Planning for the Future: What Working Women Need to Know about Social Security and Retirement Savings

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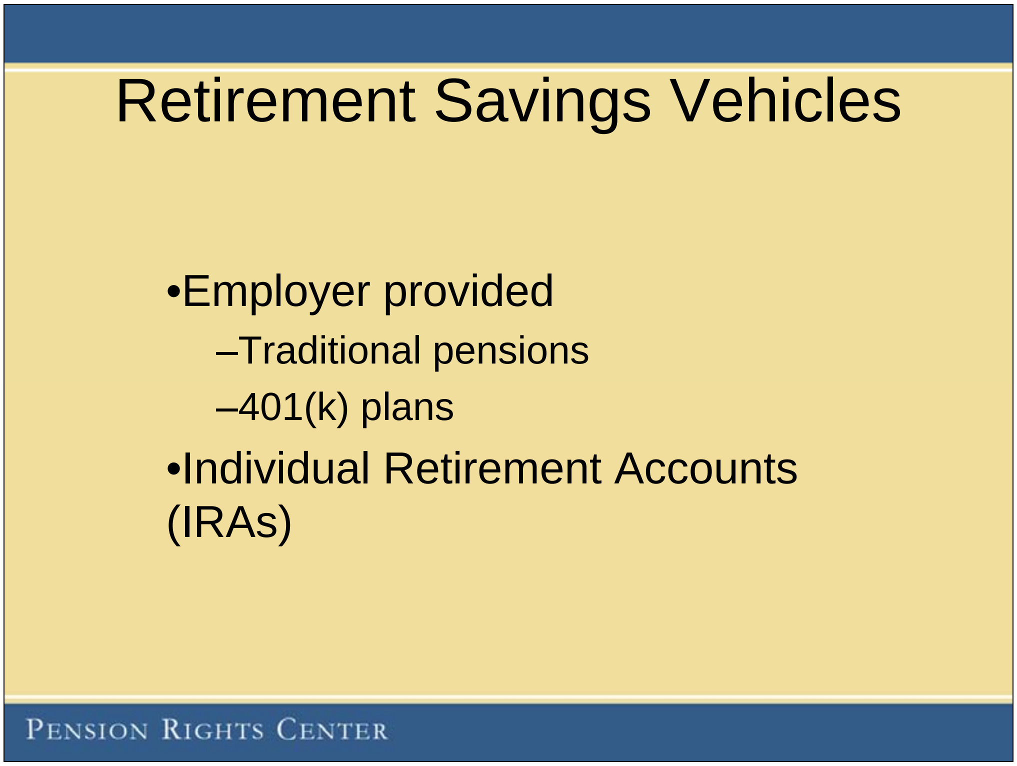

The main differences between Traditional pension plans (Defined benefit-DB) and 401(k) type plans (Defined Contribution-DC):

(1) Funding

-DB plans are funded primarily by the employer

-DC plans generally require employees to make contributions and then employers provide matches.

(2) Payout

-DB plans pay a monthly benefit for life, other options are available but the default benefit is the life annuity

-DC plans are comprised of an account balance and the employee decides how to take distributions from the account. There are some minimum distribution requirements in the Tax Code to prevent a 401(k) from being used as a permanent tax shelter.

(3) Investment Risk

-In DB plans the employer bears the investment risk, and employers must fund the plan so that it may pay out all earned benefits

-In DC plans the employee may be responsible for choosing investment options, and earns what the benefit earns regardless of whether it makes gains or suffers losses.

(4) Insurance

-DB plans are insured up to a guaranteed amount by the federal pension insurance program, the Pension Benefit Guaranty Corporation

- DC plans are uninsured so there is no guarantee that investments will grow and in fact they could lose money.

(5) Spousal protections

-DB plans have important spousal protections to ensure that spouses receive survivor rights, and that their right to a share of the benefit is preserved with spousal consent requirements.

- Spouses in DC plans have survival rights, but no spousal consent requirement for the worker to cash out the benefit after leaving employment.

Defined Benefit Pensions

- Traditional pension plans and cash balance plans
- Upon retirement, pays a specific monthly benefit for life
- Benefit based on a formula taking into account years of service and salary
- No investment risk to workers and workers don’t have to make investment decisions

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Types of benefit formulas

(1) Compensation based: Final salary multiplied by a percentage multiplied by number of years.

