2: Medium Plans (6-100 participants)	319,026	70%	700	455.75
Stratum 3: Large Plans (101-2,500 participants)	56,465	12%	130	434.35
Stratum 4: Very Large Plans (2,501+ participants)	3,235	1%	200	16.18
Total	455,880	100%	1,200	

The largest plans (as defined by number of participants) were sampled at a higher rate. While the number of plans with more than 2,500 participants in the section 401(k) population is small compared with the number of plans in the other strata, the total number of individuals covered by these plans is considerably larger. Plans from this stratum represent 17% of the sampled plans (200 plans out of 1,200), and the remaining strata were sampled in numbers proportionate to the total number of plans in the section 401(k) plan population.

### **Responses to the 401(k) Questionnaire**

After contact, 116 of the 1,200 randomly selected plans were removed from the sample because they were not section 401(k) plans or were no longer in existence. Of the 116 plans, 27 indicated they were not defined contribution plans and 49 indicated they did not permit elective deferrals. Additionally, 34 plan sponsors could not be located and 6 indicated they were either in bankruptcy, out of business, or had merged into or with another entity.

Therefore, the total sample size for the 401(k) Questionnaire was 1,084. Of these 1,084 plans, 1,060 plans returned the 401(k) Questionnaire while 24 plans did not. This resulted in an overall response rate of 98%.<sup>10</sup>

A review of available data on the 24 non-responders reveals no obvious anomalies. Specifically, the non-responders are:

- spread across the strata (meaning, there were non-responders in each of the four strata),
- geographically diverse, and
- not different from responders in terms of their past audit history.<sup>11</sup>

<sup>10</sup> Of the 1,060 responses, 38 respondents provided partial data.

<sup>11</sup> Analysis was performed on examinations conducted on or after the 2006 plan year. We were able to compare these two groups in terms of geographic location and previous examination history.

Based on the foregoing, population projections contained within this report assume any non-response error to be random.<sup>12</sup>

The IRS initiated follow-up action on all non-responders. EP agents nationwide have conducted full-scope examinations of section 401(k) plans of sponsors who did not complete the 401(k) Questionnaire in order to gather the information that the IRS requested.

### **Persons Tasked With Completing the Questionnaire**

We asked plan sponsors to identify, from among a number of categories, the persons who completed the Questionnaire on their behalf. In some cases, more than one category was involved in completing the Questionnaire on behalf of a plan sponsor. Accordingly, respondents were permitted to identify more than one category in their response.

Figure 2 below shows the categories offered to respondents and the number of times respondents indicated that each category was involved in completing the Questionnaire on the plan sponsor's behalf.

**Figure 2: Person That Completed the Questionnaire**

<b>Respondents</b>	<b>Count<sup>13</sup></b>
Company financial staff	391
Company human resources staff	380
Company legal staff	41
External accountant	62
External legal	94
Insurance company	9
Third-party administrator	515
Actuary	12
Other external provider	60
Other internal staff	140

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<sup>12</sup> According to Guideline 1.3.4 and 1.3.5, Office of Management and Budget (OMB), Standards and Guidelines for Statistical Surveys, September 2006, non-response bias analysis is not needed when the unit response rate is above 80%.

<sup>13</sup> Sample size = 1,025. Instructions for this question permitted respondents to select more than one answer.

## **STRUCTURE OF THIS FINAL REPORT AND PRESENTATION OF DATA**

Analyses are based on 2008 plan year data unless otherwise noted. Data was collected regarding the 2008 year because, at the time of the questionnaire, it was the most recent year that complete data would have been available. All of the data is self-reported by respondents and has not been independently verified by the IRS. In most instances analyses are based on responses to more than one question.

The 401(k) Questionnaire was designed to collect information from a broad cross section of section 401(k) plans. In most instances, the questions were answered by a majority of respondents. However, in some cases, the number of responses to a question was relatively small because the question did not apply to all plans. Plan sponsors that indicated their plans were safe harbor plans, for example, were not required to answer questions regarding highly and nonhighly compensated employees. Additionally, some respondents did not complete all questions in the 401(k) Questionnaire. Thus, the sample size for responses to particular questions may vary. Throughout this report, the sample sizes for results are presented in the footnotes.

In this report, the findings are generalized to the section 401(k) plan population that files the Form 5500. Therefore, references to section 401(k) plans throughout this report refer to the population of section 401(k) plan sponsors that regularly file an annual Form 5500. Plans that are not subject to the Form 5500 filing requirements, or which are subject to the filing requirements but for which a Form 5500 was not filed, are not represented in this report. All findings are calculated using strata weights, which are presented in Figure 1. The only exception to this is the open-ended questions. Not all respondents chose to answer these optional questions and, as a result, these responses cannot be generalized to the population. Any reference to the responses obtained from an open-ended question reflects only the opinions of the respondents who answered that particular question.

This report includes point estimates for both population level analysis and comparisons of the four plan size stratifications: small, medium, large and very large.<sup>14</sup> A 95% confidence level was used for all analyses. Unless indicated in a footnote, the margin of error for all analyses is less than or equal to 7%. The margin of error is the error caused by observing a sample instead of the entire population when calculating estimates. For example, if we estimate that 60% of the population has a certain plan feature and there is a 7% margin of error, then there is a 95% chance (i.e., 95% confidence) that the actual number of plans in the population with that feature is somewhere between 53% and 67%.

The margin of error is influenced by sample size, with a smaller sample size increasing the likelihood of a larger margin of error. For example, out of the 1,060 plans that responded to the 401(k) Questionnaire, 104 indicated that they have an Automatic Contribution Arrangement (ACA). This small number of section 401(k) plans in our sample that have an ACA feature resulted in larger margins of error for the majority of

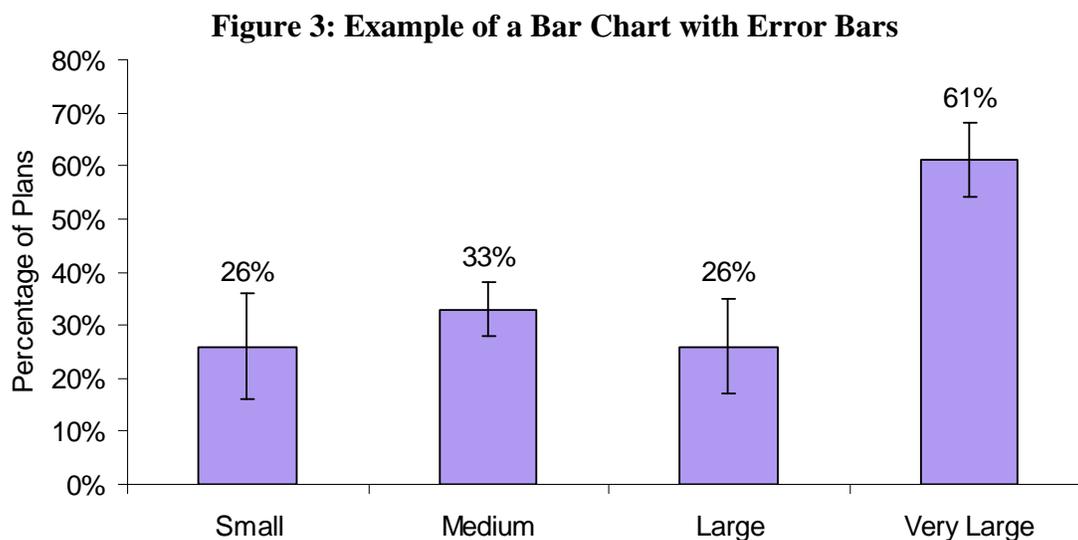
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<sup>14</sup> The point estimate is the single value given as an estimate of the defined population.

analyses in that section. Caution should be exercised in relying on findings where the margin of error is high.

When making comparisons among the four plan sizes, consideration of the margins of error is necessary in order to determine if an apparent difference is statistically significant. In Figure 3, for example the percentage of small plans that provide for matching contributions that made a discretionary match (26%) appears to be less than the percentage of medium plans (33%). However, when the respective margins of error (10% and 5%) are taken into account, we cannot conclude that these two plan sizes differ from each other because the intervals overlap.<sup>15</sup>

Throughout the Final Report, comparisons between plan sizes are reported only if the intervals of possible values (calculated using the margins of error) do not overlap (meaning there is a statistically significant difference between the plan sizes). All margins of error, regardless of size, will be reported in footnotes when comparisons among plan sizes are reported. Furthermore, in instances where an analysis by plan size is presented in a bar chart, each estimate will be accompanied by an error bar. An error bar visually depicts the margin of error by indicating, with a line, the lowest and highest possible value for each point estimate. When error bars overlap, we cannot conclude that a plan size difference exists. An example of a bar chart with error bars is presented in Figure 3.



<sup>15</sup> While our analysis allows us to report differences between the stratum in the population, we are not able to project, with the same confidence, when the stratum do not differ from each other in the population. For a more detailed explanation please consult <http://www.cscu.cornell.edu/news/statnews/stnews73.pdf>.

## ELECTIVE DEFERRAL AND OTHER EMPLOYEE CONTRIBUTIONS

Under the Code, plan sponsors have choices regarding the design of their section 401(k) plans. These include options concerning the eligibility to make elective deferral and other employee contributions, and limitations on the amount of any such contributions. A plan sponsor also must determine how the plan will be structured so that it does not inappropriately discriminate in favor of highly compensated employees.

We asked plan sponsors to provide information related to elective deferrals and other employee contributions. Specifically, plan sponsors were asked questions related to:

- age and service eligibility requirements for elective deferral contributions;
- timing of elective deferral elections;
- catch-up contributions;
- designated Roth contributions;
- employee after-tax contributions; and
- limitations on elective deferral contributions.

### **Age and Service Eligibility Requirements for Making Elective Deferral Contributions**

A section 401(k) plan may require that an employee meet age and/or service requirements to be eligible to participate in the cash or deferred arrangement. Code section 401(k)(2)(D) provides that such requirements may not exceed age 21 and one year of service.

Figure 4 shows the percentage of section 401(k) plans that utilize various age requirements for eligibility to make elective deferral contributions.

**Figure 4: Age Requirements for Participation**

<b>Age Requirement</b>	<b>Plans<sup>16</sup></b>
None	20%
18 years	13%
19-20 years	4%
21 years	64%

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<sup>16</sup> Sample size = 1,040. The total percentage is more than 100% due to rounding.

As shown in Figure 5, very large plans are more likely than small, medium, and large plans to have no age requirement for eligibility to make elective deferral contributions. Furthermore, as the strata size increases, from small up to very large plans, the requirement that employees attain at least age 21 in order to make elective deferral contributions decreases.

**Figure 5: Age Requirements for Elective Deferrals by Plan Size**

<b>Age Requirement</b>	<b>Small<sup>17</sup></b>	<b>Medium<sup>18</sup></b>	<b>Large<sup>19</sup></b>	<b>Very Large<sup>20</sup></b>
None	12%	20%	24%	57%
18 years	3%	13%	20%	17%
19-20 years	1%	4%	6%	2%
21 years	84%	63%	50%	24%

Figure 6 shows the percentage of section 401(k) plans that contain service requirements for eligibility to make elective deferral contributions.

**Figure 6: Service Requirements for Participation**

<b>Service Requirement</b>	<b>Plans<sup>21</sup></b>
None	13%
One month	4%
Six months	14%
One year	54%
Other	14%

<sup>17</sup> Sample size = 134; None margin of error = 6%, 18 years margin of error = 3%, 19-20 years margin of error = 2%, 21 years margin of error = 6%.

<sup>18</sup> Sample size = 602; None margin of error = 3%, 18 years margin of error = 3%, 19-20 years margin of error = 1%, 21 years margin of error = 4%.

<sup>19</sup> Sample size = 114; None margin of error = 8%, 18 years margin of error = 7%, 19-20 years margin of error = 4%, 21 years margin of error = 9%.

<sup>20</sup> Sample size = 190; None margin of error = 7%, 18 years margin of error = 5%, 19-20 years margin of error = 2%, 21 years margin of error = 6%.

<sup>21</sup> Sample size = 1,040. The total percentage is less than 100% due to rounding.

Service-based requirements for elective deferrals differ by plan size. As indicated in Figure 7, very large plans are more likely than small, medium and large plans to have no service requirement. Additionally, as the strata size increases, from small up to very large plans, a service requirement of one year (the maximum permitted by law) becomes less likely.

**Figure 7: Service Requirements for Elective Deferrals by Plan Size**

<b>Service Requirement</b>	<b>Small<sup>22</sup></b>	<b>Medium<sup>23</sup></b>	<b>Large<sup>24</sup></b>	<b>Very Large<sup>25</sup></b>
None	8%	13%	18%	44%
One month	1%	3%	9%	8%
Six months	10%	15%	16%	8%
One year	77%	54%	29%	9%
Other	4%	14%	28%	31%

### **Timing of Elective Deferral Elections**

An employee's ability or desire to voluntarily save for retirement under a section 401(k) plan is and may change from time to time. The law allows plan sponsors flexibility in determining when elections may be modified.

<sup>22</sup> Sample size = 134; None margin of error = 5% , One month margin of error = 2%, Six months margin of error = 5%, One year margin of error = 7%, Other margin of error = 3%.

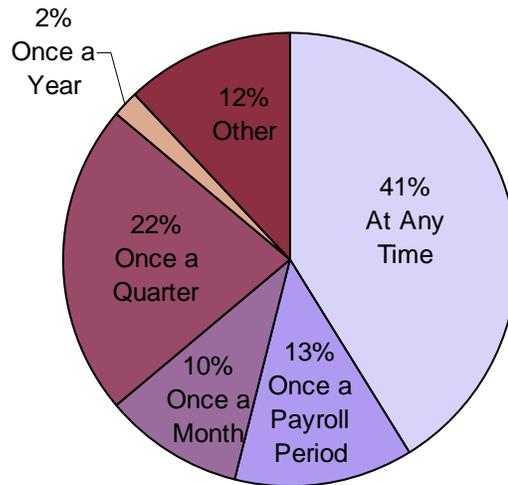
<sup>23</sup> Sample size = 602; None margin of error = 3% , One month margin of error = 1%, Six months margin of error = 3%, One year margin of error = 4%, Other margin of error = 3%.

<sup>24</sup> Sample size = 114; None margin of error = 7% , One month margin of error = 5%, Six months margin of error = 7%, One year margin of error = 8%, Other margin of error = 8%.

<sup>25</sup> Sample size = 190; None margin of error = 7% , One month margin of error = 4%, Six months margin of error = 4%, One year margin of error = 4%, Other margin of error = 6%.

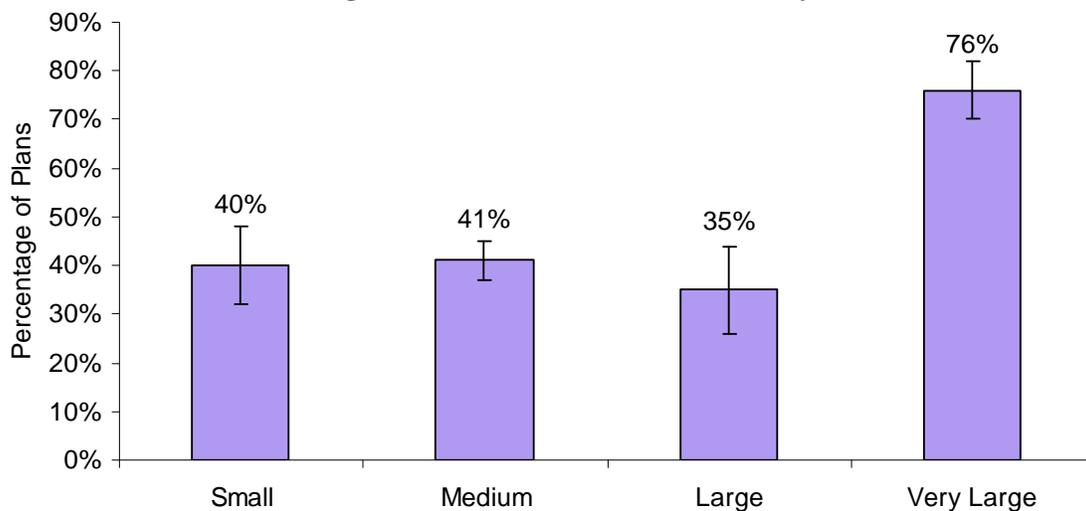
Figure 8 shows the percentage of section 401(k) plans that permit participants to change their elective deferrals at different frequencies (i.e., at any time, once a payroll period, once a month, once a quarter, or at other intervals).<sup>26</sup>

**Figure 8: Frequency With Which Participants Can Change Their Elective Deferrals**



As shown in Figure 9, very large plans are more likely than small, medium or large plans to allow participants to change their elective deferrals at any time.<sup>27</sup>

**Figure 9: Percentage of Plans That Allow Participants to Change Their Elective Deferrals At Any Time**



<sup>26</sup> Sample size = 1,034.

## **Catch-Up Contributions**

Section 402(g) of the Code generally limits the total annual amount an employee may defer under a section 401(k) plan to a dollar amount that is indexed for inflation. For 2012, the amount is \$17,000.<sup>28</sup> However, an individual age 50 or older is permitted to make additional elective deferrals, called catch-up contributions, up to a specified dollar limit, which is also subject to a cost-of-living adjustment. For 2012, the maximum catch-up contribution is \$5,500.<sup>29</sup>

A section 401(k) plan is not required to permit employees to make catch-up contributions. However, almost all section 401(k) plans (96%) allow participants age 50 and older to make catch-up contributions.<sup>30</sup>

## **Roth Contributions**

Employers may offer employees an opportunity to make after-tax salary deferral contributions (known as designated Roth contributions) to a separate designated Roth account in an employer's section 401(k) plan. Unlike pre-tax elective deferrals, the amount an employee contributes to a designated Roth account is includible in his or her gross income. Qualified distributions from the designated Roth account, including previously untaxed earnings, are tax-free. Twenty-two percent of section 401(k) plans permit employees to make designated Roth contributions.<sup>31</sup>

Qualified distributions from a Roth account may be rolled over to another designated Roth account (but only in a direct rollover) or to a Roth IRA. Section 401(k) plans are not required to provide for receipt of such direct rollovers. Of the plans that permit designated Roth contributions, 14% have initiated an eligible rollover distribution from a designated Roth account.<sup>32</sup>

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<sup>27</sup> Small Plans: Margin of error = 8%, Sample size = 133; Medium Plans: Margin of error = 4%, Sample size = 597; Large Plans: Margin of error = 9%, Sample size = 114; Very Large Plans: Margin of error = 6%, Sample size = 190.

<sup>28</sup> 2006 = \$15,000; 2007 = \$15,500; 2008 = \$15,500.

<sup>29</sup> For 2006, 2007, and 2008 the maximum for a year was \$5,000.

<sup>30</sup> Sample size = 1,034.

<sup>31</sup> Sample size = 1,026.

<sup>32</sup> Sample size = 228.

## **Reasons for Not Offering Designated Roth Contributions**

Figure 10 provides the reasons section 401(k) plans do not offer designated Roth contributions.

**Figure 10: Reasons Given for Not Offering Designated Roth Contributions**

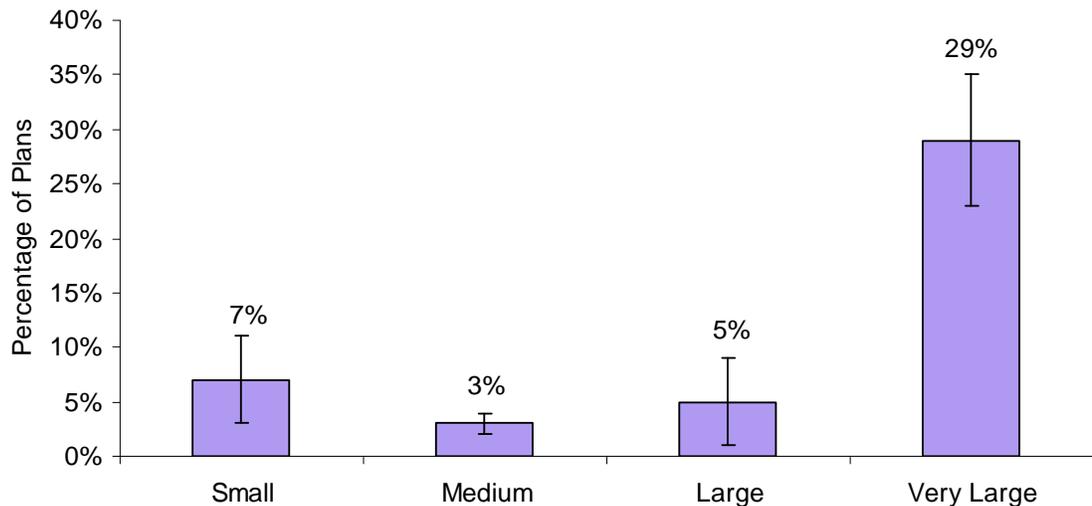
<b>Reason for Not Offering Roth Contributions</b>	<b>Plans<sup>33</sup></b>
Participants are not interested	65%
Administratively burdensome	44%
Rules are too complicated	26%
Too expensive	12%
Service provider does not offer the option	8%
Other	7%

## **Employee After-Tax Contributions**

In addition to providing for a qualified cash or deferred arrangement under Code section 401(k), four-percent of section 401(k) plans permit employees to make employee after-tax contributions.<sup>34</sup>

As shown in Figure 11, the likelihood that a plan permits employees to make after-tax contributions differs by plan size. Very large plans are more likely than small, medium or large plans to permit employee after-tax contributions.<sup>35</sup>

**Figure 11: Percentage of Plans That Permit Employee After-Tax Contributions**



<sup>33</sup> Sample size = 798. Respondents to the 401(k) Questionnaire were provided 6 response options and instructed to select all that apply.

<sup>34</sup> Sample size = 1,034.

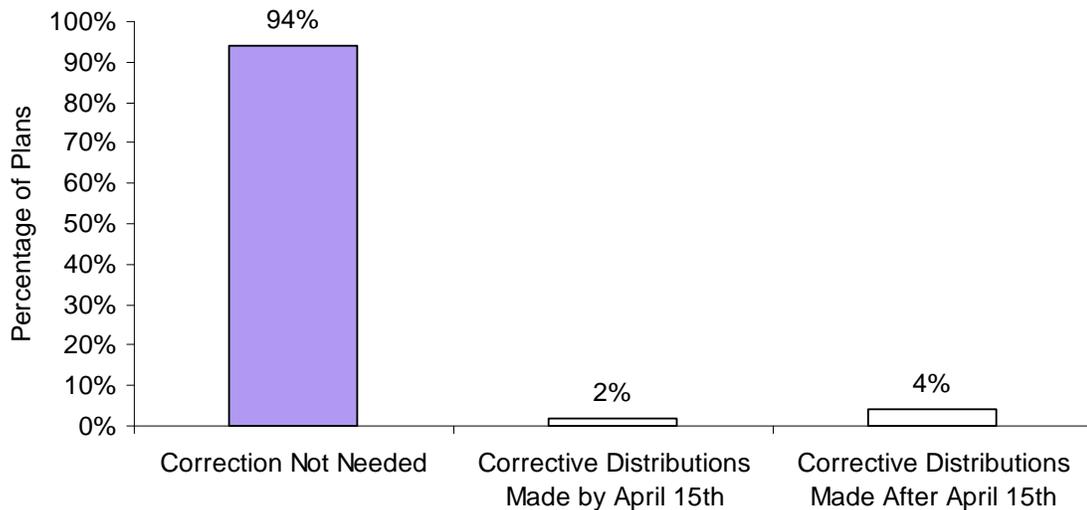
<sup>35</sup> Small Plans: Margin of error = 4%, Sample size = 133; Medium Plans: Margin of error = 1%, Sample size = 597; Large Plans: Margin of error = 4%, Sample size = 114; Very Large Plans: Margin of error = 6%, Sample size = 190.

