What To Do If You Think Your Plan Will Fail Discrimination Tests This Year?

By Jewell Lim Esposito on July 30, 2010

It's the end of July, and right about now, I get some panicked questions from employers regarding their retirement plans. It's really to be expected. For calendar-year plans, Forms 5500 are due, so there are questions there. For those plans that required audit (new especially for 403(b) plans for 2009), the audits produce a host of issues that surface from close inspection. As well, employers start to receive their retirement plan's *mid-year* discrimination tests. The results there give an indication if their plans will pass the discrimination tests *at the end of the year*.

What if it looks like an employer might fail its discrimination tests at the end of the year? It could mean there is low participation from its non-highly compensated employees (NHCEs). This is the time that an employer should consider "working around" failed discrimination tests. Some things to investigate:

Further educate employees? Consider asking your service provider to inform employees of the ability to enroll and/or increase savings into the company retirement plan. Increasing participation at the NHCE level might improve upon what mid-year testing results seem to be indicating.

Stop accepting contributions from highly compensated employees (HCEs)? If it looks like the HCEs will "overcontribute" relative to NHCEs, an employer can step in and limit what HCEs can contribute. Now would be a good time to consider stopping HCE contributions or even refunding back money to lower the contribution ratio of the HCEs, relative to the NHCEs.

Consider a safe harbor plan? There is a way for an employer to avoid having to run discrimination tests that analyze employee deferrals or employer contributions. With a safe harbor plan, an employer commits to making a set contribution. The employer should compare that contribution against what it thinks a failed discrimination test might cost (as well as the additional TPA fees). Note: when implementing a safe harbor plan, an employer must give appropriate notice (between 30-90 days before the next plan year) of this design change.

Consider an automatic enrollment feature? Sometimes viewed as too paternalistic, automatic enrollment means just that: an employer automatically enrolling its employees into its retirement plan. An employer will automatically withhold a certain amount from an employee paycheck and contribution that amount into the retirement plan, unless an employee opts out. You can see why this increases participation immediately.

In sum, employers should use these mid-year testing results to evaluate their current plans and employee participation

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