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Fundamentals of Public Sector DC Plans Workshop

Sunday, September 27 at 3:00 – 4:30 pm

- **Sandy Blair**, Chief, Administrator, California Savings Plus
- **Claire Bouffard**, Of Counsel, Morgan Lewis & Bockius
- **Marcus Wu**, Partner, Morgan Lewis & Bockius



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Agenda



- Welcome and Polling
- Overview of Public Sector Retirement Plans
 - Group Activity
- Public Sector Defined Contribution Plans
 - Group Activity
- Public Sector Retirement Plan Investments and Vendor Management
 - Group Activity
- Myth vs. Reality: Public Sector DC plans
- Perspectives and Q&A

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Coming Soon: NAGDCA's Fundamentals Certificate Course

A new **self-paced online certificate course** designed for professionals working in and alongside public sector retirement plans.

What will you learn?

- Public sector retirement plan structures & plan types
- Fiduciary responsibilities & plan oversight
- Investments, distributions & plan costs
- Vendor selection & management
- Employee communication & investment education

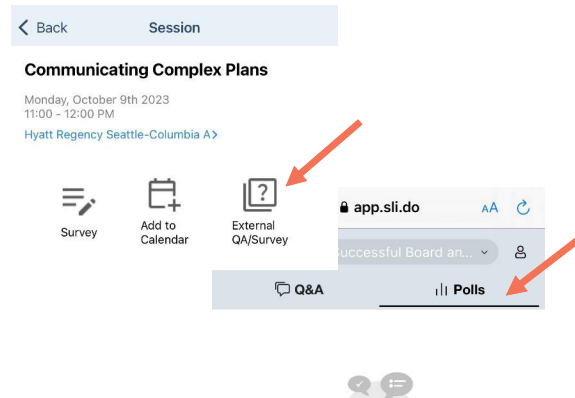
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What is your role?

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How many years have you worked with public sector DC plans?

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Which plan types are you most familiar with?

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What are you hoping to learn more about today?

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Module 1: Overview of Public Sector Retirement Plans



How public sector retirement systems are structured and the role of defined contribution plans



Defined benefit, defined contribution, and hybrid plan designs



Legal framework



Social Security considerations

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Public-Sector Retirement System Models

The question is not just which plans exist. It is what job the DC plan does.

DC plan role increases →

DB-Focused	Hybrid	DC-Focused
Pension is the primary retirement benefit • DC plan generally supplements the pension • Often includes voluntary 457(b) savings • Employer bears most retirement-income risk Example: Pension + voluntary 457(b)	Pension and DC plan are both core benefits • DC plan provides meaningful retirement income • Often includes mandatory 401(a) or 403(b) contributions • Retirement risk is shared more broadly Example: Pension + mandatory 401(a) + 457(b)	DC plan is the primary retirement benefit • Pension may be absent or secondary • Mandatory employer and/or employee contributions are common • Participant bears more investment and income risk Example: Primary 401(a) + supplemental 457(b)

Takeaway: The same DC plan can play very different roles depending on the retirement system around it.

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Legal Framework for Governmental Plans

Federal Tax Law

Plan qualification, contributions, distributions, and tax treatment. The Employee Retirement Income Security Act of 1974 (ERISA) doesn't apply to state and local governmental plans.

State Law

Constitutional, statutory, fiduciary, and public-retirement requirements. ERISA often supplies a useful benchmark for fiduciary process, documentation, and oversight.

Local Rules

Ordinances, policies, personnel rules, and collective bargaining.

Plan Documents

Plan, trust, governance, investment, and administrative documents.

Fiduciary Duties

May arise under state law, trust law, governing documents, or board authority.

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Social Security Coverage

218 Agreement. Whether an employee's wages are subject to SS taxes depends first on whether the employee's position is covered by an agreement with the Social Security Administration (SSA) mandating SS coverage for that position ("218 Agreement").

