Overview of Defined Contribution Plans

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Qualified Retirement Plans

- Employer contributions are not subject to federal income tax or payroll tax
- Employee contributions are not subject to federal income tax
- Employee contributions are subject to payroll tax
- Tax-deferred growth
- ERISA protection
- Timing of income tax deduction

Qualified Plans

	Pension Plans	Profit Sharing Plans	
Defined Benefit Plans	▪Defined Benefit Pension Plans ▪Cash Balance Pension Plans	▪Profit Sharing Plans ▪Stock Bonus Plans ▪ESOPs ▪401(k) Plans	Defined Contribution Plans
Defined Contribution Plans	▪Money Purchase Pension Plans ▪Target Benefit Pension Plans	▪Thrift Plans ▪New Comparability Plans ▪Age-Based Profit Sharing Plans	

Pension Plans vs. Profit Sharing Plans

Characteristic	Pension Plan	Profit Sharing Plan
Legal Promise of the Plan	Paying a pension at retirement	Deferral of Compensation
In-Service Withdrawals?	No*	Yes (after two years)
Mandatory Funding?	Yes	No
Investment in ER Securities	10%	100%
QJSA & QPSA?	Yes	No

*Under the PPA 2006, defined benefit pension plans can provide for in-service distributions to participants who are age 62 or older.

Defined Benefit vs. Defined Contribution

Characteristics	Defined Benefit	Defined Contribution
What is the Annual Contribution Limit?	Not less than the unfunded current liability*	25% of Covered Compensation
Who assumes the investment risk?	Employer	Employee
How are forfeitures allocated?	Reduce Plan Costs	Reduce plan costs or allocate to other participants
Is the plan subject to Pension Benefit Guaranty Corporation (PBGC) coverage?	Yes (except professional firms with less than 25 employees)	No
Does the plan have separate investment accounts?	No, they are commingled	Yes, they are usually separate
Can credit be given for prior service?	Yes	No

* This is the annual contribution limit for 2006 and 2007. Beginning in 2008, defined benefit plans are subject to new annual contribution limits under the PPA 2006.

Nonqualified Plans

- Nonqualified plans are retirement plans that do not need to meet the requirements of qualified plans.
- Needs met by nonqualified plans:
  - –Can discriminate in favor of highly compensated employees.
  - –Can provide a second level of benefits to executives.
  - –Lower administrative costs to employer than qualified plans.
  - –Benefits and contributions are not limited by qualified plan rules.

Nonqualified Plans

- Examples of nonqualified plans:
  - –Section 457 plans.
  - –Salary reduction plans.
  - –Salary continuation plans (SERPs).
  - –Phantom stock plans.
  - –Rabbi trusts.
  - –Secular trusts.

403(b) Plans – Tax Sheltered Annuities

- Retirement plan for the following:
  - –Public schools or educational organizations, and
  - –Tax Exempt Organizations under IRC Section 501(c)(3).

ERISA Applicability

- ERISA applies to:
  - –Employee benefit pension plans of 501(c)(3) organizations
    - Unless employer involvement is minimal
      - –Employer only provides salary reduction agreement.
- ERISA does NOT apply to:
  - –Governmental 403(b)s
  - –Church Related 403(b)s

When ERISA Applies

- Plan must meet the following tests:
  - –Nondiscrimination Test
  - –Matching contributions must satisfy ACP test.
- Plan must offer the following distribution options:
  - –Preretirement Joint and Survivor Annuity
  - –Qualified Joint and Survivor (QJSA)

Eligibility

- Plan may require employees to meet the general eligibility requirements of:
  - –Age 21 and one year of service

Contributions to 403(b) Plans

- Employee elective deferrals
  - Tax deductible or nondeductible (Roth)
  - Subject to payroll taxes
  - Limited to $16,500 per year, plus $5,500 for age 50 and over catch-up
    - Combined limit with other CODA plans
- Employer matching allowed
- After-tax contributions allowed
- All contributions are 100% vested to the employee.

15-Year Catch-Up Contributions

- Permits up to an additional $15,000 (maximum $3,000 additional per year) of contributions to the 403(b).
- Participant must have 15 years of service with the employer.
- For 2010 and 2011, maximum deferral contribution would be $25,000
  - $16,500 – Employee Deferral
  - $ 5,500 – Age 50 and over catch-up
  - $ 3,000 – 15-Year Catch-Up

Investment Choices

- Funds within a 403(b) account can only be invested in either of the following:
  - Insurance Annuity Contracts
  - Mutual Funds

Loans from 403(b) Plans

- Only permissible from ERISA plans
- Subject to same rules as loans from 401(k) plans

Distributions from 403(b) Plans

- Distributions related to employee deferral contributions can only be paid after the following:
  - 59½
  - Death
  - Separation from Service
  - Disability
  - Hardship
- Distributions from nonelective contributions are not restricted.
- Distributions are taxed as ordinary income and potentially subject to a 10% penalty.

Required Minimum Distributions

- 403(b) Plans are subject to the same required minimum distribution rules as IRAs and Qualified Plans.

