Modern Defined Contribution Plan Design

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70TH ANNUAL EMPLOYEE BENEFITS CONFERENCE

International Foundation OF EMPLOYEE BENEFIT PLANS

Agenda

1. Current Situation
2. Optimal Investment Menu Design
   A. Brokerage Window
   B. Managed Accounts
3. Automatic Features
4. Distribution Options
5. Participant Education
6. Secure Act 2.0 Changes

Current Situation

First, a Quick Refresher...

DB Plans

Pension plans, traditional DB, money purchase, cash balance

Monthly annuity benefit at retirement

Same retirement benefit if the market returns are 5%, 8% or 12% and regardless of cost of plan

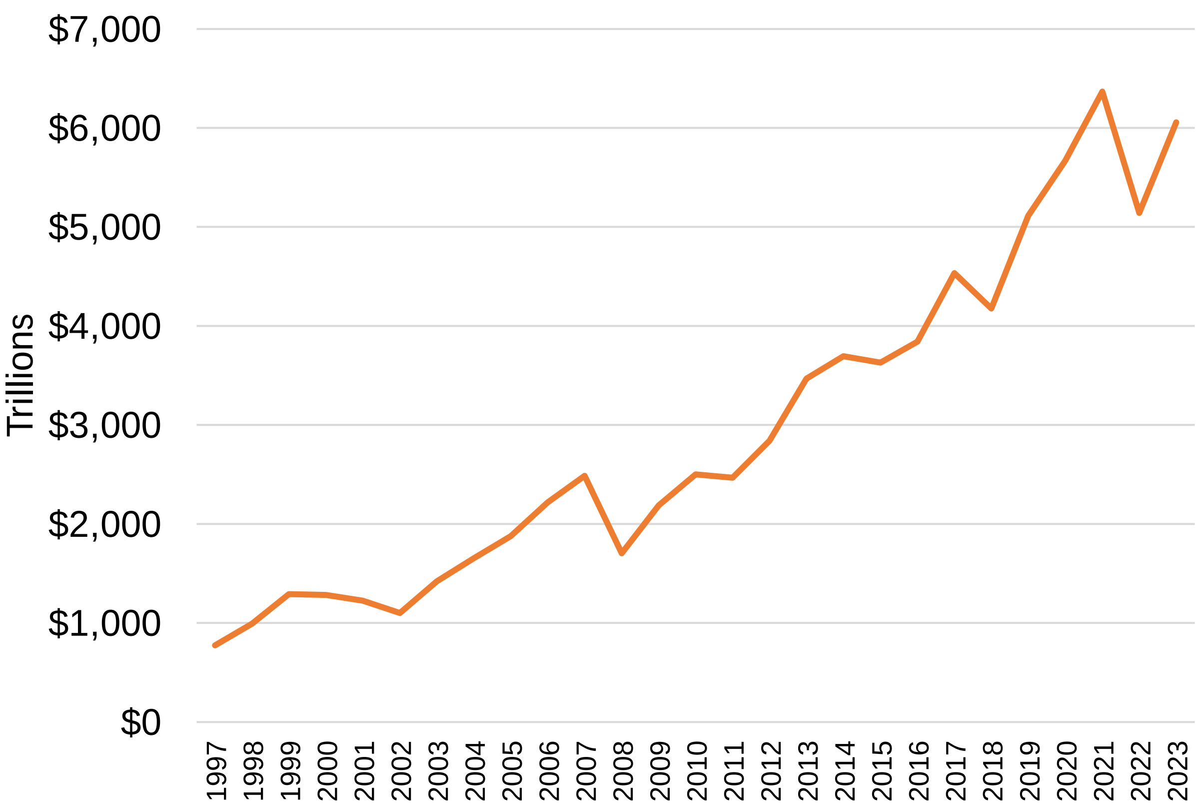
DC Plans

401(k), 403(b), 457, profit-sharing, or hybrid plans

An account for each participant (investments usually participant directed)

Retirement benefit based on the value of vested contributions plus investments minus fees and costs

