A Detailed Defined Benefit Resource Guide

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Why Defined Benefit Plans?

Defined Benefit plans (hereafter "DB" plans) plans can be a powerful tool in promoting financial security in retirement. They are a valuable option for businesses considering a retirement plan, providing benefits to employees and their employers.

Employers start a DB plan for many reasons:

- A well-designed DB plan can help attract and keep talented employees.
- Employers are entitled to a tax deduction for contributions to employees accounts.
- A DB plan benefits a mix of rank-and-file employees and owners/managers.
- The money contributed may grow through investments in stocks, bonds, mutual funds, money market funds, savings accounts, and other investment vehicles.
- Contributions and earnings generally are not taxed by the Federal Government or by most state governments until they are distributed.
- A DB plan may allow participants to take their benefits with them when they leave the company, easing administrative responsibilities.

This publication highlights some of the DB plans advantages, some of your options and responsibilities as an employer operating a DB plan, and the differences among the types of DB plans.

Establishing A DB Plan

When you establish a DB plan, you must take certain basic actions. One of your first decisions will be whether to set up the plan yourself or to consult a professional or financial institution such as a bank, mutual fund provider, or insurance company to help with establishing and maintaining the plan. In addition, there are four initial steps for setting up a DB plan:

- Adopt a written plan document,
- Arrange a trust for the plans assets,

- Develop a recordkeeping system, and
- Provide plan information to employees eligible to participate.

Adopt a written plan document

Plans begin with a written document that serves as the foundation for day-to-day plan operations. If you have hired someone to help with your plan, that person likely will provide the document. If not, consider obtaining assistance from a financial institution or retirement plan professional. In either case, you will be bound by the terms of the plan document.

Once you have decided on a DB plan, you will need to choose the type of DB plan that is best for you: A traditional DB plan, a cash balance plan, or a type of alternative DB plan.

A traditional DB plan offers a relatively large contribution as compared to many other qualified plans. Annual testing ensures that benefits for rank-and-file employees are proportional to benefits for owners/managers.

Arrange a trust for the plans assets

A plan's assets must be held in trust to assure that assets are used solely to benefit the participants and their beneficiaries. The trust must have at least one trustee to handle contributions, plan investments, and distributions. Since the financial integrity of the plan depends on the trustee, selecting a trustee is one of the most important decisions you will make in establishing a DB plan. If you set up your plan through insurance contracts, the contracts do not need to be held in trust.

Develop a recordkeeping system

An accurate recordkeeping system will track and properly attribute contributions, earnings and losses, plan investments, expenses, and benefit distributions. If a contract administrator or financial institution assists in managing the plan, that entity typically will help keep the required records. In addition, a recordkeeping system will help you, your plan administrator, or financial provider prepare the plans annual return/report that must be filed with the Federal Government.

Provide plan information to employees eligible to participate

You must notify employees who are eligible to participate in the plan about certain benefits, rights, and features. In addition, a summary plan description (SPD) must be provided to all participants. The SPD is the primary vehicle to inform participants and beneficiaries about the plan and how it operates. The SPD typically is created with the plan document. (For more information on the required contents of the SPD, see Disclosing Plan Information to Participants below.)

You also may want to provide your employees with information that discusses the advantages of your DB plan. The benefits to employees such as pretax contributions via employer contributions and compounded tax-deferred earnings help highlight the advantages of participating in the plan.

Operating A DB Plan

Once you have established a DB plan, you assume certain responsibilities in operating it. Elements of operating DB plans include:

- Participation
- Contributions
- Vesting
- Nondiscrimination
- Investing DB plan monies
- Fiduciary responsibilities
- Disclosing plan information to participants
- Reporting to government agencies
- Distributing plan benefits

Participation

Typically, a plan includes a mix of rank-and-file employees and owners/managers. However, a DB plan may exclude some employees if they:

- Have not attained age 21;
- Have not completed one year of service;

- Are covered by a collective bargaining agreement that does not provide for participation in the plan, if retirement benefits were the subject of good faith bargaining; or
- Are certain nonresident aliens.

