SESSION 2: Components of the 401(k)

TOPIC: What is a 401(k)? And why should employers offer one?

The types of Plans and how they work.

There are 4 main types of 401(k)s for business owners:

The most popular is a Safe Harbor 401(k).

A Traditional 401(k) gives owners more options regarding employer contributions, vesting schedules and even the choice to not match at all.

A Simple 401(k) is ideal for small businesses.

Automatic Enrollment 401(k)s give employees a chance to keep up with their contributions.

Also don't forget about the Roth 401(k).

The Safe Harbor 401(k) is a popular choice for businesses with less than 15 employees and for good reason. These Plans allow business owners to contribute the maximum deferral amount to their own account ($17500 in 2014 or $23,000 for those 50 year of age and over) and, at the same time, automatically satisfy IRS non-discrimination testing – a governmental check and balance that ensures plans serve all employees and not just a few at the top.

A Traditional 401(k) enables small business owners to customize their Plan. The rule of thumb is that traditional Plans are a good fit for businesses that are highly seasonal, or for those whose employees are expected to contribute seven percent or more of their salaries. A traditional 401(k) offers the maximum flexibility. Employers have discretion over whether to make contributions for all participants, to match employees' deferrals, to do both, or to do neither.

A Simple 401(k) is a Plan for the small business owner with 100 or fewer employees. An employee can elect to defer some compensation. But unlike a regular 401(k) Plan, the employer must make either:

1. A matching contribution up to 3% of each employee's pay, or
2. A non-elective contribution of 2% of each eligible employee's pay.

No other contributions can be made. The employees are totally vested in any and all contributions.

If you establish a Simple 401(k) Plan, you:

- Must have 100 or fewer employees.
- Cannot have any other retirement plans.
- Need to annually file a Form 5500.

An Automatic Enrollment 401(k) allows employers to automatically enroll employees and place deductions from their salaries in certain default investments, unless the employee elects

otherwise. This is an effective way for many employers to increase participation in their 401(k) Plans. It provides a high level of participation and makes it easy to withhold employee contributions and select the investments for those contributions.

Unfortunately, approximately 30 percent of eligible workers do not participate in their employer's 401(k)-type Plan. Studies suggest that automatic enrollment plans could reduce this rate to less than 15 percent, significantly increasing retirement savings.

Why should employers offer a 401(k) Plan?

- It helps attract and keep talented employees.
- It increases Plan participation among both rank-and-file employees and owners/ managers.
- Allows for salary deferrals into certain Plan investments.
- Simplifies selection of investments appropriate for long-term retirement savings for participants.
- Helps employees begin saving for their future.
- Offers significant tax advantages (including deduction of employer contributions and deferred taxation on contributions and earnings until distribution).

Establishing A 401(k) Plan

Adopt a written Plan document.

Arrange a trust for the Plan's assets:

- Develop a record keeping system.
- Select Plan investments or hire an investment expert.
- Provide Plan information to employees eligible to participate.

A Note about the Roth 401(k)

A relatively new phenomenon, The Roth 401(k) is simply a feature available in a 401(k) Plan. You can choose to put some, none or all your contributions after-tax into your Roth 401(k) savings up to $17,500 a year in 2014, or $23,000 if you are 50 years of age or older. You receive no tax deduction on contributions, while withdrawals, including investment gains, are tax-free when you reach retirement.

Roth tax rules are the exact opposite of how traditional tax-deferred 401(k) contributions work. You get the tax break today for traditional 401(k) contributions versus tomorrow with the Roth. Your tax-deferred contributions will be taxed when you withdraw the money at retirement. Plus, the Roth 401(k) has no income limits.

TOPIC: The components of a 401(k) and what they do:

Sponsor:

The Sponsor is most often the employer that offers to the employees. However, there are some multi-employer Plans that offer efficiencies of scale to participants. For instance, an MEP—a Multiple Employer Plan can have hundreds of different employers who offer the Plan to their employees.

Plan Design:

Plan Design is the structure of the Plan and specific details about it, such as:

- How and when employees can join.
- Deferrals and matching limits.
- And maybe a Roth 401(k) option.

