Can We Tweak our 401(k) to Allow Additional Savings for Reasons More Immediate than Retirement?

Facts

Our company takes a holistic approach to the benefits we offer. We want our employees to have access to benefits that assist them with their overall financial security. We offer several health insurance options as well as a 401(k) plan with company match. We would also like to make it easy for our employees to set money aside for other savings goals as well as everyday emergencies, but it needs to be easy for our employees and cost-effective for us as a company.

Question

Is there any way to tweak our 401(k) plan to allow for this type of additional savings without employees having to tie up those dollars until retirement?

Answer

The answer is a definite yes!

If there's one thing that everyone seems to agree on, it's the need for increased savings across most workforces. Studies cite all sorts of reasons for low savings rates including costs, confusion, and inertia. There is a feature called the after tax or voluntary contribution that you can add to your 401(k) plan to help overcome some of these barriers to savings.

Just like in fashion, retirement plan trends seem to come back in style if you wait long enough (whether or not they should), and after-tax contributions are an example of that. Every few years, they become the shiny "new" buzzword following a financial industry article touting them as the holy grail for highly compensated employees to boost savings using Roth conversions, etc., etc. We've covered that strategy along with its limitations here.

We won't debate the pros and cons of mom jeans or shoulder pads, but you might just find merit in after-tax contributions if viewed from a slightly different angle. Rather than a means of stockpiling contributions for HCEs, after-tax contributions could be an easy and effective way for your non-HCEs to create a savings account (whether as a rainy day fund or simply to save for an upcoming expenditure) within the 401(k) plan.

Before we continue, it is not uncommon to be confuse after-tax contributions and Roth deferrals or to use the two types of contributions interchangeably. However, there are some important differences between the two, and we cover those differences here.

Utilizing the already familiar 401(k) plan to provide your employees with a vehicle for everyday savings, beyond their retirement savings, can be beneficial in several ways.

> **Ease |** Participants can elect to have after-tax contributions payroll-deducted from each check just like their 401(k) deferrals. This makes for an easy and thought-free way to accumulate rainy day savings without any additional effort from the participant.

Access | Participants are able to take withdrawals of after-tax contributions at any time without being subject to the early withdrawal penalties that apply to other plan accounts prior to age 59 ½. Any investment gains are subject to regular income tax, but that is no different than the fact that interest earned in a standard savings account would also be subject to tax. In fact, the interest in a savings account is taxable even if the person doesn't withdraw it.

Cost | The plan will typically offer participants access to lower cost funds or investment options than would be available to them via an individual savings account. Providing participants with the ability to take advantage of more sophisticated and cost-effective savings vehicles means each dollar saved is that much more impactful for the participant.

If you're wondering what's in it for you as a plan sponsor, that's a fair question. Granted, offering the after-tax option is a relatively light lift, it's still reasonable to look for potential benefits you and your firm might reap. First, enhancing the retirement plan offerings is a great way to garner increased participation in the plan overall. Second, employees who are less distracted by financial strain or uncertainty are more productive in their roles. Offering this after-tax savings opportunity, at no additional cost to the employer, may be a way to boost employee productivity and peace of mind.

While after-tax contributions may not provide a practical way for HCEs to increase savings, this plan provision may very well fill a void that many NHCEs have when it comes to financial planning. Strengthening your retirement plan offering and creating an easy and cost-effective means of savings could be a recruitment and retention tool at low to no cost to you as an employer. If you'd like to look at provisions such as this, exploring the pros, cons, and potential costs, our team would be happy to help you find the options that are a perfect fit.