Participant and Trustee Education in DC Plans

Jason S. Fuiman
Partner
O’Dwyer & Bernstien, LLP
New York, New York

John E. Slatery, CEBS
Director, Benefits Department
International Brotherhood of Teamsters
Washington, D.C.

The opinions expressed in this presentation are those of the speaker. The International Foundation disclaims responsibility for views expressed and statements made by the program speakers.
Overview of Defined Contribution Retirement Plans

- Defined Contribution (DC) Plans
  - What they are vs. defined benefit plans
  - Different types
- Specific Features of DC Plans
  - Annual limits/contributions
  - Distributions
  - Tax implications
  - Loans/hardship withdrawals
  - Fees
- Best Practices in Managing DC Plans
What Are DC Plans?

• “Defined contribution” vs “defined benefit”
• Defined benefit = set benefit amount at retirement regardless of expenses or investment performance
• Defined contribution = benefit at retirement is equal to contributions plus investment gains/losses minus expenses.
Trustee Duties in DB vs. DC Plans

- Same fiduciary responsibility to act solely in the best interests of plan participants and beneficiaries
- 401(k) Plans allow participants to make their own investment elections, which creates different disclosure and monitoring responsibilities than a regular DB Plan
Types of Defined Contribution Plans (Individual Account Plans)

- Profit sharing plan
  - Traditional “annuity plan”
- 401(k)
  - Standalone or within profit sharing plan
- 403(b)
- 457(b)
- Others:
  - Employee stock ownership plan (ESOP)
  - Money purchase, target benefit
  - IRAs, SEPs, SIMPLES, stock purchase plan
• 401(k), 457 and 403(b) Plans are CODAs “cash or deferred arrangements”
  – Purpose is to allow employees to defer a portion of their compensation instead of receiving as wages
Profit Sharing/
Traditional DC Plan

• Employer Contributions
  – Can be either discretionary or predetermined. Not required every year but must be “recurring and substantial” to maintain tax qualification
  – Usually expressed as a percentage of salary or profits
  – Also hourly basis—Typical collectively bargained arrangement
  – Subject to compensation limits

• Investments
  – Typically employer (or trustee) directed; they choose the investment lineup and allocation
  – Returns allocated pro rata
401(k) Plans

- Can be standalone or part of profit sharing plan
- Who can participate?
  - Mostly private sector
    - Traditional collectively bargained employees
- Types of contributions:
  - Employee—Always 100% vested
    - Pre-tax contributions ("Elective deferrals")
    - After-tax contributions
    - ROTH contributions
    - Catch-up contributions (Over 50)
    - Rollovers
  - Employer
    - Matching contributions
    - Profit sharing option for employer non-elected contributions
- Investments
  - Lineup selected by trustees/employer; Participants select their own investments
403(b) Plans

• Who can participate?
  – Certain tax exempt organizations and public educational organizations

• Types of Contributions:
  – Similar to 401(k) except no ROTH (after-tax)
457(b) Plans

• Who can participate?
  – State and Local governments generally, some tax exempt organizations.

• Types of contributions
  – Also similar to 401(k) but no ROTH
  – Catch up—if adopted by plan
    • Regular $6,000 additional per year
    • Also “Special catch up” option available one time only

• Only contribution limits on elected deferrals apply, no 415 limits or discrimination testing.
401(k) Annual limits

- Elective deferrals
  - $18,000
  - $24,000 including $6,000 for catchup contributions
  - Combined across all plans offered by employer
    - If employer offers 401(k) and ROTH options, combined contributions (both pre-tax and ROTH) cannot exceed those amounts

- Total contributions (employee elective deferral, ROTH, employer match, employer non-elective) cannot exceed $53,000; $59,000 if catchup contributions are available.
Distributions—When?

401(k) plan (and profit sharing)
• Severance from employment
• Death
• Disability
• Attainment of age 59½
• Hardship—if permitted by plan
• Loans—if permitted by plan
• Required minimum distributions (Age 70½)
Distributions—When?

