FINANCIAL WELLNESS

EARNING RETIREMENT BENEFITS

Once you have learned what type of retirement plan your employer offers, you need to find out when you can participate in the plan and begin to earn benefits. Plan rules can vary as long as they meet the requirements under federal law—check with your plan administrator or review the plan booklet (called the Summary Plan Description) to learn your plan's rules and requirements. There are several different types of retirement plans outlined by the IRS, each with a specific set of rules and subject to additional customization by employers or the account holder. The following article answers general questions about common retirement benefit plans, how retirement benefits are earned and stored, and when they can be redeemed.

Who can participate in your employer's retirement plan?

Federal law allows employers to include certain groups of employees and exclude others from a retirement plan. For example, your employer may sponsor one plan for salaried employees and another for union employees. Part-time employees may be eligible if they work at least 1,000 hours per year, which is about 20 hours per week. Find out whether you are in the group of employees covered by your employer's retirement plan.

When can your participation begin?

Once you know you are covered, you need to find out when you can begin to participate in the plan. You can find this information in your plan's Summary Plan Description. Generally, a plan may require an employee to be at least 21 years old and to have one year of service with the company before being able to participate in a plan. However, plans may allow employees to begin participation before reaching age 21 or before completing one year of service. For administrative reasons, your participation may be delayed up to six months after you meet these age and service criteria, or until the start of the next plan year, whichever is sooner. The plan year is either the calendar year or an alternative 12-month period that a retirement plan uses for plan administration.

Employers may require additional years of service in some circumstances. For example, if your plan allows you to contribute immediately upon participating in the plan, it may require that you work for the company for two years before you may participate in the plan.

Federal law also imposes other participation rules for certain circumstances. For example, if you were an older worker when you were hired, you cannot be excluded from participating in the plan just because you are close to retirement age.

Some 401(k) plans and SIMPLE IRA plans enroll employees automatically. This means that you will automatically become a participant in the plan unless you choose to opt out. The plan will deduct a set contribution level from your paycheck and put it into a predetermined investment. If your employer has an automatic enrollment plan, you should receive a notice describing the automatic contribution process, when your participation begins, your opportunity to opt out of the plan or change your contribution level, and where your automatic contributions are invested. If you are in a 401(k), the notice will also describe your right to change investments, or, if you are in a SIMPLE IRA plan, your right to change the financial institution where your contributions are invested.

When do you begin to accumulate benefits?

Once you begin to participate in a retirement plan, you need to understand how you accrue, or earn, benefits. Your accrued benefit is the amount of money that you have accumulated or funds that have been allocated to you under the plan at any particular point in time.

Defined benefit plans often count your years of service in order to determine whether you have earned a benefit and also to calculate how much you will receive in benefits at retirement. Employees in the plan who work part time, but who work 1,000 hours or more each year, must be credited with a portion of the benefit in proportion to what they would have earned if they were employed full time. In a defined contribution plan, your benefit accrual is the amount of contributions and earnings that have accumulated in your 401(k) or other retirement plan account, minus any fees charged to your account by your plan.

Special rules for when you begin to accumulate benefits may apply to certain types of retirement plans. For example, in a Simplified Employee Pension Plan (SEP), all participants who earn at least $600 a year from their employers are entitled to receive a contribution.

Can a plan reduce promised benefits?

Defined benefit plans may change the rate at which you earn future benefits, but they cannot reduce the amount of benefits you have already accumulated. For example, a plan that accrues benefits at the rate of $5 a month may be amended to provide that benefits will be credited at a rate of $4 per month in future years. Plans that make a significant reduction in the rate at which benefits accumulate must provide you with written notice generally at least 45 days before the change goes into effect.

Also, in most situations, if a company terminates a defined benefit plan that does not have enough funding to pay all of the promised benefits, the Pension Benefit Guaranty Corporation (PBGC) will pay plan participants and beneficiaries some retirement benefits, but possibly less than the level of benefits promised.

In a defined contribution plan, the employer may change the amount of employer contributions in the future. Depending on the plan terms, the employer may also be able to stop making contributions for a few years or indefinitely.

Your employer may terminate a defined benefit or a defined contribution plan, but may not reduce the benefit you have already accrued in the plan.

How soon do you have a right to your accumulated benefits?

For any contributions that you make, you immediately have the right to keep them and any earnings on them without the risk of forfeiting them (that is, you are “vested” in your contributions), though there are restrictions for when you can use these benefits.

However, you do not necessarily have an immediate right to any contributions made by your employer. Federal law provides a maximum number of years a company may require employees to work to earn the right to all or some of these benefits. This timeframe is known as a vesting schedule.

In a defined benefit plan, an employer can require that employees have five years of service in order to become 100 percent vested in the employer-funded benefits (called cliff vesting). Employers can also choose a graduated vesting schedule, which requires an employee to work seven years in order to be 100 percent vested, but provides at least 20 percent vesting after three years of service, 40 percent after four years, 60 percent after five years and 80 percent after six years. Plans may provide a different schedule as long as it is more generous than these vesting schedules.

The exception to this rule is cash balance plans. A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance. Unlike most defined benefit plans, in a cash balance plan, employees vest in employer contributions after three years.

In a defined contribution plan, such as a 401(k) plan, you are always 100 percent vested in your own contributions to a plan, and in any subsequent earnings from your contributions. However, in most defined contribution plans you may have to work several years before you are vested in the employer’s matching contributions. (There are exceptions, such as the SIMPLE 401(k) and safe harbor 401(k), in which you are immediately vested in all required employer contributions. You also vest immediately in the SIMPLE IRA and the SEP.)

Currently, employers have a choice of two different vesting schedules for employer-matching 401(k) contributions. Your employer may use a schedule in which employees are 100 percent vested in employer contributions after three years of service (cliff vesting). Under graduated vesting, an employee must be at least 20 percent vested after two years, 40 percent after three years, 60 percent after four years, 80 percent after five years, and 100 percent after six years. If your automatic enrollment 401(k) plan requires employer contributions, you vest in those contributions after two years. Automatic enrollment 401(k) plans with optional matching

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contributions follow one of the vesting schedules noted above.

You may lose some of the employer-provided benefits you have earned if you leave your job before you have worked long enough to be vested. However, once vested, you have the right to receive the vested portion of your benefits even if you leave your job before retirement. But even though you have the right to certain benefits, after you leave your job, your defined contribution plan account value could decrease as a result of investment performance.

What if you leave your company and come back later?

If you leave your company and return, you may be able to count your earlier period of employment towards the years of service needed for vesting in the employer-provided benefits. Unless your break in service with the company was five years or a time equal to the length of your pre-break employment, whichever is greater, you likely can count the time prior to your break. Because these rules are very specific, you should read your plan document carefully if you are contemplating a short-term break from your employer, and then discuss it with your plan administrator.

Vesting Rules

Generally, an employer must count your years of service for vesting credit starting with your date of employment. Two exceptions provide that your employer may start counting your years of service with the first plan year following (1) your 18th birthday if you were under 18 years of age when you started working there, and (2) the date you start contributing to a 401(k) plan if you elected not to contribute when you first were eligible.

Source: Department of Labor's "What You Should Know About Your Retirement Plan"

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