

NAGDCA

BEST PRACTICES GUIDE TO ADMINISTERING YOUR GOVERNMENTAL DEFINED CONTRIBUTION PLAN

PLAN ADMINISTRATION



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INTRODUCTION

The National Association of Government Defined Contribution Administrators (“NAGDCA”) is an association for defined contribution retirement plans of government employers. Our mission is to unite representatives from state and local governments, and from private sector organizations servicing defined contribution plans, for the common purpose of providing our plan participants with financial security at retirement.

NAGDCA provides an environment to foster growth in professional development of its members through peer networking, educational opportunities and information sharing. NAGDCA is well-regarded by Federal lawmakers and regulatory agencies because it offers an objective window into the behaviors, preferences and aspirations of Governmental plan participants.

This “Best Practices Guide-Plan Administration” publication is the first in a series of guides designed as a resource for state and local government administrators of defined contribution plans. Our goal is to provide you with some of the best thinking from the plans that comprise NAGDCA’s membership.

A “best” practice is by definition subjective. It is a method or technique that has consistently shown results superior to those achieved with other means, and that is used as a benchmark. Best practices are used to maintain quality. But of course what’s “best” for one plan sponsor may not be what’s “best” for all plan sponsors. In addition to being subjective it is also dynamic. Our ideas about what’s best can and will evolve over time. When applying best practice to organizations, the strategic ability to balance the unique qualities of one’s own organization with the practices that it has in common with others is important.

At NAGDCA we believe that the most valuable benefit of being a member is having the opportunity to learn from one another. Approach this guide as if you were sitting down with your peers and asking a few basic questions: How is your plan structured? How do you select your providers? Do you work with a Consultant? What do you do well? What’s working in your plan? What struggles have you encountered and how have you addressed those issues? Consider the information in this guide along with other resources you may currently rely on (experts within your organization, educational materials, consultants, providers, etc.). With access to all these valuable resources you can make well-informed decisions for your plan.

Above all, continue to reach out to other NAGDCA members to learn more. If you’re confronted with an issue that feels challenging, chances are others have encountered something similar and can share their experience. It’s the personal connections and sharing of experiences that makes our organization such a valuable resource.

**What struggles
have you en-
countered and
how have you
addressed those
issues?**

And remember – there are no trivial questions. We deal in an industry that is complex, and which continues to increase in complexity as time goes by. All of NAGDCA’s members serve important roles. Some of us are experts in certain areas and students in others. That’s what makes the administration of these plans stimulating and rewarding.

We hope this guide is a helpful tool for you and others within your organization. If you have questions that are not addressed in this guide, please reach out to NAGDCA so we can help with answering those questions. We are always here to provide help when you need it, and wish you much success in administering your program.

OVERVIEW

Defined contribution plans allow employees of an organization to save for their retirement needs in certain tax-advantaged ways. The benefit the employee receives from a defined contribution plan is based on the assets accumulated in one’s account. Defined contribution plans differ from defined benefit plans, which provide a benefit based on a specific formula set by the employer, usually including factors such as final average compensation, age at retirement and years of service at the employer.

Among governmental employers, defined contribution plans are generally supplemental to defined benefit plans. In some cases, however, employers may use the defined contribution plan as the primary retirement saving vehicle, or create “hybrid” plans incorporating elements of both defined contribution as well as defined benefit. This guide is focused on the use of defined contribution plans as supplemental plans.

PLAN ADMINISTRATION

Plan Administration is concerned with the ways we create our plans and structure the services we provide. Think of Plan Administration as if you were setting up a small business, like a bakery shop. To get your bakery started you need to create the legal structure (by determining what type of tax entity it will be, obtaining licenses and permits, etc.), identify the products you’ll be offering (cakes, pies, bread, etc.), and determine the extent to which you’ll be using internal or external resources to get things done (e.g. making your own pies versus contracting with a pie-maker).



We follow essentially the same path with our defined contribution plans. We create the plans

within the legal structures by which we are governed, decide what services will be offered, and evaluate whether we'll be doing the work ourselves or entering into contracts with experts. Later chapters of this guide will examine some of the more complex issues with plan administration in greater detail.

The “you” that creates a defined contribution plan is referred to as a “**Plan Sponsor.**” The plan sponsor is responsible for not only creating the plan but defining the rules under which the plan will operate (within the limitations imposed by law).

Now let's dive into the particulars of what is administered and how it's done.

I. Plan Set-Up: 457(b), 401(k), 403(b) and the “Plan Document”

The term “defined contribution plan” in the government sector involves learning a bit of alphabet soup from the Internal Revenue Code (IRC). We'll first take a look at what the term means broadly, and then examine how the alphabet soup works in the universe of governmental plans.