- **403(b) Plan**
  - Severance of service
  - Hardship—Only for employee deferrals, not employer
  - Disability
  - Attains age 59½.
  - Age 70½—required minimum distribution

- **457 Plan**
  - Severance of Service
  - Age 70½—required minimum distribution
  - Cash out of less than $5,000
  - “Unforeseeable emergency”—Similar to hardship withdrawals in a 401(k) plan
Distribution—Type

• Lump Sum
  – Typical form of payment
  – Full account balance payable to beneficiary upon death

• Annuity
  – Straight life
  – Fixed
  – Qualified pre-retirement survivor annuity (QPSA)
  – No requirement to offer annuity payments but if the plan does it is subject to other requirements (qualified joint and survivor annuity (QJSA), etc. . . .)

• Rollovers
Tax Implications

Contributions:

• Employee pays no income tax on elective deferrals to the plan as long as within annual limits ($18,000 for 2016, $24,000 for over age 50)
• After Tax contributions—Tax at normal federal/state rates
• Employer (within limits—$53,000 total combined including employee contributions; $59,000 if there are catchup contributions) may deduct its own contributions to the plan
Tax Implications

Distributions

• Elective deferrals and pre-tax employer contributions
  – Taxed at normal federal/state rates (including investment returns)

• Additional 10% penalty for early distributions
  – Hardship or defaulted loans
    • Certain hardships (medical expenses) not subject to 10%
Tax Implications

ROTH 401(k)

- Employee contribution made after tax so normal federal/state rates deducted
- Upon distribution, not taxable (even investment gains) as long as the contributions have been held in the plan for five years, and are distributed:
  - After the participant is age 59½
  - Made to a beneficiary after the participant's death, or
  - Are attributable to the participant being disabled.
• Loans
  – Restricted? Open (general purpose)?
  – Pros and cons
    • Retain assets—Better for fees/economies of scale
    • Likely cheaper to participants
    • Paternalistic?
      – Protect them from themselves
      – “It’s their money”
    • Administrative burden
• Process for implementing loans
  – Plan document language
  – If restricted then need policies on how to handle
    • Restrict to only hardship withdrawal reasons?
    • Criteria for denial
  – Loan documents
    • Promissory notes
      – Promise to pay back in certain period at agreed upon interest rate
    • Plain English default terms
    • Other communications
Loan Promissory Note

Loan Application Agreement

Loan Policy Limitations. Each Plan has a separate loan policy that controls loan availability and related rules.
- If the Plan allows only one outstanding loan at a time, I must payoff the first loan prior to requesting this current loan.
- In most cases, I must be actively employed in order to obtain a loan.
- In no event may my loan exceed 50% of my vested account balance.

Adjustment to Loan Amount, Repayment Amount and/or Loan Amortization as a result of IRS requirements. The loan amount, the repayment amount and/or the amortization schedule may vary from the estimates provided by you via our website. The Internal Revenue Code and IRS regulations control the calculation your loan’s maximum amount and amortization schedule. This calculation is affected by your account balance, the repayment period, the timing of the loan distribution and the first payroll repayment date. As a result of these variables, the original amount of your loan, the periodic repayment amount and/or the repayment schedule may differ from the estimate provided to you via the Areas’ website.

Liquidation Order of Investments. The loan proceeds will be obtained by liquidating and available investments pro-rata, mutual fund redemption fees, if any, shall be deducted from the loan proceeds.

Irrevocable Pledge and Assignment. In consideration of a loan to me in the amount requested herein, I irrevocably pledge and assign to the Trustee of the Plan, or to its successor or successors, 50% of my vested account balances, at any time existing under the Plan, but not less than 50% of my vested account balances determined on the date of the loan which is subject to this pledge, to the extent necessary to satisfy each loan. Any unpaid interest on such loan, all attorneys’ fees necessary for collection of this obligation and all costs of collection. Failure by me to repay this loan when due or to pay any installment or interest when due authorizes the Trustee to foreclose on this security or to bring a lawsuit to collect the outstanding indebtedness and interests on the indebtedness. This Irrevocable Pledge and Assignment binds my heirs, personal representatives or other legal representatives.

Promissory Note. At the time I receive the check for my loan proceeds, I will receive a Promissory Note outlining the loan terms and conditions. By endorsing the check, I agree to the terms contained in the Promissory Note.

Salary Deduction Authorization. I authorize my employer to deduct loan payments from my salary each pay period until the loan is repaid in full.

NOTE: I am responsible for making certain that my employer is withholding the proper loan payments. If the loan payments have not been withheld, I must notify the employer and arrange for make-up loan payment(s) by the end of the loan cure period. If I do not make the missed loan payment(s) by the close of the cure period, the loan will be in default and I will be subject to adverse Federal income tax consequences.