## **Limitations on Elective Deferral Contributions**

Elective deferral contributions that exceed the applicable dollar amount under Code section 402(g) for a year are referred to as excess deferrals. Excess deferrals (and any associated earnings) must be distributed from the section 401(k) plan by April 15 of the year following the year of deferral. Excess deferrals are taxable to the individual for the year in which the deferrals were made; but the earnings on excess deferrals are taxable in the year distributed. If excess deferrals are distributed by the section 401(k) plan sponsor after April 15 of the year following the year in which the deferrals were made are taxable for the year in which the deferrals were made, but the associated earnings are taxed for the year in which the distribution is made.<sup>36</sup>

Most section 401(k) plan sponsors (96%)<sup>37</sup> have procedures in place to ensure that elective deferrals are limited to the Code section 402(g) amount. Each year from 2006 through 2008, 94% of section 401(k) plan sponsors did not need to make a correction. Between 2006 and 2008, 2% of section 401(k) plan sponsors made corrective distributions by April 15 of the year following the year in which the excess deferrals occurred. During that same period, 4% of section 401(k) plan sponsors made corrective distributions of excess deferrals after April 15 of the year following the year in which the deferrals were made (see Figure 12).<sup>38</sup>

**Figure 12: Corrective Distributions of Excess Deferrals**



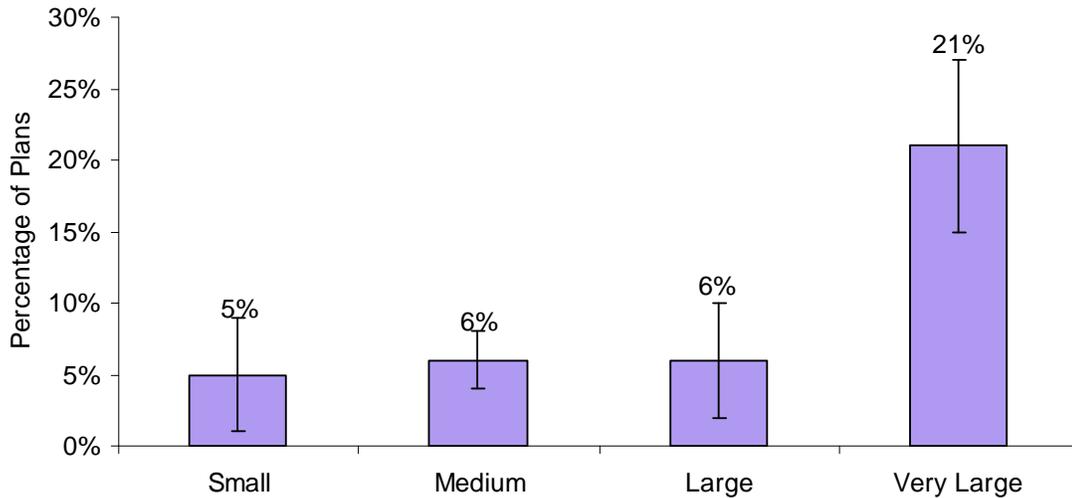
<sup>36</sup> IRC section 402(g)(6) and Treas. Reg. 1.402(g)-1(e)(8).

<sup>37</sup> Sample size = 1,026.

<sup>38</sup> Sample size (2006) = 1,025; Sample size (2007) = 1,024; Sample size (2008) = 1,025.

As shown in Figure 13, very large plans are more likely than small, medium or large plans to have needed to make a corrective distribution of excess deferrals in 2008.<sup>39</sup> Of the plans that did need to make a corrective distribution in 2008, very large plans are more likely than small, medium or large plans to have made corrective distributions before April 15<sup>th</sup> of the year following the year in which the deferrals were made.<sup>40</sup>

**Figure 13: Percentage of Plans That Needed to Make Distributions of Excess Deferrals in 2008**



<sup>39</sup> Small Plans: Margin of error = 4%, Sample size = 133; Medium Plans: Margin of error = 2%, Sample size = 589; Large Plans: Margin of error = 4%, Sample size = 113; Very Large Plans: Margin of error = 6%, Sample size = 190.

<sup>40</sup> Small Plans: Point estimate = 0%, Margin of error = 0%, Sample size = 133; Medium Plans: Point estimate = 2%, Margin of error = 1%, Sample size = 589; Large Plans: Point estimate = 1%, Margin of error = 2%, Sample size = 113; Very Large Plans: Point estimate = 16%, Margin of error = 5%, Sample size = 190.

## EMPLOYER CONTRIBUTIONS

Employer contributions under a section 401(k) plan may be either matching contributions or nonelective contributions. Matching contributions generally match a percentage of an employee's elective deferral contributions. Nonelective contributions are employer contributions that are not dependent upon the level of employee contributions

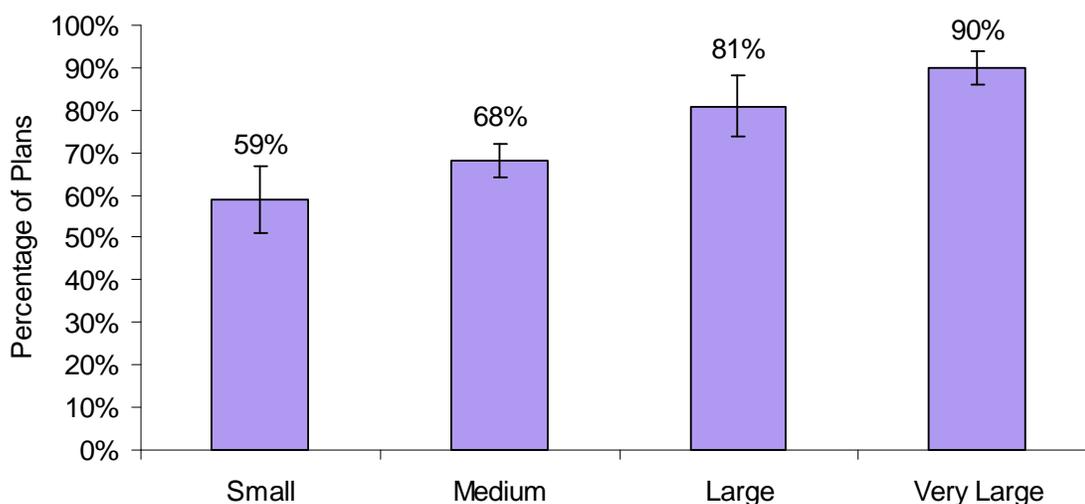
The 401(k) Questionnaire included questions related to employer contributions. Specifically, plan sponsors were asked questions related to:

- the offering of, and eligibility requirements for, matching contributions on elective deferrals;
- the offering of, and eligibility requirements for, nonelective contributions; and
- employer contributions under top-heavy plans.

### Matching Contributions

Many section 401(k) plans (68%) provide for matching contributions on elective deferrals.<sup>41</sup> The likelihood of offering matching contributions differs by plan size. As shown in Figure 14, both small and medium plans are less likely than both large and very large plans to offer matching contributions.<sup>42</sup>

**Figure 14: Percentage of Plans That Provide for a Matching Contribution**



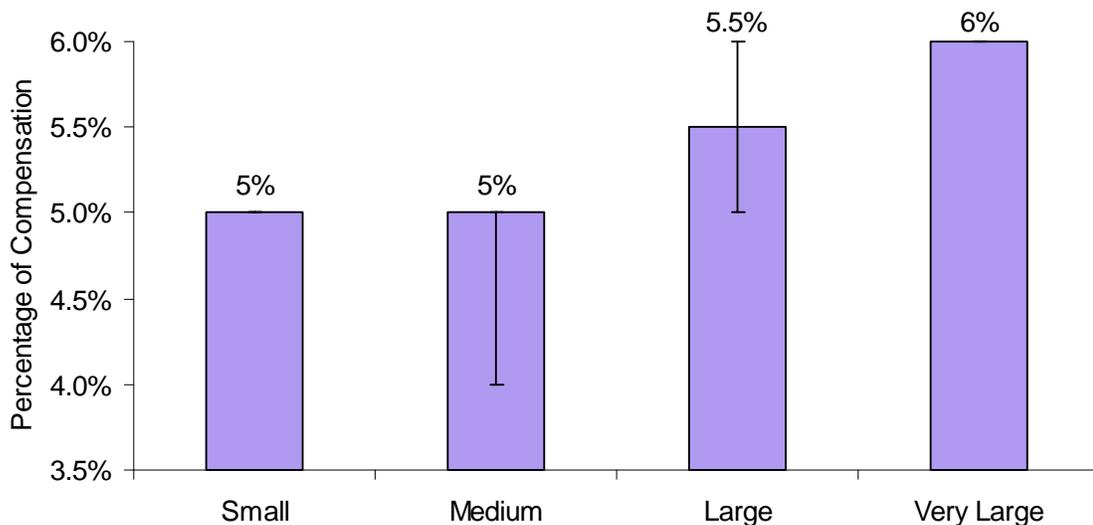
<sup>41</sup> Sample size = 1,034.

<sup>42</sup> Small Plans: Sample size = 133, Margin of error = 8%; Medium Plans: Sample size = 597, Margin of error = 4%; Large Plans: Sample size = 114, Margin of error = 7%; Very Large Plans: Sample size = 190, Margin of error = 4%.

Of those plans providing matching contributions, 88% match on the basis of the percentage of compensation deferred.<sup>43</sup> The remaining 12% match on the basis of the dollar amount deferred.<sup>44</sup>

For those plans that provide for matching contributions based on the percentage of compensation deferred, the amount of matching contributions made to the plan also differs by plan size. As illustrated in Figure 15, the median of the maximum rate of matching contributions is higher in very large plans than in small and medium plans.<sup>45</sup>

**Figure 15: Plans with Matching Contributions - Median Maximum Rates of Compensation Matched**



Matching contributions can be fixed or discretionary. A fixed matching contribution is a matching contribution that is paid at a level that is specified in the plan, while a discretionary matching contribution is made at a level that is determined by the plan sponsor, in its discretion, each year. Of the section 401(k) plans that provide for a matching contribution, 32% of plan sponsors made a fixed matching contribution, and 39% of plan sponsors made a discretionary matching contribution. Twenty-nine percent made neither a fixed or discretionary match despite identifying as a plan that provides for matching contributions on elective deferrals.<sup>46</sup>

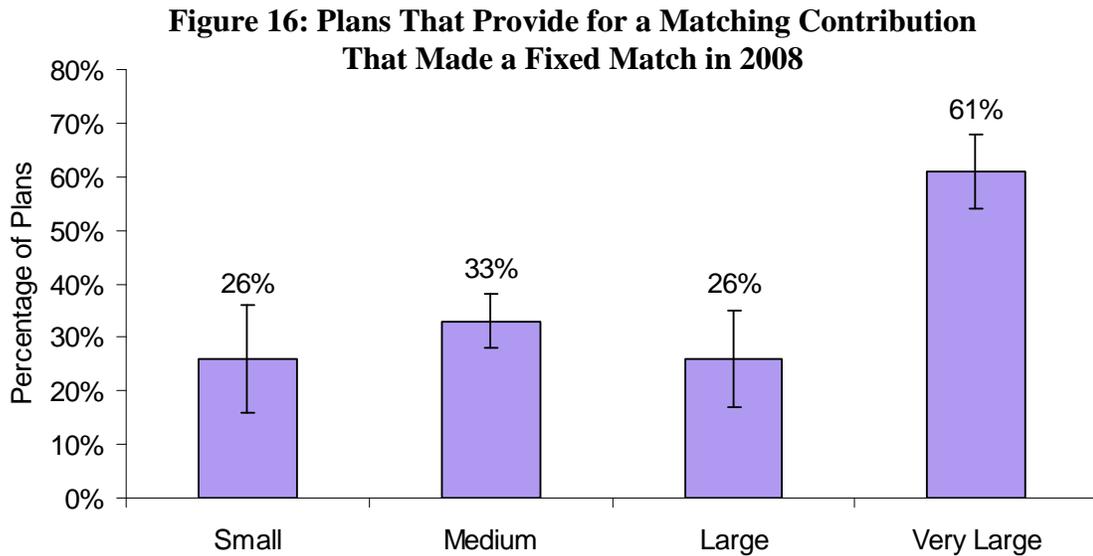
<sup>43</sup> Sample size = 736.

<sup>44</sup> Sample size = 736.

<sup>45</sup> Small plans: lower bound = 5%, upper bound = 5%, Sample size = 67; Medium plans: lower bound = 4%, upper bound = 5%, sample size = 344; Large plans: lower bound = 5%, upper bound = 6%, Sample size = 82; Very Large plans: lower and upper bound = 6%, Sample size = 159. No error bars are illustrated for Small and Very Large plans as the margin of error is zero.

<sup>46</sup> Sample size = 731.

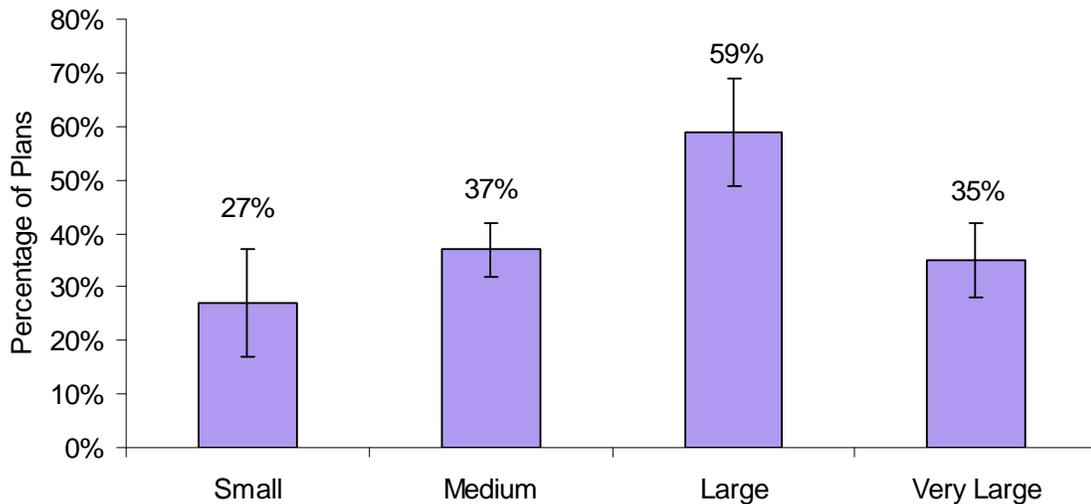
As illustrated in Figure 16, sponsors of very large section 401(k) plans are more likely than sponsors of small, medium, and large section 401(k) plans to make fixed matching contributions.<sup>47</sup>



<sup>47</sup> Small Plans: Sample size = 77, Margin of error = 10%; Medium Plans: Sample size = 392, Margin of error = 5%; Large Plans: Sample size = 91, Margin of error = 9%; Very Large Plans: Sample size = 171, Margin of error = 7%.

As shown in Figure 17, of the section 401(k) plans that provide for employer matching contributions on elective deferrals, sponsors of large plans are more likely than small, medium, and very large plans to make a discretionary match.<sup>48</sup>

**Figure 17: Plans That Provide for a Matching Contribution That Made a Discretionary Match in 2008**



### **Age and Service Eligibility Requirements for Matching Contributions**

A section 401(k) plan may require that an employee satisfy a specified age and/or service requirement before becoming eligible for an allocation of matching contributions under the plan. Code section 410(a)(1) provides that a qualified plan may not require, as a condition of participation in the plan, a period of service extending beyond the later of the date on which the employee attains the age of 21 or the date on which he or she completes one year of service (two years in certain plans).

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<sup>48</sup> Small Plans: Sample size = 77, Margin of error = 10%; Medium Plans: Sample size = 392, Margin of error = 5%; Large Plans: Sample size = 91, Margin of error = 10%; Very Large Plans: Sample size = 171, Margin of error = 7%.

Of the plans that offer matching contributions on elective deferrals, Figure 18 shows the percentage of plans that have age requirements for eligibility to receive matching contributions.

**Figure 18: Age Requirements for Matching Contributions**

<b>Age Requirement</b>	<b>Plans<sup>49</sup></b>
None	23%
18 years	13%
19-20 years	3%
21 years	61%

As shown in Figure 19, very large plans are more likely than small, medium, and large plans to have no age requirement for matching contributions. Conversely, small plans are more likely than medium, large and very large plans to employ the most stringent eligibility requirement based on age permitted by law (21 years).

**Figure 19: Age Requirements for Matching Contributions By Plan Size**

<b>Age Requirement</b>	<b>Small<sup>50</sup></b>	<b>Medium<sup>51</sup></b>	<b>Large<sup>52</sup></b>	<b>Very Large<sup>53</sup></b>
None	21%	22%	28%	61%
18 years	3%	14%	18%	14%
19-20 years	1%	3%	6%	2%
21 years	75%	61%	49%	23%

<sup>49</sup> Sample size = 826.

<sup>50</sup> Sample size = 95; Margin of error: None = 8%, 18 years = 4%, 19-20 years = 2%, 21 years = 9%.

<sup>51</sup> Sample size = 459; Margin of error: None = 4%, 18 years = 3%, 19-20 years = 2%, 21 years = 4%.

<sup>52</sup> Sample size = 101; Margin of error: None = 9%, 18 years = 7%, 19-20 years = 5%, 21 years = 10%.

<sup>53</sup> Sample size = 171; Margin of error: None = 7%, 18 years = 5%, 19-20 years = 2%, 21 years = 6%.

Of the section 401(k) plans that offer matching contributions on elective deferrals, Figure 20 shows the percentage that have service requirements for eligibility to receive matching contributions.

**Figure 20: Service Requirements for Matching Contributions**

Service Requirement	Plans <sup>54</sup>
None	13%
One month	2%
Six months	14%
One year	58%
Other	14%

Service-based eligibility requirements for matching contributions also differ by plan size. As indicated in Figure 21, very large plans are more likely than small, medium, and large plans to have no service requirement for eligibility to receive such contributions. As the strata size increases from small up to very large plans, a service requirement of one year for matching contributions (the maximum permitted by law) becomes less likely.

**Figure 21: Service Requirements for Matching Contributions by Plan Size**

Service Requirement	Small <sup>55</sup>	Medium <sup>56</sup>	Large <sup>57</sup>	Very Large <sup>58</sup>
None	9%	12%	17%	33%
One Month	1%	2%	3%	6%
Six Months	11%	14%	17%	10%
One Year	75%	59%	37%	21%
Other	4%	13%	27%	30%

**Requirements Applicable to Allocations of Matching Contributions**

In addition to the eligibility requirements described above, some section 401(k) plans have separate requirements applicable to whether a participant is entitled to an allocation of matching contributions to his or her account. Twenty-two percent of section 401(k) plans that provide for matching contributions on elective deferrals require participants to be employed on the last day of the plan year in order to be entitled to an allocation of matching contributions.<sup>59</sup> Seventeen percent of section 401(k) plans that provide for matching contributions require employees to be employed on the last day of the plan year

<sup>54</sup> Sample size = 827. The total percentage is more than 100% due to rounding.

<sup>55</sup> Sample size = 95; Margin of error: None = 6%, One Month = 2%, Six Months = 6%, One Year = 9%, Other = 4%.

<sup>56</sup> Sample size = 459; Margin of error: None = 3%, One Month = 1%, Six Months = 3%, One Year = 4%, Other = 3%.

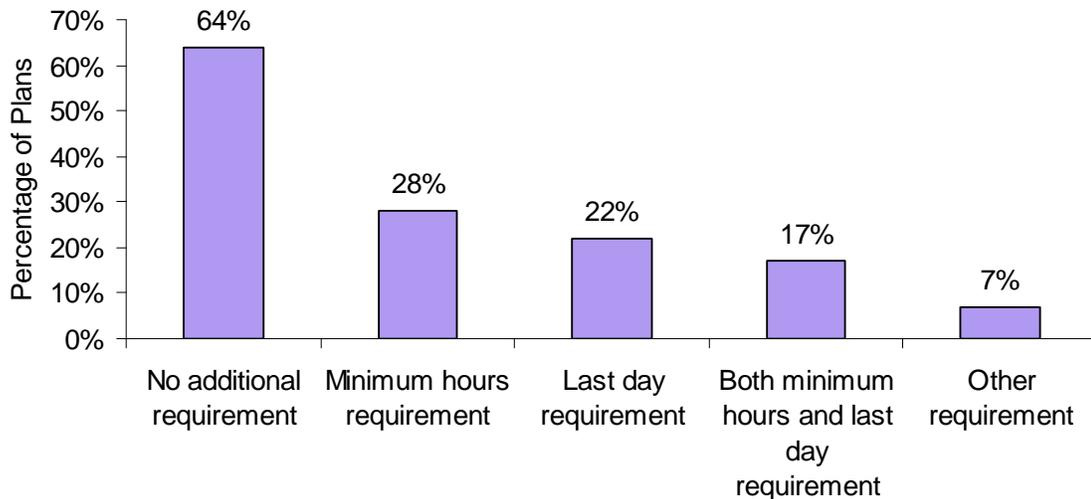
<sup>57</sup> Sample size = 101; Margin of error: None = 7%, One Month = 3%, Six Months = 7%, One Year = 9%, Other = 9%.

<sup>58</sup> Sample size = 172; Margin of error: None = 7%, One Month = 4%, Six Months = 4%, One Year = 6%, Other = 7%.

<sup>59</sup> Sample size = 736.

and to complete a minimum number of hours of service in order to receive an allocation of matching contributions (see Figure 22).<sup>60</sup>

**Figure 22: Additional Eligibility Requirements Among Plans Offering Matching Contributions**



### **Nonelective Contributions**

Sixty-five percent of section 401(k) plans provide for some form of employer nonelective contribution, such as a profit-sharing contribution.<sup>61</sup> The percentage of participants in a plan that received a nonelective contribution decreased by an average of 13% between 2006 and 2008.<sup>62</sup>

### **Age and Service Eligibility Requirements for Nonelective Contributions**

As with matching contributions, a section 401(k) plan may require that an employee satisfy a specified age and/or service requirement before becoming eligible for an allocation of employer nonelective contributions under the plan.

<sup>60</sup> Sample size = 736. Instructions for this question permitted respondents to select more than one answer.

<sup>61</sup> Sample size = 1,027.

<sup>62</sup> Sample size = 307.

Figure 23 shows the percentage of plans that provide for nonelective contributions and impose age requirements for eligibility to receive allocations of employer nonelective contributions.

**Figure 23: Age Requirements for Nonelective Contributions**

Age Requirement	Plans <sup>63</sup>
None	22%
18 years	11%
19-20 years	3%
21 years	63%

The age requirements for eligibility for nonelective contributions differ by plan size. As shown in Figure 24, very large plans are more likely than small, medium, and large plans to have no age requirement for nonelective contributions. Conversely, small plans are more likely than medium, large, and very large plans to mandate that a participant be at least age 21 in order to be eligible for nonelective contributions.

**Figure 24: Age Requirements for Nonelective Contributions By Plan Size**

Age Requirement	Small <sup>64</sup>	Medium <sup>65</sup>	Large <sup>66</sup>	Very Large <sup>67</sup>
None	15%	23%	27%	60%
18 years	3%	12%	21%	13%
19-20 years	2%	3%	5%	2%
21 years	80%	62%	47%	25%

Figure 25 shows the percentage of section 401(k) plans that provide for employer nonelective contributions and impose service requirements for eligibility to receive allocations of employer nonelective contributions.