A defined contribution plan is a retirement savings program which allows employees to set aside part of their income in a tax-advantaged way. The tax advantages are broken down into two key categories:

- Pre-Tax Saving – This means you contribute income into the plan you have not paid taxes on; tax is paid later when you withdraw from your account.
- Post-Tax Saving (referred to as “Roth”) – This means you contribute after-tax income into the plan; your investment grows tax-free, and you're not taxed on your earnings when you withdraw from your account, provided you meet certain conditions.

With either approach, the tax code is providing a tax benefit to the saver. Some individuals will realize more benefits from avoiding tax today and paying it tomorrow; others will realize more benefits from paying today and avoiding it later.

Now, on to the alphabet soup. There are three primary IRC sections that are used to create governmental defined contribution plans: 401(k), 457(b), and 403(b).

“**401(k) Plans**” are the retirement plans discussed most frequently in the media. This is because they are widely used by private sector employers as either the primary or supplemental retirement programs. Some governmental plans offer 401(k) plans, but most do not because the Federal government closed the window in the 1980s for governmental plans to create new 401(k) plans; governmental entities which had established 401(k) plans prior to that date could keep them, but new plans could not be established. No such restriction exists in the private sector, where new 401(k) plans are created every day.

“**457(b) Plans**” are designed specifically for state and local government entities. Their rules are very similar to 401(k) plans but there are a few differences. Most state and local govern-

ment entities offering defined contribution plans do so under IRC Section 457(b). 457(b) plans are also available to school districts, most universities, and tax-exempt employers under IRC section 501(c).

“403(b) Plans” are designed primarily for school districts, educational institutions, and non-profits, such as healthcare providers and religious institutions.

It should be noted that some plan sponsors also use 401(a) plans as part of their plan design structure. 401(a) plans permit plan sponsors to contribute employer monies on behalf of plan participants, and are often used as part of hybrid DB/DC structures in which participants can elect to receive 401(a) plan contributions in lieu of receiving a DB plan benefit.

For most governmental agencies, decisions around plan type have already been resolved, and it's likely you are working with a program that is already established. If your entity is considering some change (for example, a school district with a 403(b) plan might be contemplating adding a 457(b) plan), then you may want to work with your entity's tax counsel and consultants as part of your assessment. You may also wish to consult with other school districts (including those who are NAGDCA members) offering both plan types to learn more about the issues involved in creating a new plan.

When considering defined contribution plans, remember that more is not necessarily better. Investing can be complex and difficult for most employees, so plan sponsors should make participation and decision making as easy as possible. Offering multiple plans, providers, and/or too many investment options can discourage participation¹. Offering multiple plan providers also increases the plan sponsor's responsibilities.

It's important to note that certain important regulatory guidelines and provisions should be considered in relation to these programs. For each Internal Revenue Code section the Treasury Department has regulations providing greater detail and explanation for how to apply the statutes. Other Federal and state laws can also come into play, including those which regulate fiduciary responsibilities and certain types of investment products. One of the most significant of these is the Federal Employee Retirement Income Security Act of 1974, or ERISA. ERISA establishes standards for retirement plans in the areas of disclosure and standards of conduct for those acting in a fiduciary capacity for plan assets. While many provisions within ERISA do not typically apply to state and local government plans, some sponsors still use the provisions as guidelines or best practices for their plans.

Plan Documents - A Plan Document is a written document that describes the Plan's terms and conditions related to the operation and administration of a Plan. Someone might ask, “If the Federal government sets the rules, why do I need a Plan Document?” First, within the

¹ [When Choice is Demotivating: Can One Desire Too Much of a Good Thing?](#) Iyengar, S. S., & Lepper, M. Journal of Personality and Social Psychology, 79, 995-1006. (2000)

broad rules that the Federal government establishes, a number of features are optional to plan sponsors (for example, allowing loans and hardship withdrawals). Second, there are certain internal processes that are unique to each plan that can be spelled out in a Plan Document (for example, your rules around payroll processing of contributions).

Plan Documents are living, evolving documents. As the law changes (and it changes often), updates will be required. Additionally, as you refine the administration of your plan, you will need to incorporate those changes into your Plan Document.

A best practice for administering your Plan Document is to review it on a regular basis (e.g. annually), to make sure the document is current. It's easy for your internal processes to evolve over time and get out of synch with your Plan Document. The Plan Document is the source document the IRS uses to ensure your plan is administered in accordance with the applicable code and the established rules. It is prudent as a plan sponsor to periodically conduct your own review to ensure consistency.

II. Plan Services

Within a defined contribution plan there are various areas of service offered to plan participants. The best practice in understanding these services is to identify them as separate and important parts of plan administration, with each having its own goals and objectives to help ensure your overall plan goals are met.