Choose a Plan design that fits the business' specific needs now and a provider that has the services and options that can grow as your company evolves. Whether they need a Plan that vests over time for the employees, or want to consider advanced profit sharing options, select a provider that can meet those needs today and tomorrow. A key to ensuring this is strong ongoing support and guidance from the provider. If the employer is not getting that, it's a red flag.

Administration

Someone has to manage all the paperwork, deposits and accounting for each Participant. This is the Plan Administrator.

Plan Management and Operating the Plan

Plan Management, often the employer or a vendor selected by the employer, manages all the other vendors and is responsible to see that every part is pulling its weight.

Elements of operating 401(k) Plans include:

- Participation
- Contributions
- Vesting
- Nondiscrimination
- Investing 401(k) Plan monies
- Fiduciary responsibilities
- Disclosing Plan information to participants
- Reporting to government agencies
- Distributing Plan benefits
- Controlling costs

Topic: ***CASES:***

Tibbie v. Edison

Court ruled that the investment committee violated ERISA's duty of Prudence by "not properly investigating the differences between selecting Retail & Institutional share classes."

Tussey v. ABE Inc.

"...the Court finds that the Plan overpaid for Fidelity Trusts record-keeping and administrative services ..." Accordingly, the Court finds that the Plan suffered losses of $13.4 million as a result of ABE's failure to monitor record-keeping costs [...] All ABE Defendants are held jointly and severally liable for this amount.

ERISA section 409 - "Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligation, or duties imposed upon fiduciaries by this title shall be personally liable ... "

Investment Selection and Management.

Investment options in the Plan are selected by the Sponsor or a delegated Fiduciary (see below). Often an outside Investment Manager selects the fund or ETF options available for Participants to pick. This saves Employers the time and energy and liability of selecting and regularly reviewing fund performance and costs to ensure they are prudent, in the best interest of the employees, and ultimately diversify investments to minimize risk of large losses.

Perhaps as important, this also reduces the employer's business risks of providing 401(k) benefits to employees. By choosing a provider that serves as an investment fiduciary, employers gain the peace of mind that they will ensure the investments are managed in line with the investment goals and policy agreed on (e.g. performance, low expense fund focus, diversification, etc.).

CASE:

Kruger V. Ameriprise:

"Hundreds or thousands of investment options cannot insulate a Plan's fiduciaries from liability. Self-dealing does not just mean taking kickbacks. Using a Plan to expand market exposure to proprietary investment options also runs afoul of ERISA."

Participant Services

Communications are critical, and the Sponsor or its delegated vendor will have a dedicated person to call with questions and help Participants facilitate the process of enrolling, picking funds and getting things done on time.

Topic: The Fiduciaries:

There are four "Fiduciaries" under ERISA. Three are required and one is optional.

1. The Named Fiduciary

   The "Named Fiduciary" is the person, etc. who is named in a Plan instrument [i.e. Plan document] or who, pursuant to a procedure specified in the plan, is identified as a fiduciary, usually the Plan Sponsor. The Named Fiduciary has control over the Plan, retains the fiduciary duties and responsibilities for the Plan, has the ability to appoint other fiduciaries and has control over all other fiduciaries.

2. 3(16) Plan Administrator

   Not to be confused with a third party administrator (TPA), the 3(16) Plan Administrator is the fiduciary charged with the day to day operations of the Plan.

   The 3(16) is identified in the Plan Document. Unless specifically named in the Plan Document, the Plan Sponsor becomes the 3(16) fiduciary. The 3(16) Administrator has discretionary control over the management and, therefore, is a fiduciary of the Plan.

3. 403(a) Trustee

   This trustee can be either a "Discretionary Trustee," with the power to act independently, or a "Directed Trustee," in which case, the trustee acts at the direction of the Named Fiduciary.

4. 3(38) Fiduciary: Investment Manager

   A 3(38) has the sole responsibility and liability to select, monitor, and replace a Plan's investment options. A 3(38) has the authority and mandate to make the decision on the addition or removal of investment options.

   A 3(38) will relieve the Named Fiduciary and Trustees of all of the liability associated with the investment management of the Plan's assets.

   The Named Fiduciary remains only responsible to ensure that the initial decision to hire the 3(38) was prudent and continues to be prudent.