

Defined Contribution Plans 2.0:  
Counseling for Defined Contribution Plan  
Participants

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

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June 15, 2016

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Agenda

■ Defined Contribution Plans Overview

■ Participant Claims

■ Maximizing Retirement Income

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Defined Contribution Plans Overview

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## Defined Contribution Plan Overview

- What is a defined contribution plan?
- How does it differ from a defined benefit plan?
- What are the different types of DC plans?

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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 generally 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
  - (Note exception for money purchase pension plans with funding waiver)
- Benefits not directly linked to plan assets in DB plans
  - Benefits = promised payments unrelated to plan assets
  - Sum of value of DB benefits ≠ plan assets
  - (Note possible distinction of certain hybrid plans)
- 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 DC Plans

### ■ Profit-Sharing Plan

- Non-pension defined contribution plan
- Types of contributions
  - Elective Contributions
  - Non-Elective Contributions
  - Matching Contributions
- Employer no longer required to have profits to contribute
- Must have a definite allocation formula for contributions

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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
- Roth 401(k) generally available for plans that offer 401(k) feature
  - Treated generally the same as an elective deferral
  - Requires separate account
  - After-tax contribution / tax-free "qualified distributions"
- Cumulative \$18k limit (in 2017)

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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

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## Different Types of DC Plans

### ■ 457(b) Plan

- Typically includes state and local governments and tax-exempt employers
- Salary reduction arrangement similar to 401(k)s and 403(b)
  - Akin to deferral elections
  - Employer contributions
  - \$18k contribution limit in 2017 – but also can contribute to another plan
- Non-governmental 457 plans must remain unfunded

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## Different Types of DC Plans

### ■ Other DC Plans

- Stock Bonus Plan
- Money Purchase Pension Plan
- Target Benefit Plan

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## Participant Claims

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## Participant Claims

- How Plan Structure Influences Claims
- Investment Option Claims
- Fiduciary Conflict Rule
- Timing Rules

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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 of unrelated employers
  - Largely geared to institutional investors and retirement plan 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 advise or manage individual account investment
- 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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## Investment Option Claims

### ■ Investment Selection and Monitoring

#### ■ Fees

- Excessive fees
- Self-dealing

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## Fiduciary Conflict Rule

- Recommendations regarding distributions = fiduciary advice
- Private right of action to enforce fiduciary breach RE distributions
- Best Interest Contract Exemption requirements:
  - Rollover recommendation must be in client's best interest
  - Documentary/disclosure requirements beginning 1/1/2018
  - Additional requirements if rollover to "commission-based" account

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## Timing Rules

### ■ 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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## Maximizing Retirement Income

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## Maximizing Retirement Income

- Investment Selection
- Distribution Requirements / Considerations
- IRA Rollover Requirements / Considerations
- Spousal Rights

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## 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 (dynamic adjustment)
    - Balanced Funds (purely static)
- Cost considerations

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## Distribution Considerations / Requirements

### ■ Benefit Forms

- Lump sums
  - Perennial problem: where to re-invest them?
- Installments
  - Interesting new twist: managed accounts that handle investments and distributions in retirement (a real challenge for individuals)
- Purchase of annuities
  - Tantalizing possibility: deferred so-called "longevity" annuities

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## Distribution Considerations / Requirements

### ■ Timing

- Distributable events (termination of employment, age 59 ½, death, disability, etc...)
- Early distribution = 10% additional tax
- Loans / hardship withdrawals = permitted, not required
- Qualifying loans ≠ early distribution
- Hardship withdrawals = generally early distribution

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## Distribution Considerations / Requirements

### ■ Loans

- Maximum loan = lesser of 50% of vested account balance or \$50k (\$10k floor)
- Generally, must be repaid in 5 years
- Accelerated repayment could be required if termination of employment
- Failure to repay = "deemed distribution"
- Deemed distribution = remaining balance treated as early distribution

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## Distribution Considerations / Requirements

### ■ Hardship Withdrawals of 401(k) Elective Deferrals

- Requires immediate and heavy financial need
- Limited to amount necessary to satisfy need
- Distribution subject to income tax
- Can be subject to early distribution 10% penalty tax

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## IRA Considerations / Requirements

### ■ Rollovers

- Direct Plan-to-Plan or Plan-to-IRA Rollover
- Indirect Rollover
  - Subject to withholding (mandatory for rollovers from plans)
  - 60-Day requirement to rollover to eligible plan or IRA
  - 60-Day requirement can be waived
- Fiduciary conflict rule considerations

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## Spousal Rights

### ■ 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, without involving the spouse,
  - takes a hardship withdrawal, or
  - takes a loan and fails to repay it?

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## Spousal Rights

### ■ Qualified Domestic Relations Orders

- Exception to anti-alienation rule
- Exception to early distribution tax
- Court can assign all or part of a participant's benefit to "Alternative Payee"
- Cannot increase benefit or provide any benefit form not provided under the plan

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