The major categories include:

- **Recordkeeping** – Recordkeeping means keeping track of participant accounts, including contributions, withdrawals, balances, transactions (e.g. fund transfers), and other activities. Most agencies will contract with an outside vendor to provide recordkeeping services. Some large government plans perform them in-house.
- **Administration** – Administrative services are often performed by the recordkeeping provider, but not always. These include items such as processing payroll files, distributions from the plan, hardship withdrawals, maintaining plan documents, compliance services, and other ministerial functions of the plan.
- **Communications** – Communications includes education and promotion of your plan. It encompasses all communication venues, including print materials, quarterly statements, a website, agents who enroll employees or provide educational seminars, a customer service line, etc. It can also include participant advisory services.
- **Investments** – Providing participant access to a broad range of diversified investment choices is a primary responsibility of Plan sponsors. This topic will be explored in detail in a separate installment addressing best practices for investments.

- **Custodian/Directed Trustee** – Responsible for the safekeeping of plan assets; complying with applicable rulings, regulations, and legislation; and acting in accordance with the provisions of custodial agreements.

A firm that the plan sponsor contracts with to provide any of the services noted above is generally referred to as a “service provider”, or “third party administrator (TPA).”

III. Bundled and Unbundled Models

Two terms you’ll often hear referred to within defined contribution plan administration are “bundled” and “unbundled.” They refer to how the major participant service categories identified in this section are administered and delivered to plan participants.

“**Bundled**” involves an arrangement where a plan sponsor contracts with a single provider to provide most or all of the major service categories: recordkeeping, administration, communications and investment management. For example, a plan sponsor might contract with XYZ Bundled Mutual Fund Company which, in addition to offering its XYZ Funds, will also provide recordkeeping and communications services. A good analogy for this is the contract you might have with a cable or phone company to provide a bundled service package for your television, telephone and Internet.



A plan sponsor can also have “bundled” services with more than one provider. This would typically not be considered a best practice because such an investment structure creates a greater likelihood for marketing bias (since providers are directly competing against one another for your participants’ investment dollars), confusion, higher fees, and more administrative costs that are ultimately passed on to participants (see Best Practice Alert, page 7).

“**Unbundled**” means that the plan sponsor is breaking apart the primary group of key services rather than allowing one provider to handle all such services. A typical example of this would involve a plan sponsor contracting with one company to provide recordkeeping and communication services, and another company to handle the selection of investment products (usually referred to as open architecture).

BEST PRACTICE ALERT – Unbundling investment services from recordkeeping and communications is generally considered a best practice for defined contribution plans as they grow in size. Why? Because unbundling offers the plan sponsor greater leverage in being able to obtain best-in-class services and more transparent pricing. In bundled arrangements, it's unlikely that you will be able to obtain a provider that is “best-in-class” for not only all of your recordkeeping/communication services but each of your investment categories as well. By separately contracting for investment and administrative/recordkeeping services plans can avoid situations in which it becomes necessary to determine if it is acceptable to maintain subpar investment or administrative services in order to maintain another element of the plan. However, unbundling can involve additional responsibilities on the part of the plan sponsor in terms of administering multiple service contracts, using consultants to assist in oversight, etc.

Nevertheless, if you presently administer a bundled plan, you may want to consider unbundling the services in your next procurement process. You can “unbundle” the plan by procuring your investment and recordkeeping/communications services separately. You can work with a consultant to help you design your procurement; additionally you can consult with other NAGDCA members who have unbundled their programs to determine how they did it and how they designed their procurement process.

Case Study –Prior to 1999 the City of Los Angeles had bundled contracts with two providers, an insurance company and a bank. Each firm provided recordkeeping for its products. Working with a consulting firm, the City issued two Requests for Proposal (RFP), one for investment management services and one for recordkeeping/communication services. For the investment management RFP, each investment category was evaluated separately. As a result, different vendors were chosen to administer the various primary asset classes (e.g. Large-Cap Stocks, International Stocks, etc.). One vendor was chosen to provide recordkeeping/communications services. As a result of that RFP, the City reduced both administrative as well as investment management fees by as much as 80%. Just as importantly, the City will not have to weigh the quality of investment management against the quality of administrative services offered to the plan.

IV. Contracted and In-House

Plan sponsors can provide services using their own technological and human resources, or they can use contracted service providers. The more typical approach is to use a mix of the two.

In general, the more technical or specialized a service, the more cost-effective it will be to use a contracted provider. But the more involved a particular service is with the unique operational environment of the plan sponsor, the more it will make sense for the plan sponsor to perform the task. Let's review some examples.