Offset Authorization. If I terminate employment while this obligation is unpaid and under circumstances in which the Trustee ordinarily would make a distribution from the Plan to me or to my named Beneficiary, I authorize the Trustee to reduce the amount otherwise distributable to me or to my named Beneficiary, by this outstanding indebtedness, together with any accrued interest due on the indebtedness, unless on the day after my termination of employment the employer I am a "party in interest" with respect to the Plan or unless the Loan Policy otherwise provides otherwise.

Loan Fees. I understand a setup fee may be applied (see your employer for the current loan fees and whether or not the fee is deducted from the amount requested). I also understand that there is an overnight fee if I request that my loan check be sent via overnight mail. In certain plans, the loan may be subject to the same asset based fee as other plan investments.

I acknowledge that I have read, understand and agree to the terms this Loan Application Agreement.

R07-20
Loans

• Interest must be charged at reasonable rate
• Substantially level amortization and quarterly payments
• Repayment terms
  – 5 years generally
  – Can allow additional time for purchase of primary residence (generally 15-30 years)
Loans

• Tax Implications
  – Repayments made on after-tax basis
  – No tax issue if repaid in full by repayment date
  – If defaulted and deemed distributed, subject to early 10% penalty as well as normal federal/state taxes
Hardship Withdrawals

- Allows participants access to their accounts where they have not reached distribution requirements (59½, disability, etc.)
- Must be:
  - Immediate and heavy financial need and
  - Necessary to satisfy the financial need.
- Can only be for amount necessary to meet that need
- Also cannot be satisfied by other means (e.g., a loan within the same 401(k) plan
  - Participant must satisfy and trustees are permitted to rely on participant representation
Hardship Withdrawals

• But comes with tax implications
  – 10% early withdrawal penalty (exemption for qualified medical expenses)
  – 20% withholding and subject to federal and state taxes
• Not required to be offered
• Generally only elective deferrals
  – Not investment earnings or qualified contributions from employer (including matching)
Hardship Withdrawals

What is immediate and heavy financial need?

Six Safe Harbor events:

• Medical care incurred by the participant, the participant's spouse, or any of the participant's dependents
• Purchase of a principal residence for the participant (excluding mortgage payments);
• Tuition and related educational fees;
• Prevent the eviction of the participant from the participant's principal residence or foreclosure on the mortgage on that residence;
• Burial or funeral expenses for the employee's deceased parent, spouse, child, or dependent; and
• Repair of damage to employee's principal residence
Hardship Withdrawal

• Administration
  – Applications
  – Review documents for safe harbor compliance

• Employees taking hardship distributions cannot make elective or employee contributions for six months after the distribution.

• This can include requiring the employee to exhaust other available means of credit before obtaining a hardship distribution.
401(k) Fees

• Different types of fees:
  – Fixed (loan, QDRO, check by mail)
  – Investment—Expense ratio. Always % of assets in that investment vehicle
  – Administration—Either hard dollar ($100/quarter) or % of assets
    • May be separate from expense ratio or included
401(k) Fees

- Bundled vs. unbundled services
- Hard dollar vs. asset based charges
  - $ per month/quarter vs. % of assets in the plan
  - Higher account balances pay more under % model
    - Also tend to be more active users of the Plan
- Revenue sharing
- Expense ratios
  - Are you in the best share class? Cheapest price? Are you monitoring your fees?
- Recent cases
  - Tussey
  - Ivy League cases
  - Chevron
## Hard Dollar vs. Asset Based Charges

<table>
<thead>
<tr>
<th></th>
<th>$12,000,000</th>
<th>$900,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Plan Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Participants</td>
<td>200</td>
<td>32,000</td>
</tr>
<tr>
<td>Average Investment fees (expense ratio)</td>
<td>0.40%</td>
<td>0.32%</td>
</tr>
<tr>
<td>Investment fees on $100,000 account</td>
<td>$400</td>
<td>$320</td>
</tr>
<tr>
<td>Average revenue Share from Funds (from 408b2)—Administrative fees</td>
<td>0.60%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Average Account Balance</td>
<td>$60,000</td>
<td>$28,125</td>
</tr>
<tr>
<td>Rev Share converted to Average Per Participant Charge</td>
<td>$360</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Hard Dollar Charge</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$300</td>
<td>$0</td>
<td>$40 or $98</td>
</tr>
<tr>
<td>$15,000</td>
<td>$2</td>
<td>$40</td>
</tr>
<tr>
<td>$25,000</td>
<td>$90</td>
<td>$98</td>
</tr>
<tr>
<td>$50,000</td>
<td>$150</td>
<td>$98</td>
</tr>
<tr>
<td>$500,000</td>
<td>$300</td>
<td>$98</td>
</tr>
<tr>
<td>$200,000</td>
<td>$1,200</td>
<td>$98</td>
</tr>
<tr>
<td>$500,000</td>
<td>$3,000</td>
<td>$98</td>
</tr>
</tbody>
</table>
Because this is a DC Plan, the amount of fees directly impacts amount available in retirement. As opposed to DB Plan which has a set benefit.
401(k) Best Practices

