

**Western Pension & Benefits
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Dancing with the Experts**

**Breakout Session I(c)
Choreography of a 401(k) Plan
401(k) Plan Design Updates**

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**CASE STUDY #1
Acme Manufacturing Company**

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Current Situation

- The Acme Manufacturing Company sponsored a 401(k) Plan with a match of 40% of Compensation deferred. The match was not capped. The Plan provided for a discretionary profit sharing contribution, but that feature is not utilized. Acme also sponsors a defined benefit pension plan. There are 50 eligible employees, and the Plan is not Top-Heavy.
- The owner and 5 of his top managers are limited in their 401(k) deferrals, because the Plan does not pass the ADP tests. In addition, these same top executives receive a minimal matching contribution, because of the Plan's inability to pass the ACP tests.

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Current Cash Outlays

DC Match:	\$ 72k
DC Profit Sharing:	\$ 0
DB Plan:	\$434k
Total Outlay:	\$506k

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Issue

Owners and top management are precluded from realizing full benefits under the Plans as currently structured.

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Solution

- Convert the 401(k) Plan to a Safe Harbor Plan, with 100% of the first 4% of pay deferred matching contribution*.
- Add a discretionary PS contribution to favor the top people.

*Eliminates the need for ADP and ACP testing.

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New Profit Sharing Structure

Owners:	9% of pay
5 Managers:	8% of pay
All others:	4.4% of pay

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Convert DB to Tiered Cash Balance Plan

Owners:	45% of pay
5 Managers:	8% of pay
All others:	3.1% of pay

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New Cash Outlays

DC Match:	\$ 95,000
DC Profit Sharing:	\$191,000
DB Plan:	\$256,000

Total Outlay: \$542,000

(Owners get \$126k more under this structure)

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Case Study #2 Free-for-All Non Profit Corporation

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Current Situation

- The Free-for-All Non-Profit Corporation maintains a 401(k) Plan for its employees.
- There is a matching contribution of 80% of a participant's deferred compensation up to 7% of pay (so maximum match is 5.6% of pay), as well as a discretionary "profit sharing" contribution that is tiered based upon Years of Service.
- There are 5 tiers, and the profit sharing contribution ranges from 4% of pay up to 10% of pay. This Plan includes 133 active employees and is not Top-Heavy.
- In 2006, the Plan passed the ACP test but failed the ADP test. The profit sharing portion of the Plan passed the minimum Gateway test, and the Plan passed the Average Benefit Percentage Test (using permitted disparity). Therefore, the Plan passed Code Section 401(a)(4).

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2006 Cash Outlays

Based on 2006 deferrals of \$443k and eligible payroll of \$6.288 million
(overall average percent deferred = 7.045%):

Employer Match: \$274k

Employer Profit Sharing: \$353k

Total Outlay: \$627k

(overall contribution is 9.97% of payroll)

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Issue

Top Management receiving refunds based on unfavorable testing results.

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Solution

- Convert the matching portion to a Safe Harbor formula. The Safe Harbor formula is 100% of the first 4% of compensation deferred, plus 80% of salary reductions between 4% and 6% of compensation.

NOTE: The increase in the match affected employee behavior, so the average deferral as a % of Compensation increased by 8.45%.

- Eliminates the need for ADP and ACP testing
- No change in the profit sharing structure, because this passed Code Section 401(a)(4) in the past, and passes again in 2007.

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2007 Cash Outlays

based on 2007 deferrals of \$490k, and eligible payroll of \$6.414 million
(overall average percent deferred = 7.640%):

Employer Match: \$309k

Employer Profit Sharing: \$387k

Total Outlay: \$696k

(overall contribution is 10.85% of payroll)

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Case Study #3 Dewey, Cheatem and Howe Law Firm

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Current Situation

- Dewey, Cheatem & Howe maintains both a 401(k)/profit sharing Plan and a tiered Cash Balance Plan. The 401(k) Plan is not a Safe Harbor Plan; the current matching formula is 50% of the first 6% of Compensation deferred. Employees are broken into 4 groups: Equity partners, non-equity partners, Associate attorneys, and staff. There are 84 eligibles.
- Eligibility for the 401(k) portion of the Plan was immediate with monthly entry dates; for the match and profit sharing portions it was age 21, 1 Year of Service, with semiannual entry dates.
- Equity and non-equity partners, as well as staff employees, are matched at the 50% rate; however, Associate attorneys may opt out of the¹⁷ DC plan and receive higher cash pay.

Current Situation

(continued)

- The profit sharing portion of the Plan is tiered; with equity partners receiving a dollar amount such that their total under the Plan is \$46,000. Non-equity partners receive a lower \$ amount, sufficient to pass the Gateway test (3.4% of pay). Associates do not receive a profit sharing contribution. Most staff employees receive a 3.4% contribution as well, a few receive 5.5% of pay, in order for the plan to pass Code Section 401(a)(4).

