

GAO

Fact Sheet for the Ranking Minority
Member, Special Committee on Aging,
U.S. Senate

April 1988

401 (k) PLANS

Participation and Deferral Rates by Plan Features and Other Information



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Program Evaluation and
Methodology Division

B-230447

April 29, 1988

The Honorable John Heinz
Ranking Minority Member
Special Committee on Aging
United States Senate

Dear Senator Heinz:

As you requested, we have done additional analyses of data we collected for a report on retirement plans provided for under section 401(k) of the Internal Revenue Code. We are forwarding the results of our analyses in this fact sheet, in which we address three questions: (1) How many workers are employed in firms that provide no retirement plan other than a 401(k) plan? (2) What kinds of plans, if any, were converted or replaced when firms set up their 401(k) plans? (3) How do average participation rates and average deferral percentage (ADP) rates differ among plans with different provisions? This information is based on the results of a 1987 survey of 5,000 corporations, with a 70-percent response rate; the data apply to plan year 1986. The results may be generalized only to the firms represented by our respondents; we cannot estimate the results for firms represented by nonrespondents.

Background

Congress has provided a number of tax incentives to encourage corporations to sponsor, and employees to participate in, a variety of retirement plans. Among these plans are cash or deferred compensation arrangements, commonly called 401(k) plans in reference to the section of the Internal Revenue Code that qualifies them for special tax treatment.

Employees may participate in 401(k) plans sponsored by their employers by designating a portion of their salary or wage income to be contributed to their plan accounts rather than paid to them as cash income. The amounts so contributed are not taxed at the time of the contribution; rather, the individual income taxes that would have been due are deferred until the contributing employee (or his or her estate) receives the funds as a distribution at retirement, death, age 59-1/2, or the occurrence of some other event as stipulated by the plan documents. The employer may deduct the amount of the contribution, and any employer matching or other contributions made to the plan on behalf of participants, from corporate income for tax purposes.

In response to your request, we have previously reported on information about 401(k) plans developed from the same survey of corporations used for the analyses in this fact sheet. (See 401(k) Plans: Incidence, Provisions, and Benefits, GAO/PEMD-88-15BR, March 29, 1988.) In that report, we provided information on the incidence of 401(k) plans, plan provisions and experiences, the extent to which plans benefit employees at various salary levels, and the expectations of corporate respondents on the effects of the Tax Reform Act of 1986 on employee participation in and employee and employer contributions to 401(k) plans.

How Many Workers Are Employed in Firms With No Retirement Plan Other Than a 401(k) Plan?

In regard to the first question, on the number of workers employed at firms where the 401(k) plan is the only retirement plan, we previously reported that only 4 percent of the firms represented by our respondents sponsored 401(k) plans in 1986. Among these sponsoring firms, 31 percent offered no other retirement plan to their employees. The percentage of plans offering only a 401(k) retirement plan varied considerably by firm size, however, as shown in appendix I, table I.1. Virtually no companies with 500 or more employees used their 401(k) plan as the sole retirement vehicle, while significant percentages of firms in the smaller size categories, including a majority of those with 50 to 99 employees, did so.

Overall, the companies represented by our respondents that sponsored only 401(k) plans employed nearly 800,000 workers. These amounted to about 9 percent of the 9.9 million employees in 401(k) plan-sponsoring firms represented by our respondents, and about 1 percent of all full-time civilian workers in 1986.

What Kinds of Plans Were Converted to or Replaced by 401(k) Plans?

On the second question, the data reported in table I.2, show that 61 percent of 401(k) plans were established as new plans, rather than as replacements for existing plans of other types. This was the case especially among small firms, those with fewer than 100 employees. A majority of these companies did not establish their 401(k) plans by replacing or converting existing plans. Among firms with more than 100 employees, a majority of 401(k) plans did replace some other type of plan.

Overall, the most common type of plan replaced by a 401(k) plan was a profit-sharing plan; 29 percent of all 401(k) plans involved conversion or replacement of these. Among the largest companies, those with 5,000

or more employees, 48 percent of the 401(k) plans replaced other thrift/savings plans.

How Are Plan Provisions Related to Participation and Average Deferral Rates?

