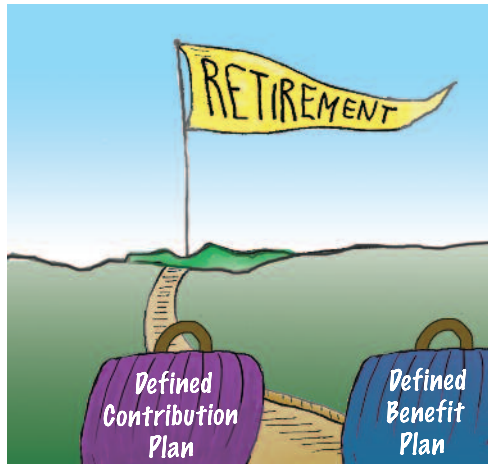
# Employer Retirement Plans: Two Basic Types

There are two basic types of retirement plans typically offered by employers – *defined benefit plans* and *defined contribution plans.*




## Defined Benefit Plans

In a defined benefit plan, the employer establishes and maintains a pension that provides a benefit to plan participants (employees) at retirement.

- Employers are responsible for making contributions to the plan and ensuring there is enough in the plan to pay the benefits when the employee retires. Some plans also provide for participants to contribute.
- At retirement, the participant gets a monthly benefit, usually based on age at retirement, rate of pay, and number of years the participant worked under the plan. The benefit would also factor in whether there is a spouse who may be entitled to survivor benefits.
- Most defined benefit plans are insured by the federal government.

### *How do I become a participant of the pension plan at my job?*

- Ask your employer or the human resource manager if there is a pension plan. If there is a plan, ask how you would become a participant. Often the employer has to work a set number of years to eligible for the pension plan (see below).
- Under the law, the employer can decide which categories of employees are covered by the pension. Employees working part-time or as independent contractors are not likely to be covered.

### *How many years do I need to work to be entitled to pension benefits?*

- Under many defined benefit pension plans, you will be entitled to receive benefits at retirement after you are a participant for 5 years. This is called vesting.
- Some pensions provide for gradual vesting beginning when an employee has been a participant for 3 years and ending with full vesting at the 7 year mark.
- You are always vested in contributions you make to the pension from your salary.
- If you leave before you are vested, you will likely forfeit the benefit unless you return to the job within 5 years. Check with your plan and make sure you know the rules.

*continued*





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### *What is Social Security integration?*

Some defined benefit pensions factor in employees' Social Security in the pension benefit formula. This results in a smaller pension amount.

## Defined Contribution Plans

In a defined contribution plan, the employee contributes a portion of a participant's salary to a retirement plan that the employer sets up.

- The benefit at retirement depends on how much is in the participant's account.
- Sometimes the employer matches part or all of the employee's contribution.
- The most common defined contribution plan is a 401(k) plan.

### *What is a 401(k) or 403(b)?*

A 401(k) is a defined contribution retirement plan maintained by the employer. You contribute a portion of your salary to the plan and the employer may match your contributions. A 403(b) plan operates like a 401(k) and is used by tax-exempt organizations.

- The contributions go into your individual account.
- The money you contribute is taken from your paycheck before taxes.
- You decide how to invest the contributions using the choices that the plan provides.
- You pay taxes during retirement as you receive benefits.
- There is an early withdrawal tax penalty of 10% if benefits are taken out before age $59\frac{1}{2}$.
- Check to see what the rules are for vesting in any employer contributions. You are always vested in the contributions you make from your salary.
- A 401(k) plan is "portable," meaning that when you leave a job you often can roll the amount you contributed, any employer contributions that are vested, plus earnings into another qualified or individual retirement account (IRA). Check with the plan to see what the rules are for doing this, including whether it makes sense to leave the money in the 401(k).

### *Disadvantages of 401(k)s:*

- The employee has the responsibility to decide whether and how much to contribute to the plan under the plan rules.
- The employer's plan offers a variety of investment choices and the employee has the responsibility to decide which investments to choose.
- The amount in the 401(k) account at retirement depends on the amount participants have been able to contribute, the investment returns, minus plan fees, expenses, and investment losses.
- Some people cannot afford to participate or to contribute enough to retire with adequate income.

### *Resources*

Pension Rights Center
1-888-420-6550
**www.pensionrights.org**

The *Pension Rights Center* also offers free information and legal assistance through Pension Help, **www.pensionhelp.org**.