Employees cannot be excluded from a plan merely because they are older workers.

Contributions

In all DB plans, company owners make contributions. The result: It is a business deduction as you are investing in your employee's future. The contributions are based upon a number of factors that the actuary takes into account. Typically, most contributions are completed once a year normally when taxes are due, or if extended, as late as September 15th (if a calendar year). Normally the contributions are stated as a range. One example, can be $80,000 to $120,000 while another may be $200,000 to $400,000. The range depends upon some variable like: Gender, date of hire, date of birth, and annual salary. Additionally, the rate of return and IRS announcements impact the contributions as well.

Traditional DB Plan vs Cash Balance Plan

A traditional DB plan provides for a certain dollar amount at retirement as dictated by the account value. A cash balance plan is more akin to a defined contribution plan as the participant has a stated value in the account at any one time whereas DB traditional plans have a future benefit provided. In either, a large amount is contributed versus most other retirement plans.

Nondiscrimination

To preserve the tax benefits of a DB plan, the plan must provide substantive benefits for rank-and-file employees, not just business owners and managers. These requirements are called nondiscrimination rules and compare both plan participation and contributions of rank-and-file employees to those of owners/managers.

Traditional DB plans are subject to annual testing to ensure that the amount of contributions made for rank-and-file employees is proportional to contributions made for owners and managers.

Investing DB Plan Monies

After you decide on the type of DB plan, you can consider the variety of investment options. Typically, your actuary will give you a “goal rate of return.” That goal rate is expressed as a percentage and is equal to the rate of return goal your plan is attempting to attain to meet future investment obligations. Continually monitoring the investment options ensures that your selections remain in the best interests of your plan and its participants.

Fiduciary Responsibilities

Many of the actions needed to operate a DB plan involve fiduciary decisions. This is true whether you hire someone to manage the plan for you or do some or all of the plan management yourself. Controlling the assets of the plan or using discretion in administering and managing the plan makes you or the entity you hire a plan fiduciary to the extent of that discretion or control. Hiring someone to perform fiduciary functions is itself a fiduciary act. Thus, fiduciary status is based on the functions performed for the plan, not a title.

Some decisions for a plan are business decisions, rather than fiduciary decisions. For instance, the decisions to establish a plan, to include certain features in a plan, to amend a plan, and to terminate a plan are business decisions. When making these decisions, you are acting on behalf of your business, not the plan, and therefore, you would not be a fiduciary. However, when you take steps to implement these decisions, you (or those you hire) are acting on behalf of the plan and thus, in making decisions, may be acting as fiduciaries.

Basic Responsibilities

Those persons or entities that are fiduciaries are in a position of trust with respect to the participants and beneficiaries in the plan. The fiduciary's responsibilities include:

- Acting solely in the interest of the participants and their beneficiaries;
- Acting for the exclusive purpose of providing benefits to workers participating in the plan and their beneficiaries, and defraying reasonable expenses of the plan;
- Carrying out duties with the care, skill, prudence, and diligence of a prudent person familiar with such matters;
- Following the plan documents; and

- Diversifying plan investments.

These are the responsibilities that fiduciaries need to keep in mind as they carry out their duties. The responsibility to be prudent covers a wide range of functions needed to operate a plan. Since all these functions must be carried out in the same manner as a prudent person would, it may be in your best interest to consult experts in various fields, such as investments and accounting.

For all contributions, employee and employer (if any), the plan must designate a fiduciary, typically the trustee, to make sure that contributions due to the plan are transmitted. If the plan and other documents are silent or ambiguous, the trustee generally has this responsibility. As part of following the plan documents in operating your plan, the plan document will need to be updated from time to time for changes in the law.

Limiting Liability

With these responsibilities, there is also some potential liability. However, there are actions you can take to demonstrate that you carried out your responsibilities properly as well as ways to limit your liability.

