

U.S. Pension Plans for Small Employers

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The Problem

- In most countries with voluntary pension systems, including Canada and the U.S., pension coverage rates are lower among small employers than large employers.

Plans Generally Available

- Small employers in the U.S. have access to all the types of pension plans available to large employers – notably, DB plans and 401(k) plans.
- In addition, all workers not covered by a pension can contribute to an Individual Retirement Account (IRA).

SEP

- A simplified plan designed to encourage plan sponsorship.
- SEP Simplified Employee Pension plan – Any employer can establish (no size limit).
- Employer contributes directly into the IRAs of all workers. No employee contribution permitted.
- Employer not locked into contributing each year.
- Employers do not have to file documents with the government.

SEP Reform

- Reform – reverse match SEP, would allow employees to match employer contributions on a tax deferred

Small Employer Plans

- In addition, some plan types are only available to small employers.
- In order to encourage small employers to offer pension plans, an attempt has been made to provide simplified plan types that place minimal administrative burden on the small employer.

SIMPLE IRA

- SIMPLE IRA --- any employer with 100 or fewer employees that does not have another plan can establish.
- Both employer and employees can make tax deductible contributions.
- No annual government filing requirements for employer. Bank or financial institution handles most of the paperwork.
- Employee can decide how much to contribute.
- Employer must make matching contributions or contribute 2% of each employee's compensation.

SIMPLE IRA Coverage

Must be offered to all employees who have earned income of at least \$5,000 in any prior 2 years, and are reasonably expected to earn at least \$5,000 in the current year.

DB(k)

- DB(k) taking effect this year, a new plan type only available to employers with 500 or fewer workers.
- This plan combines a traditional DB plan with a 401(k) plan.

DB(k) Ratioanle

- The paperwork burden is lighter for DB(k) than for a separate DB and 401(k) plan – one filing instead of two. Also, exemption from top heavy rules, concerning the pensions of higher-paid employees.
- Idea to encourage a resurgence of DB plans, combined with 401(k) plans, but smaller and less expensive DB plans than in the past.

DB(k) Features

- A defined benefit equal to 1% of final average pay for each year of the employee's service, up to 20 years.
- An automatic enrollment feature for the 401(k) portion. Unless an employee specifically opts out or changes the contribution level, 4% of pay is automatically contributed into 401(k) plan.
- An employer match of at least 50% of employee 401(k) contributions, with a maximum required match of 2% of pay

Conclusions

- Many different types of pension plans are available to small US employers.
- Some plans are designed particularly to encourage small employers to offer plans.
- The DB(k) plan, available starting this year, is the most recent innovation.
- The SIMPLE IRA is another small employer plan.

Further Information

- Retirement USA www.retirement-usa.org principles for pension reform
- Conversation on Coverage, Working Group 1
<http://www.conversationoncoverage.org/about/final-report/wg-i-report.pdf>
proposes new types of plans for small employers
- US DOL EBSA Choosing a Retirement Solution for Your Small Business
<http://www.dol.gov/ebsa/pdf/choosing.pdf>
Information on choosing a plan for a small employer

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