Defined Contribution Plan Growth



70 million

Active 401(k) participants

Source: Investment Company Institute, 2023

ERISA Fiduciary Responsibilities

Act Solely in Participants' Interests

Demonstrate Prudence

Diversify Investments

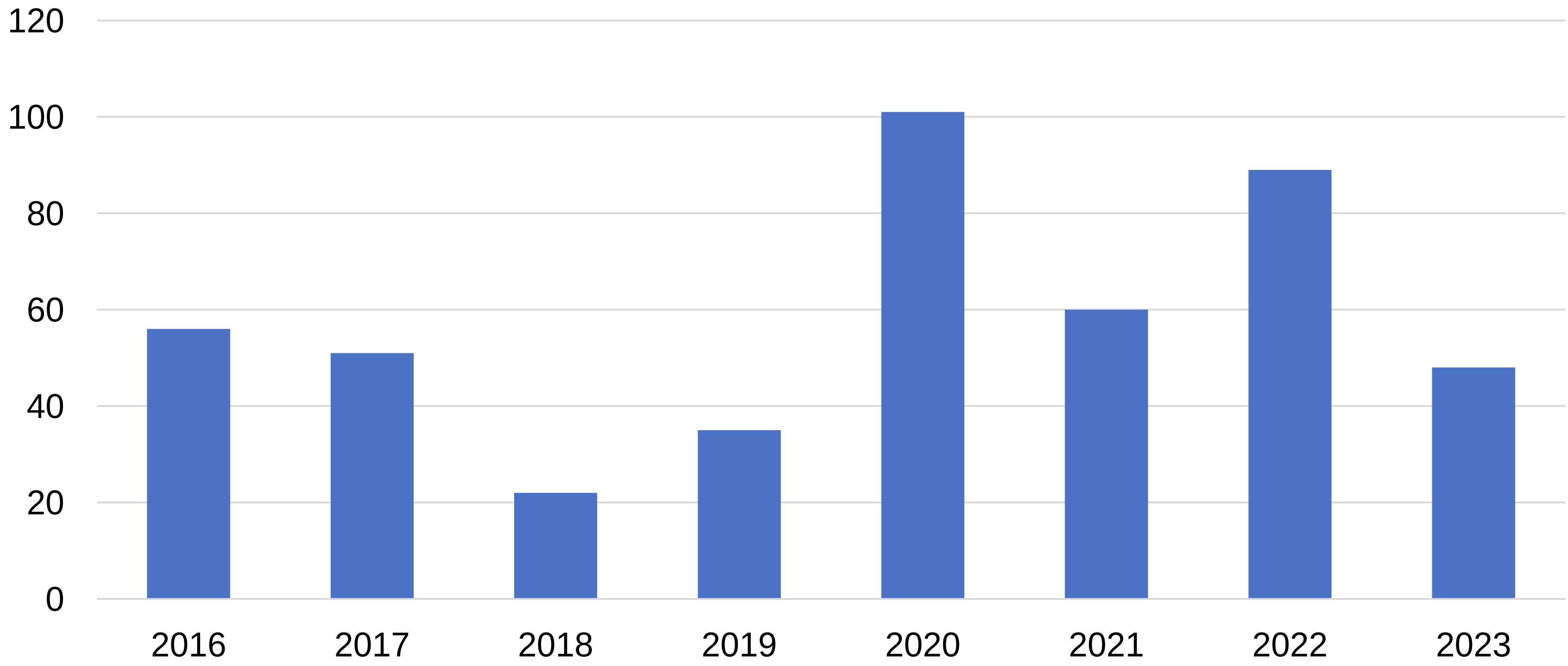
Follow Plan Documents

