Power Over Life
Life Skills That Put YOU in Control

Retirement Basics 101 – Types of Retirement Plans

I want to focus on sharing the basics of the four most common retirement plan options: 401(k) Plans, IRA Plans, and two different Pension Plans (Defined Contribution and Defined Benefit).

1. 401(k) Plans

Summary: 401(k) plans are employer-sponsored retirement saving plans. These plans allow you, as an employee, to contribute a portion of your paycheck into an investment account. You typically have the freedom to pick from an array of investment options that your plan sponsor has chosen to include in the plan.

Most plans have two 401(k) contribution options: Traditional 401(k) plan and Roth 401(k) plan.

- Traditional
    - Contributions are **pre-tax**, which lowers your taxable income in the year that you make a contribution.
    - You will pay taxes when you withdraw money from the plan during retirement.
    - If you anticipate being in a lower tax bracket in retirement, then this option allows you to save on the amount of taxes you will pay overall.
- Roth
    - Your contributions are **after-tax.**
    - You can withdraw money from the plan during retirement without paying taxes.
    - If you anticipate being in a higher tax bracket at retirement, then this option allows you to have a tax free retirement.

Key Points to Remember:

- These plans are the most widespread private-sector employer-sponsored plans in the U.S.
- Many employers make a match contribution based on the amount you make, or the amount you contributed.
- The government allows higher contribution limits than with an IRA.
- There will be higher fees, due to higher administrative responsibilities.
- There are penalties for early withdrawals.

2. Individual Retirement Accounts (IRAs)

Summary: IRAs, or Individual Retirement Accounts, are designed to do two things:

1. Become a retirement vehicle for those who don't have access to an employer-sponsored retirement plan.
2. Play a complementary role to employer-sponsored plans and to help preserve rollover assets at job changes or when you retire.

Just like 401(k) plans, IRA's offer a pre-tax (Traditional) or after-tax (Roth) plan options. You can contribute to both a 401(k) plan and IRA, but talk to an adviser about making the most of that situation. You have increased control over the types of investments that you can invest your money in; however, the majority invests in mutual funds.

Key Points to Remember:

- These plans are relatively inexpensive and simple to start.
- Some employers will match your contribution, but it's not likely.
- The government allows lower contribution limits than with a 401(k) plan.
- Depending on your tax bracket, your contributions may be claimed as tax deductions.
- There are penalties for early withdrawals.

3. Defined Contribution Pension Plan (DC Plan)

Summary: DC Pension plans are a different type of employer-sponsored retirement savings plan. Pension plans, by definition, are plans that require an employer to make contributions on behalf of their employees into a pool of funds that is set aside for the future benefit of its' employees.

A DC Plan is based on a **defined contribution** that is paid into the plan on your behalf each year. **This is a specific dollar amount**. That amount, plus investment growth, equals the amount you get out of the plan.

Key Points to Remember:

- Pension plans are becoming less common.
- Safer financially for the **employer** (not based on present/future obligations).
- Employer contributions are easily calculated and don't rise and fall with performance.
- Employees bear the risk of investment performance.
- Some plans have a voluntary employee contribution component, or even an employer match.
- Each plan is designed differently.

4. Defined Benefit Pension Plan (DB Plan)

Summary: This is often referred to as a "traditional" pension plan. This plan provides a **specific level of benefits**, depending on the years of service you provide for your company. For example, if you work for 30 years with your company, they will provide you with $2,000 a month until you die. That is a specific level of benefit.

Key Points to Remember:

- Provides a steady benefit after you retire.
- Not as safe financially for employers (contributions are based on present/future obligations, making the amount change year to year).
- Long-term employees are rewarded heavily.
- Employers direct the investments, not employees.