• “Keep it in the plan”
  – Larger plans have lower fees. Simple economies of scale.
• Monitoring fees
  – Ask your investment advisors to do a fee analysis annually
  – Are your participants being charged more in aggregate than it takes to run the fund?
• Multiemployer plans tend to having larger assets which helps drive down fees.
• Loans: “Do’s and Don’ts”
• Investment lineup
  – Know your share classes and get the lowest/best ones
• Revenue sharing—Make sure you know what’s going on
• Educate your participants and yourself
With You for the Long Road Ahead

When you participate in the Plan you can save a portion of your earnings on a pre-tax basis, and your account can grow tax-deferred through a variety of investment options over the course of your career and beyond.

Prepare for the road ahead by keeping your money working for you—long after your last day on the job.

Plan Benefits:

Among the benefits available to you as a Plan participant, whether you’re actively employed or have moved on or retired:

Account Assistance
Have questions about terminology, how to grow your savings or whether to make changes to your account?
Take advantage of knowledgeable participant service representatives by calling

Easy Account Management
Investing can be complicated—but it doesn’t have to be. The plan includes quick access to online and phone account management, along with professionals who will provide assistance and answer your questions.

Flexible Distribution Options
Many plans restrict your options, but the plan gives you flexibility to choose what to do with your savings when you switch jobs. Roll your savings over to a new account, withdraw it or keep it invested in the Plan for the future—the choice is yours.

Low Account and Investment Fees
Thanks to the Plan’s size and negotiating power, you benefit from pricing scale, which could save you money versus the costs you could face as an individual investment account holder.
401(k)
“Keep it in the Plan”

Mythbusting: Facts vs. Fiction
When it comes to retirement saving, there’s plenty of information—and misinformation—out there. Here’s the scoop on some common misconceptions:

<table>
<thead>
<tr>
<th>Myth</th>
<th>Truth</th>
</tr>
</thead>
<tbody>
<tr>
<td>I need to move my retirement savings when I leave my current job.</td>
<td>If you leave your job and your existing employer provides a company match, you can rollover your matching contributions to your new employer's plan. If your current employer did not provide a match, you may be able to rollover your contributions to an IRA or another retirement plan. If you're under age 59 1/2, you may be subject to a 10% early withdrawal penalty from your current employer's plan.</td>
</tr>
<tr>
<td>Withdrawing money is the easiest way to keep it in the plan.</td>
<td>You can choose to have your money invested in a variety of options, including stocks, bonds, and money market funds, and you can change your investment options at any time.</td>
</tr>
<tr>
<td>If I withdraw, I must withdraw in full.</td>
<td>You can choose to withdraw as little or as much as you want.</td>
</tr>
<tr>
<td>Saving through an IRA is more efficient than saving through a 401(k).</td>
<td>While IRAs may offer more investment options and other benefits, they also have investment minimums, rules, and fees that vary by provider. Also, your Plan gives you lower “institutional pricing” on investments.</td>
</tr>
</tbody>
</table>

*However, distributions from the Plan begins at age 59 1/2, for the benefit of those age 59 1/2 or older, without the risk of penalty, 50 years of age or older, or age 50 years of age or older with at least 10 years of vesting service, you may withdraw principal and earnings without penalty. This benefit is limited to 50% of earnings and is subject to favorable income tax treatment. This option may also be available to those who have not participated in the Plan for at least 20 years.
401(k) “Keep it in the Plan”

Changing Jobs or Retiring? Know Your Options

What to do with your account when you change jobs or retire is one of the most important decisions you’ll need to make. Here’s what you should know:

If you have questions, contact the plan office:

- Keep your money in the Plan. If you leave your job but stay with the company, you don’t need to take any action—your savings will still be available to you and will continue to grow tax-deferred for retirement. Additionally, you’ll maintain access to your account and investment fees as well as professional expertise, tools, and resources.