Pay Only Reasonable Fees and Expenses

Avoid Conflicts of Interest

Important, as Litigation Is Increasing

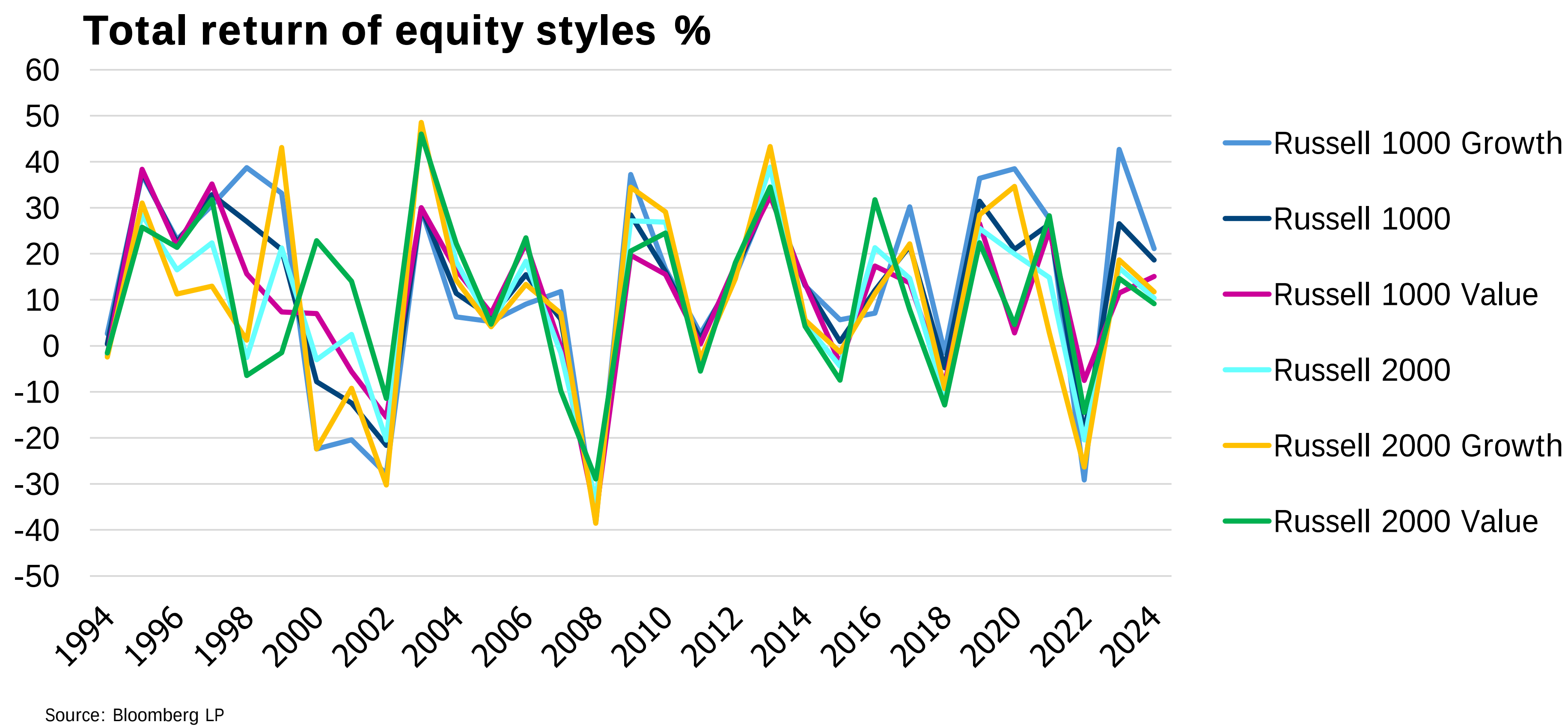
Excess Fee and Performance Lawsuits by Year as of 12/31/2023



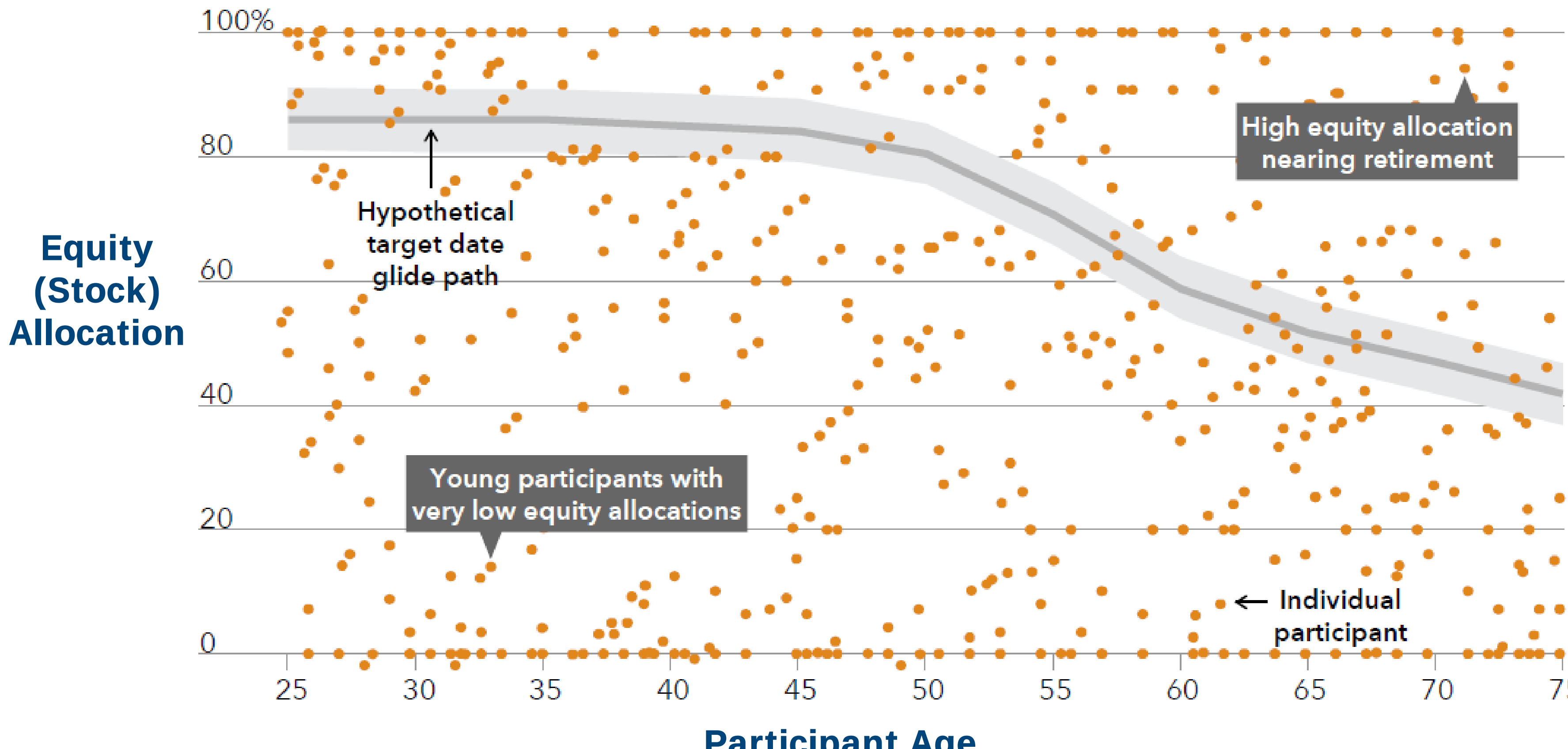
Source: Euclid Fiduciary Excess Fee and Performance Case Tracking