(2) Non-compensation based: monthly benefit is $10 multiplied by number of years.

(3) Cash Balance

Form of benefit

(1) Joint and Survivor benefit- This is the default benefit for DB plans. Pays a benefit to the worker for his or her life and then a percentage (usually 50%) to a surviving spouse for his or her life.

(2) Single life annuity- pays a monthly benefit for the life of the worker. Meaning the worker won’t outline her benefits.

(3) Lump sum- A one time payment representing the present value of the single life annuity

Cash Balance Plans

These are technically DB plans but they look like DC plans.

(1) Each employee is assigned a “hypothetical” account balance.

(2) Accounts are credited each year with a percentage of pay and an interest credit.

(3) In this way it looks like an individual account plan earning interest, but the benefit is guaranteed, insured, and the employer bears the investment risk.

401(k) Plans

- Individual account plan called a Defined Contribution (DC) plan
- Employees contribute their own money to an individual account; there is often an employer match
- Benefits are the accumulation of employee and employer contributions plus or minus:
  - gains, losses, earnings and expenses.
- Other kinds of DC plans include Employee Stock Ownership Plans (ESOPs), and 403(b) Plans, money purchase, and profit sharing

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<u>Contributions</u>

•Employee contributions are pre-tax.

•Employers often provide a match on the employee's contributions.

<u>Investment options</u>

•Most 401(k) plans allow workers to select their own investments.

•If you are unsure about how to invest, seek independent investment advice.

> •Retirement income calculators, most economists recommend that people have at least 70% of their income replaced in retirement and new studies show that low income workers need even more than 70% income replacement in retirement. Some people may need to replace up to 100% of their pre-retirement income.

•Investments are important because their earnings, losses and the fees associated with investment options directly impacts benefits.

Individual Retirement Accounts (IRA)

- Account set up by an individual with a financial service provider
- Saver's Tax Credit
  - Tax credit up to $1,000 for making contributions to 401(k)s, IRAs, or other retirement savings accounts.
  - Rewards low- and moderate-income workers who save for retirement.
  - Depending on how much you make, the credit is 10 to 50 percent of each $1 contributed

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<u>Types</u>

•Traditional IRA

•Money contributed pre-tax and grows tax free until individuals make withdrawals in retirement.

•Individuals can contribute if they are under age 70 ½ and earned income in the year they contribute.

•Contributions are fully tax deductible if individual has no employer sponsored retirement plan, or if modified adjusted gross income is less than a certain amount.

•Roth IRA

•Money contributed after-tax, grows tax free and no taxes on withdrawals.

•No age restrictions but individuals can make a full contribution to a Roth IRA only if income is less than a certain amount.

•Payroll deduction IRA

•The employer deducts IRA contributions from employee's salary and forwards money on to the employee's IRA.

How do you get started?

- Is your job covered by the plan?
- Are you eligible to participate in the plan?
  - The plan may have age and years of service requirements
  - 21 years of age
  - 1 year of service
- Automatic Enrollment
  - Employees are notified that they may opt out

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Coverage

The worker must be in a job that is covered by the pension plan. Plans do not have to include all workers. Some plans specifically exclude workers who are in certain types of jobs (such as salary only; hourly only; geographic location; or line of business) or may even exclude specific individuals.

If you have questions ask your employer's personnel office or if you are represented by a labor union, contact the union.

Eligibility

(1) Age requirements generally:

-A plan may chose not to have any age requirements at all. But, if the employer wants to exclude employees from participation based on age, the minimum age cannot be greater than age 21. So, an employee who is age 21 and has met all other participation requirements must be allowed to participate in the plan.

-There are exceptions to the rule: check the Summary Plan Description for your plan's rules.

(2) Service requirements:

-An employer can require employees to satisfy a waiting period before they begin earning benefits, known as the "service requirement." Generally, the maximum waiting period is one year of service.

