Glossary Terms Used To Discuss Retirement Plans

At Pension Plan Specialists, we realize the retirement plan industry can be complex, with all the rules and regulations provided by the IRS and DOL. We strive to help each client have a better understanding of their plan, so they are confident in the benefit they are providing. This glossary is composed of the most frequently used terms to help you better understand the industry.

Actual Contribution Percentage (ACP) Test
In a 401(k) plan, this is the test that is performed to determine if the employer matching contribution is discriminatory in favor of the owners and other highly paid employees.

Actual Deferral Percentage (ADP) Test
In a 401(k) plan, this is the test that is performed to determine if the owners and other highly paid employees' contributions are too high in comparison to the other employees. Generally, the owners and other highly paid employees cannot have an average 401(k) deferral percentage that is 2% above all of the other employees that are eligible for the plan. In a traditional 401(k) plan, this is the test that is most often failed resulting in refunds to the owners and highly paid employees.

Bundled Plan
This is usually available through a large investment company. This type of arrangement provides that the investment company will provide all services for the plan, such as investments, administration, education, and recordkeeping. An unbundled plan provides a more independent and flexible approach to the 401(k) plan structure in which the plan sponsor can individually hire each provider separately.

Catch-up Contributions
In a 401(k) plan, an eligible employee who has attained age 50 can make higher annual contributions to the plan (an additional $6,000 for 2017).

Cross-Tested/New Comparability Plan
This type of plan allows profit sharing contributions to be allocated to different employee groups. The general rule is that the owners must be older than the staff, in order to maximize the full benefits of cross testing.

Defined Contribution Plan
These types of retirement plans are 401(k), 403(b), ESOP and Profit Sharing Plans. The employees retirement benefit will be based on how much is saved.

Defined Benefit Plan
The employer promises a specific monthly benefit upon retirement.

Discrimination Testing
All tax qualified retirement plans must be administered in compliance with numerous regulations to comply with IRS guidelines, every tax qualified retirement plan (like a 401(k)) must pass a number of compliance tests each year. These tests include the ADP Test, ACP Test, and the Top-heavy Test. The common term for these tests is called discrimination testing.

ERISA
Employee Retirement Income Security Act. ERISA, passed in 1974, is a comprehensive package dealing with all areas of pensions and employee benefits. ERISA includes requirements on pension disclosure, participation standards, vesting rules, funding, and administration.

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Fiduciary
Any person who (a) exercises any discretionary authority or discretionary control respecting management of the Plan or exercises any authority or control respecting management of disposition of its assets, (b) renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of the Plan or has any authority or responsibility to do so, or (c) has any discretionary authority or discretionary responsibility in the administration of the Plan.

401(k) Plan
A 401(k) plan is one of the most popular and cost effective types of employer sponsor retirement plans. This type of plan gives employees the opportunity to shelter income with pretax contributions and allows the employer to provide a valuable benefit as well.

403(b) Plan
A 403(b) is maintained by public school systems and certain charitable and nonprofit organizations (Section 501(c)(3)). This type of plan is very similar to a 401(k) plan, but does not require as much discrimination testing.

Highly Compensated Employee (HCE)
A Highly Compensated Employee (HCE) is an employee who received more than $120,000 (limit for 2016) in compensation during the last plan year OR is a greater than 5% owner in the company (including certain family members).

In-Service Distribution
Some plans allow employees that have not terminated employment to receive a distribution from the retirement plan. In-service distributions are very restricted by federal law and most plans.

- In-service distributions of 401(k) contributions (employee salary reduction contributions) are prohibited by law prior to age 59 1/2.
- In-service distributions of employer contributions are allowed under some circumstances prior to age 59 1/2, but most plans prohibit it.

Integration with Social Security
A plan design option in which contributions are based on Social Security benefits. Generally, Social Security provides a greater percentage benefit to lower paid employees, integration allows the company to increase contributions to higher paid employees.

Non-Elective Contribution
A type of employer contribution. This type of contribution does not require an employee to contribute to the plan (Profit Sharing).

Non-Highly Compensated Employee (NHCE)
These employees are sometimes referred to as the “rank and file”. This group does not include owners or HCEs (Highly Compensated Employees).

Participant Contributions
The money that employees contribute to their 401(k) plan.

Participant Directed Account
Allows plan participants to select their own investment options.

Plan Administrator
The employer sponsoring the retirement plan. This term is often confused with “Third Party Administrator” (TPA).

Plan Year
The calendar or fiscal year for which plan records are maintained.

Profit Sharing Plan
A retirement plan that is solely funded by employer contributions. Profit sharing plans allow employers to choose annually whether or not they want to make a contribution to the pension plan

Qualified Domestic Relations Order (QDRO)
A judgment, decree or order that creates or recognizes an alternate payee’s (such as former spouse, child, etc.) right to receive all or a portion of a participant’s retirement plan benefits.

Rollover
An employee’s retirement fund from an old employer or qualified IRA.

Roth 401(k)
A 401(k) provision feature that allows employees to make contributions on an after-tax basis. Qualified withdrawals are generally tax free if made after 5 years and after attaining age 59 1/2.

SPD
A Summary Plan Description (SPD) is a plain language version of the plan terms and must be distributed to each plan participant and to each beneficiary receiving benefits under the plan.

Top Heavy
A retirement plan that primarily benefits “key employees” is called a “top-heavy plan.” Key employees are certain owners or officers of the Employer. A plan is generally a “top-heavy plan” when more than 60% of the plan assets are attributable to key employees.

Trustee
All money that is contributed to the Plan is held in a trust fund. The Trustees are responsible for the safekeeping of the trust fund and must hold and invest Plan assets in a prudent manner and in the best interest of the participants and beneficiaries.

Vesting
Employees typically have to complete a certain number of years of service with the employer in order to retain the entire discretionary employer contributions (Profit Sharing and Employer Matching) contribution to their account. An employee usually earns a year of vested service after completing 1,000 hours of service for the employer. The plan will stipulate the required number of years to become 100% vested in the employer contributions.