



Matching Makes a Comeback

SITUATION: As a cost-cutting measure, we stopped making matching contributions to our 401(k) plan a couple of years ago. Since then, plan participation by new employees has dropped. We're considering resuming matching contributions at some level, on the thought that it could make a difference in our participation rates.

QUESTION: Do matching contributions really influence plan participation?

ANSWER: Yes. Studies show that a majority of employees view matching contributions as an incentive to save in their employers' plans and that plans with matching contributions generally have higher participation rates than those without.

DISCUSSION: According to the Employee Benefit Research Institute's *2005 Retirement Confidence Survey*, 72% of employees who do *not* currently participate in their employers' plans would be much more likely or

somewhat more likely to participate if their employers offered them a matching contribution of up to 5% of salary. About half (51%) said that a 3% match would induce them to participate.

However, while studies agree that offering *any* match as opposed to no match generally increases participation, there's no real consensus among researchers as to what the optimal match is. If you decide to resume your match, you may want to review the matching formulas other companies in your industry use. The table below may be helpful.

How Much?

(% of companies using fixed match amount)

Employer Match per Dollar Contributed by Employee

Industry	< 25¢	25¢	26¢ – 49¢	50¢	51¢ – 99¢	\$1	>\$1
Durable Goods Manufacturing	1.0%	15.7%	4.2%	49.9%	7.3%	21.9%	0.0%
Nondurable Goods Manufacturing	3.1%	15.6%	0.0%	62.5%	9.4%	6.2%	3.1%
Wholesale & Retail Trade	3.4%	11.9%	13.6%	37.3%	1.7%	30.6%	1.7%
Financial, Insurance & Real Estate	1.3%	8.6%	0.7%	44.6%	4.0%	40.0%	0.7%
Services	3.8%	17.0%	6.6%	43.4%	5.7%	21.6%	1.9%

Source: 48th Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing /401(k) Council of America, www.psc.org.

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Moving in the Right Direction

Employees need to understand that to save enough money for retirement, they need to keep their retirement savings working for them throughout their entire career. One way employers try to get this point across is by encouraging employees to roll over any retirement plan distributions they receive.

This effort seems to be paying off. A recent study* found that 46.7% of plan participants who reported receiving lump-sum distributions through 2003 said they rolled over at least part of their distribution. The percentage

reported for distributions received through 1993 was 41.5%.

Of greater note is the increase in the percentage of participants who rolled over their *entire* distribution. For distributions received through 1993, only 19.3% rolled over all the money they received. In contrast, 43.4% of those who received their most recent distribution through 2003 rolled over the total amount they received.

* *Lump-Sum Distributions*, Craig Copeland, Employee Benefit Research Institute, 2005

By Default

What can a retirement plan sponsor do when employees fail to direct the investment of their retirement account assets? One solution is a default investment option. Research shows that an increasing number of plans — both those with and those without an automatic enrollment program — offer a default investment option.

According to one study,* the percentage of plans offering a default investment grew from 54% in 2001 to 78% in 2004. The most common default investments were GIC/stable value funds, balanced/lifestyle funds, and money market funds — with GIC/stable value funds being the most popular. However, the study noted a trend toward balanced funds. The use of balanced funds increased from 21% in 2001 to 29% in 2004.

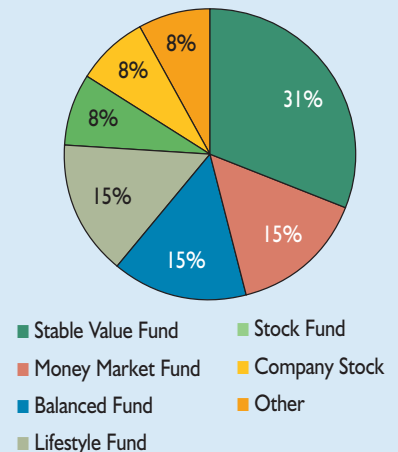
As the accompanying graphs show, research by the Profit Sharing/401(k) Council of America found a similar increase in the use of balanced funds among plans with automatic enrollment.

When choosing a default investment option or reviewing a current option, plan sponsors should consider their choices carefully with an awareness of their responsibilities as a plan fiduciary. In the case of automatically enrolled employees who don't direct the investment of their account assets, the sponsor is responsible for the investment of those accounts in the default investment option. Please call if you would like assistance in reviewing the suitability of your current default and/or choosing a new one.