Ideal Investment Choices

Similarity of Stock Performance

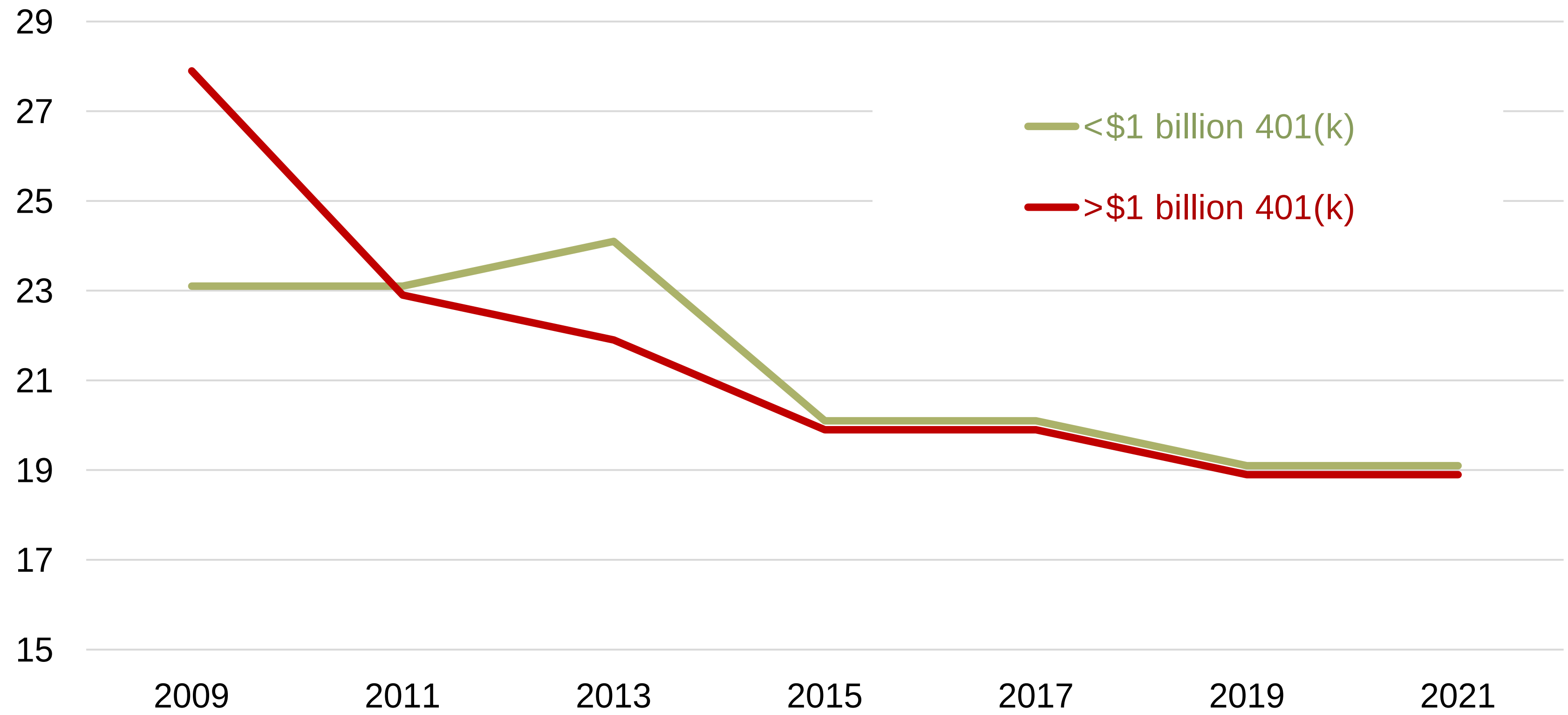


Participant Decisions May Be Poor



Source: American Funds

Number of Options Is Declining



Source: The BrightScope/ICI Defined Contribution Plan Profile (2024). Data counts the Target Date Funds as a single option.

