Your Employer's Role in Your 401(k)

Employers set up 401(k) plans for four reasons: to attract, retain, motivate, and facilitate retirement for high-quality workers like you. In order to accomplish this goal, employers design their 401(k) plans specifically for the employees at their company. This means that while the general principles of 401(k) participation are the same for all plans, the application of those principles may vary from company to company. Do not be surprised when you change jobs to find that your new 401(k) plan is different than your previous employer's plan.

The government encourages employers to offer 401(k) plans. Employer-provided benefit programs encouraged by the government-including 401(k)-are called qualified plans. This means that you and your employer are qualified to get the benefits of 401(k) plan participation only if your employer designs and operates your 401(k) plan within a framework of rules established by the government.

This chapter addresses your employer's role in setting up and maintaining your 401(k) plan. Government rules will be interwoven into the discussion as they apply. The chapter is divided into two sections:

1. Plan Design
2. Additional Support

To take full advantage of the opportunities your 401(k) provides, you must understand how your plan is designed and why.

Plan Design

Employers have the flexibility to design a 401(k) plan tailored for their specific company and the needs of their employees. Within the 401(k) framework provided by the government, your employer is in charge of deciding:

- Who can participate in the plan
- When you are eligible to start contributing
- How much you can contribute to your plan
- Whether you must make investment choices or if the company will invest for you
- What your investment options are
- When and how often you can change your contribution amount or investment allocation
- Whether there will be an employer matching contribution and how much it will be
- When the matching contribution will be provided
- How long you have to work to earn the matching contribution (this is called vesting)
- Whether loans or hardship withdrawals will be permitted
- Whether to automatically enroll you in the plan at a specific contribution level and invested in default investments
- Whether to accept rollovers from your IRA and/or other qualified plans

Who Can Participate

The right of an employee to save in a 401(k) plan is not given to everyone. However, full-time salaried and hourly employees are nearly always eligible to participate, and approximately half of companies sponsoring 401(k) plans allow their part-time employees to participate. On the other hand, many 401(k) plans exclude employees compensated on a commission basis, temporary employees, and leased employees. If you are a member of a union, your union contract may provide for 401(k) plan participation. In some cases, your 401(k) plan may include union members even if the union contract does not address 401(k) participation.

When You Can Start Saving

In order to start saving in your 401(k) plan, many companies require you to have at least one year of service with the company and be at least 21 years of age. Other companies let you start saving as soon as you start work or at the same time you are eligible for other company benefit programs, such as health coverage. Once you are eligible to participate you will probably have to wait for the next specific enrollment date to begin saving in your plan. This date could be the first of the month following your date of eligibility, which would allow for 12 enrollment dates every year; or your company might limit the enrollment dates to twice a year, for example January 1st and July 1st.

If your company has a one-year eligibility requirement, in most cases your eligibility period is any 12-month period during which you were employed and you worked 1,000 hours. If you start out as a part-time worker ineligible for the plan, and then get hired to work full time, your part time employment must count towards your year of service.

Contribution Limits

Your employer wants to let you save in your 401(k) plan with out limit, according to your own needs. However, your company must put a cap on what you can save to comply with contribution limits imposed by law and to provide for other payroll deductions.

There are two types of legal limits on employee 401(k) plan contributions: dollar limits and percentage limits. The amount that you can contribute is always the lower of any of these limits. The dollar denominated limit that employees can contribute to their 401(k) plans is $15,500 in 2007 ($20,500 if you are over age 50) and is indexed in $500 increments going forward. However, the ability to save the full dollar amount provided by law depends upon your meeting the percentage limitations as well.

Starting in 2002, your employer is permitted by law to let you save as much as 100 percent of your annual pay in your 401(k) plan. However, your employer cannot let you contribute so much to your 401(k) plan that there is no money left in your paycheck to pay your Social Security taxes or to make other payroll deductions, such as payment for your employer-provided health care plan. For this reason, companies allowing their employees to save more than 70 percent of their annual pay in a 401(k) plan are rare. But this is still a favorable percentage. If the percentage of pay allowed in your plan is 70 percent and your salary is $22,150 a year or more, you will be able to contribute $15,500 to your 401(k) plan in 2007-the full amount allowed by law. Note that many companies still limit the percentage of pay that employees may contribute to between 15 and 25 percent.

An additional percentagelimitation may be imposed on employees that the law defines as "highly compensated." Basically, plans must maintain a legally set balance between the contributions of a company's highest-paid employees (in 2007, anyone earning $100,000 or more, or as indexed annually) and the contributions of other employees. If you fit the description of highly compensated, this means the percentage of your annual pay that you can contribute to your 401(k) plan may be limited. This will depend on the average contribution of those not defined as highly compensated. Your employer is responsible for determining this percentage limitation, communicating it to you, and making sure you do not exceed your limit.

Safe Harbor Contributions: Some plans provide a federally man dated match or contribution at a minimum level set by the federal government. This could be (1) either a 3 percent of pay employer contribution for all eligible non-highly compensated employees regardless of whether they are making 401(k) contributions themselves, or (2) a matching contribution of 100 percent on the first 3 percent of pay, and a 50 percent matching contribution on the next 2 percent of pay. The safe harbor match contribution must vest immediately. Companies that adopt one of these contribution approaches are permitted to allow their highly compensated employees to contribute the maximum amount provided by law without consideration of the average contribution of non-highly-compensated employees.

Catch-up Contributions: Companies can allow employees 50 years of age or older to make additional contributions to their 401(k) plans. These contributions are not counted against any of the dollar or percentage limitations discussed previously, including the highly compensated percentage limitation. In fact, you must save the maximum possible (under your plan or the law) before you can make this additional contribution.

In 2007, this additional contribution can be as much as $5,000. The limit on this special contribution is indexed to increase in $500 increments each year. This means that in 2007, those 50 years of age or older may be able to contribute $20,500 to their 401(k) plans ($15,500 plus a$5,000 catch-up contribution). Coordinating this special contribution with normal 401(k) plan limitations and company payroll systems is complex and some plans do not permit it.