The fiduciary responsibilities cover the process used to carry out the plan functions rather than simply the end results. For example, if you or someone you hire makes the investment decisions for the plan, an investment does not have to be a winner if it was part of a prudent overall diversified investment portfolio for the plan. Since a fiduciary needs to carry out activities through a prudent process, you should document the decision making process to demonstrate the rationale behind the decision at the time it was made.

Prohibited Transactions and Exemptions

There are certain transactions that are prohibited under the law to prevent dealings with parties that have certain connections to the plan, self-dealing, or conflicts of interest that could harm the plan. However, there are a number of exceptions under the law, and additional exemptions may be granted by the U. S. Department of Labor, where protections for the plan are in place in conducting the transactions.

One exemption allows the provision of investment advice to participants who direct the investments in their accounts. This applies to the buying, selling, or holding of an investment related to the advice as well as to the receipt of related fees and other compensation by a fiduciary adviser. Please check dol.gov/ebsa for more information.

Another exemption in the law permits you to offer loans to participants through your plan. If you do, the loan program must be carried out in such a way that the plan and all other participants are protected. Thus, the decision on each loan request is treated as a plan investment and considered accordingly.

Bonding

Persons handling plan funds or other plan property generally must be covered by a fidelity bond to protect the plan against loss resulting from fraud and dishonesty by those covered by the bond.

PBGC

The Pension Benefits Guaranty Corporation (PBGC) is a US Governmental Agency that provides guarantees for DB plans and their performance. For details go to…

https://www.pbgc.gov/wr/benefits/guaranteed-benefits/your-guaranteed-pension

Disclosing Plan Information to Participants

Plan disclosure documents keep participants informed about the basics of plan operation, alert them to changes in the plans structure and operations, and provide them a chance to make decisions and take timely action about their accounts.

The summary plan description (SPD) is a basic descriptive document that is a plain-language explanation of the plan and must be comprehensive enough to apprise participants of their rights and responsibilities under the plan. It also informs participants about the plan features and what to expect of the plan.

Among other things, the SPD must include information about:

- When and how employees become eligible to participate in the DB plan;
- The contributions to the plan;
- How long it takes to become vested;
- When employees are eligible to receive their benefits;

- How to file a claim for those benefits; and
- Basic rights and responsibilities participants have under the Federal retirement law, the Employee Retirement Income Security Act (ERISA).

The SPD should include an explanation about the administrative expenses that will be paid by the plan. This document must be given to participants when they join the plan and to beneficiaries when they first receive benefits. SPDs must also be redistributed periodically during the life of the plan.

A summary of material modification (SMM) apprises participants of changes made to the plan or to the information required to be in the SPD. The SMM or an updated SPD must be automatically furnished to participants within a specified number of days after the change.

An individual benefit statement (IBS) shows the total plan benefits earned by a participant, vested benefits, the value of each investment in the account, information describing the ability to direct investments, and (for plans with participant direction) an explanation of the importance of a diversified portfolio. Plans that provide for participant-directed accounts must furnish quarterly individual benefit statements. Plans that do not provide for participant direction must furnish statements annually.

As noted above, for plans that allow participants to direct the investments in their accounts, plan and investment information, including information about fees and expenses, must be provided to participants before they can first direct investments and generally annually thereafter – with information on the fees and expenses actually paid provided at least quarterly. The initial plan-related information may be distributed as part of the SPD provided when a participant joins the plan. The information provided quarterly may be included with the IBS.

A summary annual report (SAR) is a narrative of the plans' annual return/report, the Form 5500, filed with the Federal Government. It must be furnished annually to participants.

Reporting to Government Agencies

In addition to the disclosure documents that provide information to participants, plans must also report certain information to Government entities.

Form 5500 (normally with Schedule SB) Annual Return/Report of Employee Benefit Plans

Plans are required to file an annual return/report with the Federal Government, in which information about the plan and its operation is disclosed to the IRS and the U.S. Department of Labor. Plans that must file the Form 5500 must do so electronically. These returns/reports are made available to the public.