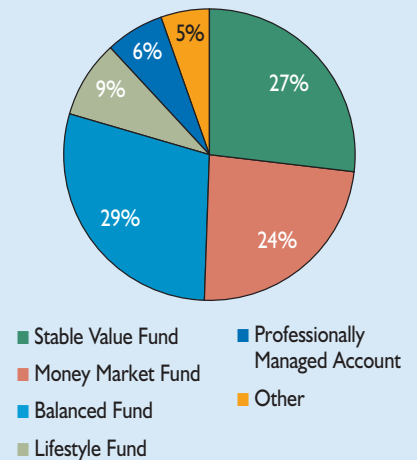
* Conducted by Cost Effectiveness Measurement Inc., a global information company that provides performance benchmarking for defined contribution/401(k) plans.

Default Investment Options

1999 Plan Year



2004 Plan Year



Source: 43rd and 48th Annual Survey of Profit Sharing and 401(k) Plans, Profit Sharing/401(k) Council of America, www.pasca.org.

FAQs About Plan Contributions

Elective salary deferrals, catch-up contributions, employer matching contributions, and now Roth contributions. Most 401(k) plans offer employees more than one way to build up their retirement savings. As a result, employers need to stay on top of the rules for each type of contribution. Below, we answer some questions employers may have about the various types of plan contributions.

What is an employer's deadline for depositing elective deferrals? Generally, employees' salary deferrals become plan assets on the earliest date they can *reasonably* be segregated from the employer's general assets. What is reasonable in this context? For amounts withheld from an employee's wages, regulations set a latest date of the 15th business day of the month immediately following the month when the deferrals would have been payable to participants as cash wages.

However, U.S. Department of Labor (DOL) auditors have made it clear that the 15-business-day rule is *not* a safe harbor. The DOL believes that many employers, particularly those with a single payroll system, should be able to deposit plan contributions as quickly as they deposit amounts withheld for other items, such as FICA taxes. These other deposits are often made within a week or less of the payroll date.

Can we really set the limit on deferrals to our plan at 100% of compensation? Theoretically, yes. In practice, no, for a couple of reasons. First, FICA and many state-required payroll withholding items must be subtracted from income before the elective deferrals can be made. Second, "annual additions" to a defined contribution plan, such as a 401(k) plan, are limited to 100% of compensation or \$44,000 (in 2006), whichever is less. This limit could be exceeded simply by the allocation of plan assets forfeited by employees who left the employer during the year, by the addition of an employer matching contribution, or by a profit sharing contribution.

Who can make catch-up contributions? Employees who are age 50 or older by the end of the year and who have otherwise made the maximum allowable

deferral to the plan can make catch-up contributions. So, an employee who will turn 50 on December 31, 2006, can make catch-up contributions for the 2006 calendar plan year, if all other requirements are met.

How can an employer determine whether an employee's elective deferral is a catch-up contribution? The employer can compare the amount deferred by a catch-up eligible employee to the tax law's annual dollar limit on elective deferrals or a plan-imposed limit written in the plan document. Amounts exceeding these limits qualify as catch-up contributions. Also, if the plan fails the average deferral percentage (ADP) nondiscrimination test, excess deferrals can be recharacterized as catch-up contributions if the participant is eligible to make catch-up contributions and has not already contributed the maximum catch-up amount for the year.

If a 401(k) plan offers Roth contributions, does it have to continue to offer traditional pretax contributions? Yes. In final regulations issued at the end of 2005, the IRS clarified that a plan that offers Roth contributions must also offer participants the option of making pretax contributions.

If an employer matches Roth contributions, should the matches be added to the employee's designated Roth account? No. Neither employer matching contributions nor plan forfeitures can be allocated to an employee's Roth account. However, gains, losses, and other credits and charges *must* be separately allocated between an employee's Roth account and his or her other accounts under the plan.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.



RECENT DEVELOPMENTS In Benefit Plans

Roth 401(k) Contributions.

For the most part, the final regulations on implementing Roth contributions to 401(k) plans, issued by the IRS in late 2005, adopt the proposed regulations — with a few notable clarifications and changes. Plans that offer the Roth option must allow both pretax and Roth contributions. Roth contributions are subject to the same nonforfeitability and distribution restrictions that apply to traditional pretax contributions, and must be included in the plan's annual nondiscrimination

testing. Highly compensated employees who make both Roth and traditional pretax contributions can choose whether to have any excess contributions attributed to Roth or pretax contributions. (Plans do not have to offer this option.) Distributions of excess contributions are not includable in gross income to the extent they are distributions of Roth contributions. Direct rollovers from a Roth account can only be made to a Roth account under another applicable retirement plan or to a Roth IRA.

Critical 401(k) Plan Issues.

The Institute of Management & Administration asked 401(k) plan sponsors what they saw as the most critical plan issues they expect to face over the next 12 months. Here are their top three responses: (1) improve plan performance and participation rates (75.6%); (2) improve fiduciary oversight and reduce risk (51.7%); and, (3) expand or add web-based investment education, enrollment, and loans (45.6%).

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