Taxation of 403(b) Distributions

- Employee Deferral Contributions
  - Ordinary Income
- After-Tax Contributions
  - Return of Adjusted Taxable Basis

457 Plans

- Nonqualified Deferred Compensation Plan
  - Eligible Tax-Exempt Entities
  - Eligible Governmental Entities
- Employee elective tax-deferred savings

Eligible Tax-Exempt Entities

- Trade Associations
- Religious Organizations (Not CHURCHES)
- Private Hospitals
- Rural Electric Cooperatives
- Farmers' Cooperatives
- Private Schools
- Labor Unions
- Charitable Organizations

Eligible Governmental Entities

- States
- Political Subdivisions of a State
- State Agencies

3-Year Catch-Up

- Three years prior to normal retirement age an employee may defer an additional $16,500 to the 457 plan.
  - Limited to prior unused deferral amounts
  - Maximum contribution equals $33,000
    - $16,500 Contribution + $16,500 catch-up contribution
  - Do not include 50 and over catch-up contribution when determining the 3-year catch-up.

	Public 457(b) Plans	**Private 457(b) Plans**
Eligible/Ineligible	Eligible	Eligible
Employer/Sponsor	Government	Tax-Exempt – 501(c)
Assets in Plan	Protected by Trust	Not Protected
Contribution Limits	$16,500, employer matching allowed	$16,500
Participants	All Employees	Key Management and HC for tax-exempt; all employees for church
Pretax and Tax Deferral	Yes	Yes
Catch-Up Available	Yes	Yes
Rollovers	Permitted to 401(k), 403(b), 457(b) or IRA Plans	Only to other 457(b) Plans

457(f) Plans

Eligible/Ineligible	Ineligible
Employer/Sponsor	Governmental and Tax-Exempt 501(c)
Assets in Plan	Not Protected by Trust
Contribution Limits	No Limit
Participants	Key Management and HC
Pretax and Tax Deferral	Yes
Catch-Up Available	No
Rollovers	Not Permitted

KPERS

- Members contribute 4% of salary.
- Contributions earn 8% before 7/1/93; 4% after.
- Members vest in 5 years.
- Taxed like a Roth IRA – not deductible, not taxable.
- Three/four year average highest compensation x 1.75% x years of service
- Rule of 85 (age plus service)
- Reduction for early retirement
- Members receive term life insurance equal to 150% of income.
- Long-term disability equal to 60% of salary.

University of Missouri Employees

- Fully-funded defined benefit plan, 2.2% x Average high five years compensation x length of service. Also 403(b)s available.
- Negative returns in 2008 caused concern about university risk.
- University enacts first-time-ever 1 to 2% employee contributions in 2009.
- University proposes defined contribution plan in response to number of employees not vesting (mainly administrators, not faculty) and university risk.
- Significant push back from long-term employees, particularly faculty, who felt the university was breaching the "contract" entered at hire.
- In response to countless hours of testimony and analysis, Board of Curators keeps current DB plan in effect for all current employees. New employees contribute to DC plan with an employer match.

Reflections on the University of MO Process

- Shift of risk from the university to the employees. University contribution levels are projected to be the same, but more employee contributions and no market risk to the university.
- Concern about whether employees, particularly lower-paid employees, will (be able to) save enough and understand the risk/return payoff. More education required.
- The university pays below average compensation.
  - Isn't this an additional cut in pay?
  - Are middle and lower class employees the victims of poor State planning?
- Good process – lots of transparency and release of documents, committees made up of faculty/staff and administrators, and public meetings.

Disadvantages of Qualified Retirement Plans

- Costs to qualify, fund, and administer the plan
- Annual compensation limit
- Eligibility requirements
- Coverage of employees
- Top-heavy plans
- Vesting requirements
- Disclosure requirements
- Annual testing

Eligibility

- Age 21 and one year of service (1,000 hours worked in a 12 month period)
  - Special election to require two years of service – 100% vesting requirement
  - Tax-exempt educational institutions can require age 26
- Plan Entrance Dates – usually two

Coverage

- Can exclude:
  - Ineligible employees
  - Employees covered under a collective bargaining agreement
  - Nonresident alien employees that do not perform services in the U.S.

Coverage

- Plan must be nondiscriminatory with regard to highly compensated (HC) and non-highly compensated (NHC)

Owner Employees	Nonowner Employees
Either An owner of >5%* Or Compensation in excess of $110,000 ($110,000 in 2009 and 2010)**	Compensation in excess of $110,000 ($110,000 in 2009 and 2010)**

*Anyone who owns more than 5% of a company's stock or capital

** If elected, add "and in top 20% of employees ranked by salary"

Vesting

- Employer contributions must vest at least as rapidly as:
  - 5 year cliff
  - 3-7 year graded
- Employer matching and defined contribution plan contributions:
  - 3 year cliff
  - 2-6 year graded
- The plan provisions may always be more generous towards employees.

Vesting - Years of Service

- 1,000 hours in a 12 month period
- Includes all years except:
  - Before age 18 or
  - Period in which employer did not maintain a plan
- Special rules
  - Breaks in service – one year of service after return brings back earlier years
  - Qualified military leave – no contributions during leave, but must be made up after return
  - Maternity/paternity leave – hours absent still count toward participation

Plan Limitations on Benefits and Contributions

- Covered Compensation
  - $245,000 (2009 – 2011); $230,000 (2008)
- Defined Benefit Plans
  - Lesser of
    - $195,000 in 2009 - 2011 ($185,000 in 2008), or
    - 100% of the average of the employee's three highest consecutive years salary

Plan Limitations on Benefits and Contributions

- Defined Contribution Plans
  - Maximum contribution for the year
    - Lesser of:
      - 100% of an employee's compensation, or
      - $49,000 in 2009 - 2011
  - Limit consists of:
    - Employer Contributions, and
    - Employee Contributions, and
    - Any forfeitures allocated to participant's account.