

Counseling for
Defined Contribution Plan Participants

U.S. Administration on Aging's Pension Counseling and Information Program

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Agenda

- **Background**
- **Different Types of Defined Contribution Plans**
- **Common Legal Issues in Defined Contribution Plans**

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Background

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Background

- What is a defined contribution plan?
- How does it differ from a defined benefit plan?

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DC vs. DB Plan

■ Defined Contribution Plan

- No promise to pay a particular benefit at a future time
- Only promise is to make current contributions
- Contributions are allocated to individual account
- Earnings on account are credited to account
- Benefit equals account balance at time of distribution

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DC vs. DB Plan

■ Defined Benefit Plan

- Promise to pay a benefit at a future time or times
- Contributions are made to fund promised benefits
- Benefits are calculated independently of contributions

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DC vs. DB Plan

■ Key Distinctions between DC and DB Plans

- Benefits directly linked to plan assets in DC plans
 - Benefits = assets allocated to individual account
 - Sum of account balances = plan assets
- Benefits not directly linked in DB plans
 - Benefits = promised payments unrelated to plan assets
 - Sum of value of DB benefits \neq plan assets
- Key differences in funding
 - Unlike DC plans, DB plans can be over/under-funded
 - DC accrued benefit is defined simply as account balance

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Different Types of Defined Contribution Plans

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Different Types of DC Plans

■ Profit-Sharing Plan

- Non-pension defined contribution plan
- Types of contributions
 - Elective Contributions
 - Non-Elective Contributions
 - Matching Contributions
- Employer is not required to have profits to contribute
- Employer contributions can be made pursuant to a specific formula or may be discretionary – but must be recurring and substantial
- Must have a definite allocation formula for contributions

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Different Types of DC Plans

■ Stock Bonus Plan

- Non-pension defined contribution plan
- Similar to a profit sharing plan, except that benefits must be distributable in employer stock (upon request)
- Commonly, invested in employer stock
- Same contribution and allocation formula options as a profit sharing plan

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Different Types of DC Plans

■ Money Purchase Pension Plan

- DC plan that is a pension plan subject to minimum funding requirements, spousal annuity, and 204(h) notice rules
- Must provide a specific contribution formula that is not subject to employer discretion
- Employer contributions may not be geared to profits
- Generally, may not have a 401(k) feature

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Different Types of DC Plans

■ Target Benefit Plan

- Type of money purchase plan that mimics a DB plan
- Defines contributions by reference to annual amounts needed to fund hypothetical or "target" deferred annuity benefit
- Promise is to make contributions to fund benefit
- As a DC plan, the accrued benefit still is just the account balance

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Different Types of DC Plans

■ Cash Balance Plan

- DB plan that mimics DC plan
- Defines hypothetical individual account
 - Hypothetical contributions or "pay credits"
 - Hypothetical income or "earnings credits"
 - Hypothetical individual account or "cash balance"
 - Benefits defined by reference to cash balance
- Deemed contributions and earnings to account
- Promise to pay benefit equal to account balance
- As DB plan, actual contributions/earnings generally irrelevant

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Different Types of DC Plans

■ 401(k)

- Cash or Deferred Arrangement (CODA)
 - Election to contribute part of compensation, pre-tax
 - Choice between employer contribution and equal amount in cash
- Technically, part of a qualified plan
 - Profit-sharing plan, stock bonus plan, or pre-ERISA money purchase plan that permits before-tax contributions
 - Not a plan of its own

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Different Types of DC Plans

■ 403(b) Plan

- Available for public education organizations, 501(c)(3) tax-exempt organizations, and certain ministers
- Typically includes salary reduction arrangement similar to 401(k)s
 - Akin to deferral elections
 - Same contribution limits as 401(k) plans
 - But more lenient qualification rules

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Different Types of DC Plans

■ 457 Plan

- Typically includes state and local governments and certain tax-exempt employers
- May establish “eligible deferred compensation plans”
- Salary reduction arrangement similar to 401(k)s and 403(b)
 - Akin to deferral elections
 - \$18k contribution limit in 2016 – but also can contribute to another plan
 - No non-discrimination rules

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Common Legal Issues in DC Plans

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Common Legal Issues in DC Plans

- How Plan Structure Influences Claims
- Maximizing Retirement Income
- Common Participant Questions

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How Plan Structure Influences Claims

■ Participant Discretion in Investment Selection

- Participant-Directed 401(k) Funding Vehicles
- 401(k) Investment Platforms

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How Plan Structure Influences Claims

■ Participant-Directed 401(k) Funding Vehicles

- Mutual Funds
 - Active vs. Passive Management
 - Share classes generally based on plan size
- Exchange-Traded Funds (ETFs)
 - Typically, passive management tracked to indices
 - Perceived as charging lower fees
 - Challenges to include in 401(k) menus

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How Plan Structure Influences Claims

■ Participant-Directed 401(k) Funding Vehicles

- Collective Investment Trusts
 - Pooled investments of 401(k) plans.
 - Largely geared to institutional investors and retirement market
 - Generally, not available for retail investors
 - Fewer SEC filings than mutual funds and reduced advertising/marketing costs
- Separate Accounts
 - Custom investments
 - Typically used by the largest plans
 - Potential cost savings

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How Plan Structure Influences Claims

■ Participant-Directed 401(k) Funding Vehicles

- Variable Annuities
 - Offered by insurance companies
 - Variable annuity contract "wrapped" around investment options
 - Fee concerns raised by DOL
- Stable Value Funds
- Individual Securities

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How Plan Structure Influences Claims

■ 401(k) Investment Platforms

- Traditional Platform
 - Investment options selected by plan fiduciary
 - Third-party fiduciary can manage/provide investment advice
- Brokerage/Mutual Fund Window
 - More investments but options typically not selected by a fiduciary
 - No efficiencies of scale
 - Challenges for individual to properly diversify

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How Plan Structure Influences Claims

■ Common Claims

- Fees
 - Excessive fees
 - Self-dealing
- Investment Selection and Monitoring
- Conflicted Advice/Fiduciary Conflict Rule

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Maximizing Retirement Income

■ **Investment Selection**

- Diversification
 - By Third Party (if available)
 - Investment advice/online asset allocation modeling
 - Managed accounts
 - By Participant
 - Self-selection of investment funds
 - Single investment options intended to provide diversification
 - Target Date Funds
 - Balanced Funds
 - Cost considerations

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Maximizing Retirement Income

■ **Distribution Options/Considerations**

- Lump sums, installments, purchase of annuities
- Ability to get in-service distributions in some plans
- Loan defaults and extraction of value through loans

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Maximizing Retirement Income

■ **IRA Rollover / Plan Transfer Considerations**

- Fiduciary Conflict Rule
- Size of Transferor Plan

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Common Participant Questions

■ Timing of contributions/distributions

- When must an employer transfer elective deferrals to the trust?
- When must an employer transfer employer contributions to the trust?
- What can a participant do if the plan is taking a long time to make a distribution?

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Common Participant Questions

■ Spousal Consent

- What types of distribution options are available to a surviving spouse?
- Does a spouse have to consent to a loan?
- Does a spouse have to consent to a hardship withdrawal?
- What happens if the participant takes a hardship withdrawal or loan without involving the spouse (and consent was required), uses the money, and then dies before paying it back?

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