KEY TERMS & DEFINITIONS

401(k) Plan

These terms and phrases are commonly used to describe investment options and plan features that one may have access to through an employer-sponsored 401(k).

Asset allocation — Describes how contributions are divided and deposited into the different investment funds selected by a participant.

Automatic enrollment — A plan feature in which eligible employees are enrolled into the plan automatically at a predetermined contribution percentage of their salary, which they can change before enrollment in the plan or after.

Beneficiary — The person or entity designated to receive any benefits provided by the plan when the participant dies.

Blackout period — A period extending more than 3 business days during which participants are not allowed to make changes to their 401(k) balances. This generally occurs during a conversion when plan assets are transferred to a new recordkeeper or when significant investment changes are being made to the plan.

Bundled plan — A type of full-service 401(k) plan which includes plan administration, recordkeeping, and professional investment management for the plan.

Catch-up contribution — An additional salary deferral contribution of up to $7,500 (for 2024) is allowed for plan participants age 50 or older by the end of the year. The catch-up contribution may be made with either pre-tax or with Roth deferrals (if permitted by the plan).

Commission — Fees paid to a financial advisor and/or third-party administrator to cover the costs of services. It is often presented as a flat annual fee, but can be based on a percentage of plan assets under management.

Compounding interest — Interest that accumulates over time, is reinvested, and then works to accumulate more interest in a repeated cycle, allowing for exponential growth.

Contributions — A payment or deposit made by an employee or employer to a qualified retirement plan. The Internal Revenue Service (IRS) defines the maximum amount participants can contribute to their 401(k) plan each year.

Deferral — The action by an employee to defer or delay receiving part of their pay, instead investing it as a contribution into a 401(k) plan. Depending on what is allowed for your plan, deferrals may be contributed on a pre-tax or Roth (after-tax) basis.

Defined contribution plan — A retirement plan which provides for an individual account for each employee, and retirement benefits are based solely on the amount contributed to the employee's account (e.g., profit sharing plans, 401(k) plans).

Diversification — When investors manage their risk tolerance by choosing investments across a variety of asset classes. Diversification is a key strategy for avoiding major losses during periods of market volatility.

Fiduciary — The person or entity who has management or investment responsibility for the plan or exercises discretionary control over the plan. An ERISA plan must have at least 1 fiduciary named in the plan document. Other fiduciaries may be appointed by the named fiduciary or become a fiduciary because of the discretionary functions they perform.

A fiduciary is held to a very high standard of behavior, is prohibited from managing the plan for any personal gain, and has the following additional responsibilities, according to the Department of Labor:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out their duties prudently;
- Following the plan documents (unless inconsistent with ERISA);
- Diversifying plan investments; and
- Paying only reasonable plan expenses.

Hardship withdrawals — A withdrawal of an employee's contributions to a 401(k) allowed when the amount requested is the exact amount needed to fund a financial hardship. Not available in all plans.

Matching contributions — Contributions made by an employer that correspond with how much is contributed by the employee. The amount is usually a certain percentage of what the employee contributes and is often capped at a specific percent of total pay.

Maximum annual employee contribution — Employees can defer 100% of compensation (up to $23,000 for 2023, plus catch-up contributions, if applicable). Employee elective contributions may be made with pre-tax salary deferrals and Roth* deferrals. Contributions of higher paid employees and owners may be limited based on nondiscrimination testing.

Model portfolios — Professionally managed investment groupings designed to meet specific risk tolerance preferences of plan participants, often gradually shifting from more aggressive investments to more conservative ones over time based around the participant's age or years until anticipated retirement.

Participant — An employee who has met the plan's eligibility age and service requirements and entered the plan on the plan's entry date. A person remains a participant until all benefits due to the participant have been distributed.

Payroll deduction — Money that is withdrawn from a participant's paycheck for plan savings or loan payments.

Plan document — The document that details the provisions of the 401(k) plan, such as participation requirements, vesting schedules, distribution options, etc.

Plan loans — If allowed by the plan document, participants may take a loan from their plan, but certain limits apply on the maximum amount of the loan and the loan period. Loans must have a reasonable rate of interest and must be repaid according to specific payment schedule. If loan payments are missed, the loan becomes taxable.

Plan recordkeeper — Responsible for keeping track of plan participant accounts and their contributions according to their investment choices. The recordkeeper also provides plan participants access to their retirement account via online services, phone, and account statements.

Plan sponsor — The employer or organization that establishes and funds a benefits offering, like a 401(k). Typically, the plan sponsor is a specific employer, labor union, or group of employers. The plan sponsor is always a fiduciary with respect to the qualified plan.

*If Roth deferrals are allowed by the plan document.

Pre-tax contributions — Traditional contributions made to a 401(k) plan, pulled from a participant's paycheck before any applicable taxes are taken. These tax-deferred contributions and any earned interest can grow tax-free until the funds are withdrawn.

Profit sharing — A discretionary employer contribution to participant 401(k) plans.

Required minimum distribution (RMD) — A specified amount of retirement savings required to be withdrawn annually, generally starting the year a plan participant reaches the applicable age.

Risk tolerance — The amount of variability in investment returns that a plan participant is willing to withstand.

Rollover contribution — A type of distribution that is transferred from an eligible retirement plan to another eligible plan. By making a qualified rollover, the plan participant can avoid paying taxes on the distribution.

Roth contributions — Contributions made to a retirement savings account with money that has already been taxed. Earned interest on Roth contributions will not be subject to income taxes when distributed as long as it has been at least 5 years since your first contribution and you are at least age 59½. Not available in all plans.

Safe harbor 401(k) — A safe harbor 401(k) plan allows the plan to automatically meet non-discrimination testing requirements. Employees benefit by receiving required employer safe harbor contributions. Highly paid employees can appreciate the fact that their own salary deferrals are no longer tied to the deferral rates of the non-highly compensated employees.

Target date funds — A professionally managed asset allocation or investment grouping designed to gradually shift from higher risk (aggressive) to lower risk (conservative) investments based on a chosen target date, often based on an anticipated retirement date.

Target risk funds — A professionally managed asset allocation designed to shift investments to continually maintain or target a designated risk level ranging from conservative to more aggressive, rather than a future date.

Third-party administrator — A provider of ongoing, comprehensive administrative services for retirement plans to help the plan sponsor remain in compliance with the complex tax laws that govern 401(k) plan operations.

Vesting — The level of ownership a participant has over their retirement funds. A vesting schedule can offer 100% immediate ownership of any employer plan contributions or give employees a certain amount of ownership over their employer contributions that grows by a specified percentage with each year of service. Employee contributions, which include elective deferrals and rollover contributions, are always 100% vested.

Withdrawals and distributions — Money saved in the retirement account that is withdrawn or taken out and paid to the plan participant.

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