Current Situation

(continued)

- The Plan as structured passed all nondiscrimination testing requirements. But in 2007 when the Top Heavy testing was performed based on 2006 allocations, it was discovered that the plan had become Top Heavy, primarily because of the generous benefits provided to the equity partners under the Cash Balance Plan.
- Because of the exclusion of the Associates, and the earlier eligibility to make 401(k) deferrals, many individuals who would not otherwise be eligible to receive a profit sharing contribution *are* required to receive a 3% minimum Top-Heavy contribution. The additional Top-Heavy contribution in 2008 was projected to be in excess of \$100,000.

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Cash Outlays Projected for 2008

Employer Match:	\$196k
Employer Profit Sharing:	\$516k
Top Heavy Minimum:	\$108k
Total Outlay:	\$820k

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Issue

How to avoid a Top Heavy Minimum Contribution in excess of \$100,000.

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Solution

- Change the eligibility* for 401(k) deferrals to be the same as that for the match and profit sharing contributions.
- Separate the Plan into 2 Plans: a Safe Harbor 401(k) Plan with match of 100% of the first 4% deferred, and a separate profit sharing Plan. Now we have a Safe Harbor 401(k) Plan with no additional contributions and consistent eligibility for all contribution types, and that plan automatically satisfies Top-Heavy requirements under Code Section 416(g)(4)(H).
- The separate Profit Sharing Plan also automatically satisfies Top Heavy requirements

*HCE Associates are ineligible to participate in both plans.

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Cash Outlays Projected Under the Redesigned Plan for 2008

Employer Safe Harbor Match:	\$266k
Employer Profit Sharing:	\$457k
Top Heavy Minimum:	\$0

Total Outlay: \$723k

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Employee Relations Issue for 2007

- Effective January 1, 2008 when the new eligibility requirements for deferrals took effect, we did not allow existing employees who had completed less than 1 Year of Service as of that date to continue to make elective deferrals. We verified this was NOT a problem under Code Section 411(d)(6).
- However, these same employees received an unexpected 3% Top-Heavy minimum contribution for 2007, because by the time it was determined there was a Top-Heavy problem, it was too late to avoid the minimum contribution for 2007.

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Case Study #4 Majestic Realty Co.

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Current Situation

- This Company amended its 401(k) plan to provide a tiered discretionary match based on Years of Service. There are 5 tiers. Matching percents initially ranged from 20% to 100% of the amounts deferred, with no cap.
- In the first year, the plan passed both the ADP and ACP tests, but in the second year, plan eligibility was expanded and the tests failed. In the third year, refunds were required because the plan could not pass Code Section 401(a)(4) either.
- The plan provides for a discretionary profit sharing contribution, but this feature is not utilized.

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Issue

Employer wants to retain tiered match structure and liberalized eligibility, but wants to avoid refunds of any kind.

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Solution

- Implement an Automatic Enrollment feature. In 2006, Majestic implemented a 2% Automatic Enrollment feature for all employees who were eligible and who had not elected to make deferrals to the Plan.
- Most of the newly eligible employees deferred at least 2% of Compensation to the Plan for 2007. About 25% of newly eligible employees elected to stop the 2% deferral; these were predominantly lower paid field employees.

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Solution

(continued)

- For 2008, the regular Automatic Enrollment feature was amended to be an EACA. All those who were deferring at 2% of compensation or below were moved up to 3%, and the amount of the automatic enrollment is scheduled to increase by 1% per year for each of the next several years.

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Testing Results

Correction: Bottom up QNEC

Very small refunds

ADP/ACP combo pass

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Cash Outlays

2005 Employer Match:	\$610k
2006 Employer Match:	\$771k
2007 Employer Match:	\$874k

Note that the Average Deferral Percent for the NHCEs steadily increases.

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Case Study #5 Painless Dentists, Inc.

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Current Situation

- Painless Dentists, Inc. is owned by two dentists. They also employ 16 staff people, most of whom earn less than \$20,000 annually, and many of whom work part time (less than 1000 hours/year).

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Issue

They want to maximize contributions for the Dentists, and they know most of the staff people can't afford to defer any portion of their compensation.

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Solution

- Implement a Safe Harbor 401(k) Plan, with an enhanced matching formula of 100% of deferrals up to 4% of Compensation. Add a discretionary matching formula, which is intended to be as follows:
- 231.5 % match up to 4% of Compensation (total is limited by Code Section 415(c))
- Dental Assistants can be excluded from the Plan, as long as without them it satisfies the coverage requirements of Code Section 410(b).

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2008 Projected Benefits for Owners

With this structure, the owners/dentists receive a match of 300% of deferrals up to 4% of Compensation.

Deferrals:	\$15,500 each (6.739% of \$230,000 Compensation)
Employer Safe Harbor Match:	\$9,200 each (100% of first 4% deferred)
Employer Discretionary Match:	\$21,298 each
Total for each Owner:	\$46,000

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