



410(b) Coverage Testing

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410(b) Coverage Tests

- What is the 410(b) Coverage Test?
 - Ratio Test
 - Average Benefits Test
- Who is included the tests?
- How do you perform the tests?
- Does the plan pass?



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410(b) Coverage Tests

- Separate Coverage Test done for:
 - Employer - Includes Employer, Safe Harbor Non-elective and QNEC
 - 401k - Includes Salary Deferrals, both pre-tax and Roth
 - 401m - Includes Matching and QMAC
- Each Coverage Test is run as if it were its own plan



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410(b) Coverage Tests

Each portion of the plan must pass 1 of 2 tests:

- Ratio Test; or
- Average Benefits Test



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410(b) Coverage Tests

Who is included in the tests?

- All employees except for those who:
 - Fail plan entry requirements
 - Collectively Bargained Employees (when testing a non-union plan)
 - Nonresident Alien
 - Terminate with 500 hours or less and fails to accrue a benefit due to an hours or last day requirement (does not apply to 401k portion and only applies on the 401m if there is a last day and/or hours requirement)



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410(b) Coverage Tests

Who is considered Benefitting?

- Employer - those who receive a contribution for the year
- 401k - those eligible to make deferrals
- 401m - those eligible for the match contribution



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410(b) Ratio Test

Ratio Test is

- $\frac{\text{NHCEs Benefiting}}{\text{Total NHCEs in plan}}$
 $\frac{\text{HCEs Benefiting}}{\text{Total HCEs in plan}}$
- Ratio must be at least 70%



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410(b) Average Benefits Test

Average Benefits Test (ABT) is a 2-part Test

1. Nondiscriminatory Classification Test
 - Reasonable Classification Test
 - Nondiscriminatory Classification
 - NHCE Concentration Percentage
 - Ratio Test must be at least equal to Safe Harbor Midpoint
2. Average Benefits Percentage Test (ABPT)
 - Average Rate for NHCEs must be at least 70% of the Average Rate for the HCEs



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410(b) Average Benefits Percentage Test

Determining Rates for ABPT

- Allocation Rate
- Converting Allocations to Equivalent Benefit Accruals
 - Annual Accrual Method (used most often)
 - Accrued To Date Method



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410(b) Average Benefits Percentage Test

Allocation Rate Method

- Rates are determined for each employee in test
- Include allocations from **all** sources for 410(b)

Formula:

$$\frac{\text{(All Contributions + All Forfeitures)}}{\text{Compensation}}$$



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410(b) Average Benefits Percentage Test

Performing ABPT using Allocation Method

- Find Average NHCE Allocation Rate
 - Sum allocation rates from All NHCEs divided by the Total Number of NHCEs in Test
- Find Average HCE Allocation Rate
 - Sum allocation rates from All HCEs divided by the Total Number of HCEs in Test
- Determine Average Allocation Percentage
 - $(\text{Avg NHCE AR}) / (\text{Avg HCE AR}) \geq 70\%$



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410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Converting Allocations to Benefit Accruals

- Retirement Age Assumptions
- Interest Rates
- Mortality Tables
- Choosing Annual Accrual vs. Accrued to Date
- Imputed Permitted Disparity (optional)



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410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Annual Accrual Method (include All Sources)

- Step 1: Lump Sum at Testing Age (NRA)
Allocation * Accumulation Factor
Accumulation Factor = $(1 + \text{Interest Rate})^{\text{Years to Retirement}}$
- Step 2: Benefit Accrual
Lump Sum at Testing Age / Annuity Purchase Rate
- Step 3: Annualize Benefit Accrual
Benefit Accrual * 12
- Step 4: Equivalent Benefit Accrual Rate (EBAR)
Annualized Benefit Accrual / Testing Compensation



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410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Performing ABPT using the Annual Accrual Method

- Find Average NHCE EBAR
Sum EBARs from All NHCEs divided by the Total Number of NHCEs in Test
- Find Average HCE EBAR
Sum EBARs from All HCEs divided by the Total Number of HCEs in Test
- Determine Average Benefit Percentage
 $(\text{Avg NHCE EBAR}) / (\text{Avg HCE EBAR}) \geq 70\%$



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410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Accrued to Date Method

- Step 1: Lump Sum at Testing Age (NRA)
Account Balance * Accumulation Factor
Accumulation Factor = $(1 + \text{Interest Rate})^{\text{Years to Retirement}}$
- Step 2: Benefit Accrual
Lump Sum at Testing Age / Annuity Purchase Rate
- Step 3: Annualize Benefit Accrual
Benefit Accrual * 12
- Step 4: Average Benefit Accrual (per Year of Service)
Benefit Accrual / Past Service
- Step 5: Equivalent Benefit Accrual Rate (EBAR)
Average Benefit Accrual / Testing Compensation



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410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Performing ABPT using the Accrued to Date Method

- Find Average NHCE EBAR
Sum EBARs from All NHCEs divided by the Total
Number of NHCEs in Test
- Find Average HCE EBAR
Sum EBARs from All HCEs divided by the Total
Number of HCEs in Test
- Determine Average Benefit Percentage
 $(\text{Avg NHCE EBAR}) / (\text{Avg HCE EBAR}) \geq 70\%$



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Failed Average Benefits Percentage Test

Adjustments to Pass a Failed ABPT

- Test on an Allocations, Accrual or Accrued to Date
- Test with Imputing Permitted Disparity
 - Employer allocations only (excluded Safe Harbor)
 - Integrated allocations are excluded
 - Can only impute disparity on 1 plan for sponsor
- Test Otherwise Excludables Separately
 - Must test 401(a)4 and Gateway separately
 - Both OEX and non-OEX must pass all tests



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Testing Otherwise Excludable Employees Separately

Must pass two separate sets of tests

- Not Otherwise Excludable Employees
 - Pass Ratio Test or
 - Pass Average Benefits Test
- Otherwise Excludable Employees
 - Pass Ratio Test or
 - Pass Average Benefits Test

*Note: Please see our upcoming webinar on Otherwise Excludable Employees for more information



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Testing Otherwise Excludable Employees Separately

- Example of 401(k) Plan contributions include:
 - Salary Deferrals
 - Matching
 - Profit Sharing
 - Safe Harbor Non-elective
- How many tests will need to pass in order to pass 410(b) Coverage Tests?



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Testing Otherwise Excludable Employees Separately

- Not Otherwise Excludable Tests
 - Employer
 - 401(k) Portion
 - 401(m) Portion
- Otherwise Excludable Tests
 - Employer
 - 401(k) Portion
 - 401(m) Portion



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Failed 410(b) Test Adjustments

Other Adjustments to Pass when failing ABT

- Adjust allocations
 - Increase allocations to NHCE group(s)
 - Decrease the allocation to HCE group(s)
- Future Plan Adjustments
 - Remove last day requirement
 - Remove hours requirement
- Watch for changes in Demographics



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410(b) Average Benefits Percentage Test

Summary of Rates used in ABPT

- Allocation Method
Allocation / Compensation
- Annual Accrual Method
Allocation * $\frac{(12 * \text{Accum Factor} / \text{Annuity Pur Rate})}{(\text{Compensation})}$
- Accrued To Date Method
 $\frac{(\text{Account Balance})}{(\text{Past Service})} * \frac{(12 * \text{Accum. Factor} / \text{Ann. Pur. Rate})}{(\text{Average Compensation})}$
- Allocations from All Source allocations
- Acct Bal from All Sources where allocations are possible