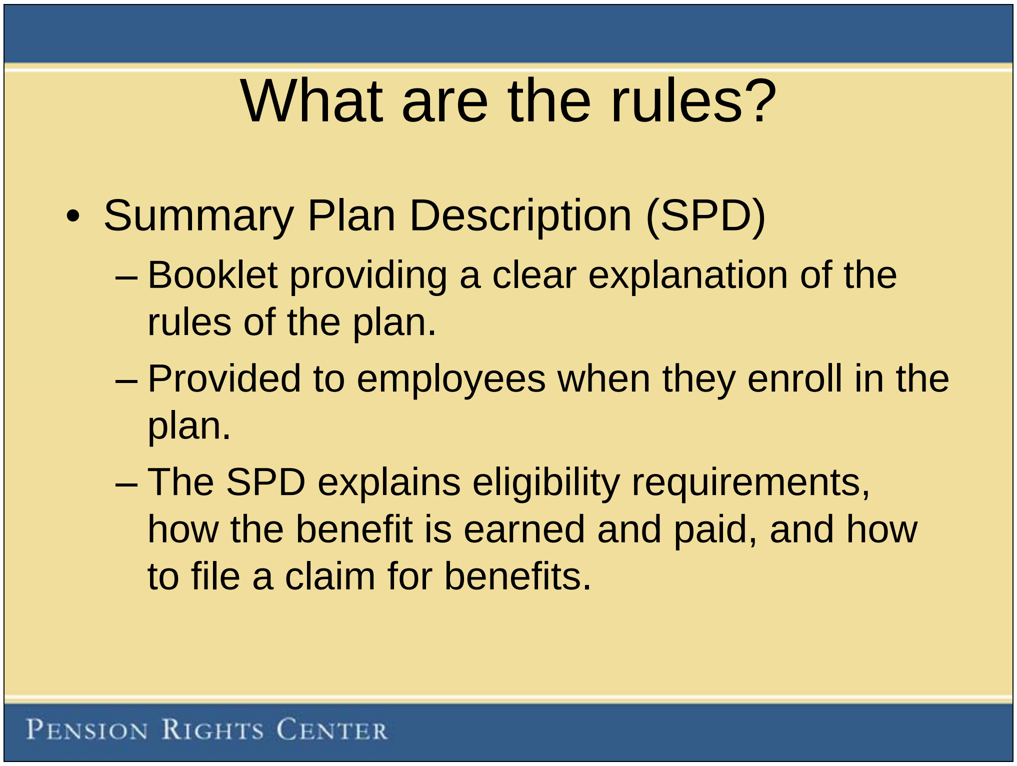
-To determine if an employee has satisfied the service requirement, a year of service means that the employee has worked at least 1000 hours in one 12-month period, beginning on the day that the employee started working for the employer.

- Generally, an employee must be credited with an hour of service for every hour that he or she is paid for hours worked and for vacations, holidays, sick leave, jury duty, military duty, layoff or authorized leave of absence.

Automatic Enrollment

Most 401(k) plans require employees to affirmatively choose to put money into a 401(k) plan. In recent years, some employers have instituted "automatic enrollment," which means that they withhold a certain percentage of their employees' pay, put it into the 401(k), and then give the employees the opportunity to opt-out of the plan.

Accounts will be automatically invested and employees will be given the option to choose investments other than the initial investment.



The SPD must be written in plain terms that can be understood by the average participant and must contain basic plan information, including:

•The plan's employer identification number (EIN);

•The plan's location;

•The name address and telephone number of the plan administrator

•Descriptions of benefits and survivor's benefits;

•Eligibility requirements;

•Vesting and forfeiture rules;

•How to get plan documents;

•How to apply for benefits;

•How to appeal benefit denials; and

•The right to pursue a benefit claim in court.

Benefit Statements

- Total benefits earned
- Vested accrued benefit, or the earliest date the benefit will be non-forfeitable
- An explanation if Social Security or other payments will be subtracted when the benefits are calculated.
- Remember, this is only an estimate.

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Individual Benefit Statements

Traditional pension plans are required to automatically provide individualized benefit statements to employees working under the plan every three years, unless they notify employees once a year that the statements are available. For retirement savings plans, such as 401(k) plans, where employees have control over their investment choices, statements must be provided once every quarter. Other individual account plans, such as profit-sharing plans, employee stock ownership plans, and those 401(k) plans where employees do not have control over their investments, have to provide benefit statements once a year. Workers and their widows and divorced spouses may also make written requests for benefit statements once a year.

Leaving your job

- