Retirement Plan Terms You Should Know

NATIONAL Employee Benefits Day April 2 www.ifebp.org

Pension plans provided through your work are an important component of retirement income. There are two basic types of plans, defined benefit and defined contribution.

Defined benefit (DB) plans, sometimes called traditional pension plans, provide retirees with a guaranteed monthly payment based on a formula. With this type of plan, the benefit you receive when you retire is likely to depend on how long you've worked and your wages. Your employer contributes money to the plan based on calculations.

Defined contribution (DC) plans make use of individual accounts with the value based on both contributions and investment earnings. Both you and your employer may contribute money to your personal account. When you retire, you aren't guaranteed a certain amount of money. Your benefits are tied to the amount of money in your account. Examples of DC plans in the U.S. include 401(k) plans, 403(b) plans, 457 plans, money purchase plans and profit-sharing plans. In Canada, DC plans are also referred to as capital accumulation plans, and include profit-sharing plans, money purchase plans and group-registered retirement savings plans.

Here are some key retirement plan terms you should know.

While you're working:

Automatic Enrollment: In order to increase participation, your employer may automatically add new workers to the retirement plan, who then have a percentage of their wages contributed into the plan. Workers are able to opt out of this arrangement.

Matching Contribution: When you put money into your retirement account, your employer may match this amount. Your employer may contribute this money to your account to encourage and reward your participation in the plan, and to help you save more money for retirement. With a matching contribution, your employer's amount is typically a percentage of what you set aside, up to a set maximum. For example, your employer may contribute 50 cents for every dollar you save, up to 6% of your salary. Experts advise you to take advantage of any matching contribution offered, and liken it to "leaving money on the table" if you do not.

Pretax Contribution: Depending on the type of plan, you likely are able to transfer part of your wages to your retirement account before income taxes are paid on the amount. See also *tax deferred*.

Rollover: When you change jobs, you're given the option to roll over the money in your DC retirement account to another plan. If you roll the money directly from one plan to another, you'll incur no taxes or penalties. With an indirect rollover, you receive the money first, then deposit it to another plan. This type of rollover may incur taxes and penalties if not handled within a specific time period. In Canada, rollovers are called *transfers*.

Tax Deferred: Income that is not taxed until a later date. For example, the money you set aside in your retirement account, and the investment earnings on that money, are not taxable until you receive them as retirement benefit payments.

Transfer: See Rollover.

Vesting: After a certain amount of time participating in a retirement plan, you'll obtain nonforfeitable rights to benefits from the plan. Typically, the amount of time is tied to how long you've worked at your job. Once you're vested, your benefits can't be taken away from you.

When you're ready to retire:

Phased Retirement: Your employer may offer this formal or informal arrangement, through which you can transition from full-time work to full-time retirement. The transition may involve part-time or temporary work, extended leaves of absence and/or a special retirement plan option that allows you to keep working while drawing pension benefits.

Retirement Income: Payments from retirement plans and other sources to which you, as a retiree, are entitled. These sources may include pension payments from your work-related plan(s), government benefits, and income from your personal savings and investments. Benefits and payments from your work-related plan(s) are called distributions, and can take two forms:

- ***Annuities*** provide income with payouts starting at retirement. By giving an insurance company a lump sum of money or by paying them regular premium amounts, you or your employer can set up an arrangement where the insurance company will pay you a steady amount of money at regular intervals (e.g., monthly) over time.
- ***A lump sum distribution*** is a one-time payment, made when you retire, for the entire amount of your retirement account balance.

Definitions developed by International Foundation staff using *Benefits and Compensation Glossary*, 12th edition (International Foundation) and government resources.

MK140171

PDF/214