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Safe-Harbor 401(k) Plans Force U.S. Companies to Pay
(Update1)

By Jeff Plungis

April 8 (Bloomberg) -- Marty McGreevy, owner of a company that designs convention booths, wanted to avoid cutting jobs by stopping payments to his employees' 401(k) savings plan.

U.S. regulations for smaller companies such as McGreevy's Cyclonix in Morgan Hill, California, prevented him from doing so. His choices were to make the $70,000 payment in 2009 or liquidate the 401(k) retirement plan. Since Cyclonix had already committed to the 2009 outlay, it was too late, he said.

"As long as we make small companies contribute in the worst of times, a lot won't have" retirement savings plans, said David Wray, president of the Profit-Sharing/401k Council of America in Chicago. "They're so close to the margin that a 3 percent contribution can make or break these guys. They can't put their company at risk just because they want this benefit."

Companies with fewer than 250 employees are considering liquidating their so-called safe-harbor 401(k) plans as earnings deteriorate in what may be the worst U.S. recession in 70 years, said Stephen Dobrow, president of Primark Benefits, a San Francisco-based retirement-plan adviser. The U.S. economy shrank at an annual pace of 6.3 percent in the fourth quarter.

"I was somewhat floored that there were no other options," Cyclonix's McGreevy said.

In the kind of safe-harbor 401(k) plan used most often by small firms, employers make payments equal to 3 percent of eligible employees' compensation. The contributions are paid regardless of whether employees add their own money to the plan.

Safe-Harbor Plans

Safe-harbor plans permit businesses to avoid a requirement with regular 401(k)s: having to demonstrate that a firm's most highly paid employees, such as the owners of a small business, aren't reaping the lion's share of the retirement benefits.

The Arlington, Virginia-based American Society of Pension Professionals and Actuaries wrote in a Feb. 20 letter to the Treasury Department that terminating the plans would result in “unnecessarily depriving affected employees of the opportunity to save.”

When retirement plans are closed, employees get a lump-sum check that they can cash or roll into an Individual Retirement Account. In most cases, if they cash the check, they’ll be subject to income taxes and a 10 percent tax penalty.

When plans are terminated, employees don’t have the opportunity to contribute their own money to the 401(k). Workers are then usually limited to $5,000 of tax-deferred savings a year for a traditional IRA rather than $16,500 per year permitted in a 401(k), said Primark’s Dobrow.

About 1.7 percent of companies that offer 401(k) options use this type of safe-harbor plan, said Wray, citing an annual survey by Profit-Sharing/401k Council of America of 1,011 plans representing 7.4 million employees and $730 billion in assets.

Benefits Choice

Retirement-plan benefits are a target for stressed employers because they’re not as big a recruiting tool as health insurance, said Andy Keeler, a partner with Everhart Financial Group in Dublin, Ohio, who consults with businesses about retirement benefits. Cuts to 401(k)s can allow the firms to save jobs and stay in business, he said.

Large U.S. companies have the flexibility to reduce or temporarily suspend their 401(k) payments without terminating their plans, said Robyn Credico, director of defined-contribution consulting at Arlington, Virginia-based Watson Wyatt Worldwide Inc.

Large-Company Contrast

More than 50 of the largest U.S. companies have scaled back their retirement-plan contributions during the current recession, compared with about 15 in the last decline in 2003 and 2004, Credico said. All of those companies restored the contributions when the economy improved, she said.

The U.S. Treasury Department is searching for ways to give plans more flexibility because terminations are worse for employees than skipping the payment, Thomas Reeder, the Treasury’s benefits tax counsel, said at a March 7 meeting of financial-services industry groups.

Jan Jacobson, senior counsel for retirement policy at the American Benefits Council, which advocates for U.S. employers that provide benefit plans, including Coca-Cola Co., JPMorgan Chase & Co. and Wal-Mart Stores Inc., said the Treasury is strongly considering changes that will allow companies to keep their plans in place without the 3 percent contributions.

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