

### 3.1: Employer-Sponsored Retirement Plans



Image: [Pension](#). EpicTop10.com via Flickr

## Introduction to Employer-Sponsored Retirement Plans

## What is a retirement plan?

- a retirement plan allows you to invest now in order to have financial security for you and your family in the future when you are ready to stop working
- first private sector plan was offered in 1875 by the American Express Company

## Why would an employer offer one?

- retirement plans are part of a competitive total compensation package in today's market
- can attract quality candidates and keep high performing employees which reduces new employee training costs

## Types of Retirement Plans



## Defined Benefit Plans

- **Promises a specified 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 commonly, it may calculate a benefit through a plan **formula** that considers such factors as **salary** and **service** - for example, 1 percent of average salary for the last 5 years of employment for every year of service with an employer. The benefits in most traditional defined benefit plans are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation (PBGC)

## Defined Contribution Plans

- **Does not promise a specific amount of benefits at retirement.**
  - In these plans, the employee or the employer (or both) contribute to the employee's individual account under the plan, sometimes at a set rate, such as 5 percent of earnings annually. These contributions generally are invested on the employee's behalf. The employee will ultimately receive the balance in their account, which is based on contributions plus or minus investment gains or losses. The value of the account will fluctuate due to the changes in the value of the investments. Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans.

## Qualified Plans

- A qualified plan must satisfy the Internal Revenue Code in both form and operation. That means that the provisions in the plan document must satisfy the requirements of the Code and that those plan provisions must be followed.
- [A Guide to Common Qualified Plans](#) (IRS.gov) lists 21 plan requirements to help employers in implementing practices, procedures and internal controls to monitor plan operations.

### Non-Qualified Plans

- NOT subject to ERISA rules and are often only used for high-ranking executives
- funded with post-tax dollars
- arrangement between employer and employee to receive payment in the future in order to defer income taxes on their earnings

### Additional Terms



### Vesting

- “vesting” in a retirement plan means ownership.
  - each employee will vest, or own, a certain percentage of their account in the plan each year.
  - an employee who is 100% vested in his or her account balance owns 100% of it and the employer cannot forfeit, or take it back, for any reason
- amounts that are **not vested** may be forfeited by employees when they are paid their account balance
  - when the employee terminates employment
  - when they don’t work more than 500 hours in a year for five years
- an employee’s own contributions are always 100% vested, meaning the only money at risk is the employer’s contribution
- **cliff vesting** occurs when an employee becomes fully vested in an employer-sponsored savings plan on a specified date rather than becoming partially vested over an extended period
  - more about **cliff vesting** at [Investopedia.com](https://www.investopedia.com)

### Non-discrimination Rules and Testing

- non-discrimination testing rules were created by the IRS and are generally designed to prevent plans from discriminating in favor of individuals who are either highly compensated or otherwise key to the business.
- a nondiscrimination rule states that all employees of a company are able to receive the same benefits, regardless of their position within the company.

### Safe Harbors

- a safe harbor 401(k) plan is a simpler 401(k) that is exempt from many of the tax rules and compliance requirements of traditional 401(k) plans

### Fiduciary

- [fiduciaries](#) are persons or organizations that act on behalf of others and are required to put the clients’ interests ahead of their own, with a duty to preserve good faith and trust
- fiduciaries are legally and ethically bound to act in the other’s best interests
- fiduciaries may be personally responsible to restore losses to the plan or restore profits made through improper use of plan assets

### Automatic Enrollment

- automatic enrollment allows an employer to automatically deduct from an employee’s wages unless the employee makes an election not to contribute or to contribute a different amount.
  - any plan that allows elective salary deferrals (such as a 401(k) or SIMPLE IRA plan) may have this feature
- an employer must give notice before any deferrals are withheld from wages to allow none withheld or to have a different amount withheld.
  - employees have the option to withdraw their money within 90 days of the date the first automatic contribution was made, depending on the plan

**Note:** A PowerPoint is attached below for download.

3.1: Employer-Sponsored Retirement Plans is shared under a [CC BY 4.0](#) license and was authored, remixed, and/or curated by Mabel Gehrett and Western Technical College.