President's Page

DC Plan Limits Reduction

Be careful what you wish for.

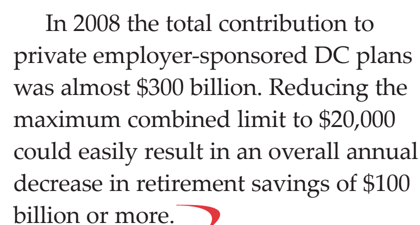
By David Wray

The Presidential Debt Commission suggested reducing the current $49,000 combined contribution limit for employer-sponsored DC plans to $20,000, or 20 percent of pay, whichever is lower, to help reduce the deficit. It was their intention, of course, to reduce tax-deferred retirement savings in DC plans, thus increasing immediately paid federal income tax. My comment is be careful what you wish for. I believe that such a change will reduce retirement savings by a great deal more than they expect. Here's why:

Profit sharing, or what some call non-elective contributions, will be eliminated, and matching contributions will be reduced. Plans are designed so legal limits are not violated, especially by highly-compensated employees (HCEs). If the overall limit is $20,000, then the company contribution, including the match, cannot exceed $3,500, or 1.4 percent for the owner/manager making the maximum covered compensation of $245,000 and making the maximum elective deferral of $16,500. This means that unless the company wants to further reduce the maximum amount HCEs can contribute, the employer contribution will have to be substantially reduced. According to the DOL, employers contributed more than $120 billion to private employer DC plans in 2008. According to PSCA survey data, the total company contribution was 4.1 percent of pay in 2008. Reducing the company contribution to comply with the new limit could reduce the employer contribution by as much as two-thirds, or $80 billion annually.

The lower matching maximum will also reduce the incentive of not highly-compensated employees (NHCEs) to save. A majority of matching formulas provide 3 percent or more of pay if the participant contributes enough to get the maximum match. I interpret this as the collective understanding that matching contributions have to be meaningful to motivate behavior, which is usually 3 percent or more. Reducing the maximum match to 1.4 percent of pay will likely reduce the number of NHCEs willing to save in the system. Certainly those proposing the change do not intend to increase federal revenue by reducing the number of NHCEs saving in employer-sponsored DC plans, but that is one of the unintended consequences of such a change.

Finally, it is no surprise that many small companies do not have plans. Companies with fewer than 100 employees are owner-managed. Because most of these plans will eventually be top-heavy, this means a mandatory employer contribution of 3 percent for every eligible employee that comes directly from the owner manager's pocket. Reducing the combined limit from $49,000 to $20,000 for small employers, who are responsible for implementing and maintaining plans while continuing to require a mandatory 3 percent of pay contribution for every employee when the plan becomes top heavy, will definitely help reduce the federal deficit. A great many small employers with plans will terminate them.



In 2008 the total contribution to private employer-sponsored DC plans was almost $300 billion. Reducing the maximum combined limit to $20,000 could easily result in an overall annual decrease in retirement savings of $100 billion or more.

David Wray is PSCA's president.