**Figure 25: Service Requirements for Nonelective Contributions**

Service Requirement	Plans <sup>68</sup>
None	11%
One month	2%
Six months	13%
One year	62%
Other	12%

<sup>63</sup> Sample size = 1,039. The total percentage is less than 100% due to rounding.

<sup>64</sup> Sample size = 133; Margin of error: None = 7%, 18 years = 3%, 19-20 years = 3%, 21 years = 8%.

<sup>65</sup> Sample size = 602; Margin of error: None = 4%, 18 years = 3%, 19-20 years = 2%, 21 years = 4%.

<sup>66</sup> Sample size = 114; Margin of error: None = 10%, 18 years = 9%, 19-20 years = 5%, 21 years = 11%.

<sup>67</sup> Sample size = 190; Margin of error: None = 9%, 18 years = 6%, 19-20 years = 2%, 21 years = 8%.

<sup>68</sup> Sample size = 756.

As with eligibility requirements based on age, service-based eligibility requirements for nonelective contributions differ by plan size. As indicated in Figure 26, very large plans are more likely than both small and medium plans to have no service requirement for nonelective contributions. Conversely, as the strata size increases from small up to very large plans, a one year service requirement for matching contributions (the maximum permitted by law) becomes less likely.

**Figure 26: Service Requirements for Nonelective Contributions by Plan Size**

<b>Service Requirement</b>	<b>Small<sup>69</sup></b>	<b>Medium<sup>70</sup></b>	<b>Large<sup>71</sup></b>	<b>Very Large<sup>72</sup></b>
None	9%	10%	17%	30%
One Month	1%	3%	3%	5%
Six Months	8%	13%	18%	8%
One Year	78%	62%	45%	24%
Other	4%	13%	17%	32%

### **Top-Heavy Section 401(k) Plans**

Under section 416 of the Code, a section 401(k) plan is top-heavy if the aggregate amount held in the accounts of key employees under the plan exceeds 60% of the aggregate amount held in the accounts of all employees.<sup>73</sup> The term key employee generally refers to an employee who, at any time during the plan year, is:

- an officer of the employer with annual compensation greater than \$165,000 (as adjusted for increases in the cost-of-living);
- a 5% owner of the employer; or
- a 1% owner of the employer having annual compensation of more than \$150,000.<sup>74</sup>

If a plan is top-heavy, it must meet special minimum contribution requirements. Specifically, contributions made on behalf of non-key employees under a top-heavy plan must be at least equal to the lesser of:

- 3% of compensation; or
- the highest percentage contribution made for a key employee.<sup>75</sup>

<sup>69</sup> Sample Size = 107; Margin of error: None = 6% , One Month = 2%, Six Months = 5%, One Year = 8%, Other = 4%.

<sup>70</sup> Sample Size = 457; Margin of error: None = 3% , One Month = 1%, Six Months = 3%, One Year = 4%, Other = 3%. The total percentage is more than 100% due to rounding.

<sup>71</sup> Sample Size = 77; Margin of error: None = 8% , One Month = 4%, Six Months = 9%, One Year = 11%, Other = 8%.

<sup>72</sup> Sample Size = 115; Margin of error: None = 8% , One Month = 4%, Six Months = 5%, One Year = 8%, Other = 8%.

<sup>73</sup> IRC § 416(g)(1)(A)(ii).

<sup>74</sup> IRC § 416(i)(1)(A).

<sup>75</sup> IRC § 416(c)(2).

If an employer maintains more than one qualified plan, the plans may be aggregated for purposes of satisfying the top-heavy contribution requirements.<sup>76</sup> If an employer sponsors more than one qualified plan, the plan documents must specify how the minimum top-heavy contribution requirement will be coordinated between or among those plans.<sup>77</sup> If an employer sponsors a defined contribution plan and a defined benefit plan, the top-heavy contribution requirement can be satisfied by providing a 5% contribution in the defined contribution plan to employees who are participants in both plans.<sup>78</sup>

Some types of qualified plans are not subject to the top-heavy minimum contribution requirements. For example, the top-heavy-minimum contribution rules do not apply to collectively bargained plans.<sup>79</sup> Further, safe harbor section 401(k) plans, which are discussed later in this report, are not subject to the top-heavy minimum contribution requirements.<sup>80</sup>

### **Top-Heavy Requirements and Employer Contributions**

Twenty percent of section 401(k) plan sponsors identify their plans as top-heavy while 55% do not. The remaining 25% of all section 401(k) plan sponsors state that the top-heavy rules are not applicable to them.<sup>81</sup> Of the 20% of section 401(k) plans that are top-heavy, 79% provide non-key employees with a minimum contribution, 19% do not provide a minimum contribution, and 2% make the minimum contribution to another plan.<sup>82</sup>

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<sup>76</sup> IRC § 416(g).

<sup>77</sup> Treas. Reg. § 1.416-1.

<sup>78</sup> Treas. Reg. § 1.416-1, M-12.

<sup>79</sup> IRC § 416(i)(4).

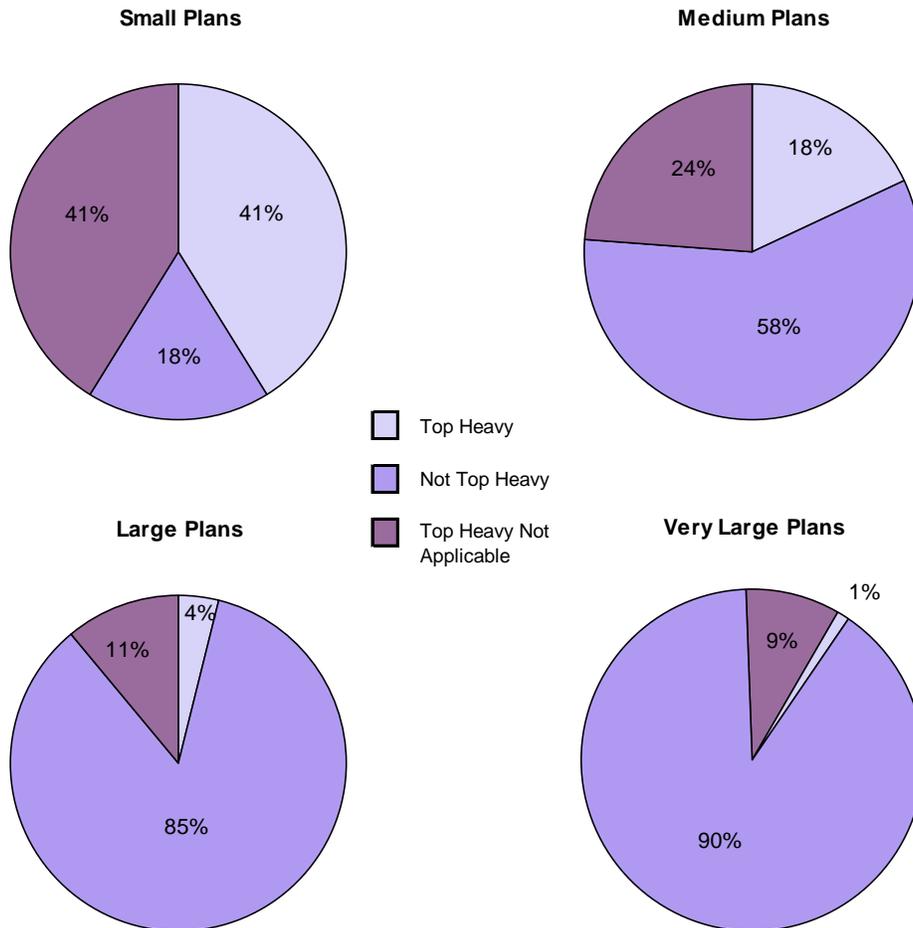
<sup>80</sup> IRC § 416(g)(4)(H).

<sup>81</sup> Sample size = 1,027.

<sup>82</sup> Sample size = 172.

As illustrated in Figure 27, sponsors of small and medium plans are more likely than sponsors of large and very large plans to state that the top-heavy rules are not applicable to their plans. Small and medium plans are also more likely to be top-heavy than both large and very large plans.<sup>83</sup>

**Figure 27: Top-Heavy Plans by Plan Size**



<sup>83</sup> Small Plans: sample size = 133, Top heavy margin of error = 8%, Not top heavy margin of error = 7%, Top heavy not applicable margin of error = 8%; Medium Plans: sample size = 591, Top heavy margin of error = 3%, Not top heavy margin of error = 4%, Top heavy not applicable margin of error = 3%; Large Plans: sample size = 113, Top heavy margin of error = 4%, Not top heavy margin of error = 7%, Top heavy not applicable margin of error = 6%; Very Large Plans: sample size = 190, Top heavy margin of error = 1%, Not top heavy margin of error = 4%, Top heavy not applicable margin of error = 4%.

Of those plan sponsors that provided top-heavy minimum contributions on behalf of non-key employees, the contribution levels varied. Figure 28 shows the percentage of top-heavy section 401(k) plans that provided specified amounts of top-heavy minimum contributions (expressed as a percentage of compensation).<sup>84</sup>

**Figure 28: Contributions Provided by Top-Heavy Plans**

<b>Contributions Provided</b>	<b>Plans</b>
Less than 3% of compensation	8%
3% of compensation	72% <sup>85</sup>
5% of compensation	7%
Any combination of the above choices	1%
Other contribution amount	12%

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<sup>84</sup> Sample size = 136.

<sup>85</sup> Margin of error = 8%.

## CHANGES IN ELECTIVE DEFERRALS AND EMPLOYEE AFTER-TAX CONTRIBUTIONS

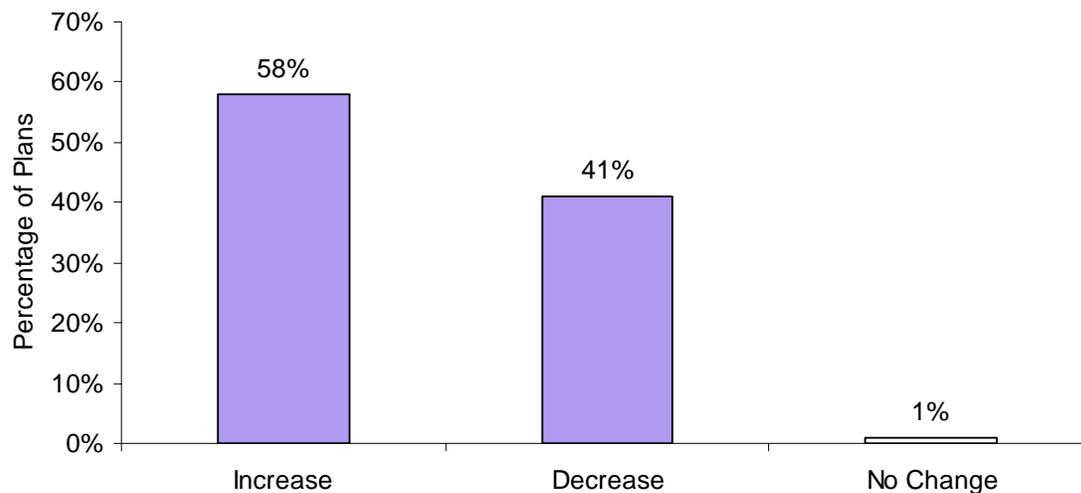
We asked respondents about employee contributions in 2006, 2007 and 2008. Specifically, we asked respondents about:

- the amount of participant elective deferrals;
- the amount of participant compensation;
- catch-up contributions; and
- employee after-tax contributions.

### **Amount of Elective Deferral Contributions**

From 2006 to 2008, 58% of section 401(k) plans experienced a per-participant increase in the dollar amount of elective deferrals while 41% experienced a per-participant decrease (see Figure 29).<sup>86</sup>

**Figure 29: Plan Experiencing a Per-Participant Change in the Dollar Amount of Elective Deferrals From 2006 - 2008**

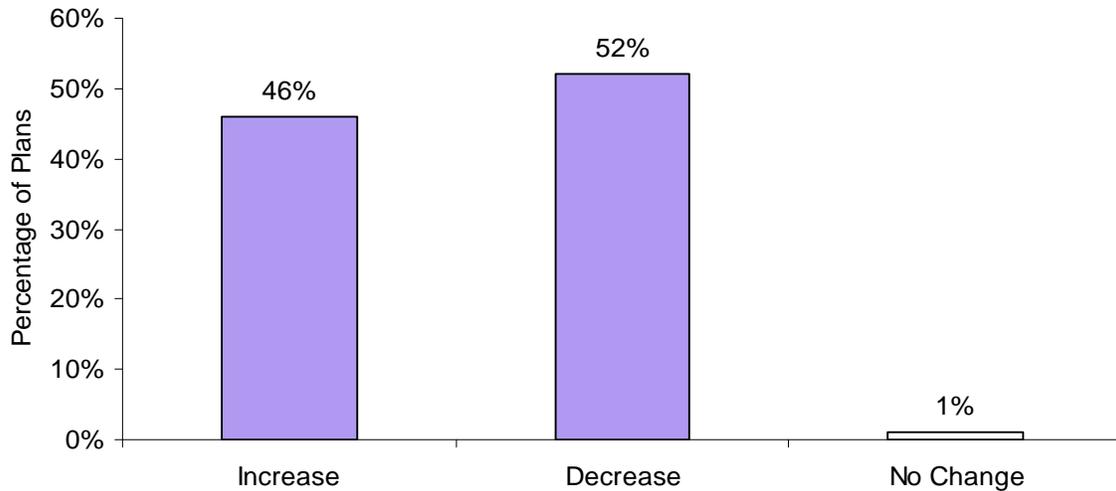


<sup>86</sup> Sample size = 870. Catch-up contributions are included in these elective deferral dollar amounts.

## **Elective Deferrals as a Percentage of Compensation**

During the same 2006 to 2008 period, 46% of section 401(k) plans experienced an increase in the percent of employee compensation deferred under the plan while 52% experienced a decrease (see Figure 30).<sup>87</sup>

**Figure 30: Plans Experiencing a Change in Percent of Employee Compensation Deferred Under the Plan From 2006 – 2008**



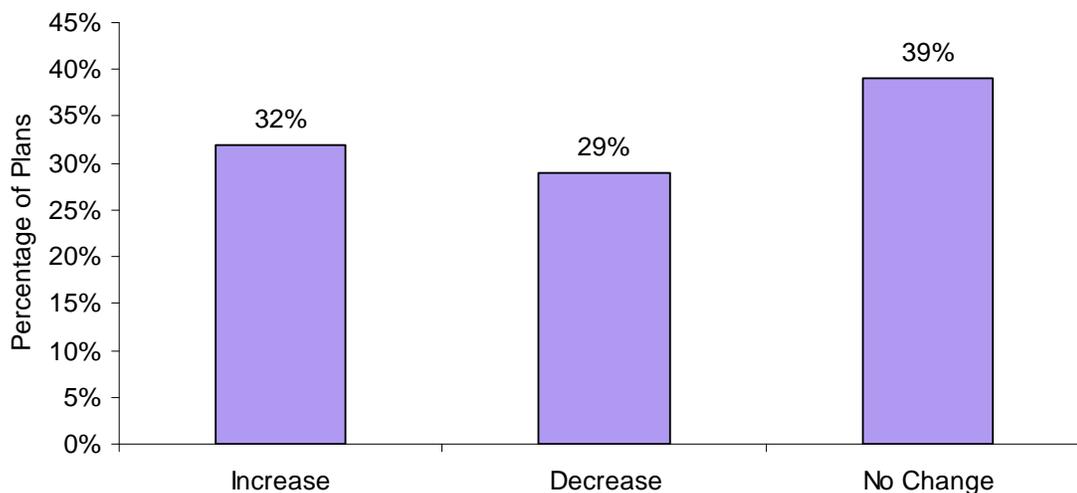
<sup>87</sup> Sample size = 882. The total percentage is less than 100% due to rounding.

## **Changes in Catch-Up Contributions**

As noted earlier, almost all section 401(k) plans (96%) allow participants age 50 and older to make catch-up contributions. Figure 31 depicts the percentage of section 401(k) plans that allowed catch-up contributions that experienced a change in catch-up contributions from 2006 to 2008.<sup>88</sup>

The change in catch-up contributions made per participant from 2006 to 2008 differs based on plan size. A very large plan is more likely than a small, medium or large plan to have a per-participant increase in the dollar amount of catch-up contributions.<sup>89</sup> Small and medium plans are more likely than large and very large plans to have no change in the dollar amount of catch-up contributions per participant.<sup>90</sup>

**Figure 31: Plans Experiencing a Per-Participant Change in the Dollar Amount of Catch-Up Contributions From 2006 - 2008**



<sup>88</sup> Sample size = 430.

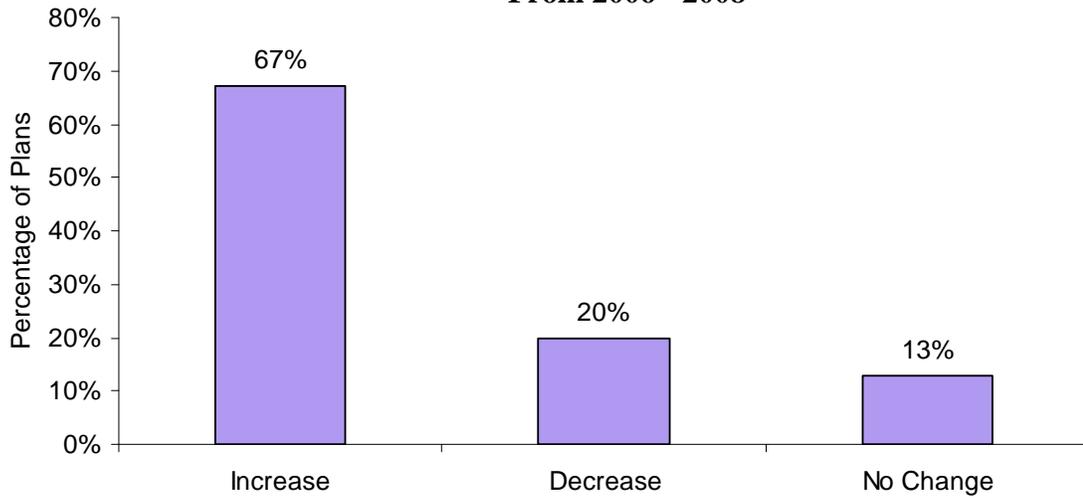
<sup>89</sup> Small Plans: Point estimate = 21%, Margin of error = 17%, Sample size = 24; Medium Plans: Point Estimate = 30%, Margin of error = 7%, Sample size = 172; Large Plans: Point estimate = 41%, Margin of error = 12%, Sample size = 66; Very Large Plans: Point estimate = 63%, Margin of error = 7%, Sample size = 168.

<sup>90</sup> Small Plans: Point estimate = 63%, Margin of error = 20%, Sample size = 24; Medium Plans: Point Estimate = 48%, Margin of error = 7%, Sample size = 172; Large Plans: Point estimate = 8%, Margin of error = 6%, Sample size = 66; Very Large Plans: Point estimate = 2%, Margin of error = 2%, Sample size = 168.

## **Changes in Employee After-Tax Contributions**

As noted previously, only 4% of section 401(k) plans permit employees to make employee after-tax contributions. Figure 32 shows that section 401(k) plans are more likely to experience a per-participant increase in the dollar amount of employee after-tax contributions over the 2006 to 2008 period.<sup>91</sup>

**Figure 32: Plans Experiencing a Per-Participant Change in the Dollar Amount of Employee After-Tax Contributions From 2006 - 2008**



<sup>91</sup> Sample size = 59, Increase margin of error = 25%, Decrease margin of error = 20%.

## CHANGES IN EMPLOYER CONTRIBUTIONS

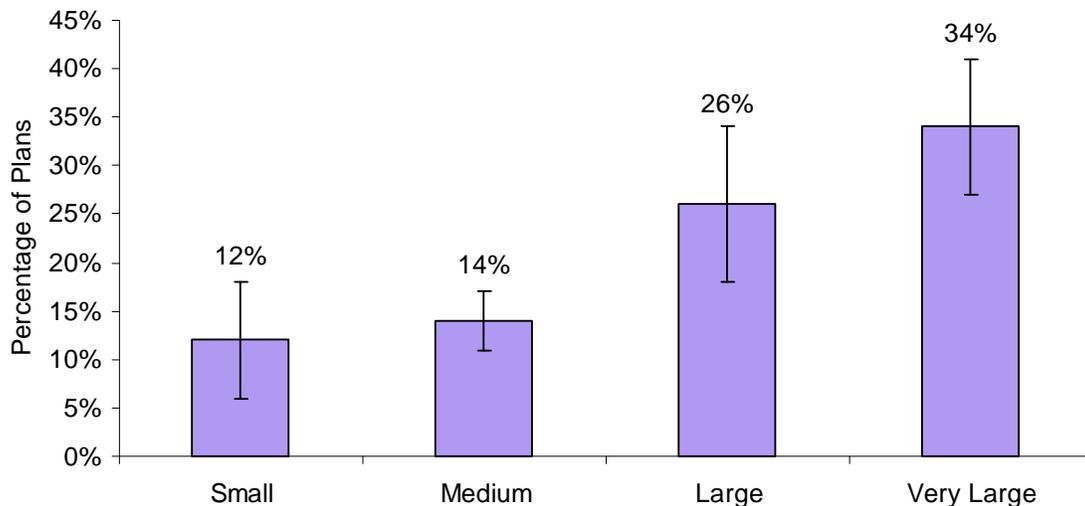
We asked respondents whether matching or nonelective employer contributions were suspended, discontinued or reduced during the period 2006 through 2008. Specifically, plan sponsors were asked whether, at any time during such period, there was:

- a suspension or discontinuance of matching contributions;
- a reduction of matching contributions;
- a suspension or discontinuance of nonelective contributions; or
- a reduction of nonelective contributions.

### **Overall Changes in Employer Contributions for the Period**

Overall, 15% of section 401(k) plan sponsors reported a suspension, reduction or discontinuance of matching or nonelective contributions during the period 2006 through 2009.<sup>92</sup> As shown in Figure 33, very large plans were more likely than small or medium plans to have experienced a suspension, discontinuance or reduction of such contributions during such period.<sup>93</sup>

**Figure 33: Percentage of Plans That Have Experienced a Suspension, Reduction or Discontinuance of Matching or Nonelective Contributions**



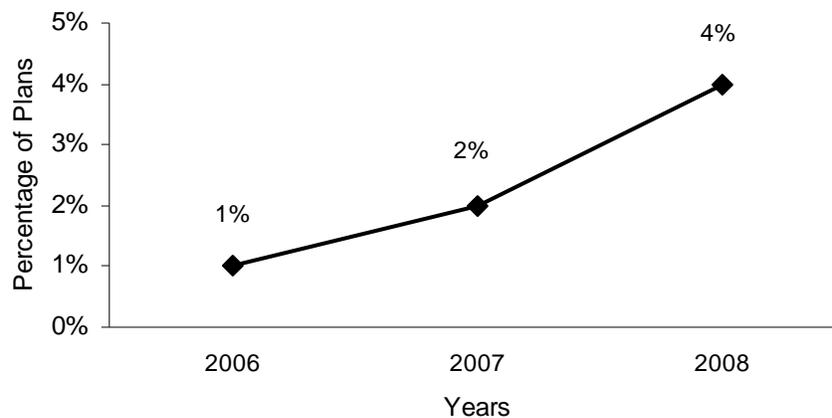
<sup>92</sup> Sample size = 1,027.