Right Number of Options, Less Is More

	Plan Size by Number of Participants					
Number of Funds	1–49	50–199	200–999	1,000–4,999	5,000+	All Plans
One	1.5%	3.3%	0.0%	1.6%	2.9%	1.9%
Two to Nine	1.5%	4.4%	2.5%	6.3%	10.1%	4.9%
Ten	0.0%	2.2%	2.5%	1.6%	5.8%	2.5%
Eleven to Fifteen	21.5%	8.9%	20.0%	25.4%	31.9%	20.7%
Sixteen to Twenty	21.5%	32.2%	31.3%	27.0%	21.7%	27.2%
Twenty-One to Twenty-Five	20.0%	17.8%	25.0%	14.3%	10.1%	17.7%
Twenty-Six or More	33.8%	31.1%	18.8%	23.8%	17.4%	25.1%
	99.8%	99.9%	100.1%	100.0%	99.9%	100.0%

Data: Plan Sponsor Council of America

Consider the “Type” of Participants

Photo by Avi Naim on Unsplash

Photo by Studio Republic on Unsplash

Do It For Me Investor

- Rarely reviews investments.
- Little investment decision making.
- Limited knowledge, interest and time to manage their nest egg.

Do It Yourself Investor

- Frequent interest in markets.
- Wants control of their portfolio.
- Little need for advice; can be very vocal.

Sample "Menu" of Options

Conservative ↔ Aggressive

You Build It	I'll Build It		
Lifecycle Fund	Index Options	Active Options	Retirement Options
QDIA:		Money Market or Stable Value	"Guaranteed" Type Account
Target Date Funds (5 Year Increments)	Core Bond	Core Bond	Systematic Withdrawal
	US Stock	US Stock	
	US Small-Mid Stock	US Small-Mid Stock	
Managed Accounts	International Stock	International Stock	Brokerage Window

Selection Guidance

Most Important

1. Investment Performance
2. Cost and Fees
3. Fills Investment Style Gap
4. Investment Management Team Stability
5. Style Consistency
6. Ease of Integration with RecordKeeper
7. Brand Name and Market Image
8. Existing Plan Investment Manger
9. Communication and Educational Capabilities
10. Participant Request

Least Important

Other “Options”: Brokerage Window

Permitted Investments

Directly from the market

- Common stocks
- Bonds
- ETFs
- Other mutual funds

Usage

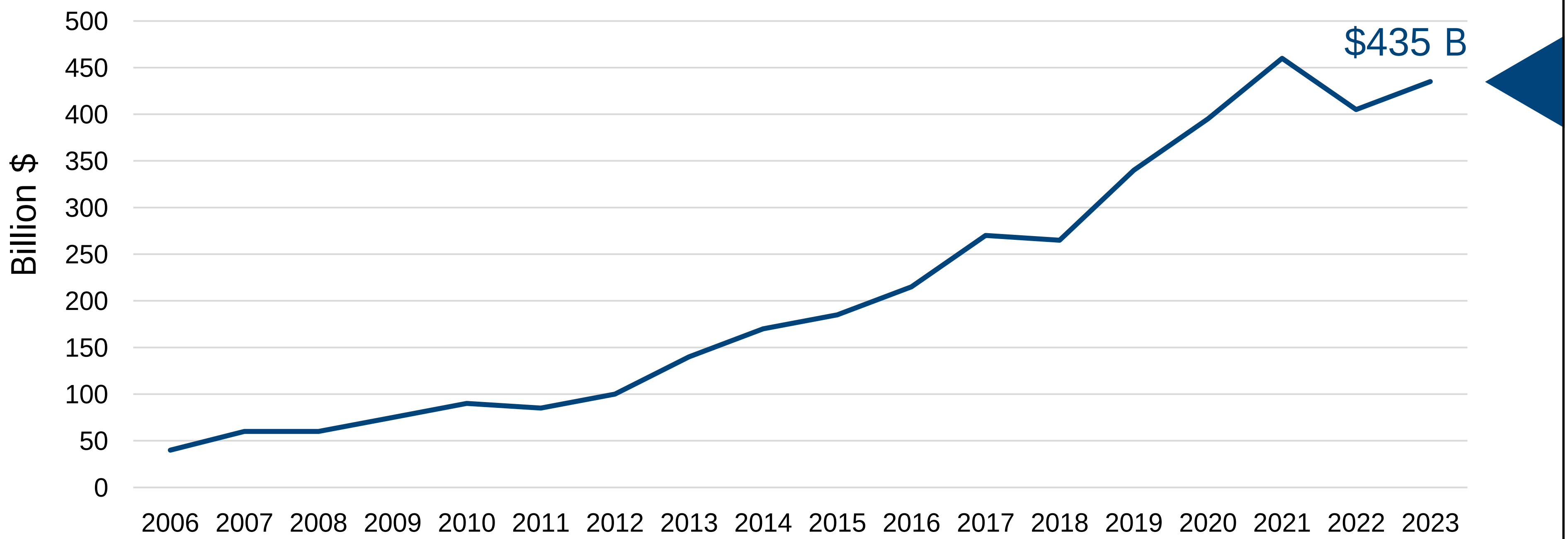
- 25% across all industries
- 35% in Taft-Hartley

