

The Price of Waiting

Often times, many of us procrastinate until the last minute to buy gifts for family and friends. Some of us wait because we were certain that prices would dip lower and we would get the deal of a lifetime! And of course there's that old saying, "good things come to those who wait". Creating a retirement plan, however, that prolongs employees' participation due to a lengthy entry period could potentially cause your employees to lose their employer contributions before they're 100% vested.

In October 2016, the Government Accounting Office ("GAO"), was able to calculate the the price of waiting. GAO's survey of eighty 401(k) plans found that many plans have policies that affect workers' ability to (1) save in plans (eligibility policies), (2) receive employer contributions, and (3) keep those employer contributions if they leave their job (vesting policies).

Thirty-three of eighty plans surveyed had policies that did not allow workers younger than age 21 to participate in the plan. In addition, nineteen plans required participants to be employed on the last day of the year to receive any employer contribution for that year (in particular, discretionary profit sharing contributions). Fifty-seven plans had vesting policies requiring employees to work for a certain period of time before employer contributions to their accounts are vested. Plan sponsors and plan professionals GAO surveyed identified lowering costs and reducing employee turnover as the primary reasons that plans use these policies.

A similar survey conducted by the Profit Sharing Council of America of over 590 plans found that 60% of plans with less than 50 employees had a one year eligibility requirement and 65% with an age 21 requirement to get into their company's plan. However, 87% of this same group had no last day rule to receive a non-matching contribution yet they also have the most restrictive vesting schedule.*

The GAO report notes that many employers' plan design have failed to take into consideration that today's workforce is more mobile – with workers between the ages of 18 and 48 having an average of 11 jobs in their working careers. The report notes that Bureau of Labor Statistics data show the median tenure for private sector workers in 2014 was 4.1 years. With increased mobility, employees find themselves forfeiting year end contributions and failing to have enough years of service to fully vest in employer contributions. The following table reflects the GAO's summary of job tenure:

*58 Annual Survey of the Profit Sharing Council of America

Average Number of Jobs Held for Persons Ages 18 to age 48 from 1978-2012

Age	Total	Men	Women
Ages 18 to 24	5.5	5.7	5.3
Ages 25 to 29	3.0	3.1	2.8
Ages 30 to 34	2.4	2.5	2.3
Ages 35 to 39	2.1	2.1	2.1
Ages 40 to 48	2.4	2.4	2.4
Ages 18 to 48, Total	11.7	11.8	11.5

Source: Bureau of Labor Statistics' data from the National Longitudinal Study of Youth 1979 (NLSY79), March 31, 2015. | GAO-17-69
 Note: More than one job could be held by an individual at a time. The jobs reflected in each age category do not necessarily represent new jobs, as jobs held in more than one of the age categories jobs were counted only once in the each age category does not add up to the overall total.

According to the GAO's projections, "being ineligible to save in a new employer's plan for 1 year on 11 occasions, especially occurring more frequently early in a worker's career, may result in \$411,439 less retirement savings (\$111,454 in 2016 dollars)".

The Employee Retirement Income Security Act of 1974 ("ERISA") provides the legal framework for eligibility rules used in retirement plans. The maximum age that employers can require as a condition of eligibility is 21 and generally, the maximum period of service to be eligible is one year. Vesting rules either allow for cliff vesting in which no employer contributions vest until the full vesting period is satisfied (no greater than three years of service) or graded vesting in which employer contributions vest over time (20% after 2 years of service with a minimum increase of 20% per year for each year thereafter). For employers with high turnover and funding concerns, designing their plans with these restrictions may reduce administrative costs and other plan fees.

The practice of making annual contributions went into place when many plan sponsors made only profit sharing contributions. With the increase in 401(k) plans, employers are frequently making employer matching contributions in place of profit sharing contributions. Under federal law, both types of contributions can be made as late as the date the company files its tax return for the previous year, including any extension. Therefore, a plan participant could receive the employer contribution as late as September of the following year. Hence contributions are not invested – and therefore not working for them – for quite some time.

The GAO report provides projections on the lost benefits to employees when age, service, and vesting restrictions are imposed by employers. The following table is based on the results of GAO's hypothetical scenarios:

Table 6: Based on the Results of GAO's Hypothetical Scenarios, Current Eligibility, Employer Contribution, and Vesting Policies Can Potentially Result in Lower Retirement Savings

Policy	When Workers are Affected	Potential Foregone or Lost Savings		
		Savings	Potential Value at Retirement (age 67) of Foregone or Lost Savings	
			Nominal	In 2016 Dollars
Minimum age of 21	Before joining the plan	\$2,643 ^a employee contributions	\$85,587	\$23,258
		\$4,140 employee and employer contributions	\$134,456	\$36,422
Minimum service for eligibility (up to 1 year and 1,000 hours)	Before joining the plan	\$3,808 ^b employee contributions	\$51,758	\$14,021
		\$5,963 employee and employer contributions	\$81,055	\$21,957
"Last day" service	After joining a plan, when leaving a job	\$2,155 ^c employer contributions	\$29,297	\$7,936
Timing of employer contributions	After joining a plan, all-year every year	\$86 ^d employer contributions	\$1,076	\$291
	If the worker's plan applied this policy for 10 years	\$1,128 ^e employer contributions	\$9,976	\$2,702
Vesting of employer contributions	After joining a plan, when leaving a job	\$4,143 ^f employer contributions	\$58,494	\$15,845

Source: GAO analysis of federal laws and hypothetical scenarios. | GAO-17-69

Note: Foregone savings are based on an assumption that the worker would have saved 5.3 percent of their salary. Salaries are based on data developed by the Social Security Administration's Office of the Chief Actuary. Lost savings are based on employer contributions, which are assumed to be 3

A survey conducted by the Employee Benefit Research Institute reveals that 45 percent of American workers have less than \$10,000 set aside for retirement. It may be time for plan sponsors to explore plan design changes that allow employees to enter their plan more quickly, eliminate end of year requirements in order to receive company contributions and/or liberalize their vesting schedule so terminating participants don't leave a significant portion of employer contributions behind. There are costs/benefits to making some of these changes and our team can help you explore these options.

Contact any member of our team at (312) 564-3806 for more information or visit our website at: www.theprivatebank.com/corporate-retirement

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