- **If position covered by 218 Agreement.** Employee's wages are subject to SS taxes.
- **If position not covered by 218 Agreement.**
 - Exempt from SS taxes. Employee's wages are exempt from SS taxes whenever *any* of the following applies:
 - Employee is an active member of the employer agency's Pension Plan;
 - Employee is a retired annuitant under the employer agency's Pension Plan; OR
 - Contributions equal to at least 7.5% of the employee's wages are allocated to one or more agency-sponsored defined contribution plans. Plans designed to provide the 7.5% (usually to PST employees) are commonly known as **FICA Replacement Plans**.
 - Subject to SS taxes. Whenever none of these exemptions applies, the employee's wages are subject to SS taxes.



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WEP and GPO Repealed

Social Security Fairness Act | Signed January 5, 2025

No WEP or GPO reduction for benefits payable for January 2024 or later.

WEP Windfall Elimination Provision

Your own benefit

Reduced retirement or disability benefits because of a pension from work not covered by Social Security.

GPO Government Pension Offset

Spousal or survivor benefits

Reduced benefits on a spouse's record because of your government pension from work not covered by Social Security.

SSA finished adjustments for identified existing beneficiaries by July 7, 2025.

Employees Check SSA notices and estimates.

Employers Continue Form SSA-1945 for new hires in noncovered positions.

Repeal changes benefits—not Social Security coverage or eligibility.

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Activity -

What makes public sector DC plans different from private sector plans?

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Module 2:
Public Sector
Defined
Contribution
Plans

-  Key features and rules for 401(a), 457(b), 403(b), and other public sector DC plans
-  Contribution and compensation limits, vesting, forfeitures, and plan administration
-  Plan investments, costs, distributions, and access to funds

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Common Plan Types

457(b) Plan

401(a) (including grandfathered 401(k) feature)

403(b) Plan

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The Savings Plus Plan

Over 260,000
Active
Participants
\$30 Billion in
Assets

Established in
1974 by
California
Government
Code

Administered
by State
employees for
State
employees
and retirees



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A CalHR Employee Benefit Program



- A voluntary defined contribution plan for State of California employees
- Traditional and Roth 401(k) and 457(b) Plans
- Managed by CalHR staff
- Flexible Investment Strategies
- Low Fees

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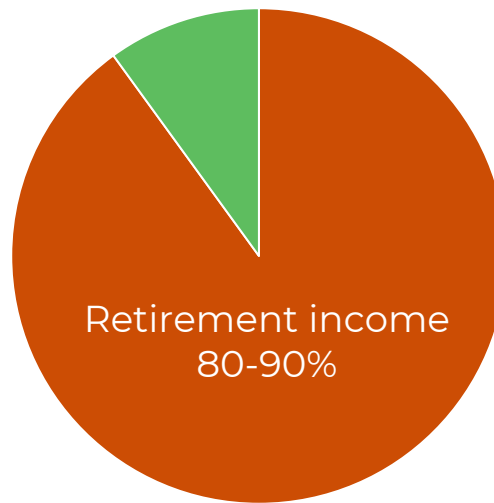
CalPERS Defined Benefit Pension

- Based on a formula
 - Years of service
 - Age at retirement
 - Compensation
- PEPPRA members have a compensation limit and a less robust retirement formula

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How much income will you need in retirement?



This percentage may be higher depending on your lifestyle

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How much can you expect?

CalPERS Defined Benefit Pension

The average state employee receives around 40%-50% of their highest average salary from pension alone
The average monthly service allowance for all retirees is \$3,543.00

Social Security if eligible

The average Social Security recipient receives \$1,864 per month
The average CA state retiree has at least three years between retirement and Social Security eligibility

Savings Plus Defined Contribution Savings

Are you already contributing?
Consider automatic increases
Consolidate other qualified savings by rolling over

Don't forget to plan for inflation!