We'll first look at a situation where working with an outside vendor might make more sense. “Recordkeeping” is a function that is complex and has grown more complex over time. Among

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the many responsibilities falling into this category are tracking the different types of money that can be held within a participant's account. For example, a participant might:

- Make voluntary pre-tax deferrals into a Section 457(b) plan
- Make voluntary after-tax deferrals into a Section 457(b) designated Roth plan
- Roll-over a Traditional IRA
- Roll-over a 401(k) or 403(b) account
- Create an account through a marital separation
- Acquire an account as a beneficiary following a participant's death
- Have an outstanding loan



Each of these “money types” must be tracked separately as they have different tax implications upon withdrawal. A plan sponsor may be able to handle the programming and administrative responsibilities to manage all this, but an outside vendor in the business of administering plans for a large number of clients can typically carry out the functions more efficiently and cost-effectively.

However, there are certain functions that are dependent upon employment data that may be processed more efficiently by the Plan Sponsor. Let's consider a plan sponsor performing the function of approving distribution requests from plan participants. The approval process involves verifying termination of employment, which a service provider could do if they had access to all the proper information. But perhaps the plan sponsor utilizes an old payroll system that does not efficiently transfer employee data, requiring a more intricate, manual process to verify termination of employment. In this case, the plan sponsor might decide that it can more efficiently administer this function by using its own staff.

Evaluating the scope of services involves much more than asking, “Can we do it?” or “Can they do it?” The real question is who can provide the service most efficiently. Who should do it? Efficiency involves not just an evaluation of cost, but also speed, accuracy and qualitative factors.

V. Consultants

Consultants are often used by plan sponsors to assist with important plan functions requiring the advice or services of experts. Consultants can assist with and enhance the fiduciary oversight of your retirement plans. They work with you to establish and maintain the tools necessary for you to demonstrate an ongoing process of prudent plan management. They provide a more efficient means of accessing technical and creative expertise than would otherwise be available to a plan sponsor from its internal resources. Consultants are not necessarily required in any or all subjects. Each plan sponsor should assess the degree to which its needs can be met by its internal resources and where the plan might benefit from outside firms with



broader experience.

Key consulting service areas include the following:

Investments – Investment consultants can provide support in the procurement, review, and termination of investment managers. Investment consultants can assist with:

- Recordkeeping and investment searches
- Investment menu design
- Investment-related regulatory compliance
- Development of an Investment Policy Statement
- Analysis of potential new investment product categories
- Design of procurement processes
- Analysis of vendor responses
- Contract development (where necessary)
- Ongoing monitoring/analysis of performance, corporate viability, and fund management, including support for terminating fund managers

Plan Administration/Regulatory – Plan Administration/Regulatory consultants can provide support in the overall design of your plan and ensuring compliance with applicable laws and regulations. These consultants can assist with:



- Plan design
- Regulatory compliance
- Analysis of potential new plan services
- Design procurement processes
- Analysis of vendor responses
- Contract development (where necessary)
- Ongoing monitoring of plan administration service providers
- Peer/Industry Benchmarking
- Total Plan Cost Analysis/Full Fee Disclosure

Communications – Communications consultants can provide support in the development of communications materials used to inform and educate your plan participants. These consultants can assist with:

- Developing educational materials
- Promoting the Plan
- Creating communications objectives and strategies

Tax and Legal Counsel – Tax and legal counsel consulting can provide support in the review of specific legal or regulatory issues impacting your plan. Such counsel also enhances the fiduciary oversight of your plan. These consultants can assist with:

- Interpreting applicable law and regulation
- Producing and updating your Plan Document
- Resolving certain investment/administrative/communication issues

Auditing – Auditing firms can provide support in reviewing the financial and regulatory processes utilized in your plan. Auditors can assist with:

- Performing financial reviews of the accounting and cash management operations within the plan
- Determining the level of compliance of plan operations relative to applicable law and your Plan Document
- Determining the need for amending or adding plan services

VI. Role of Internal Revenue Service

The Internal Revenue Service can also provide support to your plan, both in qualifying your plan as being compliant with laws and regulations and in assisting you with interpretive questions arising in ongoing administration. Some issues may be addressed with the IRS informally, and others may require a more formal review (for example, by seeking a private letter ruling). Because of the costs and time involved in more formal reviews, plan sponsors should carefully evaluate whether it is wiser to address regulatory questions directly through the IRS or through services which may be available through contracted service providers, in-house counsel, or contracted tax counsel.

Neither NAGDCA, nor its employees or agents, nor members of its Executive Board, provide tax, financial, accounting or legal advice. This memorandum should not be construed as tax, financial, accounting or legal advice; it is provided solely for informational purposes. NAGDCA members, both government and industry, are urged to consult with their own attorneys and/or tax advisors about the issues addressed herein.

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