<sup>93</sup> Small Plans: Margin of error = 6%, Sample size = 133; Medium Plans: Margin of error = 3%, Sample size = 591; Large Plans: Margin of error = 8%, Sample size = 113; Very Large Plans: Margin of error = 7%, Sample size = 190.

## **Suspension or Discontinuance of Matching Contributions**

Figure 34 shows the increase in the percentage of section 401(k) plans that experienced a suspension or discontinuance of employer matching contributions during such time period.<sup>94</sup>

**Figure 34: Percentage of Plans That Suspended or Discontinued Matching Contributions**



## **Reduction of Matching Contributions**

One percent of all section 401(k) plans reduced employer matching contributions each year from 2006 to 2008.<sup>95</sup>

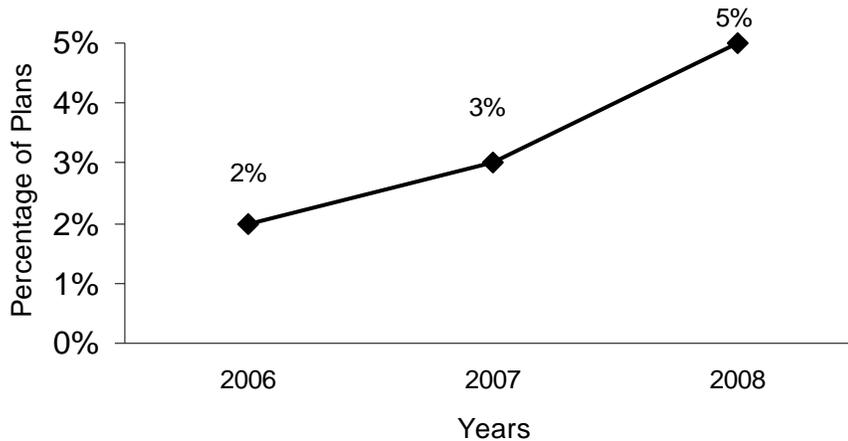
<sup>94</sup> Sample size (2006) = 948; sample size (2007) = 1,015; sample size (2008) = 1,016. A discussion specific to the suspension or discontinuance of matching contributions under safe harbor plans during the period 2006 through 2008 is provided in a later section of this report.

<sup>95</sup> Sample size (2006) = 948; sample size (2007) = 1,015; sample size (2008) = 1,016.

## **Suspension or Discontinuance of Nonelective Contributions**

Figure 35 depicts the increase in the percentage of section 401(k) plans in which nonelective contributions were suspended or discontinued from 2006 to 2008.<sup>96</sup>

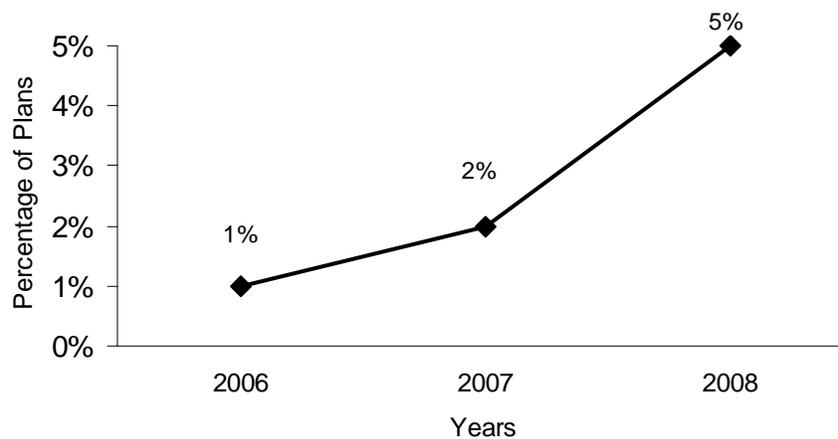
**Figure 35: Percentage of Plans That Suspended or Discontinued Nonelective Contributions**



## **Reduction of Nonelective Contributions**

Figure 36 depicts the increase in the percentage of section 401(k) plans in which nonelective contributions were reduced from 2006 through 2008.<sup>97</sup>

**Figure 36: Percentage of Plans That Reduced Nonelective Contributions**



<sup>96</sup> Sample size (2006) = 949; sample size (2007) = 1,016; sample size (2008) = 1,017.

<sup>97</sup> Sample size (2006) = 949; sample size (2007) = 1,016; sample size (2008) = 1,017.

## **NONDISCRIMINATION TESTING OF ELECTIVE DEFERRALS**

In general, employers that sponsor section 401(k) plans are required to demonstrate that their plans do not discriminate in favor of highly compensated employees (within the meaning of Code section 414(q)) by running the actual deferral percentage (ADP) test.<sup>98</sup> The ADP test is an objective test that provides a limit on the amount of elective deferrals that may be made to the plan on behalf of highly compensated employees (HCEs) as compared to the amount of elective deferrals made to the plan on behalf of nonhighly compensated employees (NHCEs). ADP testing is not required for SIMPLE section 401(k) plans described in section 401(k)(11) or for safe harbor section 401(k) plans described in Code section 401(k)(12) or 401(k)(13).

Plan sponsors were asked on the 401(k) Questionnaire to respond to questions related to:

- applying the ADP test;
- correcting ADP test failures; and
- the timing of ADP test corrective distributions.

### **Applying the ADP Test**

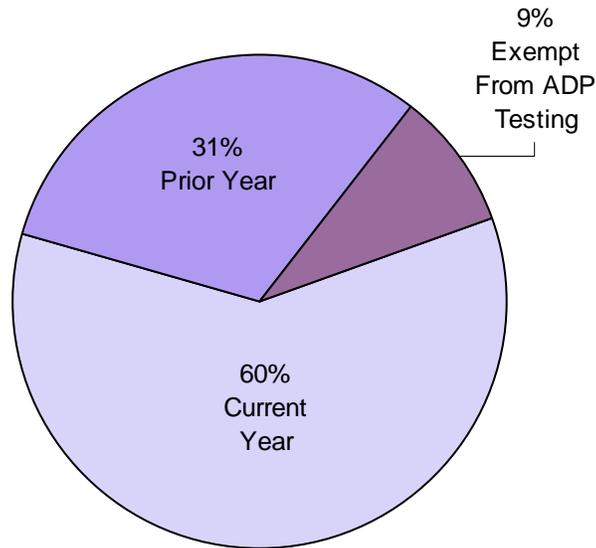
Effective for plan years beginning after December 31, 1996, plan administrators are permitted to apply the ADP test using prior year data in determining the actual deferral percentages of NHCEs.

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<sup>98</sup> IRC § 401(k)(3).

Figure 37 depicts the testing method used by section 401(k) plan sponsors subject to the ADP test.<sup>99</sup>

**Figure 37: Testing Method Used for ADP Testing**



### **Correcting ADP Test Failures**

If a section 401(k) plan fails the ADP test, the sponsor must take corrective action to protect the qualified status of the plan. The amount of elective deferral contributions allocated to the plan account of an HCE that is greater than that permitted under the ADP test is referred to as an excess contribution. A plan sponsor may correct excess contributions in one of the following ways:

- the plan sponsor may make additional contributions to the NHCEs in the plan in the form of qualified nonelective contributions (QNECs) or qualified matching contributions (QMACs) that are treated as elective deferrals for purposes of the ADP test;
- the excess contributions may be recharacterized as employee after-tax contributions;
- excess contributions, together with any corresponding earnings, may be distributed to HCEs; or
- a plan sponsor may use a combination of the foregoing correction methods.<sup>100</sup>

<sup>99</sup> Sample size = 644. Nine percent of the population identifies as exempt from ADP testing despite reporting that they made a correction in 2008.

<sup>100</sup> Treas. Reg. § 1.401(k)-2(b)(1).

Figure 38 shows the method of correction used by those plan sponsors subject to the ADP test who made a correction of excess contributions.

**Figure 38: Usage of Correction Methods by Plan Year**

<b>Method of Correction</b>	<b>2006</b> <sup>101</sup>	<b>2007</b> <sup>102</sup>	<b>2008</b> <sup>103</sup>
Distribution of excess contributions and related earnings	61% <sup>104</sup>	58% <sup>105</sup>	67% <sup>106</sup>
Additional contributions of QNECs	4%	3%	4%
Additional contributions of QMACs	0%	0%	0%
Recharacterizing elective deferrals as employee after-tax contributions	23% <sup>107</sup>	26% <sup>108</sup>	17%
More than one correction method	5%	7%	7%
Other method	7%	6%	4%

### **The Timing of ADP Test Corrective Distributions**

In order to preserve the qualified status of a section 401(k) plan, distributions of excess contributions must be completed by the end of the 12-month period following the close of the plan year in which the excess contributions occurred.<sup>109</sup> If corrective distributions are made after the first 2½ months following the end of the year of the excess, the employer is liable for an excise tax.<sup>110</sup>

<sup>101</sup> Sample size = 163.

<sup>102</sup> Sample size = 181.

<sup>103</sup> Sample size = 177. The total percentage is less than 100% due to rounding.

<sup>104</sup> Margin of error = 9%.

<sup>105</sup> Margin of error = 8%.

<sup>106</sup> Margin of error = 8%.

<sup>107</sup> Margin of Error = 8%.

<sup>108</sup> Margin of error = 8%.

<sup>109</sup> IRC § 401(k)(8); Treas. Reg. § 1.401(k)-2(b)(2)(v).

<sup>110</sup> IRC § 4979(f).

Figure 39 shows the percentage of section 401(k) plan sponsors subject to the ADP test that corrected excess contributions either within 2½ months or after 2½ months for each of the 2006, 2007 and 2008 plan years.<sup>111</sup> Figure 39 also indicates the percentage of section 401(k) plans subject to the ADP test for which correction was not applicable for each such plan year.

**Figure 39: Percentage of Plan Sponsors Correcting Excess Contributions by Time of Correction and Plan Year**

<b>Time of Correction</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Within 2½ months	63% <sup>112</sup>	67% <sup>113</sup>	68% <sup>114</sup>
Later than 2½ months	9%	11%	13%
Not Applicable	28% <sup>115</sup>	22%	18%

Figure 40 shows the percentage of section 401(k) plan sponsors subject to the ADP test that made corrective distributions of excess contributions either within 12 months or after 12 months for each of the 2006, 2007 and 2008 plan years.<sup>116</sup> Figure 40 also states the percentage of section 401(k) plans subject to the ADP test for which correction was not applicable for each such plan year.

**Figure 40: Correction Time for Excess Contributions for Years 2006-2008**

<b>Time of Correction</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Within 12 months	60% <sup>117</sup>	65% <sup>118</sup>	69% <sup>119</sup>
Later than 12 months	1%	2%	3%
Not Applicable	39% <sup>120</sup>	32% <sup>121</sup>	28% <sup>122</sup>

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<sup>111</sup> Sample size = 163.

<sup>112</sup> Margin of error = 9%.

<sup>113</sup> Margin of error = 8%.

<sup>114</sup> Margin of error = 8%. The total percentage is less than 100% due to rounding.

<sup>115</sup> Margin of error = 9%.

<sup>116</sup> Sample size = 163.

<sup>117</sup> Margin of error = 9%.

<sup>118</sup> Margin of error = 8%. The total percentage is less than 100% due to rounding.

<sup>119</sup> Margin of error = 8%.

<sup>120</sup> Margin of error = 9%.

<sup>121</sup> Margin of error = 8%.

<sup>122</sup> Margin of error = 8%.

## **NONDISCRIMINATION TESTING OF MATCHING CONTRIBUTIONS**

The actual contribution percentage (ACP) test is an objective test under the Code that provides a limit on the amount of matching contributions and employee after-tax contributions that may be made under a section 401(k) plan on behalf of HCEs as compared to the amount of matching contributions and employee after-tax contributions that may be made under the plan on behalf of NHCEs. The ACP test is not required for SIMPLE section 401(k) plans described in section 401(m)(10), or for most safe harbor section 401(k) plans described in Code section 401(m)(11) or 401(m)(12).<sup>123</sup>

Plan sponsors were asked to respond to questions related to:

- applying the ACP test;
- correcting ACP testing failures; and
- the timing of ACP test corrective distributions.

### **Applying the ACP Test**

Under the ACP test, each participant's contribution percentage is determined by dividing the participants' applicable contributions by the compensation defined in the plan document. The average of the contribution percentages of HCEs is compared to the average of the contribution percentages of NHCEs. Effective for plan years beginning after December 31, 1996, plan administrators are permitted to apply the ACP test using prior year data in determining the contribution percentages of NHCEs. Alternatively, a plan administrator may perform the ACP test using current year data for both HCEs and NHCEs. Sixty percent of plan sponsors current year data, while 31% use prior year data. Seven percent of section 401(k) plans are not subject to ACP testing.<sup>124</sup>

### **Correcting ACP Test Failures**

If a section 401(k) plan fails the ACP test, corrective action must be taken to protect the qualified status of the plan. The amount of matching contributions or employee after-tax contributions allocated to the plan account of an HCE that is greater than that permitted under the ACP test is referred to as an excess aggregate contribution. A plan sponsor may correct excess aggregate contributions in one of the following ways:

- the plan sponsor may make additional contributions to the NHCEs in the plan in the form of matching contributions or qualified nonelective contributions (QNECs);
- excess aggregate contributions may be distributed to HCEs or forfeited in accordance with applicable regulations; or
- a plan sponsor may use a combination of the foregoing correction methods.<sup>125</sup>

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<sup>123</sup> IRC § 401(m)(1).

<sup>124</sup> Sample size = 454. The total percentage is not equal to 100% due to rounding.

<sup>125</sup> Treas. Reg. § 1.401(m)-2(b)(1).

Figure 41 shows the percentages of section 401(k) plan sponsors subject to the ACP test that corrected excess aggregate contributions from 2006 to 2008 using various methods.

**Figure 41: Percentages of Plan Sponsors Correcting Excess Aggregate Contributions by Method of Correction and Plan Year**

<b>Method of Correction</b>	<b>2006</b> <sup>126</sup>	<b>2007</b> <sup>127</sup>	<b>2008</b> <sup>128</sup>
Distribution of excess aggregate contributions	83% <sup>129</sup>	88% <sup>130</sup>	90% <sup>131</sup>
Additional contributions of QNECs	0%	0%	0%
Additional contributions of QMACs	0%	0%	0%
More than one correction method	4% <sup>132</sup>	0%	0%
Other method	12% <sup>133</sup>	12% <sup>134</sup>	10% <sup>135</sup>

### **The Timing of ACP Test Corrective Distributions**

In order to preserve the qualified status of a section 401(k) plan, distributions of excess aggregate contributions must be completed by the end of the 12-month period following the close of the plan year in which the excess aggregate contributions occurred.<sup>136</sup> If corrective distributions are made after the first 2½ months following the end of the year of the excess, the employer is liable for an excise tax.<sup>137</sup>

<sup>126</sup> Sample size = 40. The total percentage is less than 100% due to rounding.

<sup>127</sup> Sample size = 46.

<sup>128</sup> Sample size = 47.

<sup>129</sup> Margin of error = 15%.

<sup>130</sup> Margin of error = 11%.

<sup>131</sup> Margin of error = 11%.

<sup>132</sup> Margin of error = 8%.

<sup>133</sup> Margin of error = 13%.

<sup>134</sup> Margin of error = 11%.

<sup>135</sup> Margin of error = 11%.

<sup>136</sup> IRC § 401(m)(6); Treas. Reg. § 1.401(m)-2(b)(2)(v).

<sup>137</sup> IRC § 4979(f).

Figure 42 shows the percentage of section 401(k) plan sponsors subject to the ACP test that corrected excess aggregate contributions either within 2½ months or after 2½ months for each of the 2006, 2007 and 2008 plan years. Figure 42 also shows the percentage of section 401(k) plan sponsors subject to the ACP test for which a correction was not applicable for each such plan year.

**Figure 42: Percentage of Plan Sponsors Correcting Excess Aggregate Contributions by Time of Distribution and Plan Year**

<b>Time of Distribution</b>	<b>2006<sup>138</sup></b>	<b>2007<sup>139</sup></b>	<b>2008<sup>140</sup></b>
Within 2½ months	79%	78%	76%
Later than 2½ months	12%	19%	17%
Not Applicable	8%	3%	7%

Figure 43 shows the percentage of section 401(k) plan sponsors subject to the ACP test that corrected excess aggregate contributions either within 12 months or after 12 months for each of the 2006, 2007 and 2008 plan years. Figure 43 also states the percentage of section 401(k) plans subject to the ACP test for which correction was not applicable for each such plan year.

**Figure 43: Correction Time for Excess Aggregate Contributions for Years 2006-2008**

<b>Time of Correction</b>	<b>2006<sup>141</sup></b>	<b>2007<sup>142</sup></b>	<b>2008<sup>143</sup></b>
Within 12 months	72%	91%	83%
Later than 12 months	4%	0%	3%
Not Applicable	25%	9%	14%

<sup>138</sup> Sample size = 40. The total percentage is less than 100% due to rounding. Margin of Error: Within 2½ months = 16%, Later than 2½ months = 13%, Not Applicable = 11%.

<sup>139</sup> Sample size = 46. Margin of Error: Within 2½ months = 14%, Later than 2½ months = 13%.

<sup>140</sup> Sample size = 47. Margin of Error: Within 2½ months = 16%, Later than 2½ months = 14%, Not Applicable = 9%.

<sup>141</sup> Sample size = 40. The total percentage is more than 100% due to rounding. Margin of Error: Within 12 months = 18%, Later than 12 months = 8%, Not Applicable = 18%.

<sup>142</sup> Sample size = 46. Margin of Error: Within 12 months = 10%, Not Applicable = 10%.

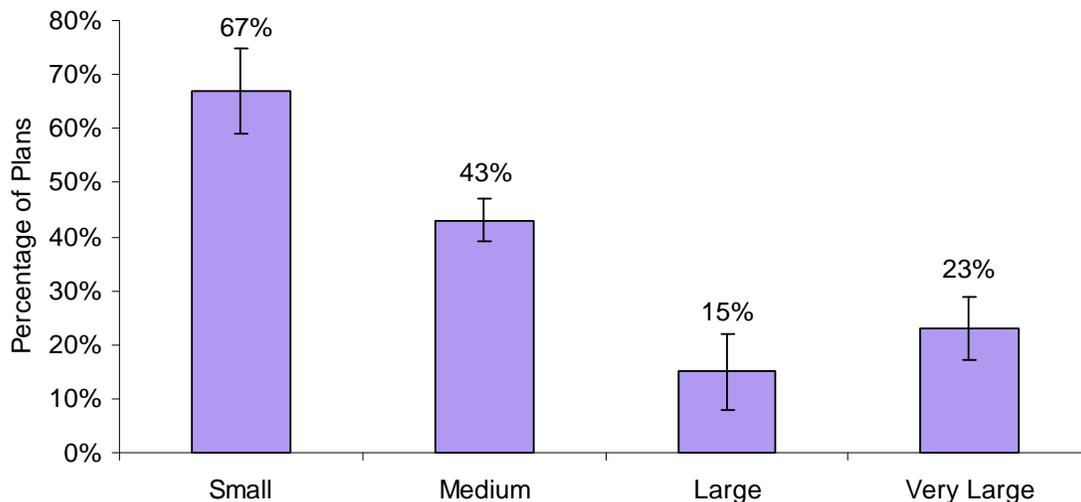
<sup>143</sup> Sample size = 47. Margin of Error: Within 12 months = 14%, Not Applicable = 13%.

## SAFE HARBOR SECTION 401(k) PLANS

Section 401(k) plans that satisfy the safe harbor requirements described in Code sections 401(k)(12) or 401(k)(13) and 401(m)(11) or 401(m)(12) are deemed to provide nondiscriminatory elective deferral contributions and matching contributions. Accordingly, safe harbor plans are not required to demonstrate that elective deferral contributions are nondiscriminatory under the ADP test of Code section 401(k)(3), or that matching contributions are nondiscriminatory under the ACP test of Code section 401(m)(2).

Forty-three percent of section 401(k) plans are safe harbor plans.<sup>144</sup> The likelihood that a section 401(k) plan is a safe harbor plan differs based on plan size. As shown in Figure 44, small plans are more likely than medium, large or very large plans to be safe harbor plans. Additionally, medium plans are more likely than large or very large plans to be safe harbor plans.<sup>145</sup>

**Figure 44: Plans That are a Safe Harbor Plan**



Safe harbor plans that satisfy the requirements of Code section 401(k)(12) and 401(m)(11) are commonly referred to as “traditional” safe harbor plans. Effective for plan years beginning on or after January 1, 2008, plan sponsors may alternatively establish or adopt a safe harbor plan that meets the requirements described in Code sections 401(k)(13) and 401(m)(12). A safe harbor plan that satisfies Code sections 401(k)(13) and 401(m)(12) is referred to as a “qualified automatic contribution arrangement” or “QACA.”

<sup>144</sup> Sample size = 1,026.

<sup>145</sup> Small plans: sample size = 133, margin of error = 8%; Medium plans: sample size = 590, margin of error = 4%; Large plans: sample size = 113, margin of error = 7%; Very Large plans: sample size = 190, margin of error = 6%.

The 401(k) Questionnaire asked safe harbor section 401(k) plan sponsors to provide information about:

- employer contributions;
- notice requirements; and
- suspension, discontinuance, or reduction of matching contributions.

### **Employer Contributions Under Safe Harbor Plans**

In order to constitute a safe harbor plan, a section 401(k) plan must provide for certain minimum matching or nonelective employer contributions. A safe harbor plan may satisfy the minimum matching contribution requirement by providing either a basic or an enhanced matching contribution. The basic matching contribution for a section 401(k)(12), or traditional, safe harbor plan is a contribution equal to:

- one hundred percent of the employee's elective deferrals up to 3% of compensation and
- fifty percent of the employee's elective deferrals to the extent that such elective deferrals exceed 3% but do not exceed 5 percent of the employee's compensation.

An enhanced matching contribution may be contributed by the employer in lieu of the basic matching contribution. The enhanced matching contribution will satisfy the safe harbor requirements if:

- the rate of the employer's matching contribution does not increase as an employee's rate of elective deferrals increases; and
- the aggregate amount of matching contributions at any rate of elective deferrals is at least equal to the aggregate amount of matching contributions that would be made under the basic matching formula for the type of safe harbor plan involved.<sup>146</sup>

Alternatively, a safe harbor plan may provide for a nonelective contribution that, unlike a matching contribution, must be contributed to the plan regardless of whether employees make elective deferral contributions. In order to meet the safe harbor requirements, such a nonelective contribution must be:

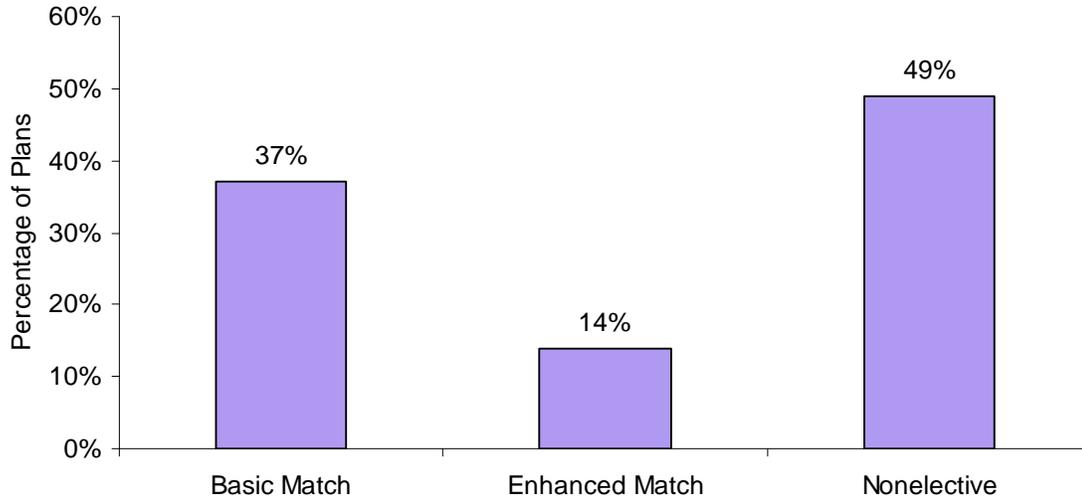
- equal to 3 percent of compensation; and
- generally made to every employee.