Depending on the number and type of participants covered, most DB plans must file one of the following forms:

- Form 5500 Annual Return/Report of Employee Benefit Plan,
- Form 5500-SF Short Form Annual Return/Report of Small Employee Benefit Plan, or
- Form 5500-EZ Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan

Form 1099-R

Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. is used to report distributions (including rollovers) from a retirement plan. It is given to both the IRS and recipients of distributions from the plan during the year.

Form 8955-SSA

Form 8955-SSA Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits, is used to report separated participants with deferred vested benefits. It is filed with the IRS. The information reported is generally given to the Social Security Administration who provides the reported information to the participants when they file for Social Security benefits.

Distributing Plan Benefits

The amount of benefits in a DB plan is dependent on a participant's account balance at the time of distribution.

When participants are eligible to receive a distribution, DB plans typically provide that participants can elect to:

- Take a lump sum distribution of their account,
- Roll over their account to an IRA or another employer's retirement plan, or
- Take periodic distributions.

More employers are offering annuity or other lifetime income distribution options in their defined contribution plans for employees who want to ensure that they do not outlive their retirement savings. You may want to look into what other employers are doing.

Terminating a DB Plan

DB plans must be established with the intention of being continued indefinitely. However, business needs may require that employers terminate their DB plans. For example, you may want to establish another type of retirement plan instead of the DB plan.

Typically, the process of terminating a DB plan includes amending the plan document, distributing all assets, and filing a final Form 5500. You must also notify your employees that the plan will be discontinued. Check with your plans financial institution or a retirement plan professional to see what further action is necessary to terminate your DB plan.

Compliance

Even with the best intentions, mistakes in plan operation can still happen. The U.S. Department of Labor and IRS have correction programs to help DB plan sponsors correct plan errors, protect participants' interests, and keep the plans tax benefits. These programs are structured to encourage early correction of the errors. Having an ongoing review program makes it easier to spot and correct mistakes in plan operations.

A DB Plan Checklist (representative; not all inclusive)

Now that you are ready to get started, here are some tips and feel free to check off once complete.

- [ ] After executing, keep a copy of the executed plan document handy for reference.
- [ ] If applicable, get an EIN (by registering with the IRS) for the new Defined Benefit plan.
- [ ] Have VastSolutionsGroup.com refer to a strategic alliance entity to set up a Trust investment account. This is done by opening an account in the name of the plan (example "Acme, LLC Defined Benefit Plan") and normally will require executed plan documents. Do this typically as soon as administratively possible.
- [ ] Provide a copy of the Summary Plan Description (SPD), found in the plan document, to eligible employees.
- [ ] Make the defined benefit contribution by the time you do your taxes. Generally, if you extend your taxes, you can make your contribution as late as September 15th after the plan year ends.
- [ ] To make the contribution, have the check/wire/etc written out to the DB plan account name (again, example "Acme, LLC Defined Benefit Plan") at the investment institution, have the amount of the check/wire within the range as determined by VastSolutionsGroup.com, and have the contribution year in the memo section. A Trustee, sometimes, is able to elect which year the contribution is applied.
- [ ] Keep copies of check or wire contributions to the Trust investment account for 20 years.
- [ ] Forward them to VastSolutionsGroup.com via Admin@VastSolutionsGroup.com or similar requested means.
- [ ] In January/February of every year, you will get a Plan Sponsor Information request. It is your responsibility to fill it out and send that back to VastSolutionsGroup.com within 30 days of receipt.
- [ ] Inform your tax professional of your contribution amount, date, and year applied. VERY IMPORTANT!

For help in establishing, operating, or closing a DB plan - look to VastSolutionsGroup.com for resources, contact us at Admin@VastSolutionsGroup.com or call 888-808-8278 x 725. At times, this checklist changes due to specifics of the plan and Trustee mandates. For services outside the scope of the Letter of Engagement, VastSolutionsGroup.com may charge additional fees.

This guide was published by VastSolutionsGroup.com.

This guide is not all inclusive. All plans are not equal and some require more reporting, etc. than outlined here. Please consult with a professional.