Possible Limitations

- Restrict % of account permitted to trade
- Restrict what can be traded
- Trustees have fiduciary protection from losses within brokerage window

Other “Options”: Managed Accounts

DC Managed Account Industry Asset Growth



Source: Cerulli Associates

Managed Accounts: A Brief Outline

Professional investment advice and management of your 401(k) portfolio **within the confines of the investments offered by your plan**.

Investment Advice
ERISA 3(21)—Advice only

- Advisor reviews your account, investment options, retirement and investment goals, etc. and makes a recommendation of how to allocate your investment (stocks/bonds/etc.)
- Lower fee. Sometimes paid by employer. Sometimes $0 if plan is large and negotiates

Investment Management
ERISA 3(38)—Discretionary

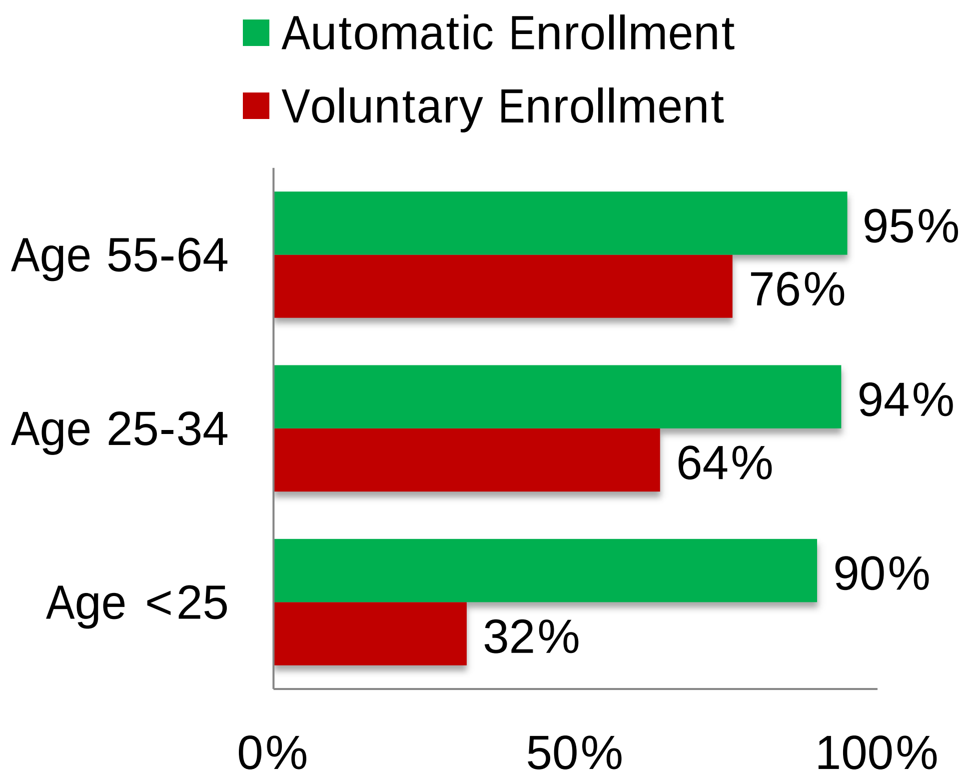
- Advisor makes all decisions related to investment of your account
- Acts as a fiduciary
- Fees around 50bps. (if account balance is approx. $250,000, that's $1,250/year)

Plan Features

Offering Elective Deferrals

Participation Rates, Better With "Auto"

- Survey of all DC plans serviced by Vanguard shows:
  - Participation rates in automatic enrollment plans was 94%.
  - Participation rate in voluntary enrollment plans was 67%

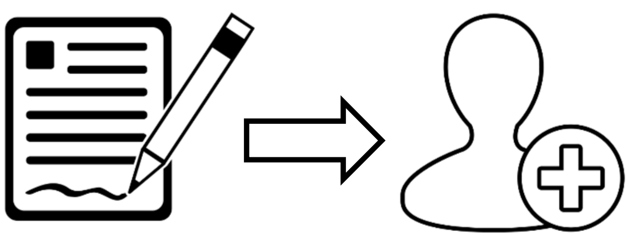


Source: Vanguard 2024

Types of Design

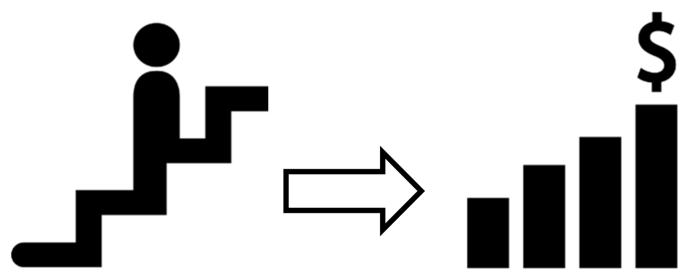
Auto-Enrollment

- Automatically gets participants saving.



