



Workshop 33: New Comparability Plans in 2015

Presented by

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Summary

- EBAR
- Basic Design
- Gateway
- Design vs. Failure
- Fixing test
- Average Compensation
- Accrued to Date
- Restructure



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New Comparability

- This is simply a reference to a DC plan tested on a benefits basis, sometimes called cross testing
- The testing is based upon an EBAR
- In order to cross test a DC plan the plan must provide a minimum allocation gateway (unless the plan meets one of several rules that are not covered in this session)



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Basic Design

For discussion purposes we will use this census

Name	Age	Compensation	Owner
Ed	55	265,000	Yes
Joan	45	265,000	Yes
Bob	40	40,000	No
Janet	35	30,000	No
Jim	30	25,000	No
Rick	25	20,000	No



Basic Design

- A standalone DC is usually improved with use of a 401(k) plan (normally a safe harbor 401(k)) but for simplicity of discussion it will be assumed that a 401(k) feature will not be included



Basic Design

- Assume that the objective is to get Ed and Joan a \$53,000 allocation
- In order for the plan to pass testing it must create one rate group for each HCE, which consists of that HCE and every other participant who has an EBAR at least as large as the EBAR of the HCE for whom the rate group is formed



Basic Design

- The ratio percentage of the rate group must generally be at least as large as the mid point between the safe harbor and the unsafe harbor
- Ratio percentage is the ratio of the percentage of non-excludable NHCEs in the rate group (out of all non-excludable NHCEs) to the percentage of non-excludable HCEs in the rate group



Basic Design

- The concentration percentage is the number of non-excludable NHCEs as a percentage of all non-excludable employees
- A non-excludable generally an employee who meets the plan's age and service requirement
- Terminated employees can be treated as excludable under certain circumstances



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Basic Design

- In order for a terminated employee to be treated as excludable, the employee
 - Must be terminated
 - Must have worked less than 500 hours
 - Must not have benefited under the plan during the year
 - Must have not benefited solely because of being terminated or failing to work enough hours



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Basic Design

- This would mean that in a safe harbor 401(k) plan, terminated employees must be included in testing (because they still benefit under the plan)
- Additionally (as discussed later) because the benefit, they must receive the gateway



Basic Design

- In our plan there are 4 non-excludable NHCEs and 2 non-excludable HCEs
- This makes the concentration percentage 4/6 or 66% (note this calculation is always rounded down)



Basic Design

- The safe harbor is 50% - $\frac{3}{4}$ of the excess of the concentration percentage over 60%, or
- $50\% - 75\% * (66\% - 60\%) = 45.50\%$
- The unsafe harbor is the greater of 20% or the safe harbor percentage minus 10% or
- $\text{Max}(20\%, 45.50\% - 10\%) = 35.50\%$
- The midpoint is the average of the safe harbor and unsafe harbor or 40.50%



Basic Design

- As a first try, assume \$53,000 for Ed and Joan, and 5% for everybody else
- The simplest EBAR is allocation, increased with interest to the normal retirement age, and converted to an annuity, and expressed as a percent of pay (or percent per year of service)
- For simplicity, assume nra is 65



Basic Design

- For Ed the EBAR would work out as
 - Allocation of \$53,000
 - Increased at 8.5% for 10 years to age 65 = 119,832
 - Converted to an annuity = $119,832 / 7.9 = 15,169$
 - Expressed as a percent of pay = $15,169/265,000 = 5.72\%$



Basic Design

- Repeating for everybody is as follows

Name	Allocation	Projected	Benefit	EBAR
Ed	53,000	119,832	15,169	5.72%
Joan	53,000	270,938	34,296	12.94%
Bob	2,000	15,374	1,946	4.87%
Janet	1,500	17,337	2,195	7.32%
Jim	1,250	21,725	2,750	11.00%
Rick	1,000	26,133	3,308	16.54%



Basic Design

- This plan would fail because the rate group for Joan would consist of only Ed, Joan and Rick
- This would make the ratio percentage
 - $(1/4) / (2/2) = 25\%$
- Since 25% is less than the midpoint, the rate group fails