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Federal Laws for 457(b) and 401(a) Plans

	401(a) Plan	457(b) Plan
Tax Classification	Qualified plan ("profit sharing plan" or "money purchase pension plan")	Eligible deferred compensation plan
Eligible Employer	Any public agency	Any public agency
Eligible Participants	Employees only	Employees or independent contractors
Investment of participant accounts	Employer may either (1) select investments, or (2) permit participants to direct the investment of their accounts among a menu of investment funds selected by the employer. (The latter approach is far more common.)	Same as 401(a) plan
Voluntary employee contributions permitted?	No, unless plan has grandfathered 401(k) feature (permitted only if adopted <i>before</i> May 6, 1986). One-time irrevocable deferral election before eligible for any of employer's retirement plans.	Yes

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Federal Laws for 457(b) and 401(a) Plans

	401(a) Plan	457(b) Plan
Employer contributions permitted?	Yes	Yes
Contribution limit	For each calendar year, total contributions to a participant's plan account cannot exceed lesser of: \$72,000 (the 2026 limit); or 100% of the employee's "compensation"	For each plan year year, total contributions cannot exceed lesser of applicable dollar limit or 100% of includable compensation. For 2026, \$24,500 if under age 50, \$32,500 if age 50+, \$35,750 if age 60-63. Higher limit (up to \$49,000 for 2026) may apply if eligible for special three-year catch-up.
When distributions are permitted, generally	- Severance from employment - Hardship (if plan isn't a money purchase pension plan) - Additional in-service distribution options permitted under SECURE 2.0 - Plan termination	- Severance from employment - Unforeseeable emergency - Additional in-service distribution options permitted under SECURE 2.0 - Plan termination

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Federal Laws for 457(b) and 401(a) Plans

	401(a) Plan	457(b) Plan
Minimum distributions required at applicable age (73 or 75, depending on birth year)?	Yes	Yes
Rollovers to IRAs or other eligible retirement plans (401(k), 403(b), governmental 457(b)) permitted?	Yes	Yes

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Employer Contributions: 457(b) vs 401(a) Plans

Employer Contributions	To 457(b) Plan	To 401(a) Plan
Federal Taxes (favors 401(a) plan)	Exempt from income taxes, but subject to applicable FICA taxes.	Exempt from all federal taxes. Results in combined tax savings as high as 15.3% (i.e., employer and employee each permanently save 7.65% in Social Security and Medicare taxes).
Contribution limits (favors 401(a) plan)	Subject to IRS limit on annual 457(b) contributions (for 2026, \$24,500 if under age 50, \$32,500 if age 50+, \$35,750 if age 60-63). Higher limit (up to \$49,000 for 2026) may apply if eligible for special three-year catch-up. Employer contributions reduce employees' annual 457(b) contribution limits.	Subject to IRS limit on annual 401(a) contributions (for 2026, \$72,000). Employer contributions don't reduce employees' 457(b) contribution limits.
Taxation of distributions (favors 457(b) plan)	Distributions are subject to income taxes but exempt from any early distribution penalty.	Distributions are subject to income taxes. Also subject to a 10% federal penalty tax if participant is under age 59½, unless exception applies (e.g., no penalty if participant's employment with plan sponsor ended at age 55 or older).

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Activity -

Reflection questions:

- Which plan type offers the most flexibility for participants? Why?
- Which plan type is most restrictive in terms of access or contributions?
- How might offering *multiple* plan types benefit employees?
- Which plan could be most valuable for early-retirement occupations (firefighters, police)? Explain your reasoning.