Auto-scalation

- Automatically gets participants saving more.



Qualified Automatic Contribution Arrangement

A QACA also must require:

- Automatic escalating deferrals, starting at 3% and increasing 1% each year, up to 6% of compensation.

Auto-Features: Pros / Cons

Pros

- Helps employees begin saving
- Increases participation
- Demonstrable benefit to members when they see account balance increase
- Helps nondiscrimination testing results if a qualified arrangement
- More assets in plan gives negotiating power for lower fees

Cons

- Increased liability if you get it wrong
- Additional administrative work
- Increased cost for recordkeeping and notices
- Difficult to administer in high-turnover environments (e.g., construction)

Distribution Options

Options

Loans

Hardship Withdrawals

Retirement Income
(Decumulation, Future Focus Area)

Loans

Loan Basics

The lesser of $50,000 or 50% of the participant's account balance.
If 50% is less than $10,000, the participant may borrow up to $10,000.

Plan document must allow:

- **Promissory note**
  Interest charged at reasonable rate
- **Level payments**

- **Repayment terms** (typical)
  – 5 years generally, 15-30 for purchase of residence
  – Made on after-tax basis; directly from employer unless terminated
  – No tax issue if repaid in full by repayment date
  – If defaulted and distributed, subject to a 10% early withdrawal penalty and applicable federal/state taxes.

Loans

Pros

- Flexibility when participants need access to money in an emergency
- Interest rate likely lower than bank or lender
- Many employees will see this as a benefit
- "It's their money"
  - 76% of plans offer a loan program

Cons

- The money is for retirement! Loan defaults across industry are 10-12%; 80+% for terminated participants
- Administration—Processing, reviewing applications, deducting repayments
- IRS offers narrow correction methods if things go wrong
- Very difficult to administer in high-turnover industries (e.g., construction)

Loans

No Restrictions: Offer a loan program without limits, or

Limit Loans: (and prevent leakage)

- Charge a fee ($50-500) to take a loan
- Set a cap on number of loans
- Restrict to hardship withdrawals (e.g., home purchase, foreclosure prevention, education, medical expenses)
- Allow only specific sources (pre-tax elective deferrals; exclude Roth and employer contributions)
- Require financial counseling (company-paid) before taking a loan
- Implement a 90-day waiting period after paying off a loan before initiating another
- Reduce maximum loan amounts

Hardship Withdrawals

In-Service Distributions for Immediate and Heavy Financial Need

- Taxable: Participant is subject to income tax and early withdrawal penalty unless exceptions apply
- Limit to Safe Harbor Reasons
  - Medical expenses
  - Purchase of principal residence
  - Tuition and educational fees
  - Eviction prevention
  - Funeral expenses
  - Home repair expenses
- Additional Permitted Withdrawals: Disaster relief and birth/adoption expenses.

Note: Pros and cons are similar to those of loans

Retirement Income

Record-keepers, insurance companies, and investment managers now provide a variety of retirement income solutions:

Guaranteed Income

- Annuity feature within investment design
- Annuity placement service (offered through record-keeper)

Non-Guaranteed Income

- Managed accounts feature
- Managed “payout” funds
- Systematic withdrawal service

Participant Education

Communications Importance?

Which of the following best describes your plan's approach to participant communications?