We report the results of our analysis of the third question, relating specific plan features to employee participation rates and average deferral percentage rates, in tables I.3 through I. 9. In these tables, we report on the percent of employees eligible to participate in the plan who actually elected to have some portion of their salaries and wages contributed to the plan as deferred compensation in 1986. We also report on the average percentage of salary that was contributed by these contributors, overall and for the higher paid one-third and lower paid two-thirds of eligible employees. The breakdown by pay categories is based on the definition of the higher and lower paid groups used to meet the nondiscrimination tests applicable to 401(k) plans in 1986.

In general, each of the provisions we examined may be considered to constitute an incentive for employees to participate in the plan as active contributors. Thus, we might expect that a plan with one of these provisions would have a higher rate of participation than one without that provision. We also might expect that the average deferral percentage would be higher in plans with these provisions than in plans without them.

In table I.3, we report that the participation rate for plans in which the employer provided contributions to match those of the employee was 88 percent, whereas for plans without matching contributions, it was less than 50 percent. The ADP for all contributors was higher for plans with matching (5.4 percent) than for those without (3.5 percent), a result that held for both the higher and lower paid groups.

The data in table I.4 show that the participation and ADP rates among plans with matching contributions varied by the level of matching provided. For plans where the employer matched employee contributions dollar for dollar, the average participation rate was 99 percent of those eligible, and for those where the match exceeded this level, the participation rate was 88 percent. These two groups of plans had higher participation rates and ADP levels than plans offering less generous matching formulas.

In general, participants may change the percentage of their salaries contributed to their 401(k) plan accounts from time to time, with limitations specified in the plan documents. Plans permitting participants to change

the percentage of their salaries and wages contributed to the plan as often as they wanted had 79-percent participation rates, as shown in table I.5. This was higher than for plans that limited the frequency with which participants could change contribution levels, except for those allowing changes semiannually. Plans without limits on the frequency of changes in contribution levels also had the highest ADP overall (7.4 percent) and for the lower paid group (4.7 percent).

Some 401(k) plans allow employees to make additional contributions, beyond those eligible for tax deferral. These are called after-tax (voluntary) contributions. The data reported in table I.6 show little difference in participation or ADP rates between plans that permit such contributions and those that do not.

Many 401(k) plans have provisions that permit participants to borrow from plan assets, usually repaying loans with interest. Plans with such provisions had a participation rate of 69 percent, compared to 82 percent for those without loan provisions. (See table I.7.) Our data do not permit a ready explanation for the apparent inconsistency of this finding with the expectations of some analysts. Both types of plans had similar ADP figures.

Another common feature of 401(k) plans is the ability of participants to withdraw their accumulated assets for hardship reasons before retirement or other conditions usually required for distributions from plan accounts. In table I.8, we report that participation rates were about the same for plans that permitted hardship withdrawals from the assets representing the employee's own contributions to the plan and those that did not (71 percent and 76 percent, respectively). The overall ADP rate was 4.5 percent for the plans that did permit such withdrawals and 6.8 percent for those that did not. Our data do not permit us to explain this apparent inconsistency with the common expectations.

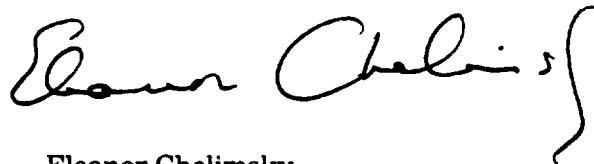
For plans that allowed hardship withdrawals of the employer's matching or discretionary contributions, the participation rate was 87 percent, compared to 50 percent for those that did not permit such withdrawals. The overall ADP rate for the plans providing for withdrawals of these assets was 5.3 percent, while that for the plans without such a provision was 3.5 percent. Similarly, the ADP rate for both the higher and lower paid employee groups was higher for the plans that did permit withdrawals.

Many 401(k) plans permit employees to direct how the assets in their plan accounts are invested. Participants may be given a list of options, such as an equity fund, a balanced fund, or a guaranteed interest contract, in which they may choose to have their plan assets invested. In table I.9, we report that among the plans that give employees these options, the participation rate (70 percent) was similar to that for plans that do not provide such options (73 percent). The overall ADP rate for the plans with choices was 5.4 percent, compared to 4.0 percent for those without such options.

Note that in the tables each provision is handled separately. It may be that different combinations of features would produce different results. Such interactions among features might help to explain some of the anomalous results we have reported.

