THE NEW RETIREMENT PLAN CURRENCY:
Interfacing 401(k) Plans and Payroll

Introduction

Pardon the pun in the headline, but more employers are achieving cost and operating efficiencies when the payroll system and 401(k) administration can directly talk to each other.

In the unconnected world, there are a multitude of steps that need to be done in order to get the employee's 401(k) contribution into the 401(k) recordkeeper's platform.

With an integrated system, all of this takes place electronically, and the employer is removed as the middleman.

Potential Savings

The result? Many employers have regained as much as 50 to 100 hours annually – time which could now be spent on strategic organizational matters.

Integration of a plan sponsor's payroll processing with 401(k) administration can, at the very least, streamline employee contribution processing by directly linking with the 401(k) provider.

Types of Payroll Systems

Employers have two types of payroll systems available: doing it themselves or outsourcing. Most small- to mid-sized employers outsource their payroll for reasons of convenience, compliance, confidentially and, usually, cost savings.

Indeed, outsourcing is a huge business in the United States. Together with electronic payment processing and health care transaction processing, payroll process is part of what's referred to as "data and payment-related transaction outsourcing." – a $62 billion business.

The payroll space that used be dominated by the Big Three - ADP, Paychex, and Ceridian - now is being invaded by a number of local, regional and national payroll processors who are using newer Web-based technology to win a larger market share.

Much of their growth is fueled by strategic alliances with plan administrators, recordkeepers and benefit advisers who see the opportunities to add value to clients.

Control and Access

So where exactly do the efficiencies - and cost savings - come from? It boils down to two essential elements that drive plan administration:

- The control over census information, and
- Access to the data.

"Unconnected" 401(k) Plans

In the unconnected world of payroll processing and 401(k) administration, there are a multitude of steps that need to be done in order to get the employee's 401(k) contribution into the 401(k) recordkeeper's platform.

Such steps could include at least these four:

1. A new employee is entered into the payroll system.

2. The 401(k) contribution file - which can include pretax contributions, Roth after-tax contributions and loan repayments - is sent to the 401(k) recordkeeper.

3. Funds are transferred from the employer's bank account to the 401(k) investments.

4. The recordkeeper reconciles the amounts, and allocates the contribution amounts and sources to the respective participant accounts.

With an integrated system, all of this takes place electronically, and the employer is removed as the middleman.

Impact on 401(k) Plan Administration

For firms like ours, access to the data can make the 401(k) plan run more efficiently.

For example, 401(k) discrimination testing can be completed soon after the end of the plan year since the employer doesn't have to provide annual census data.

It also means that midyear compliance testing can be done on the same basis, thus alerting highly compensated employees to any possibility of having excess contributions returned.

The efficiencies also can translate into dealing with the not uncommon situation when the plan year is not a calendar year.

For example, if the plan year is July 1 through June 30, compensation has to be tracked for testing and allocation purposes on a plan year basis, while employee deferrals limits are on a calendar year basis.

A Final Word

This discussion of connecting the dots between 401(k) and payroll is, by necessity, brief. In the real world, this integration can be made more robust with other HR applications, such as automatic enrollment in benefit programs and compliance with employment law reporting.

About National Benefit Services, Inc.

National Benefit Services, Inc. is a Chicago-based firm providing consulting, actuarial, and administration firm for employer sponsored retirement plans.

Founded in 1978, the firm's clients include a wide range of employers in the United States and international companies with U.S. operating entities.

Jerry Kalish, the firm's President and founder, provides continuing education programs for attorneys, CPAs and the financial services industry. He is a Guest Lecturer at John Marshall School of Law L.L.M. Program in Employee Benefits. Jerry also publishes The Retirement Plan Blog (www.retirementplanblog.com).

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