More Generic

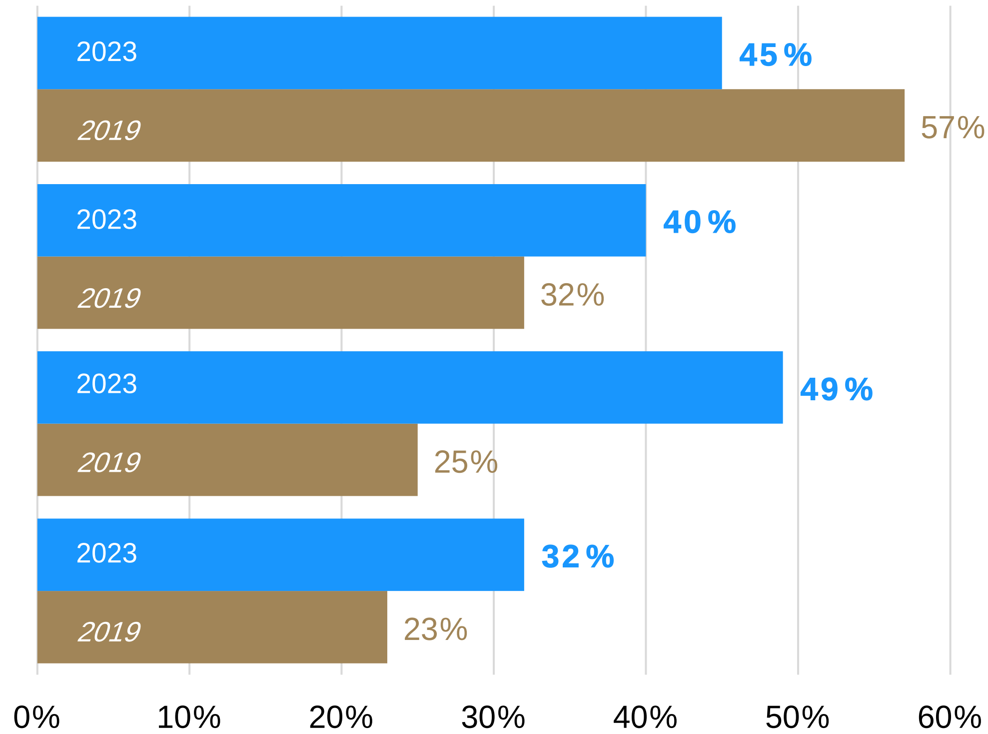
More Personalized

We provide **general communications** to participants

We provide education on **specific topics** where we are trying to drive action

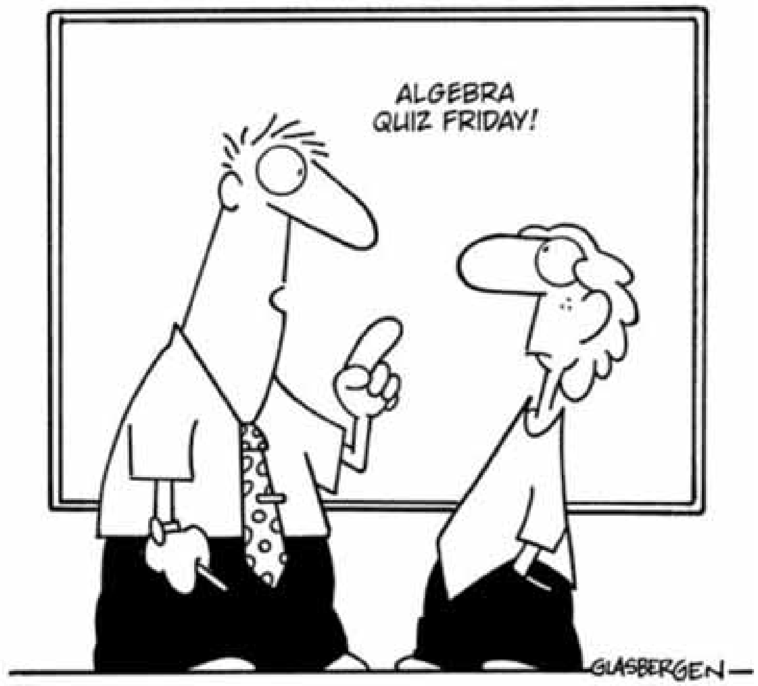
We provide targeted communications based on **participant segments**

We provide **personalized communications** at the individual participant level



Source: JP Morgan Plan Sponsor Research 2023

Education Importance



"It's important to learn math because someday you might accidentally buy a phone without a calculator."

Secure 2.0

Secure Act 2.0 (Key Points)

Auto-enrollment and escalation	• Required for new Plans established after December 29, 2022; effective for plan years after December 31, 2024 • Exceptions for small businesses and plans in effect prior to law
Required Minimum Distributions	• Changed again after Secure Act 1.0 from 72 to 73 in 2023 and then 75 in 2033 • Plans can still retain earlier required beginning date or delay until April after a participant retires
Catch-up Contributions	• Must be ROTH for participants with income > $145,000 (postponed until 2026)
Hardship self-certification	• Plan can rely on participant certification without substantiation unless they have knowledge to the contrary

Key Takeaways

Key Takeaways

- One of the challenges of offering a defined contribution retirement Plan is designing a Plan that will help participants meet their retirement goals.
- Plans can address some challenges through increasing the simplicity of the Plan's investment line-up and features.
- Understanding Plan Auto Features and Educational opportunities is essential for helping participants begin and maintain a retirement approach.
- Affirming key points from Secure 2.0 can ensure DC plan compliance with new legislation

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Session Evaluation

Q&A