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<sup>146</sup> IRC §§ 401(k)(12)(B)(iii) and 401(k)(13)(D)(ii).

Figure 45 shows the percentage of safe harbor section 401(k) plans that satisfy the safe harbor requirements by providing basic matching contributions, enhanced matching contributions, and nonelective contributions.<sup>147</sup>

**Figure 45: Types of Contributions Provided by Section 401(k) Safe Harbor Plans**



### **Notice Requirements Under Safe Harbor Plans**

In order to satisfy the section 401(k) safe harbor requirements, each employee eligible to participate must, within a reasonable period before any plan year, be given notice of the employee's rights and obligations under the arrangement.<sup>148</sup> The Code does not specify exactly how the notice must be delivered to eligible employees.

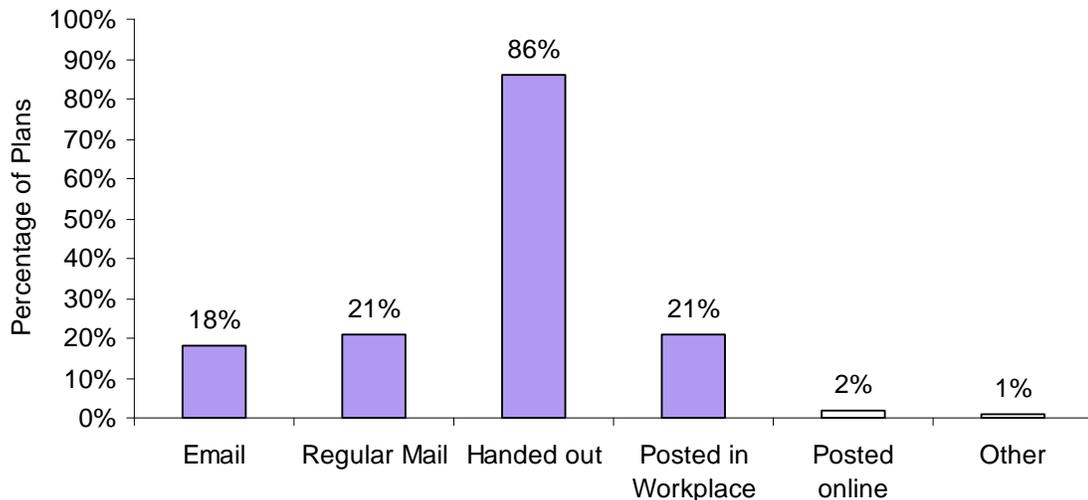
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<sup>147</sup> Sample size = 400.

<sup>148</sup> IRC §§ 401(k)(12)(D) and 401(k)(13)(E); Treas. Reg. § 1.401(k)-3(d).

Figure 46 provides the breakdown of the methods safe harbor section 401(k) plan sponsors use to provide the safe harbor notice to eligible employees.<sup>149</sup>

**Figure 46: Methods Used for Providing Safe Harbor Notices**



### **Suspension, Discontinuance or Reduction of Matching Contributions Under Safe Harbor Plans**

Safe harbor plans are generally required to be adopted before the first day of the plan year and remain in effect for an entire 12-month period.<sup>150</sup> Notwithstanding this general rule, a plan sponsor may reduce or suspend safe harbor matching contributions mid-year, but only if:

- eligible employees are provided at least 30 days advance notice before the reduction or suspension is effective;
- eligible employees are given a reasonable opportunity after receiving such notice, and prior to the reduction or suspension of basic or enhanced matching contributions, to change their cash or deferred elections and, if applicable, employee after-tax contribution elections; and
- the plan is amended to provide that the ADP and ACP tests will be satisfied for the entire plan year in which the reduction or suspension occurs.<sup>151</sup>

Due to overlapping margins of error, our analysis did not reveal any difference in the percentage of plans that reduced basic or enhanced matching contributions between 2006 (3%) and 2008 (11%). Likewise, our analysis did not show a difference in the percentage of plans that suspended or discontinued basic or enhanced matching contributions between 2006 (3%) and 2008 (11%).<sup>152</sup>

<sup>149</sup> Sample size = 400. Instructions for this question permitted respondents to select more than one of the categories shown in the Figure.

<sup>150</sup> Treas. Reg. § 1.401(k)-3(e).

<sup>151</sup> Treas. Reg. § 1.401(k)-3(g)(1). See also Reg. § 1.401(m)-3(h)(1).

<sup>152</sup> Sample size (2006) = 44; Sample size (2007) = 48; Sample size (2008) = 51.

## **QUALIFIED AND OTHER AUTOMATIC CONTRIBUTION ARRANGEMENTS**

An automatic contribution arrangement (ACA) is a feature available under section 401(k) plans under which eligible employees are deemed to have made an elective deferral election at a specified level (default deferral percentage), unless the employee has made an affirmative election to have deferrals made at a different level or to not have any deferrals made to the plan. An ACA feature may be included in a non-safe harbor section 401(k) plan, a safe harbor section 401(k) plan under Code sections 401(k)(12) and 401(m)(11), or a qualified automatic contribution arrangement (QACA) under Code sections 401(k)(13) and 401(m)(12).

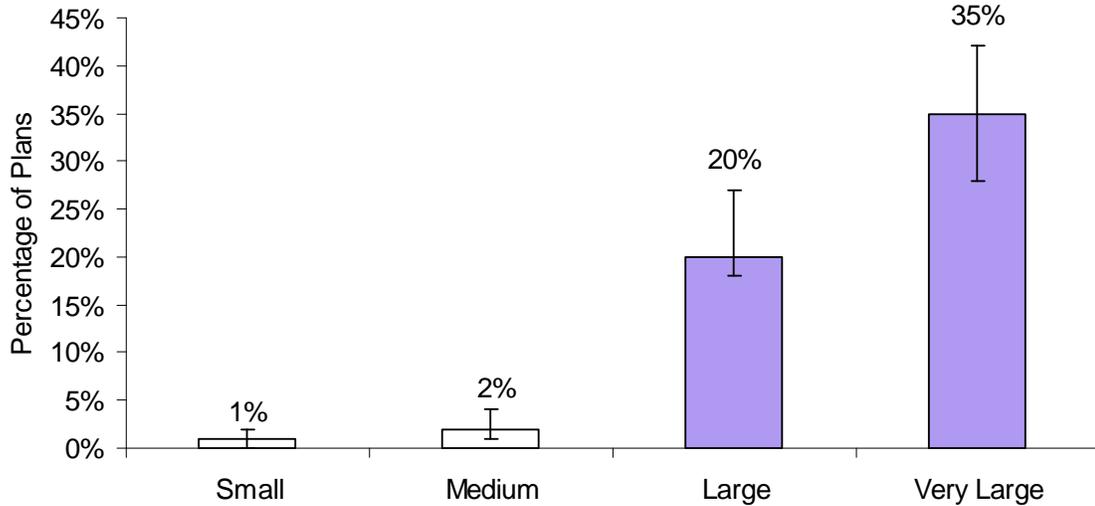
A QACA is a safe harbor section 401(k) plan arrangement that first became available for plan years beginning on or after January 1, 2008. If the requirements applicable to a QACA are met, the plan does not have to perform the ADP or ACP nondiscrimination tests. A key distinction between a QACA, as set forth in Code sections 401(k)(13) and 401(m)(12), and a traditional safe harbor section 401(k) plan described in Code sections 401(k)(12) and 401(m)(11) is that a QACA must include an ACA.

In addition, effective for plan years beginning on or after January 1, 2008, an ACA that satisfies certain requirements set forth in Code section 414(w) may allow employees to withdraw their default elective deferral contributions (and attributable earnings) from a section 401(k) plan without the 10% additional tax that would otherwise apply to early (certain pre-retirement) withdrawals. Under Code section 414(w), the request for such a withdrawal must be made within 90 days after the first default elective deferral contribution under the ACA is made. An ACA that satisfies the requirements of Code section 414(w) is referred to as an “eligible automatic contribution arrangement,” or “EACA.”

## **ACAs in Section 401(k) Plans**

Five percent of all section 401(k) plans have some form of ACA.<sup>153</sup> As shown in Figure 47 large and very large plans are more likely to have an ACA than small or medium plans.<sup>154</sup>

**Figure 47: Percentage of 401(k) Plans That Have an ACA**



## **Increase in Number of ACAs**

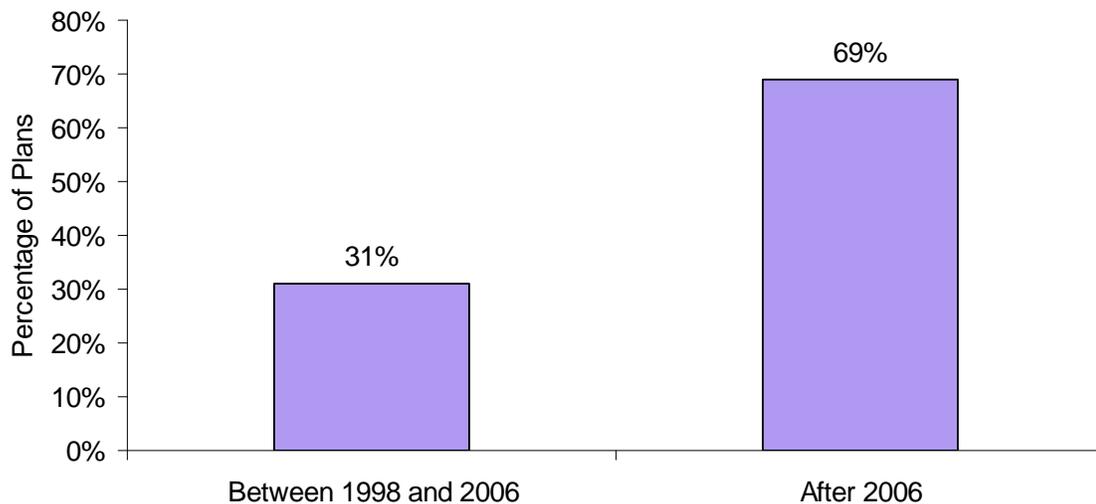
The Pension Protection Act of 2006 facilitated the adoption of ACAs by adding to the Code two new types of ACAs: QACAs and EACAs.

<sup>153</sup> Sample size = 1026.

<sup>154</sup> Small plans: sample size = 133, margin of error = 1%; Medium plans: sample size = 590, margin of error = 1%; Large plans: sample size = 113, margin of error = 7%; Very Large plans: sample size = 190, margin of error = 7%.

Figure 48 shows that a majority of sponsors of section 401(k) plans with ACAs adopted that feature after 2006.<sup>155</sup>

**Figure 48: Time Period in Which Plans Adopted an ACA**



### **QACAs and EACAs in Section 401(k) Plans**

Less than one quarter of section 401(k) plans that have an ACA feature satisfy the QACA requirements.<sup>156</sup> Moreover, less than half of section 401(k) plans that have an ACA feature satisfy the EACA requirements.<sup>157</sup> Also, less than one fifth of section 401(k) plans that have an ACA feature satisfy both the QACA and EACA requirements.<sup>158</sup>

### **ACA Default Deferral Percentages**

The default deferral percentages under an ACA may be increased over time. If the plan is structured as a QACA, the default deferral percentage must be at least 6% of compensation in the third plan year following the initial period,<sup>159</sup> and can never exceed 10%.

Less than half of section 401(k) plans with an ACA feature have a default deferral percentage that increases over some period of time.<sup>160</sup> The median maximum default

<sup>155</sup> Sample size = 104. Margin of error = 14%.

<sup>156</sup> Sample size = 104, Point Estimate = 14%, Margin of error = 9%.

<sup>157</sup> Sample size = 104, Point estimate = 27%, Margin of error = 13%.

<sup>158</sup> Sample size = 104, Point estimate = 8%, Margin of error = 8%.

<sup>159</sup> Under Treas. Reg. § 1.401(k)-3(j)(2)(ii), the initial period begins when an employee first has contributions made pursuant to a default election under the QACA. The initial period ends on the last day of the plan year following the year in which the employee first has contributions made pursuant to a default election. Accordingly, the initial period could last for as long as 2 years.

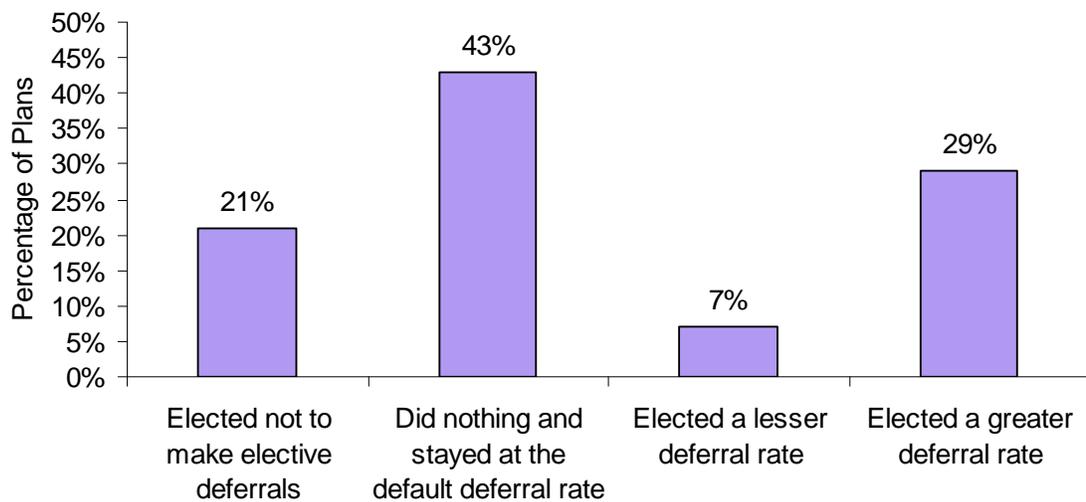
<sup>160</sup> Sample size = 104, Point estimate = 31%, Margin of error = 14%.

deferral percentage for section 401(k) plans that have an increasing default deferral percentage is 6% of compensation.<sup>161</sup>

### Frequency of Changes in Deferral Elections Under ACAs

Employees that are subject to a default deferral election under an ACA must be permitted to affirmatively elect some other deferral percentage, including zero.<sup>162</sup> Figure 49 below shows the percentage of participants who, upon being given the opportunity to change their default deferral percentage, chose to make no elective deferrals, do nothing (and stay at the default percentage), make deferrals at a lower percentage, or make deferrals at a greater percentage.<sup>163</sup>

**Figure 49: Percentage of Participants Subject to an ACA That Made Each Category of Deferral Election**



<sup>161</sup> Lower bound = 6%, Upper bound = 6%.

<sup>162</sup> See Treas. Reg. § 1.401(k)-1(e)(2).

<sup>163</sup> Sample size = 89; Margin of error: Elected not to make elective deferrals = 8%, Stayed at the default deferral rate = 10%, Elected a lesser deferral rate = 5%, Elected a greater deferral rate = 9%.

## **SIMPLE 401(k) PLANS**

Under Code sections 401(k)(11) and 401(m)(10), an employer can establish a SIMPLE 401(k) plan and avoid ADP and ACP nondiscrimination testing. A SIMPLE 401(k) plan may only be established by an employer that has no more than 100 employees who received at least \$5,000 in compensation from the employer during the preceding year. Five percent of all section 401(k) plans are SIMPLE plans.<sup>164</sup>

### **Limitations on Elective Deferral Contributions Under SIMPLE 401(k) Plans**

For 2007 and 2008, elective deferrals to a SIMPLE 401(k) plan could not exceed \$10,500.<sup>165</sup> This dollar limitation is adjusted by the Secretary of the Treasury for cost-of-living increases, in multiples of \$500. For 2006, for example, the limitation was \$10,000. Four percent of SIMPLE 401(k) plans exceeded the elective deferral limit each year from 2006 to 2008.<sup>166</sup>

### **Limitations on Employer Contributions Under SIMPLE 401(k) Plans**

Under a SIMPLE 401(k) plan, a plan sponsor must make a contribution each year of either:

- a matching contribution equal to the employee's elective deferrals (including any catch-up contributions) for the calendar year, but not to exceed 3 percent of the employee's compensation (as limited by Code section 401(a)(17)); or
- a nonelective contribution equal to 2 percent of the employee's compensation (as limited by section 401(a)(17)) for the entire calendar year for each eligible employee who had compensation of at least \$5,000 for the year.

Sixty-seven percent of SIMPLE 401(k) plan sponsors make the 3% matching contribution, while 33% percent make the 2% nonelective contribution.<sup>167</sup>

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<sup>164</sup> Sample size = 1,026.

<sup>165</sup> 2006 limit = \$10,000; 2007 and 2008 limit = \$10,500.

<sup>166</sup> Sample size = 49.

<sup>167</sup> Sample size = 49. Margin of error = 14%.

## DISTRIBUTIONS FROM SECTION 401(k) PLANS

The qualification requirements applicable to section 401(k) plans permit some plan sponsor discretion regarding the form and timing of benefit payments. The 401(k) Questionnaire asked plan sponsors to provide information regarding the form and timing of distributions under their section 401(k) plan. Specifically, data was requested regarding:

- forms of benefits;
- involuntary cash-outs of relatively small benefits of terminated employees;
- in-kind distributions;
- in-service withdrawals;
- direct rollover distributions; and
- whether distributions were properly reported to the IRS and plan participants.

### **Forms of Benefit**

Figure 50 shows the forms of benefit provided by section 401(k) plans.<sup>168</sup>

**Figure 50: Forms of Benefit Under Section 401(k) Plans**

<b>Form of Benefit</b>	<b>Plans</b>
Lump sum	99%
Installment payments	38%
Qualified joint and survivor annuity	19%
Life annuity	11%
Other	6%

### **Involuntary Cash-Outs**

Upon termination of employment, if a participant's account balance exceeds \$5,000 (not including rollovers), a section 401(k) plan generally may not require a participant to take a distribution without his or her consent.<sup>169</sup> However, if the value of the participant's account balance is \$5,000 or less, a section 401(k) plan may provide that the account balance will be distributed to the participant without his or her consent. This is known as an involuntary cash-out.<sup>170</sup>

Seventy-two percent of section 401(k) plans provide for involuntary cash-outs.<sup>171</sup> The percentage of plans that provide for involuntary cash-outs varies by plan size. As shown

<sup>168</sup> Sample size = 1,026. Instructions for this question permitted respondents to select more than one answer.

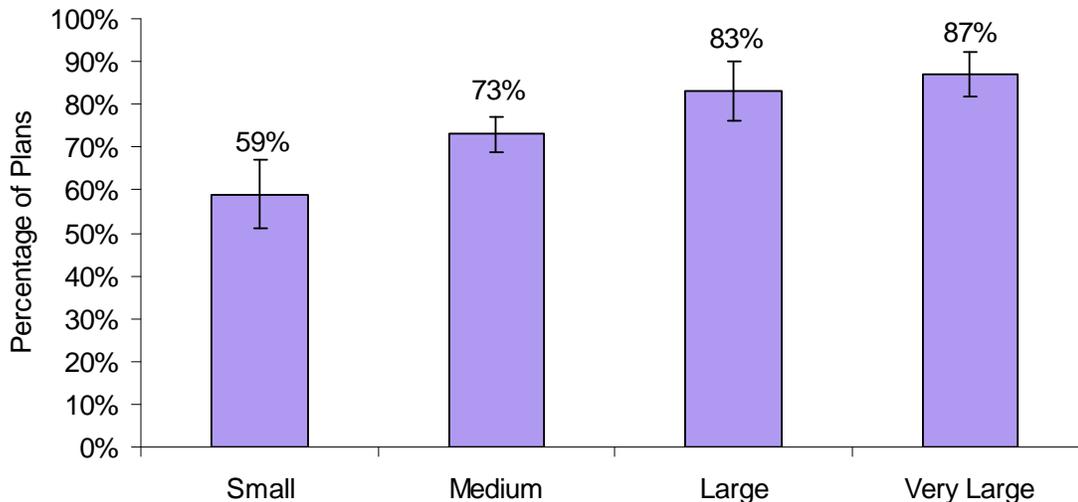
<sup>169</sup> IRC § 411(a)(11).

<sup>170</sup> IRC § 411(a)(11).

<sup>171</sup> Sample size = 1,026.

in Figure 51, very large plans are more likely than small or medium plans to allow involuntary cash-outs.<sup>172</sup>

**Figure 51: Percentage of Plans That Provide for Involuntary Cash-Outs**



Plans providing for involuntary cash-outs permit them based on different account balance thresholds. Figure 52 provides the percentage of plans that permit cash-outs based on specified account balance thresholds.<sup>173</sup>

**Figure 52: Account Balance Thresholds for Cash-Outs**

Account Balance Threshold	Plans
\$1,000	58%
\$3,500	1%
\$5,000	38%
Other Amount	3%

### **In-Kind Distributions**

A plan asset that is held in a form other than cash may be distributed to a section 401(k) plan participant in-kind. Two percent of section 401(k) plans made in-kind distributions from 2006 to 2008.<sup>174</sup>

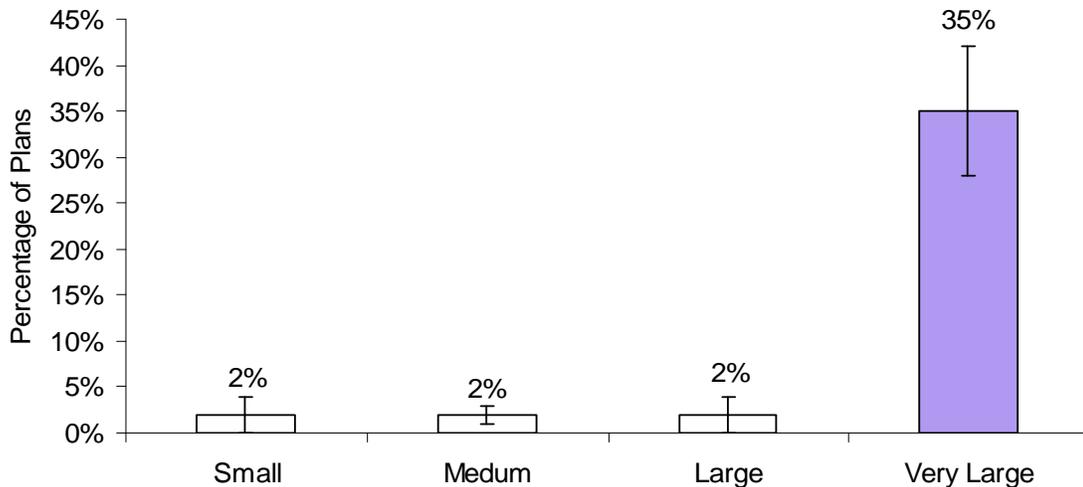
<sup>172</sup> Small Plans: Sample size = 133, Margin of error = 8%; Medium Plans: Sample size = 590, Margin of error = 4%; Large Plans: Sample size = 113, Margin of error = 7%; Very Large Plans: Sample size = 190, Margin of error = 5%.