- Roll over your savings to an individual retirement account (IRA). There are various types of IRAs with many investment options. IRAs typically have higher investment fees than you pay through the Plan, but your savings can continue to grow tax-deferred, and you are able to avoid taxes.

- Roll over your savings over to a new employer’s retirement plan (if available). If your new employer’s 401(k) allows it, you can transfer 100% of your existing savings to that plan, which will have its own rules and requirements. You won’t owe taxes if you make a "direct" rollover (from the Plan to the new plan) or "indirect" rollover (from the Plan to you and then to the new plan).

*For distributions by check or in rollover distributions, the fee is $15.

**You may have a balance above $1,500 in your account with no service fees.

***In certain circumstances, the 10% additional tax may not apply. For example, you may be able to take a distribution if you are 59 1/2 years of age or older. You should consult your tax advisor to determine the 10% tax that applies to your retirement distribution.
401(k)  
“Keep it in the Plan”

### Your Options at a Glance

Here's a quick comparison of your choices. If you have questions or want to discuss your choices, please speak to your plan administrator or call R07-35.

<table>
<thead>
<tr>
<th></th>
<th>Plan</th>
<th>Take a Cash Distribution</th>
<th>Take a Partial Withdrawal or Installments</th>
<th>Rollover to an IRA</th>
<th>Rollover to New Employer's Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax-deferred growth</strong></td>
<td>Yes</td>
<td>No</td>
<td>Yes, for the portion that remains in your account</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Taxes</strong></td>
<td>No tax implications (until distributed)</td>
<td>Federal and, if applicable, state income tax will apply to the withdrawal amount. A 10% early withdrawal penalty may apply if under age 59 1/2.</td>
<td>Federal and, if applicable, state income tax will apply to the withdrawal amount. A 10% early withdrawal penalty may apply if under age 59 1/2.</td>
<td>No tax implications if completed correctly.</td>
<td>No tax implications if completed correctly.</td>
</tr>
<tr>
<td><strong>Fees</strong></td>
<td>Regular administrative account and investment fees apply.**</td>
<td>Distribution fee may apply.*</td>
<td>Distribution fee may apply.*</td>
<td>Account and investment fees vary by IRA.*</td>
<td>Account and investment fees vary by plan.*</td>
</tr>
<tr>
<td><strong>Action required</strong></td>
<td>None</td>
<td>Call</td>
<td>Call</td>
<td>Call</td>
<td>Call</td>
</tr>
</tbody>
</table>

*For distributions by check and/or rollover distributions, the fee is $10.
**Certiﬁed by the U.S. Treasury Department. Charges may apply to participants who cash out their interest in their account. Participants are subject to a 10% penalty if the distribution is not used for eligible purposes. Rollover fees may apply. Rollover fees are subject to the plan administrator. The amount of the fee will be calculated at the time of distribution. The fee is subject to change. Please consult with your plan administrator for more information.

Note that all fees and expenses may apply to distributions that were made after tax contributions or Roth contributions.

Prepare yourself for the many years ahead.
Session #R07
Participant and Trustee Education in DC Plans

- Ask plan professionals questions about the plan you sit on as trustee, or participate in or are bargaining into a contract
- Know the basics of plan differences and rules
- Pay attention to fees. Conduct RFIs annually
- Best practices—ask other plans about:
  - Loan provisions
  - Investment options
  - Distributions: when, how and penalties
  - Contribution limits

Website Resources
https://www.ifebp.org/news/featuredtopics/retirementsecurity/Pages/default.aspx
2017 Educational Programs
Retirement Security/Financial Education

63rd Annual Employee Benefits Conference
October 22-25, 2017
Las Vegas, Nevada
www.ifebp.org/usannual

Certificate Series
February 27-March 4, 2017
Lake Buena Vista (Orlando), Florida
July 24-29, 2017
Denver, Colorado
www.ifebp.org/certificateseries

Related Reading
Visit one of the on-site Bookstore locations or see www.ifebp.org/bookstore for more books.

Ready or Not: Your Retirement Planning Guide, 43rd Edition
Item #9067
www.ifebp.org/books.asp?9067