Basic Design

- The knee jerk reaction would be to increase Jim's allocation
- If Jim's allocation were increased to 1,475 the plan would pass
- If each individual is in their own allocation tier then Jim's allocation could simply be increased, but this could lead to personnel issues



Basic Design

- One solution would be to have a minimum 1,475 allocation
- Another solution would be to allocate 5.90% of pay to the NHCEs



Past NRA

- If an individual is past testing age there are two options (either of which must be uniformly applied)
 - One option is to treat the testing age as the current age (i.e. increase the testing age)
 - The other option is treat the current age as the testing age (i.e. treat individual as if currently at testing age)



Gateway

- The regulations generally require that a minimum allocation be provided if a DC plan is cross tested (with some exceptions)
- The gateway is either
 - 1/3 of the highest allocation rate for any HCE, or
 - 5% of 415(c) compensation



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Gateway

- Normally plans use 415(c) compensation for testing, but the plan may use some other compensation for testing (such as excluding bonuses)
- If the plan uses other than 415(c) compensation, then the compensation used must satisfy 414(s)



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Gateway

- If the 414(s) compensation is significantly lower than the 415(c) compensation, it is possible that the 1/3 rule may actually produce a lower gateway
- For example if the 414(s) compensation is $\frac{1}{2}$ of the 415(c) compensation, then a gateway of 7% of 414(s) compensation would be equivalent to a 3.5% gateway on 415(c) compensation



Gateway

- If the gateway is based upon 415(c) compensation, it can be limited to 415(c) compensation earned while a plan participant (even if compensation for other purposes is not)



Design vs. Failure

- A design is the process of getting as close to the plan sponsors objective as possible
- Once the plan sponsors objective is tried, if it fails, fixing the design is effectively the same as fixing a failure in an ongoing plan



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Fixing Test

- The process of fixing a failure is a matter of increasing an NHCEs EBAR (to get them into a failing rate group) or decreasing an HCEs EBAR (to allow other NHCEs into a failing rate group)
- In the case of the average benefit percentage test, it is effectively the same objective
- In some instances improvement involves a restructure (discussed later)



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Average Compensation

- The easiest way to improve testing is usually to use average compensation
- If an HCE has a drop in compensation, the testing compensation can be increased by using an average compensation, which would decrease the EBAR
- Conversely, if an NHCE's compensation has increased, the testing compensation can be decreased, which would increase the EBAR



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Average Compensation

- Consider an individual whose compensation has increased 10% per year, as follows:
 - 2012 \$10,000
 - 2013 \$11,000
 - 2014 \$12,100
 - 2015 \$13,310



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Average Compensation

- This would produce a three year average of \$12,136.67
- This would be about a 10% improvement over the current compensation of 13,310, with an associated roughly 10% increase in the EBAR
- A four year average would be \$11,602.50, for another about 4.5% increase in EBAR



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Average Compensation

- If this individual was hired on December 1, 2011, and earned \$833 during 2011, this would greatly increase the EBAR
- A five year average would be 9,448.60 for an additional 22% improvement. All told the increase in the EBAR would be over 40% from current compensation



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Average Compensation

- The moral is that if a participant is hired late in the plan year, then including the year of hire in the average compensation can significantly improve testing



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Average Compensation

- A variation of changing compensation is to only use compensation while a plan participant
- For a mid year entrant, this would double the EBAR
- This cannot be used in conjunction with average compensation



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Accrued to Date

- If
 - Contribution rates are increased for HCEs
 - Contribution rates are decreased for NHCEs
 - Or the rates of return are low
- The EBARs can be improved through use of accrued to date testing



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Accrued to Date

- Assume that Ed has been in the plan for 4 years total (including the current year)
- If Ed's account (prior to the current contribution) is less than $\$53,000 * 3 = \$159,000$ then his EBAR would be decreased
- This is because in the EBAR formula the $\$53,000$ would be replaced by the account divided by 4



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Accrued to Date

- Assume that the actual account (prior to the current allocation) is \$100,000
- This would make the EBAR $(100,000 + 53,000) * 1.085^{10} / 7.9 / 265,000 / 4 = 4.13\%$ rather than the previously calculated 5.72%
- Note if accrued to date is used, then testing must use an average compensation



Accrued to Date

- The lower account balance can be caused by either lower contributions or low returns