<sup>173</sup> Sample size = 768.

<sup>174</sup> Sample size = 1,026.

The likelihood of a plan having made an in-kind distribution differs based on plan size. As shown in Figure 53, very large plans are significantly more likely than small, medium or large plans to have made an in-kind distribution.<sup>175</sup>

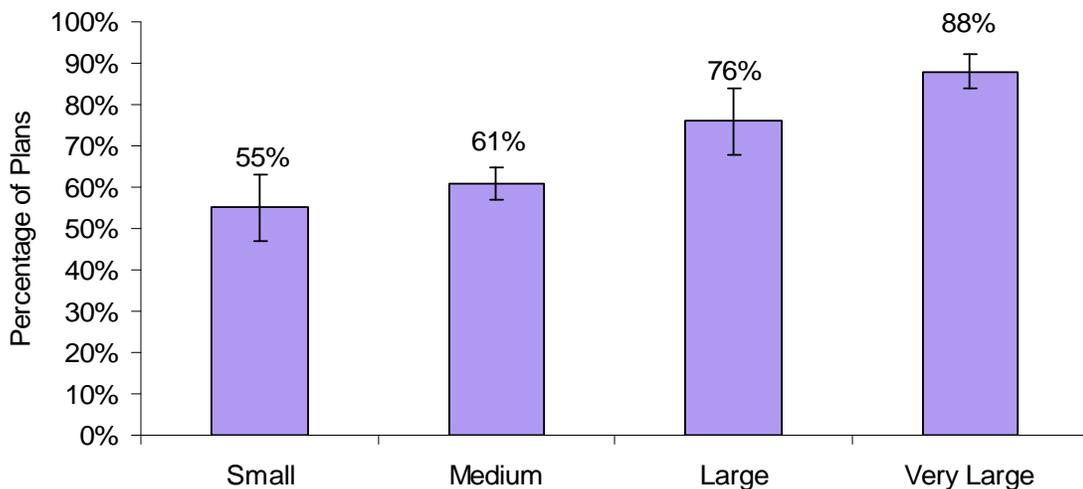
**Figure 53: Percentage of Plans That Made an In-Kind Distribution From 2006 to 2008**



**In-Service Withdrawals**

A section 401(k) plan may permit a distribution to a participant while he or she is still employed under certain circumstances. Sixty-two percent of section 401(k) plans permit in-service withdrawals other than for hardship.<sup>176</sup> As shown in Figure 54, both very large and large plans are more likely than small or medium plans to permit in-service withdrawals.<sup>177</sup>

**Figure 54: Percentage of Plans That Allow In-Service Withdrawals**



<sup>175</sup> Small Plans: Sample size = 133, Margin of error = 2%; Medium Plans: Sample size = 590, Margin of error = 1%; Large Plans: Sample size = 113, Margin of error = 2%; Very Large Plans: Sample size = 190, Margin of error = 7%.

<sup>176</sup> Sample size = 1,026.

<sup>177</sup> Small Plans: Sample size = 133, Margin of error = 8%; Medium Plans: Sample size = 590, Margin of error = 4%; Large Plans: Sample size = 113, Margin of error = 8%; Very Large Plans: Sample size = 190, Margin of error = 4%.

## **Direct Rollover Distributions**

A direct rollover from a section 401(k) plan is a direct trustee-to-trustee transfer from a section 401(k) plan to another eligible retirement plan.<sup>178</sup> A qualified plan must allow a participant to elect a direct rollover with respect to certain eligible rollover distributions.<sup>179</sup> Seventy-nine percent of section 401(k) plans permit a direct rollover distribution.<sup>180</sup>

## **Reporting of Distributions**

Distributions from a section 401(k) plan must generally be reported using IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. An employer, or its withholding agent, must provide a Form 1099-R to any section 401(k) plan participant that receives a distribution of \$10 or more. Ninety-nine percent of section 401(k) plans comply with the requirement to provide participants with a Form 1099-R for any year in which they receive a distribution.<sup>181</sup>

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<sup>178</sup> IRC § 401(a)(31).

<sup>179</sup> IRC § 401(a)(31).

<sup>180</sup> Sample size = 1,026.

<sup>181</sup> Sample size = 1,026.

## **HARDSHIP WITHDRAWALS AND PARTICIPANT LOANS**

Qualified retirement plan rules generally restrict participants' access to their account balances before they cease employment. In the case of section 401(k) plans, two exceptions to this general principle are hardship withdrawals and participant loans. The 401(k) Questionnaire asked plan sponsors to provide information regarding:

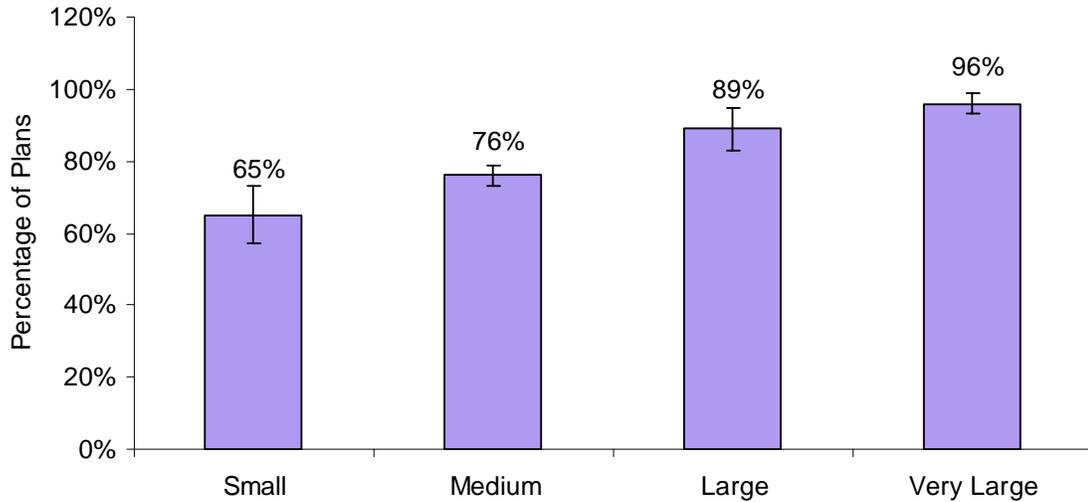
- hardship withdrawals;
- participant loans;
- employee participation in plan loans;
- whether plan loans are made on a reasonably equivalent basis and;
- plan loan interest rates, repayment periods, and repayment methods.

### **Hardship Withdrawals**

A hardship withdrawal is a distribution to a participant from his or her vested account balance in the event of an immediate and heavy financial need. A hardship withdrawal is generally a taxable distribution. In addition, under Code section 72(t), if the participant is under age 59½, the hardship withdrawal may be subject to an additional income tax equal to 10 percent of the amount withdrawn, unless certain exceptions enumerated in section 72(t) apply.

A section 401(k) plan is not required to allow hardship distributions.<sup>182</sup> Seventy-six percent of section 401(k) plans permit hardship distributions.<sup>183</sup> The likelihood that a plan allows hardship distributions differs by plan size. As shown in Figure 55 very large and large plans are more likely than small or medium plans to permit hardship distributions.<sup>184</sup>

**Figure 55: Plans That Permit Hardship Distributions**



Of the plans that permit hardship distributions, 99% allow all participants to receive such a distribution.<sup>185</sup> Figure 56 shows the percentage of section 401(k) plans that allow for a hardship distribution for specific events.<sup>186</sup>

**Figure 56: Percentage of Plans That Allow Hardship Distributions by Event**

Type of Event	Plans
Payment of Medical Expenses	98%
Purchase of Primary Residence	93%
Payment of Education Expenses	92%
Prevention of Foreclosure	94%
Payment of Funeral Expenses	86%
Making Repairs to Residence	73%
Other	4%

<sup>182</sup> Treas. Reg. § 1.401(k)-1(d)(3) provides that the determination of the existence of an immediate and heavy financial need must be made in accordance with nondiscriminatory and objective standards set forth in the plan.

<sup>183</sup> Sample size = 1,026.

<sup>184</sup> Small Plans: Sample size = 133, Margin of error = 8%; Medium Plans: Sample size = 590, Margin of error = 3%; Large Plans: Sample size = 113, Margin of error = 6%; Very Large Plans: Sample size = 190, Margin of error = 3%.

<sup>185</sup> Sample size = 820.

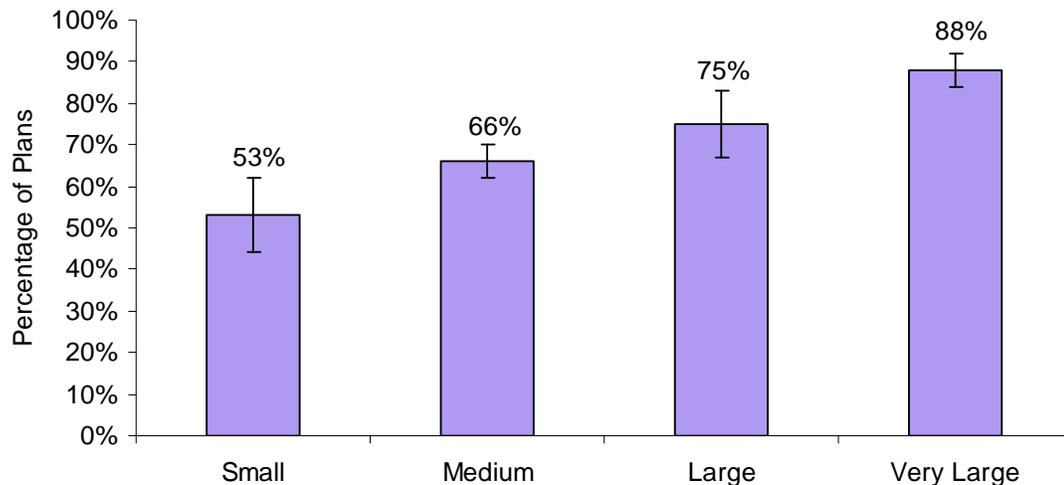
<sup>186</sup> Sample size = 820. Instructions for this question permitted respondents to select more than one answer.

## **Participant Loans**

Section 401(k) plans may, but are not required to, allow participants to borrow from their vested account balances. Such loans are subject to a number of rules and restrictions. Sixty-five percent of section 401(k) plans permit participant loans.<sup>187</sup>

The likelihood that a plan permits participant loans differs by plan size. As shown in Figure 57, very large plans are more likely than small, medium or large plans to permit participants to borrow money from the plan.<sup>188</sup>

**Figure 57: Plans That Allow Participant Loans**



## **Employee Participation in Plan Loans**

Code section 4975(d)(1)(A) provides that a participant loan will constitute a prohibited transaction unless such loans are made available to all participants or beneficiaries on a reasonably equivalent basis. Most section 401(k) plans that permit participant loans (96%) provide them to all participants.<sup>189</sup>

We asked respondents whose section 401(k) plans provided for plan loans whether participation in their plans loan program had changed from 2006 to 2008. We asked respondents about changes in the following areas:

- the number of outstanding loans at the end of the year;
- the number of loans that went into default during the year;
- the number of participants to whom loans were made; and
- the dollar amount of new loans.

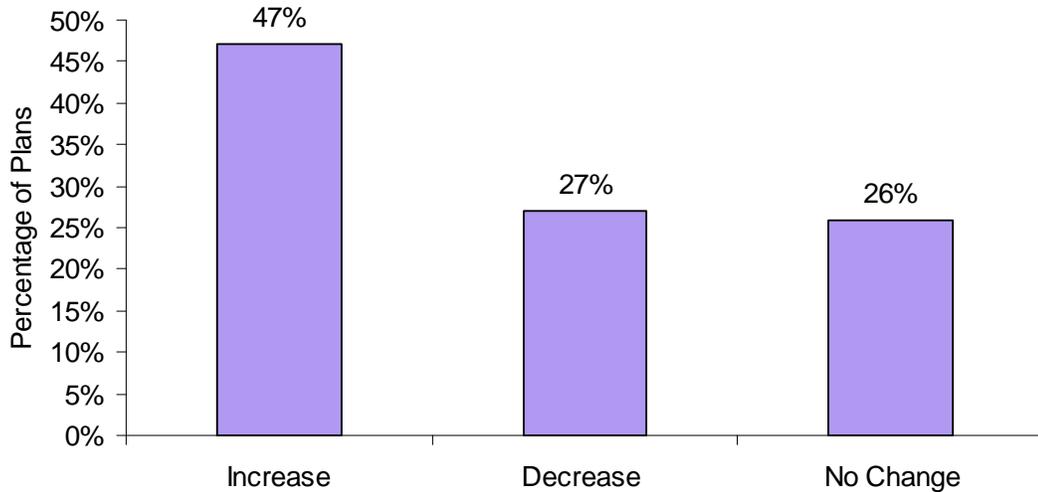
<sup>187</sup> Sample size = 1,026.

<sup>188</sup> Small Plans: Sample size = 133, Margin of error = 9%; Medium Plans: Sample size = 590, Margin of error = 4%; Large Plans: Sample size = 113, Margin of error = 8%; Very Large Plans: Sample size = 190, Margin of error = 4%.

<sup>189</sup> Sample size = 713.

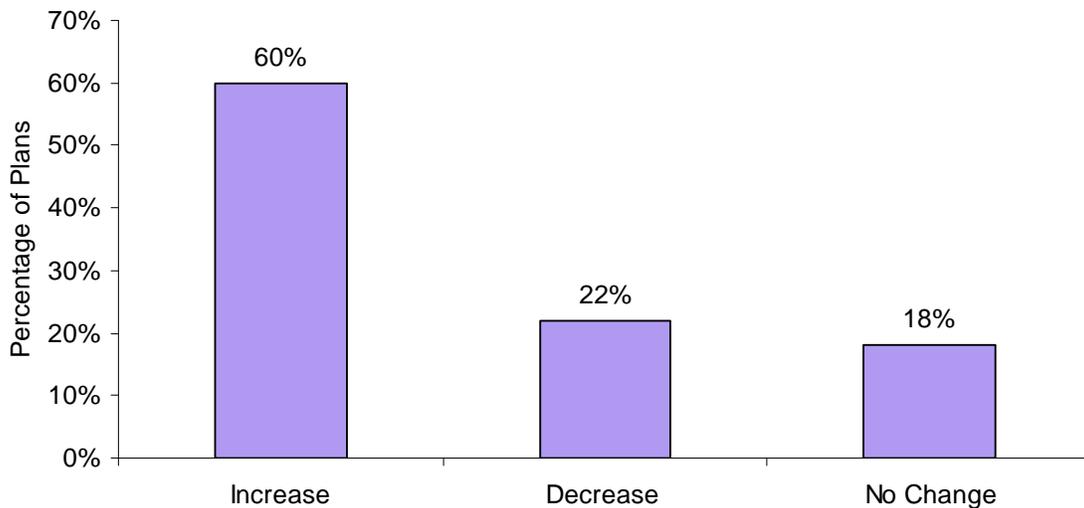
Figure 58 shows that more plans had an increase in the number of participant loans outstanding at the end of the 2008 year, as compared to the 2006 year, than experienced a decrease or no change in the number of outstanding participant loans for those years.<sup>190</sup>

**Figure 58: Change in the Number of Outstanding Participant Loans from 2006 to 2008**



As shown in Figure 59, more plans had an increase in the number of participant loans that went into default at the end of the 2008 year, as compared to the 2006 year, than had a decrease or no change in the number of participant loans that went into default for those years.<sup>191</sup>

**Figure 59: Change in the Number of Loans That Went into Default from 2006 to 2008**



<sup>190</sup> Sample size = 419.

<sup>191</sup> Sample size = 186; Margin of Error: Increase = 13%, Decrease = 10%, No Change = 9%.

Our analysis did not show a difference between the percentage of plans that had an increase, decrease, or no change in the number of participants who took out a loan from 2006 to 2008.

Respondents were asked about the number and dollar amount of new participant loans made during the period of 2006 through 2008. As shown in Figure 60, more plans had a decrease in the number of loans originated in each dollar range in the 2008 year as compared to the 2006 year than had an increase in the number of loans originated in each dollar amount range for those years.

**Figure 60: Percentage of Plans That Had a Change in the Number of Loans Originated in Each Dollar Range**

<b>Dollar Amount Range of the Loans Originated</b>	<b>Increase<sup>192</sup></b>	<b>Decrease<sup>193</sup></b>	<b>No Change<sup>194</sup></b>
Less than \$10,000 <sup>195</sup>	38%	60%	2%
At least \$10,000 but less than \$20,000 <sup>196</sup>	33%	65%	2%
At least \$20,000 but less than \$30,000 <sup>197</sup>	29%	71%	0%
At least \$30,000 but less than \$40,000 <sup>198</sup>	15%	85%	0%
At least \$40,000 but less than \$50,000 <sup>199</sup>	9%	91%	0%
\$50,000 or more <sup>200</sup>	13%	87%	0%

<sup>192</sup> Margin of Error: Less than \$10,000 = 7%, At least \$10,000 but less than \$20,000 = 9%, At least \$20,000 but less than \$30,000 = 10%, At least \$30,000 but less than \$40,000 = 9%, At least \$40,000 but less than \$50,000 = 2%, \$50,000 or more = 2%.

<sup>193</sup> Margin of Error: Less than \$10,000 = 7%, At least \$10,000 but less than \$20,000 = 9%, At least \$20,000 but less than \$30,000 = 10%, At least \$30,000 but less than \$40,000 = 9%, At least \$40,000 but less than \$50,000 = 2%, \$50,000 or more = 2%.

<sup>194</sup> Margin of Error: Less than \$10,000 = 2%, At least \$10,000 but less than \$20,000 = 3%, At least \$20,000 but less than \$30,000 = 0%, At least \$30,000 but less than \$40,000 = 0%, At least \$40,000 but less than \$50,000 = 0%, \$50,000 or more = 0%.

<sup>195</sup> Sample Size = 350.

<sup>196</sup> Sample Size = 256.

<sup>197</sup> Sample Size = 210.

<sup>198</sup> Sample Size = 162.

<sup>199</sup> Sample Size = 131.

<sup>200</sup> Sample Size = 121.

## **Interest Rates Charged for Participant Loans**

Code section 4975(d)(1)(D) states that participant loans that do not bear a reasonable rate of interest are prohibited transactions. The Code does not mandate the use of any specific, stated interest rate. Figure 61 shows the rates of interest charged by section 401(k) plans that permit participant loans.

**Figure 61: Interest Rate Charged by Plans**

<b>Interest Rate</b>	<b>Plans<sup>201</sup></b>
Prime Rate	16%
Prime Rate Plus One Percent	46%
Prime Rate Plus Two Percent	19%
Prime Rate Plus Three Percent	1%
Local Bank Rate	11%
Other Rate	8%

## **Repayment Periods for Participant Loans**

Code section 72(p)(2)(B) provides that a participant loan will be deemed to be a taxable distribution unless the loan is required to be repaid within 5 years. A longer repayment period is permitted under the Code if the loan is used by the participant to acquire a principal residence. Under Code section 72(p)(2)(C), such loan repayments must be made at least quarterly under a level amortization schedule.

Ninety-four percent of section 401(k) plans that permit participant loans conform to the requirement that loans that are not used to acquire a principal residence must be repaid within 5 years.<sup>202</sup> For those section 401(k) plans that permit participant loans for the purchase of the participant's principal residence, Figure 62 shows the repayment period applicable to such loans.

**Figure 62: Repayment Period for Principal Residence Loans**

<b>Repayment Period</b>	<b>Plans<sup>203</sup></b>
One Year	0%
Five Years	23%
Fifteen Years	22%
Thirty Years	24%
Other Period	24%
No Limit	7%

<sup>201</sup> Sample size = 713. The total percentage is more than 100% due to rounding.

<sup>202</sup> Sample size = 713.

<sup>203</sup> Sample size = 713.

For those section 401(k) plans that permit loans, Figure 63 shows the intervals at which repayment is required.

**Figure 63: Loan Repayment Interval**

<b>Frequency</b>	<b>Plans<sup>204</sup></b>
Every Payroll Period	81%
Quarterly	11%
Monthly	5%
Other Interval	2%

### **Repayment of Participant Loans**

Of section 401(k) plans that permit participant loans, 93% require repayment through payroll deduction.<sup>205</sup> The operative plan documents should specify the treatment of an outstanding loan when a participant ceases employment. Eighty-seven percent of section 401(k) plans that permit participant loans treat unpaid loans as a cash distribution or require immediate repayment upon termination of employment.<sup>206</sup> Thirteen percent allow the participant to continue to make loan repayments after a termination of employment.<sup>207</sup>

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<sup>204</sup> Sample size = 713. The total percentage is less than 100% due to rounding.

<sup>205</sup> Sample size = 713.

<sup>206</sup> Sample size = 713.

<sup>207</sup> Sample size = 713.

## TRUST ASSETS

Section 401(k) plan assets may include a variety of non-traditional holdings, including, among other things, employer securities, interests that give rise to unrelated business taxable income (UBTI) under Code section 511, and investments held overseas.

In the 401(k) Questionnaire, plan sponsors were asked about:

- investments in non-traditional assets; and
- if plan assets were invested in employer securities, whether employees were permitted to diversify the investment of their plan accounts into other types of assets.

### **Percentage of Section 401(k) Plans That Invest in Non-Traditional Assets**

Figure 64 depicts the percentage of section 401(k) plans that invest in various types of non-traditional assets at some time during the period 2006 through 2008. The likelihood that a plan holds employer securities differs based on plan size. Very large plans are more likely than small, medium or large plans to hold employer securities.<sup>208</sup> Our analysis found no differences by plan size regarding assets held in foreign investments.<sup>209</sup>

**Figure 64: Percentages of Plans That Invest in Non-Traditional Assets**

<b>Nature of Asset</b>	<b>Plans<sup>210</sup></b>
Securities of the employer maintaining the plan	1%
Assets giving rise to UBTI	0%
Assets held in foreign investments	1%

### **Diversification Rights**

Code section 401(a)(35), which was added by the Pension Protection Act of 2006, establishes participant investment diversification requirements for certain defined contribution plans holding publicly traded employer securities.

<sup>208</sup> Small Plans: Sample size = 133, Point estimate = 2%, Margin of error = 2%; Medium Plans: Sample size = 590, Point estimate = 1%, Margin of error = 1%; Large Plans: Sample size = 113, Point estimate = 2%, Margin of error = 2%; Very Large Plans: Sample size = 190, Point estimate = 38%, Margin of error = 7%.

<sup>209</sup> Small Plans: Sample size = 133, Point estimate = 1%, Margin of error = 1%; Medium Plans: Sample size = 590, Point estimate = 1%, Margin of error = 1%; Large Plans: Sample size = 113, Point estimate = 3%, Margin of error = 3%; Very Large Plans: Sample size = 190, Point estimate = 3%, Margin of error = 2%.

<sup>210</sup> Sample size = 1,026.

Ninety-eight percent of section 401(k) plans that invested in employer stock in 2006, 2007 or 2008 provided a diversification notice to employees.<sup>211</sup> The frequency with which participants are able to diversify the investment of their plan accounts varies among section 401(k) plans. The most common interval at which section 401(k) plans permit participants to sell employer securities is daily.

Code section 401(a)(35)(C) provides that participants who have completed at least three years of service (and their beneficiaries) must be allowed certain diversification rights with respect to investments in publicly traded employer securities. Of those plans that invested in employer stock (including publicly traded employer securities) in 2006, 2007 or 2008, more than half permitted participants who had completed at least 3 years of service to immediately sell employer securities held in their matching contribution accounts.<sup>212</sup>

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<sup>211</sup> Sample size = 79.

