

PENSION PLANS: DEFINED BENEFIT VERSUS DEFINED CONTRIBUTION

Traditional **Defined Benefit** plans provide workers with guaranteed lifetime annuities that begin at retirement and promise benefits that are typically expressed as a multiple of years of service and earnings received near the end of one's career (for example, 1 percent of average salary received during the final 3 years on the job, multiplied by the number of years of service). Plan participants cannot collect benefits until reaching the plan's retirement age, which varies among employers. Some plans allow workers to collect reduced benefits at specified early retirement ages. Defined Benefit plans are all but extinct in the private sector. Historically, defined benefit pension plans in the public sector required no contribution on the part of the employee. Recently, some public organizations (governments, school districts, etc.) have instituted 'tiers' of employment with the most recent requiring a level of employee contribution to the pension plan; some for a specific duration of time and others with no time period cap. Although usually invested in the marketplace, these funds are normally guaranteed (by the taxpayers) not only against any loss, but are usually also guaranteed a return percentage deemed necessary to support the total of all defined benefits projected to be paid out. These payouts also are normally increased by an inflation factor annually. If the normal investment return does not meet this 'required' return on investment, taxpayers make up the difference.

In **Defined Contribution** plans—which include 401(k), 403(b) and 457 plans—employers, employees, or both employers and employees make tax-deferred contributions to a retirement account in the employee's name. The employer contribution amount can be set either as a particular share of salary [normally a % of what the employee contributes which then mandates that the employee does, in fact, contribute] or a given dollar amount [a rare occurrence]. Employee annual pre-tax contributions from their pay are limited by the IRS in 2015 and 2016 to \$18K (= <49) and \$24k (=>50). For example, if an employer contributes 10% and the employee puts \$10,000 of their pretax earnings into the 401(k), the employer contributes \$1000 to the employee's personal pension fund. This fund is usually invested in stocks and bonds and enjoys the gains and suffers the losses of the financial marketplace.