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Module 3: Public Sector Retirement Plan Investments and Vendor Management



Retirement plan decision-making and fiduciary responsibilities



Investment policies, investment options, asset allocation, and risk



Types of service providers and vendor fee structures



Selecting, monitoring, and managing vendor relationships

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Fiduciary v. Settlor Functions

- Fiduciary/settlor distinction
 - In contrast to fiduciary functions, settlor functions can be carried out in the best interests of the Plan Sponsor
 - Fiduciary expenses can be charged against plan assets; settlor expenses cannot
- Two-hat theory
 - Essential to recognize what “hat” you are wearing
 - Corporate considerations cannot enter into fiduciary decisionmaking, but they can enter into settlor decisionmaking
- Fiduciary Committee members may wear two hats
- Settlor functions
 - plan contributions
 - plan amendments
 - cost-sharing issues
 - plan termination



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What Are the Fiduciary Duties?

- The exclusive purpose rule (duty of loyalty)
- The prudence standard
- Diversification
- Following the terms of the plan



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Fiduciary Duties: Duty of Loyalty



Duty of Loyalty

- A fiduciary must discharge his or her duties with respect to a plan:
- Solely in the interest of the participants and beneficiaries
- For the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan



Duty of Loyalty

- Duty requires that the fiduciary not put the interests of the Plan Sponsor or the fiduciaries ahead of the interests of the plan and its participants

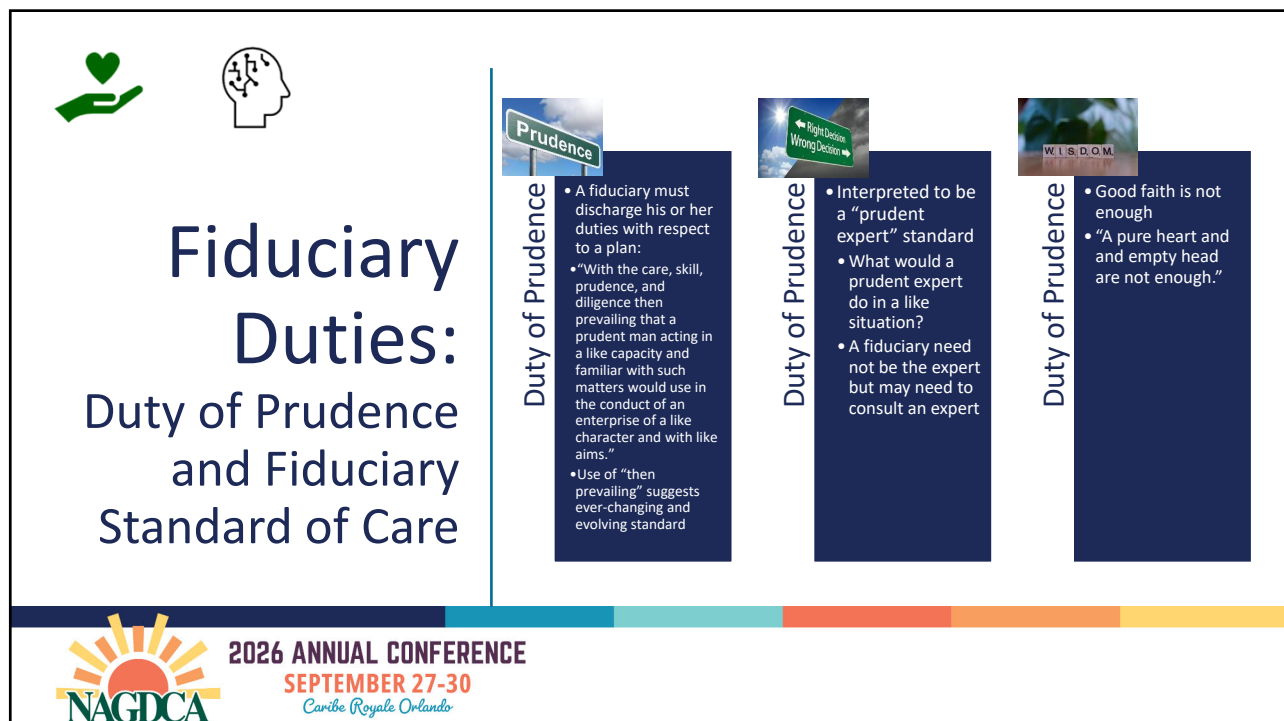


Duty of Loyalty

- Basically, a conflict-of-interest rule
- Fiduciaries cannot have conflicting loyalties when carrying out their fiduciary responsibilities