<sup>212</sup> Point estimate = 86%, Margin of error = 20%, Sample size = 79.

# EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM

EP seeks to help plan sponsors maintain the qualified status of their retirement programs. To that end, it has established the Employee Plans Compliance Resolution System (EPCRS). EPCRS is designed to promote the correction of qualification failures in a manner that is in the best interests of all affected parties.

## **The EPCRS**

EPCRS is a system of correction programs that may be used by plan sponsors to correct qualification failures with respect to a qualified plan. EPCRS permits plan sponsors to correct these failures and thereby continue to provide employees with retirement benefits on a tax-favored basis. The IRS issues a revenue procedure periodically that comprehensively the EPCRS procedures.<sup>213</sup> EPCRS consists of three basic programs -

- **Self-Correction Program (SCP)**: SCP allows plan sponsors to correct insignificant operational failures, at any time, without IRS approval and without the payment of any fees or sanctions. Plan sponsors may also correct significant operational failures through the SCP, also without IRS approval or the payment of any fees or sanctions, provided the compliance failure is corrected within a specified period of time.
- **Voluntary Correction Program (VCP)**: VCP permits a plan sponsor to correct most compliance failures, even if significant, at any time, provided the plan is not under examination by the IRS. In order to take advantage of the VCP, a plan sponsor must submit an application to the IRS seeking approval of the correction method, and pay a fee based on the size of the plan.
- **Audit Closing Agreement Program (Audit CAP)**: Audit CAP is utilized only when a plan is under examination. Under this program, the plan sponsor corrects plan qualification failures and pays a sanction that reflects the nature, extent, and severity of the plan's qualification failures. In return, the IRS enters into a closing agreement with the plan sponsor that permits the plan to retain its tax-qualified status.

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<sup>213</sup> EPCRS is currently described in Revenue Procedure 2013-12, 2013-4 IRB 313.

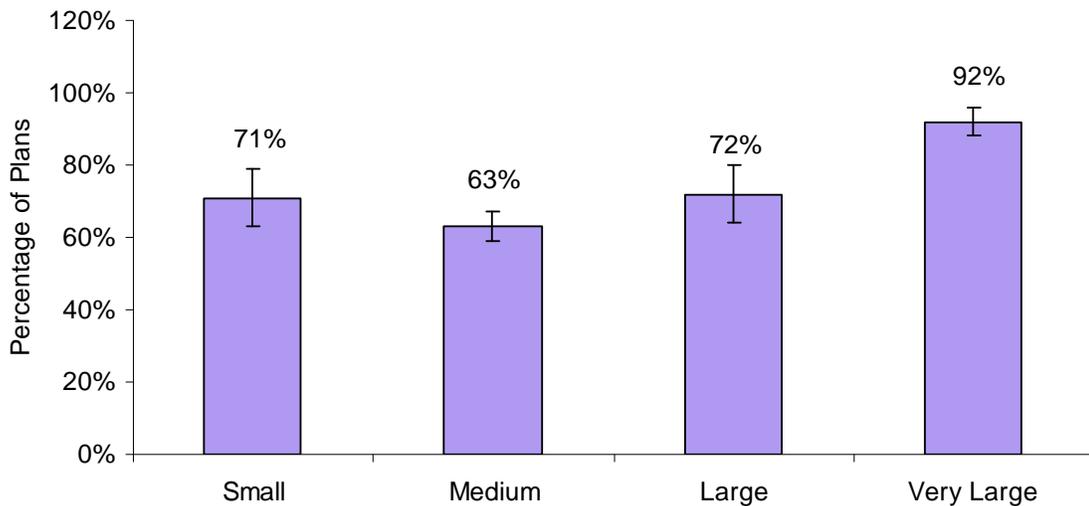
We asked plan sponsors to answer questions regarding their experiences with EPCRS. Specifically they were asked about:

- awareness of EPCRS programs;
- usage of EPCRS programs;
- usage of standard correction procedures found in the EPCRS revenue procedure;
- helpfulness of EPCRS; and
- ways to improve EPCRS.

### **Awareness of EPCRS**

EPCRS is intended to be readily available to all plan sponsors as an effective tool for maintaining compliance with applicable law. A majority of section 401(k) plan sponsors (65%) are aware of EPCRS.<sup>214</sup> As illustrated in Figure 65, very large plans are more likely than small, medium or large plans to be aware of EPCRS.<sup>215</sup>

**Figure 65: Percentage of Plans That are Aware of EPCRS**



### **Use of EPCRS Programs**

One of the cornerstone EPCRS principles is that plan sponsors must maintain administrative systems and procedures designed to facilitate overall compliance with the Code. However, mistakes occur, even with the best systems and procedures. It is not expected that all plans will find it necessary to use an EPCRS program. Six percent of section 401(k) plan sponsors have used one or more EPCRS programs.<sup>216</sup> As shown in

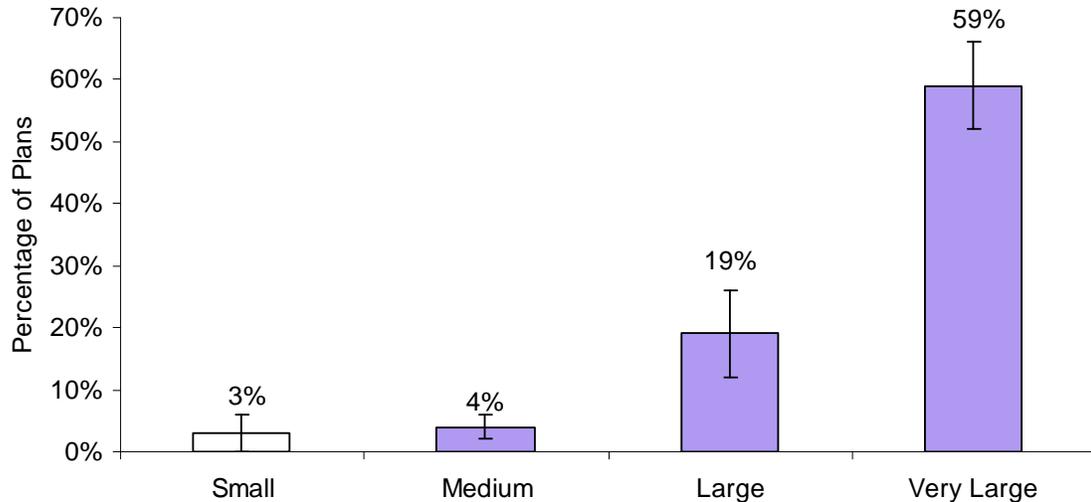
<sup>214</sup> Sample size = 1,025.

<sup>215</sup> Small Plans: Sample size = 133, Margin of error = 8%; Medium Plans: Sample size = 589, Margin of error = 4%; Large Plans: Sample size = 113, Margin of error = 8%; Very Large Plans: Sample size = 190, Margin of error = 4%.

<sup>216</sup> Respondents who indicated they were not aware of the EPCRS were not subsequently asked if they had used EPCRS. For this analysis, it was inferred that a respondent that was not aware of EPCRS had also not used it. Sample size = 1,025.

Figure 66, very large plans are the most likely to have used an EPCRS program. Additionally, large plans are more likely than small and medium plans, but less likely than very large plans, to have used an EPCRS program.<sup>217</sup>

**Figure 66: Percentage of Plans That Have Used EPCRS**



Very large plans were more likely than any other plan size to have used the SCP program.<sup>218</sup> Audit CAP usage could not be determined accurately because plans that were under examination immediately before, or at the time of, the selection of the 401(k) Questionnaire sample were excluded from the sampling frame. Some plan sponsors have used multiple EPCRS programs. Of the 6% of plan sponsors that have used EPCRS, 6% have used two or more EPCRS programs.<sup>219</sup> Of those that have used EPCRS, 75% found it helpful.<sup>220</sup>

### **Use of Standard Correction Methods**

The revenue procedure describing EPCRS provides a number of standard correction methods for the most common compliance failures. Of the 6% of plan sponsors that have used EPCRS, 75% were able to use one of the standard correction methods set forth in the revenue procedure.<sup>221</sup>

<sup>217</sup> Small Plans: Sample size = 133, Margin of error = 3%; Medium Plans: Sample size = 589, Margin of error = 2%; Large Plans: Sample size = 113, Margin of error = 7%; Very Large Plans: Sample size = 190, Margin of error = 7%.

<sup>218</sup> Small Plans: Sample size = 4, Point estimate = 3%, Margin of error = 3%; Medium Plans: Sample size = 24, Point estimate = 2%, Margin of error = 1%; Large Plans: Sample size = 22, Point estimate = 12%, Margin of error = 6%; Very Large Plans: Sample size = 112, Point estimate = 48%, Margin of error = 7%

<sup>219</sup> Sample size = 162.

<sup>220</sup> Sample Size= 162. Margin of Error = 11%.

<sup>221</sup> Sample Size= 162. Margin of Error = 12%.

## **Improving EPCRS**

Respondents to the 401(k) Questionnaire were given the opportunity to suggest how EPCRS could be made easier to use. Because these questions were optional, not all plan sponsors responded. Therefore, the summaries of general comments and recommendations to improve SCP below cannot be generalized to the entire section 401(k) population. The summary of comments in the following sections reflects only the opinions of those plan sponsors that answered the questions. In general, respondents reported that EPCRS was fairly easy to use.

### **Create SCP Compliance Forms and Checklists**

Some respondents stated that SCP would be easier to use if the EPCRS revenue procedure included forms and checklists similar to those provided for VCP. The respondents indicated that such forms and checklists would make it easier to document a plan sponsor's use of SCP and the correction method used.

### **Allow More SCP Corrections by Plan Amendment**

Under SCP, a plan sponsor generally corrects an operational failure, that is, a failure to operate the plan in accordance with plan terms, by conforming plan operation to the provisions in the plan document. However, in limited circumstances, a plan sponsor may amend its plan to conform to the way the plan was operated. Under SCP, a plan amendment that conforms the terms of the plan to the plan's operations may be adopted in the following circumstances:

- failure to apply the appropriate limitations of Code section 401(a)(17) to the amount of compensation that may be taken into account under the plan;<sup>222</sup>
- hardship distribution and plan loan failures; and
- early inclusion in the plan of otherwise eligible employees.

Respondents asked that corrections by retroactive plan amendment under SCP be permitted under more circumstances.

### **Expand Use of SCP for Correcting Significant Failures**

The correction of a significant operational failure under SCP generally must be completed by the last day of the second plan year following the plan year for which the failure occurred. Some respondents believed the two-year limit on the correction of significant operational failures under SCP should be removed, provided the correction is made in the best interests of all plan participants.

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<sup>222</sup> IRC § 401(a)(17) provides that a trust shall not constitute a qualified trust unless the annual compensation of each employee taken into account under the plan does not exceed \$200,000 (as indexed for inflation).

## THE DETERMINATION LETTER PROGRAM

The written terms of a qualified plan must satisfy numerous Code provisions. EP's determination letter program permits a plan sponsor to submit its plan document to the IRS for a determination that the plan language meets the applicable statutory requirements.

The 401(k) Questionnaire asked plan sponsors to indicate whether their section 401(k) plan:

- is part of a profit-sharing or other type of plan;
- is a pre-approved or individually designed plan;
- has been submitted under the determination letter program.

### **Section 401(k) Arrangements That Are Part of a Profit-Sharing or Other Plan**

A qualified cash or deferred arrangement (CODA) under section 401(k) of the Code may be added as a feature to certain types of plans. In the majority of cases (78%), a CODA is part of a profit-sharing plan.<sup>223</sup> A profit-sharing plan may provide for an employer contribution in addition to the employees' elective deferrals. These employer contributions may be either discretionary or fixed. Generally under a profit-sharing plan with a discretionary contribution formula, the employer may elect each year whether to make an employer contribution, separate from the employees' elective deferrals, and the amount of any such employer contribution.

A relatively small percentage of all CODAs are found within a money purchase pension plan (1.6%),<sup>224</sup> target benefit plan (0.56%), or a stock bonus or employee stock ownership plan (0.37%). Twenty percent of section 401(k) plan sponsors do not identify with any of the plan types eligible for a CODA.<sup>225</sup>

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<sup>223</sup> Sample size = 1,059.

<sup>224</sup> Code section 401(k)(1) provides that a pre-ERISA money purchase pension plan may have a cash or deferred arrangement. Code section 401(k)(6) defines such a plan as one that is a defined contribution plan which was in existence on June 27, 1974 and which included a salary reduction arrangement on that date. Neither the employee contributions nor the employer contributions may exceed the levels provided for by the contribution formula in effect under the plan on such date.

<sup>225</sup> Sample size = 1,059.

## **Plan Sponsors With Multiple Plans**

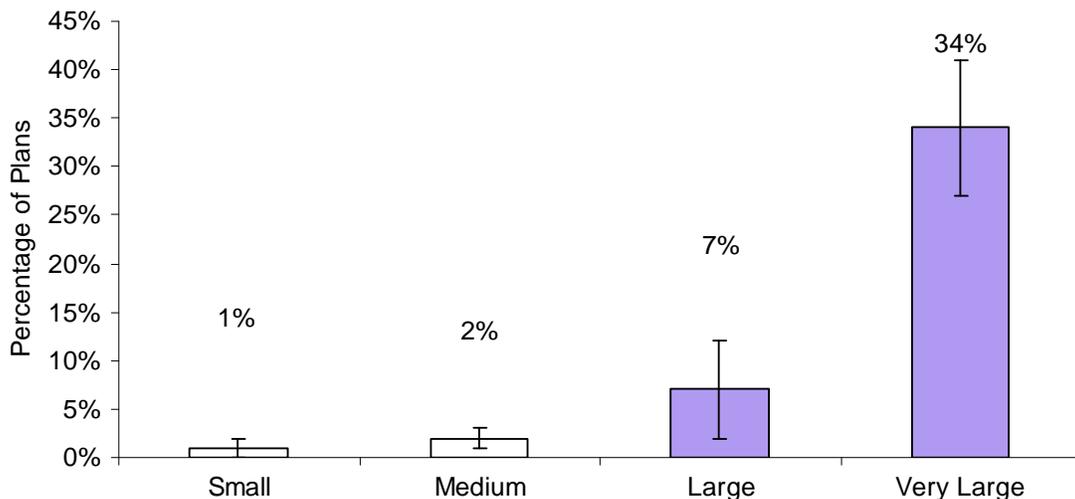
Through the 401(k) Questionnaire, we asked plan sponsors whether they maintained:

- more than one section 401(k) plan;
- a section 401(k) plan and a defined benefit plan; or
- a section 401(k) plan and a nonqualified plan.

### **Multiple Section 401(k) Plans**

Three percent of all section 401(k) plan sponsors maintain more than one section 401(k) plan.<sup>226</sup> As shown in Figure 67, very large section 401(k) plan sponsors are more likely than small, medium and large section 401(k) plan sponsors to maintain more than one section 401(k) plan.<sup>227</sup>

**Figure 67: Percentage of 401(k) Plan Sponsors That Maintain More Than One 401(k) Plan**



### **Section 401(k) and Defined Benefit Plans**

Six percent of all section 401(k) plan sponsors also maintain a defined benefit plan. Of all the very large section 401(k) plan sponsors, 50% also maintain a defined benefit plan.<sup>228</sup> However, the number of defined benefit plans maintained by section 401(k) plan sponsors has changed in the past several years. Between 1995 and 2010, 7% of all section 401(k) plan sponsors terminated a defined benefit plan.<sup>229</sup>

<sup>226</sup> Sample size = 1,054.

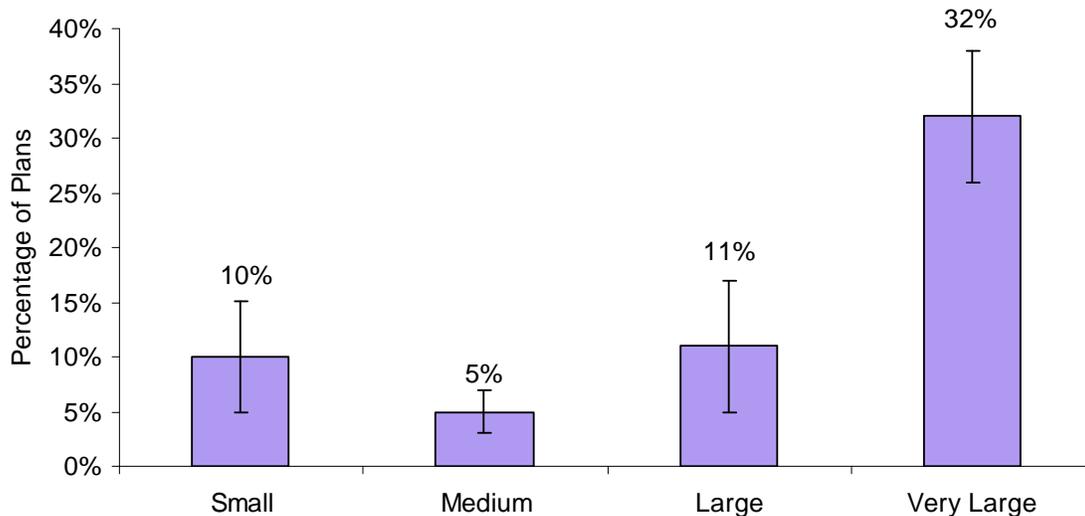
<sup>227</sup> Small Plans: Margin of error = 1%, Sample size = 135; Medium Plans: Margin of error = 1%, Sample size = 612; Large Plans: Margin of error = 5%, Sample size = 117; Very Large Plans: Margin of error = 7%, Sample size = 190.

<sup>228</sup> All Plans: Sample size = 1,054; Very Large Plans: Sample size = 190.

<sup>229</sup> Sample size = 1,053.

Thirty-two percent of very large section 401(k) plan sponsors terminated a defined benefit plan between 1995 and 2010. As shown in Figure 68, very large section 401(k) plan sponsors are more likely than small, medium or large section 401(k) plan sponsors to have terminated a defined benefit plan during that time period.<sup>230</sup>

**Figure 68: Percentage of 401(k) Plan Sponsors That Have Terminated a Defined Benefit Plan Between 1995 and 2010**



### **Section 401(k) and Nonqualified Plans**

Two percent of all section 401(k) plan sponsors also maintain a nonqualified plan.<sup>231</sup> Sixty-six percent of all very large section 401(k) plan sponsors also maintain a nonqualified plan.<sup>232</sup>

### **Pre-Approved or Individually Designed Section 401(k) Plans**

Pre-approved plan documents are drafted by service providers, such as financial institutions or consulting firms, to be made available to their customers. The form of the plan is pre-approved by the IRS. Employers adopt such a plan document after it has been approved by the IRS. Unlike a pre-approved plan, an individually designed plan is one that is prepared specifically for a particular employer.

A large majority of section 401(k) plans (86%) are some form of pre-approved plan, such as a master or prototype plan (standardized or nonstandardized) or a volume submitter plan.<sup>233</sup> The likelihood that a section 401(k) plan is a pre-approved plan differs by plan

<sup>230</sup> Small Plans: Sample size = 135, Margin of error = 5%; Medium Plans: Sample size = 612, Margin of error = 2%; Large Plans: Sample size = 116, Margin of error = 6%; Very Large Plans: Sample size = 190, Margin of error = 6%.

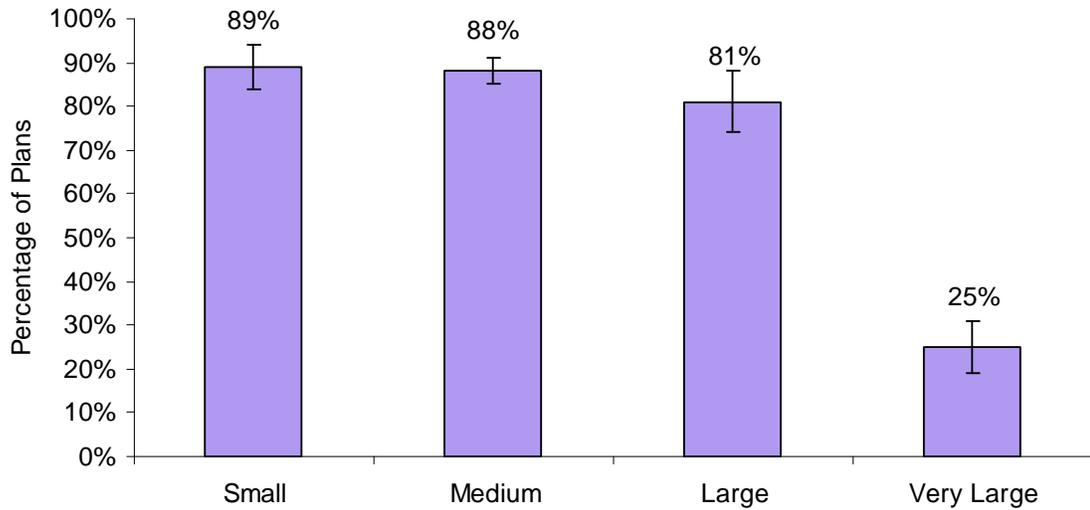
<sup>231</sup> Sample size = 1,054.

<sup>232</sup> Margin of error = 7%, Sample size = 190

<sup>233</sup> Sample size = 1,054.

size. As shown in Figure 69, very large section 401(k) plans are less likely than small, medium or large plans to be in the form of a pre-approved plan.<sup>234</sup>

**Figure 69: Pre-Approved Plans by Plan Size**

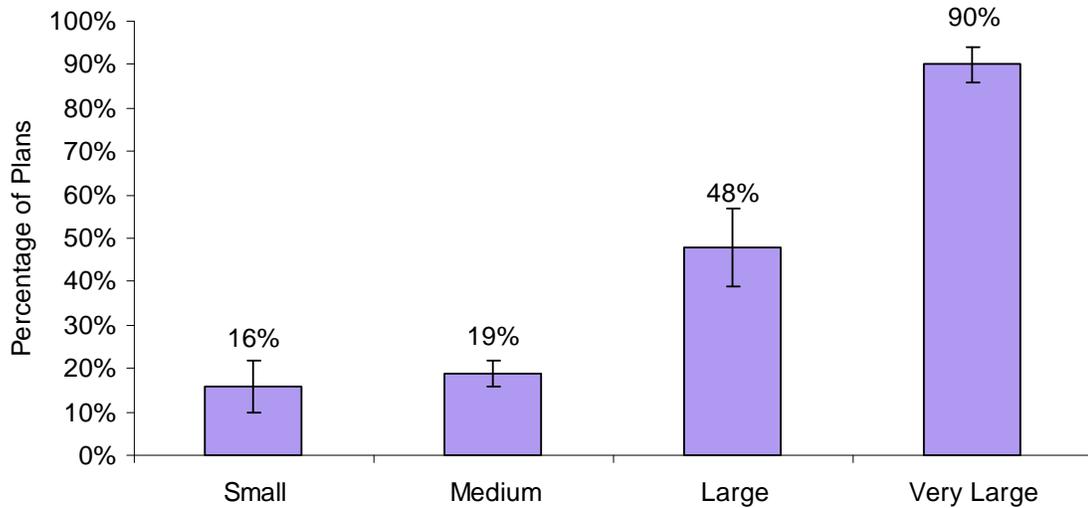


<sup>234</sup> Small Plans: Sample size = 135, Margin of error = 5%; Medium Plans: Sample size = 612, Margin of error = 3%; Large Plans: Sample size = 117, Margin of error = 7%; Very Large Plans: Sample size = 190, Margin of error = 6%.

