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## TYPES OF RETIREMENT PLANS

The first step to understanding your retirement benefits is to find out what kind of retirement plan your employer has. There are two major types of plans: defined benefit and defined contribution. Keep in mind that your employer may have more than one type of plan, and may have different participation requirements for each.

A defined benefit plan, funded by the employer, promises you a specific monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount, such as \$100 per month at retirement. Or, more often, it may calculate your benefit through a formula that includes factors such as your salary, your age, and the number of years you worked at the company. For example, your pension benefit might be equal to 1 percent of your average salary for the last 5 years of employment times your total years of service.

A defined contribution plan, on the other hand, does not promise you a specific benefit amount at retirement. Instead, you and/or your employer contribute money to your individual account in the plan. In many cases, you are responsible for choosing how these contributions are invested, and deciding how much to contribute from your paycheck through pretax deductions. Your employer may add to your account, in some cases by matching a certain percentage of your contributions. The value of your account depends on how much is contributed and how well the investments perform. At retirement, you receive the balance in your account, reflecting the contributions, investment gains or losses, and any fees charged against your account. The 401(k) plan is a popular type of defined contribution plan, and there are three types of 401(k) plans: traditional, SIMPLE 401(k), and Safe Harbor 401(k) plans. The SIMPLE-IRA plan, SEP, employee stock ownership plan (ESOP), and profit-sharing plan are other examples of defined contribution plans.

### **Note**

1. Employers can choose whether to offer a retirement plan to employees; Federal law does not require employers to offer or to continue to offer a plan.
2. The Pension Benefit Guaranty Corporation (PBGC) guarantees payment of certain retirement benefits for participants in most private defined benefit plans if the plan is terminated without enough money to pay all of the promised benefits. The government does not guarantee benefit payments for defined contribution plans. Some hybrid plans – such as cash balance plans – contain features of both types of plans described above.

### **Employee Action Item**

Ask your plan administrator, human resources office or employer for information on what type of plan or plans you have at work. You can ask for a copy of the Summary Plan Description (the retirement plan booklet that you should receive when you enroll in the plan) and review the information about the plan.

**Table 1. Characteristics Of Defined Benefit And Defined Contribution Plans**

	Defined Benefit Plan	Defined Contribution Plan
<b>Employer Contributions and/or Matching Contributions</b>	Employer funded. Federal rules set amounts that employers must contribute to plans in an effort to ensure that plans have enough money to pay benefits when due. There are penalties for failing to meet these requirements.	There is no requirement that the employer contribute, except in the SIMPLE 401(k) and Safe Harbor 401(k)s, money purchase plans, SIMPLE IRA and SEP plans. The employer may choose to match a portion of the employee's contributions or to contribute without employee contributions. In some plans, employer contributions may be in the form of employer stock.
<b>Employee Contributions</b>	Generally, employees do not contribute to these plans.	Many plans require the employee to contribute in order for an account to be established.
<b>Managing the Investment</b>	Plan officials manage the investment and the employer is responsible for ensuring that the amount it has put in the plan plus investment earnings will be enough to pay the promised benefit.	The employee often is responsible for managing the investment of his or her account, choosing from investment options offered by the plan. In some plans, plan officials are responsible for investing all the plan's assets.
<b>Amount of Benefits Paid Upon Retirement</b>	A promised benefit is based on a formula in the plan, often using a combination of the employee's age, years worked for the employer, and/or salary.	The benefit depends on contributions made by the employee and/or the employer, performance of the account's investments, and fees charged to the account.
<b>Type of Retirement Benefit Payments</b>	Traditionally, these plans pay the retiree monthly annuity payments that continue for life. Plans may offer other payment options.	The retiree may transfer the account balance into an individual retirement account (IRA) from which the retiree withdraws money, or may receive it as a lump sum payment. Some plans also offer monthly payments through an annuity.
<b>Guarantee of Benefits</b>	The Federal government, through the Pension Benefit Guaranty Corporation (PBGC), guarantees some amount of benefits.	No Federal guarantee of benefits.
<b>Leaving the Company Before Retirement Age</b>	If an employee leaves after vesting in a benefit but before the plan's retirement age, the benefit generally stays with the plan until the employee files a claim for it at retirement. Some defined benefit plans offer early retirement options.	The employee may transfer the account balance to an individual retirement account (IRA) or, in some cases, another employer plan, where it can continue to grow based on investment earnings. The employee also may take the balance out of the plan, but will owe taxes and possibly penalties, thus reducing retirement income. Plans may cash out small accounts.

*Adapted in part from the Department of Labor's publication What You Should Know About Your Retirement Plan.*