As we arranged with your office, we are sending copies of this fact sheet to the Senate Committees on Finance, Labor and Human Resources, and Small Business, the House Select Committee on Aging, the House Committees on Ways and Means, Education and Labor, and Small Business, and the Joint Committee on Taxation. Copies also will be made available to others who request them. If you have any questions, please contact Lois-ellin Datta of my office at 275-1370.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Eleanor Chelimsky". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Eleanor Chelimsky
Director

Tables Relating to 401(K) Plans

Table I.1: Percent of Firms With 401(k) Plan as Only Retirement Plan in 1986, by Firm Size

401(k) plan status	Number of employees					All firms
	5-49	50-99	100-499	500-4,999	5,000 or more	
Only plan	34%	61%	46%	0%	1%	31%
Not only plan	66	39	54	100	99	69

Table I.2: Percent of 401(k) Plans as Conversions of, or Replacements for, Other Plan Types, by Firm Size

Type of plan converted or replaced	Number of employees					All firms
	5-49	50-99	100-499	500-4,999	5,000 or more	
New plan ^a	74%	67%	48%	20%	34%	61%
Profit-sharing	22	17	32	72	10	29
Thrift or savings	1	8	5	8	48	4
Money purchase	1	0	5	b	b	2
Defined benefit	0	0	7	b	b	2
PAYSOP and ESOP ^c	0	0	0	b	0	b
Other	0	8	5	b	3	2
Not reported	1	0	0	b	4	1
Total^d	99	100	102	100	99	101

^aPlans not replacing or converted from other plans.

^bLess than 0.5 percent.

^cEmployee stock ownership plans.

^dTotal may not equal 100 percent because of rounding.

Table I.3: Mean Participation and Average Deferral Percentage Rates by Whether Employer Made Matching Contributions in 1986

Employer made matching contributions	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Yes	88.1%	6.6%	4.5%	5.4%
No	49.5	3.3	2.7	3.5

Appendix I
Tables Relating to 401(K) Plans

Table I.4: Mean Participation and Average Deferral Percentage Rates by Employer Matching Contribution Percentage in 1986

Match per \$1.00 in contributions	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
\$0.25 or less	75.3%	5.4%	2.8%	3.8%
\$0.26 to \$0.50	75.6	4.4	3.4	3.8
\$0.51 to \$0.74	81.0	4.8	3.1	3.8
\$0.75 to \$0.99	64.5	5.4	3.5	4.2
\$1.00	98.6	8.2	6.1	7.0
More than \$1.00	88.1	7.7	9.4	8.6

Table I.5: Mean Participation and Average Deferral Percentage Rates by Frequency With Which Participants Could Change Contribution Levels in 1986

Frequency	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Annually	63.6%	5.6%	3.9%	4.4%
Semiannually	78.3	4.7	3.0	3.9
Quarterly	66.3	4.1	3.9	4.4
Monthly	65.7	4.2	3.8	3.9
No limit	78.6	5.6	4.7	7.4
Other	50.8	4.9	3.0	3.7

Table I.6: Mean Participation and Average Deferral Percentage Rates by Whether After-Tax (Voluntary) Contributions Were Permitted in 1986

Voluntary contributions	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Permitted	74.6%	5.1%	3.4%	4.3%
Not permitted	68.8	5.8	4.3	5.1

Table I.7: Mean Participation and Average Deferral Percentage Rates by Whether Plan Had a Loan Provision in 1986

Loan provision	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Yes	69.3%	5.4%	3.9%	4.6%
No	81.7	5.3	3.6	4.9

Appendix I
Tables Relating to 401(K) Plans

Table I.8: Mean Participation and Average Deferral Percentage Rates by Whether Plan Permitted Hardship Withdrawals in 1986

Permitted withdrawals from	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Employee contributions				
Yes	71.3%	5.4%	3.7%	4.5%
No	75.6	5.1	4.6	6.8
Employer contributions				
Yes	86.9	6.0	4.5	5.3
No	50.1	4.1	2.4	3.5

Table I.9: Mean Participation and Average Deferral Percentage Rates by Whether Participants Could Direct Plan Investments in 1986

Participants could direct investments	Participation rate	Average deferral percentage		All contributors
		Higher paid group	Lower paid group	
Yes	69.9%	6.3%	4.7%	5.4%
No	73.1	4.6	3.0	4.0

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