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Fiduciary Duties: Duty of Prudence and Fiduciary Standard of Care



Duty of Prudence

- A fiduciary must discharge his or her duties with respect to a plan:
- "With the care, skill, prudence, and diligence then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."
- Use of "then prevailing" suggests ever-changing and evolving standard



Duty of Prudence

- Interpreted to be a "prudent expert" standard
- What would a prudent expert do in a like situation?
- A fiduciary need not be the expert but may need to consult an expert



Duty of Prudence

- Good faith is not enough
- "A pure heart and an empty head are not enough."

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Fiduciary Duties: Duty of Prudence

- Process is paramount
 - Duty of prudence does not require a fiduciary to guarantee positive outcomes
 - Instead, fiduciary must engage in a careful and diligent process
 - Trust Law does not precisely define how to achieve procedural prudence or what specific steps or activities fiduciaries must undertake
- General considerations
 - Governance structure that facilitates procedural prudence (and adherence to that structure)
 - Decisions and process should be documented
 - Involvement of internal and/or external experts
 - Decisions and outcomes should be periodically monitored



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Effective Process: Process Is Key

- Certain practices can help build a prudent process including:
 - Document, document, document
 - Have regular meetings of fiduciary committees with documentation including:
 - Meeting “books” and agendas, followed by minutes
 - “Perennials” (e.g., fee and expense reviews, presentations by outside managers and providers, reviews of delegations, reviews of investment policy statements etc.)
 - Resolutions
 - Have and follow a written investment policy and other policies
 - Make delegations to experts, including investment advisory
 - Review delegations periodically and carefully
 - Provide initial and periodic fiduciary training



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Effective Process: Managing Service Provider Relationships

- Benchmarking/RFIs/RFPs
- Important to avoid the appearance of “auto pilot” with respect to long-time service providers
- Fiduciary not required to choose the cheapest option, but Trust Law requires a prudent process where the fiduciary identifies and evaluates available fee classes and structures
- Periodic and systematic performance and fee review; consultants can play a valuable role
- Seek to use standard agreements with investment managers and consultants as a risk management tool
 - Can also save time and money in negotiating agreements
 - Help support consistent terms across service provider relationships



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Effective Process: Negotiating Vendor Agreements

- Indemnification
- Acknowledgement of fiduciary status
- Confidentiality, data privacy and cybersecurity
- Disaster recovery
- Avoid potential fiduciary pitfalls
 - Early termination penalties
 - Discounts for company or for other plans
- Subcontractors/agents
- Where possible, negotiate templates before agreeing to a vendor
- Who should sign the agreement?



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Activity -

Scenario:
A mid-sized governmental employer wants to evaluate its DC plan program –

A government employer that participates in Social Security and has a defined benefit pension plan with an average replacement ratio of 55% and a voluntary 457(b) allowing employee contributions, the employer will match 100% up to 5%. The 457(b) participation is relatively low; recordkeeper has been in place for eight years; fees have not been benchmarked recently; investment menu has grown substantially; employees find the program confusing; and responsibility is divided among HR, Finance, and a committee without clearly documented roles.

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Activity -

Scenario Discussion questions:

- What information would you gather first?
- What plan features would you review?
- What governance questions should be asked?
- What participant outcomes would concern you?

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Myth vs. Reality: Public Sector DC Plans

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**Public Sector plans do not have
fiduciary responsibilities.**

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Participants can only contribute to one DC plan.

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Investment selection is solely the participant's responsibility.

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Fees have little impact on long-term outcomes.

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Questions / Final Thoughts

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2. NAGDCA staff will email you a discount code before the course launches.
3. Use your discount code when registering for the course.



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