



STUDENT ADVOCATES FOR FINANCIAL EDUCATION

RETIREMENT ACCOUNTS

When evaluating a potential job, it is imperative to analyze the retirement benefits plan. This package will be critical in ensuring financial security during years of retirement.

Some initial criteria that need to be understood before specific details can be assessed are:

- When an employee is eligible to participate and whether the plan is mandatory or an option.
- Whether the plan is **Defined-Benefit**, **Defined-Contribution** or **Cash-Balance**.



3 MAJOR TYPES OF EMPLOYER-SPONSORED RETIREMENT PLANS

Defined-Benefit Plan

Also known as a pension, this plan promises an exact amount to an employee at the time of retirement. The quantity is calculated using a complex formula that considers average salary over the past few years, years of service, and a percentage. The benefit might be 2% of average salary for the last 5 years for every year of service. Employees do not contribute to these funds. The responsibility rests with the employer to ensure adequate funding is set aside each year for the employee's retirement. The amount received per month at retirement can vary due to age of retirement and disability and/or survivor benefits.

The Defined-Benefit Plan is currently used by less than one-fourth of employers due to the fact that other employer-sponsored retirement plans offered are less expensive.

Defined-Contribution Plan

Contributions to the retirement plan can be made by the employee only, the employer only, or both. Although, the responsibility for managing the plan falls on the employee. The amount received at retirement will be contingent upon how the funds have been managed, the amount in the account is unknown until retirement. Employees contribute a specific percentage of gross earnings to the plan each year, and the employer also makes a specified annual contribution. Employers have many options for matching employee contributions. **Matching can be made in the following ways:**

- Based on a company's annual profit.
- Only a percentage of each dollar employees contribute.
- Using company stock instead of cash.
- On a dollar for dollar basis.

***On average, employers match employee contributions up to 3% of compensation; a 6% match is generous.

Cash-Balance Plan



Basically a defined-benefit plan, the amount that will be in the interest-earning account can be calculated. The funds contributed are 100% from the employer; therefore, the risk rests on the employer. Contributions are a percentage of the employee's salary every payday. The account also accrues interest over the years at a fixed or possibly a variable rate. So, an employee can calculate how much money will be in the account in 25 years, for example. This hybrid retirement account is growing in popularity and many large companies are shifting to cash-balance plans because they are less costly to offer.

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COMMON TYPES OF DEFINED-CONTRIBUTION PLANS

- **401(k) Plans:** Employees of private corporations
- **403(b) Plans:** Employees of nonprofit organizations
- **457 Plans:** Employees of state or local governments and nonprofit organizations
- **SIMPLE IRA:** Savings Incentive Match Plan for Employees IRA—Employees of organizations with 100 or fewer employees.

There are many additional employer-sponsored supplemental savings plans to employees. Some examples are: Employee Stock-Ownership Plan, Profit-Sharing Plan, Money-Purchase Plan, Thrift and Savings Plan, and Deferred-Compensation Plan.



INDIVIDUAL RETIREMENT ACCOUNTS

It is a great idea to take advantage of personal tax-sheltered retirement accounts. IRAs can be used to augment employer-sponsored retirement plans. Currently, the maximum contribution to an IRA is \$5000 and an additional \$1000 for people over the age of 50.

Traditional IRAs offer tax-deferred growth, which means taxes are paid when the money is taken out. After retirement, sometimes, you are put into a lower tax bracket, which is beneficial to those who are in a high tax bracket while making contributions.

It is also possible for the contributions to be tax-deductible if you qualify, which depends on earnings and you or your spouse are eligible to participate in an employer-sponsored retirement plan.

Roth IRAs are tax-sheltered accounts that grow tax-free and penalty free as long as it is not withdrawn early. Roth IRAs are advantageous to those in lower tax brackets because contributions are then taxed at a lower rate.

Simplified Employee Pension—Individual Retirement Account (SEP-IRA) are plans established by employers for self-employed individuals or for small businesses. Contributions by the employer are tax-deductible and tax-deferred for the employee. The contributions are made to a Traditional IRA set up by the employee. The minimum contribution is \$500 and the maximum is \$46,000.

RETIREMENT PLANNING



It is important to begin saving for retirement early because of the time value of money. Regular deposits into work and personal retirement accounts will improve overall performance due to compounding interest and/or gains. It is critical that BOTH spouses/partners fully fund their respective retirement accounts. In today's economy, women as well as men need to provide for their own retirement. It is also important to review your retirement plan on a regular basis. Retirement requirements may change over time.

To calculate your retirement needs, go to:

<http://cgi.money.cnn.com/tools/retirementplanner/retirementplanner.jsp>

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