## **Utilization of the Determination Letter Program**

Seventy-seven percent of all section 401(k) plan sponsors have never requested a determination letter for their plan.<sup>235</sup> As illustrated in Figure 70, large section 401(k) plan sponsors are more likely than both small and medium section 401(k) plan sponsors to submit their plans to the IRS for a determination letter. Very large section 401(k) plan sponsors are more likely than all other plan sizes to have participated in the determination letter program.<sup>236</sup>

**Figure 70: Participation in the Determination Letter Program by Plan Size**



<sup>235</sup> Sample size = 1,053.

<sup>236</sup> Small Plans: Sample size = 135, Margin of error = 6%; Medium Plans: Sample size = 612, Margin of error = 3%; Large Plans: Sample size = 117, Margin of error = 9%; Very Large Plans: Sample size = 189, Margin of error = 4%.

## CUSTOMER EDUCATION AND OUTREACH

EP's Customer Education and Outreach (CE&O) provides employers and employees with information and educational programs regarding employee plans. Examples of CE&O's activities include participation in conferences, seminars and workshops, and publishing information through the IRS website.

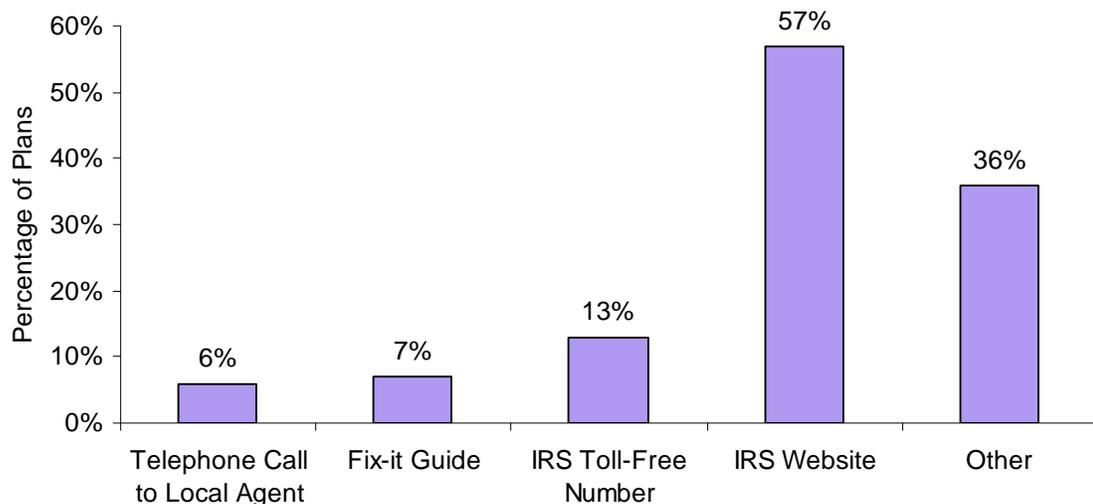
The 401(k) Questionnaire asked plan sponsors to provide information on:

- methods of getting information from the IRS; and
- awareness and usage of the 401(k) Fix-It Guide.

### **Methods of Getting Information From the IRS About Section 401(k) Plans**

Figure 71 depicts the percentage of plan sponsors that called a local agent, used the Fix-It Guides, called the IRS toll free number, used the IRS website or used another, unspecified resource to learn more about section 401(k) plans.<sup>237</sup>

**Figure 71: Methods Used to Obtain Information From the IRS**



<sup>237</sup> Sample size = 1,024. Instructions for this question permitted respondents to select more than one answer.

## **Awareness and Use of the 401(k) Fix-It Guide**

One of the most visited EP publications for section 401(k) plan sponsors on the IRS website is the 401(k) Fix-It Guide. The purpose of the 401(k) Fix-It Guide is to provide:

- a general understanding of section 401(k) plans;
- an explanation of EPCRS;
- a description of the compliance mistakes that most frequently occur with respect to section 401(k) plans; and
- tips on how to find, fix and avoid common compliance mistakes.

The 401(k) Fix-It Guide includes:

- a 401(k) Checklist, which contains review questions plan sponsors may use to identify areas of noncompliance;
- a table listing potential mistakes by category;
- an explanation of applicable laws;
- definitions of key terms; and
- instructions on how to correct, and the appropriate EPCRS correction program for, each type of common mistake.

Forty-one percent of section 401(k) plan sponsors are aware of the 401(k) Fix-It Guide.<sup>238</sup> Seven percent of section 401(k) plan sponsors have used it. Of the section 401(k) plan sponsors that used the 401(k) Fix-It Guide, the majority (82%) found it useful.<sup>239</sup>

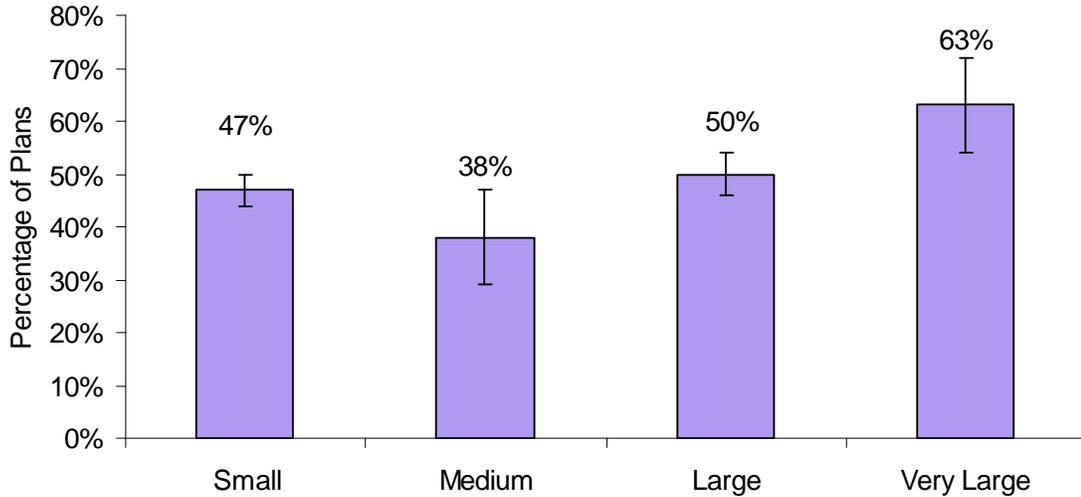
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<sup>238</sup> Sample size = 1,026.

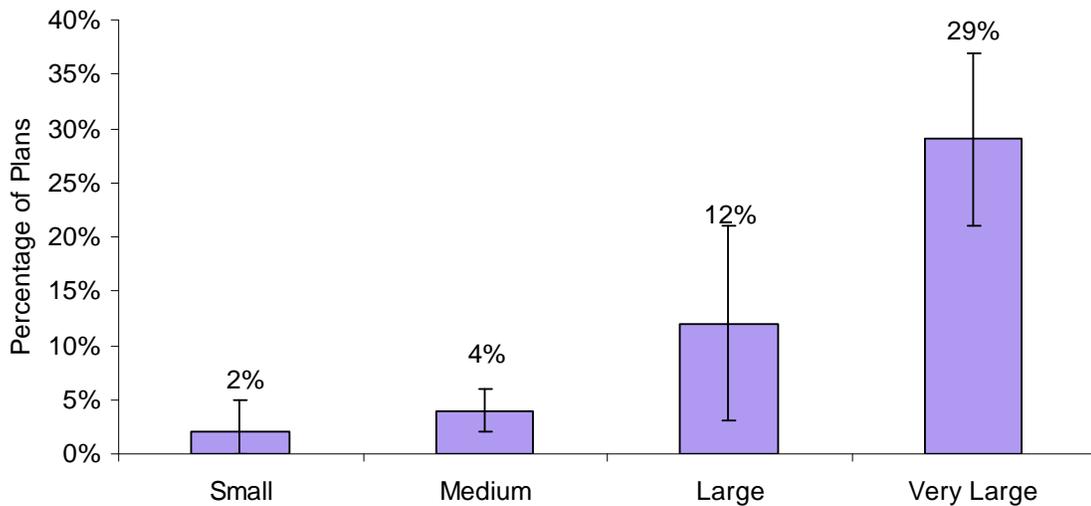
<sup>239</sup> Sample size = 51. Margin of Error = 19%.

As illustrated in Figure 72, very large section 401(k) plan sponsors are more likely than medium and large section 401(k) plan sponsors to be aware of the Fix-it Guide.<sup>240</sup> As indicated in Figure 73, very large section 401(k) plan sponsors are also more likely than small or medium section 401(k) plan sponsors to have used the Fix-it Guide.<sup>241</sup>

**Figure 72: Percentage of all 401(k) Plans That Are Aware of the Fix-It Guide**



**Figure 73: Use of the 401(k) Fix-It Guide Among Plans That Are Aware of It**



<sup>240</sup> Small Plans: Sample size = 133, Margin of error = 9%; Medium Plans: Sample size = 590, Margin of error = 4%; Large Plans: Sample size = 113, Margin of error = 9%; Very Large Plans: Sample size 190= , Margin of error = 7%.

<sup>241</sup> Small Plans: Sample size = 62, Margin of error = 3%; Medium Plans: Sample size = 225, Margin of error = 2%; Large Plans: Sample size = 57, Margin of error = 9%; Very Large Plans: Sample size = 119, Margin of error = 8%.

## **Employee Plans Efforts to Assist the Section 401(k) Community**

The Questionnaire invited section 401(k) plan sponsors to make comments regarding difficulties of complying with the requirements of sections 401(k) and 401(m) of the Code. In response to the comments received and our analysis of the Questionnaire, Employee Plans has identified new activities that we hope will address the community's needs and facilitate voluntary compliance. Some of these activities will include:

- Presenting phone forums to communicate to key stakeholders key information from the 401(k) Final Report and related current topics;
- Using data from the Questionnaire to design new and enhanced Web-based outreach products, including the IRS Fix-It Guides;
- Repackaging the 401(k) Questionnaire as a self audit tool that will highlight the relationship between good internal controls and plan compliance;
- Producing videos for You Tube that encourage small business owners to use IRS educational materials; and
- Continuing to collaborate with the Advisory Committee on Tax Exempt and Governmental Entities, an independent advisory committee of professionals, to learn more about the specialized needs of small business plan sponsors.

## PLAN ADMINISTRATION

The 401(k) Questionnaire included questions regarding:

- policies and procedures in place to self-audit plan administration;
- the persons responsible for plan administration;
- the persons responsible for plan amendments;
- preparing the Form 5500 annual report; and
- recent changes in plan administration.

### **Policies and Procedures**

Ninety-three percent of section 401(k) plan sponsors have policies and procedures in place to self-audit plan administration.<sup>242</sup> Of these, 92% review their policies and procedures once a year, while 3% review their policies and procedures once every two years. Four percent of plans review their policies and procedures at some other interval.<sup>243</sup>

### **Responsibility for Administration**

We asked plan sponsors to identify, from a list of categories, the types of persons primarily responsible for plan administration. Figure 74 indicates the percentages of section 401(k) plans that primarily rely on the stated categories of persons for the administration of the plan.

**Figure 74: Person(s) With Primary Responsibility for Plan Administration<sup>244</sup>**

<b>Person(s) Responsible</b>	<b>Plans</b>
Company Financial Staff	20%
Company Human Resources Staff	15%
Company Legal Staff	0%
External Accountant	2%
External Legal	1%
Insurance Company	1%
Third-party Administrator	53%
Actuary	0%
Other External Provider	2%
Other Internal Staff	5%

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<sup>242</sup> Sample size = 1,025.

<sup>243</sup> Sample size = 965.

<sup>244</sup> Sample size = 1,025. The total percentage is less than 100% due to rounding.

As indicated in Figure 75 below, small plans are less likely than medium, large or very large plans to have a dedicated human resources staff primarily responsible for plan administration.

**Figure 75: Person(s) With Primary Responsibility for Plan Administration by Plan Size**

<b>Person(s)</b>	<b>Small<sup>245</sup></b>	<b>Medium<sup>246</sup></b>	<b>Large<sup>247</sup></b>	<b>Very Large<sup>248</sup></b>
Company Financial Staff	20%	20%	23%	7%
Company Human Resources Staff	2%	15%	35%	47%
Company Legal Staff	2%	0%	0%	0%
External Accountant	3%	2%	0%	0%
External Legal	1%	1%	0%	0%
Insurance Company	1%	1%	1%	2%
Third-party Administrator	60%	54%	38%	41%
Actuary	1%	1%	0%	0%
Other External Provider	5%	2%	0%	0%
Other Internal Staff	7%	5%	4%	4%

### **Responsibility for Plan Amendments**

Section 402(b)(3) of the Employee Retirement Income Security Act (ERISA)<sup>249</sup> states that every employee benefit plan must provide a procedure for amending the plan, and for identifying the persons who have the authority to amend the plan. We asked plan sponsors to identify, from among a list of categories, the types of persons with the authority to amend their plans.

<sup>245</sup> Sample size = 133; Margin of error: Company Financial Staff = 7%, Company Human Resources Staff = 2%, Company Legal Staff = 2%, External Accountant = 3%, External Legal = 1%, Insurance Company = 1%, Third-party Administrator = 8%, Actuary = 1%, Other External Provider = 4%, Other Internal Staff = 4%. The total percentage is more than 100% due to rounding.

<sup>246</sup> Sample size = 589; Margin of error: Company Financial Staff = 3%, Company Human Resources Staff = 3%, Company Legal Staff = 0%, External Accountant = 1%, External Legal = 1%, Insurance Company = 1%, Third-party Administrator = 4%, Actuary = 1%, Other External Provider = 1%, Other Internal Staff = 2%. The total percentage is more than 100% due to rounding.

<sup>247</sup> Sample size = 113; Margin of error: Company Financial Staff = 8%, Company Human Resources Staff = 9%, Company Legal Staff = 0%, External Accountant = 0%, External Legal = 0%, Insurance Company = 2%, Third-party Administrator = 9%, Actuary = 0%, Other External Provider = 0%, Other Internal Staff = 3%. The total percentage is more than 100% due to rounding.

<sup>248</sup> Sample size = 190; Margin of error: Company Financial Staff = 3%, Company Human Resources Staff = 7%, Company Legal Staff = 0%, External Accountant = 0%, External Legal = 0%, Insurance Company = 2%, Third-party Administrator = 7%, Actuary = 0%, Other External Provider = 0%, Other Internal Staff = 3%. The total percentage is more than 100% due to rounding.

<sup>249</sup> 29 U.S.C. § 1102(b)(3).

Figure 76 shows the percentages of section 401(k) plan sponsors that authorized specified categories of persons to amend the plan.

**Figure 76: Person(s) With Authority to Amend the Plan<sup>250</sup>**

<b>Person(s)</b>	<b>Plans</b>
Board of Directors	26%
Plan Trustees	44%
Company Officer	24%
Other	6%

The category of persons identified by section 401(k) plan sponsors as having the authority to amend their plan differs based on plan size. As shown in Figure 77, plan sponsors of very large plans are more likely than the small, medium or large plans to identify the person with the authority to amend their plan as “other.”

**Figure 77: Person(s) With Authority to Amend the Plan By Size**

<b>Person(s)</b>	<b>Small<sup>251</sup></b>	<b>Medium<sup>252</sup></b>	<b>Large<sup>253</sup></b>	<b>Very Large<sup>254</sup></b>
Board of Directors	24%	26%	28%	40%
Plan Trustees	47%	44%	42%	13%
Company Officer	26%	24%	19%	20%
Other	3%	6%	11%	27%

<sup>250</sup> Sample size = 1,025.

<sup>251</sup> Sample size = 133; Margin of error: Board of Directors = 7%, Plan Trustees = 9%, Company Officer = 8%, Other = 3%.

<sup>252</sup> Sample size = 589; Margin of error: Board of Directors = 4%, Plan Trustees = 4%, Company Officer = 3%, Other = 2%.

<sup>253</sup> Sample size = 113; Margin of error: Board of Directors = 8%, Plan Trustees = 9%, Company Officer = 7%, Other = 6%.

<sup>254</sup> Sample size = 190; Margin of error: Board of Directors = 7%, Plan Trustees = 5%, Company Officer = 6%, Other = 6%.

We also asked plan sponsors to identify, from a list of categories, the types of persons who ensure that their section 401(k) plan is amended within appropriate time frames mandated by statute. Figure 78 shows the percentages of section 401(k) plan sponsors that rely on the stated categories of persons to ensure that the plan is amended within appropriate time frames mandated by statute.

**Figure 78: Who Ensures That the Plan is Timely Amended<sup>255</sup>**

<b>Responsibility for Timely Amendments</b>	<b>Plans</b>
Internal Legal	1%
Internal Administrator	13%
Third-party Administrator	73%
Insurance Company	2%
External Legal	6%
Other	5%

The persons plan sponsors rely upon to ensure that their plan is amended within appropriate time frames differ based on plan size. As shown in Figure 79, the plan sponsor of a small, medium or large plan is more likely to rely upon the services of a third-party administrator than is the plan sponsor of a very large plan. The plan sponsor of a very large plan, on the other hand, is more likely to engage an external legal expert for this purpose than is the plan sponsor of a small, medium or large plan.

**Figure 79: Who Ensures That the Plan is Timely Amended By Plan Size**

<b>Responsibility for Timely Amendments</b>	<b>Small<sup>256</sup></b>	<b>Medium<sup>257</sup></b>	<b>Large<sup>258</sup></b>	<b>Very Large<sup>259</sup></b>
Internal Legal	2%	1%	2%	14%
Internal Administrator	10%	13%	19%	24%
Third-party Administrator	74%	75%	61%	16%
Insurance Company	2%	2%	4%	2%
External Legal	8%	5%	12%	42%
Other	5%	5%	4%	3%

<sup>255</sup> Sample size = 1,025.

<sup>256</sup> Sample size = 133; Margin of error: Internal legal = 2%, Internal administrator = 5%, Third-party administrator = 7%, Insurance company = 3%, External legal = 4%, Other = 4%. The total percentage is more than 100% due to rounding.

<sup>257</sup> Sample size = 589; Margin of error: Internal legal = 1%, Internal administrator = 3%, Third-party administrator = 4%, Insurance company = 1%, External legal = 2%, Other = 2%. The total percentage is more than 100% due to rounding.

<sup>258</sup> Sample size = 113; Margin of error: Internal legal = 2%, Internal administrator = 7%, Third-party administrator = 9%, Insurance company = 3%, External legal = 6%, Other = 3%. The total percentage is more than 100% due to rounding.

<sup>259</sup> Sample size = 190; Margin of error: Internal legal = 5%, Internal administrator = 6%, Third-party administrator = 5%, Insurance company = 2%, External legal = 7%, Other = 2%. The total percentage is more than 100% due to rounding.

## **Responsibility for Form 5500 Annual Reports**

Form 5500, Annual Return/Report of Employee Benefit Plan, is used to report information concerning employee benefit plans, including section 401(k) plans. Each Form 5500 must accurately reflect the characteristics and operations of the plan being reported.

We asked plan sponsors to identify, from among a list of categories, the persons who completed the Form 5500 on behalf of the plan. Figure 80 shows the percentages of section 401(k) plans whose Form 5500 is prepared by the stated categories of persons.

**Figure 80: Who Prepares Form 5500 for the Plan<sup>260</sup>**

<b>Form 5500 Preparer</b>	<b>Plans</b>
Company Financial Staff	3%
Company Human Resources Staff	1%
External Accountant	6%
Third-Party Administrator	83%
Other	7%

## **Changes in Administration**

Figure 81 shows the number of times the administrator of the plan changed in the three years prior to completion of the 401(k) Questionnaire.

**Figure 81: Number of Administrator Changes in Last Three Years<sup>261</sup>**

<b>Number of Changes</b>	<b>Plans</b>
None	82%
One	16%
Two	2%
Three or More	1%

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<sup>260</sup> Sample size = 1,025.

<sup>261</sup> Sample size = 1,025. The total percentage is more than 100% due to rounding.

## **NEXT STEPS**

Employee Plans will continue to use the data collected from the 401(k) Questionnaire to gain a better understanding of section 401(k) plan compliance. This improved understanding will help EP to optimize education and outreach, guidance, voluntary correction programs and enforcement activities to foster compliance in the 401(k) community.

### **Education and Outreach**

IRS Employee Plan's Customer Education and Outreach has a long history of providing useful tools and educational programs to the retirement plan community. The responses to the 401(k) Questionnaire, in conjunction with other data, will help us refine our outreach strategies to better meet the needs of all section 401(k) plan sponsors and participants. For example, we learned that, of the plans that used the 401(k) Fix-It Guide and EPCRS, a majority found these to be very helpful. We were surprised to discover that only 65% of plan sponsors are aware of EPCRS, and only 41% are aware of the 401(k) Fix-It Guide. By analyzing which portion of the 401(k) universe is unfamiliar with these tools, we can better target and improve our education and outreach.

EP is also using data from the 401(k) Questionnaire to design web-based outreach products, including an electronic brochure on the responsibilities of plan sponsors (with a corresponding video) and electronic newsletter articles. In addition, we are planning to dialogue with internal and external stakeholders to address compliance tools in the 401(k) market segment and to further clarify anomalies in certain responses to the 401(k) Questionnaire.

In their 2012 report presented at a public hearing in June, the EP members of the TE/GE ACT stressed the importance of good internal controls. The report asserted that the use of strong internal controls is important for plans to remain compliant. EP has encouraged all plan sponsors to use the 401(k) Questionnaire as a self-audit tool, and we are very pleased that many have heeded this suggestion. To improve the usefulness of the 401(k) Questionnaire as a self-audit tool, we are adding additional questions about internal controls. This revised 401(k) Questionnaire Self-Audit Tool will be posted to the EP's website for all plan sponsors to use in future self-audits.

### **Guidance**

EP will continue to look for areas where guidance is needed to improve voluntary compliance to make it easier for plan sponsors to administer their section 401(k) plans.

## **Voluntary Correction Programs**

EP is committed to improving EPCRS to promote the voluntary correction of plan failures in a manner that is in the best interest of all affected parties. The responses to the 401(k) Questionnaire open ended questions provided suggestions for improving our correction programs. The following suggestions will be considered as we make future revisions to EPCRS:

- SCP compliance forms similar to those provided for VCP applications
- Expansion of SCP corrections through retroactive amendment.
- Expansion of SCP for correcting significant failures.

## **Enforcement Activities**

Analysis of the responses to the 401(k) Questionnaire also identified potential areas of concern. EP will continue to explore these areas to determine if they warrant further enforcement activities, and will continue to design and implement new EP Exam compliance projects including Learn Educate Self-correct Enforce (LESE); Risk Based Targeted (RBT); and EPCU Compliance Check Projects. We will use these enforcement activities to address specific areas of the 401(k) universe where potential areas of noncompliance have been identified.

Since 2001, EP's enforcement efforts have largely used a risk-based targeted method to identify plans for examination. This methodology selects plans by plan type and industry type based on historical examination activity, and results and has been very effective in identifying potential noncompliance. EP is currently developing a new 401(k) selection risk model to further refine our examination case selection. The model is intended to:

- improve the identification of section 401(k) plans with potential issues,
- reduce the burden on compliant plan sponsors, and
- efficiently leverage our limited enforcement resources.

## **Fiscal Year 2013 Section 401(k) Operating Priority**

Section 401(k) plan compliance will continue as an EP Operating Priority in FY 2013, and we will use the findings from the 401(k) Questionnaire to help us achieve that priority. We will incorporate the findings into our understanding of how section 401(k) plans actually operate – that is, how they structure themselves to stay both cost-effective and compliant. We also will use the findings in our ongoing effort to give all plan sponsors – from the smallest to the largest – the up-to-the-minute information they need to operate their plans efficiently and compliantly.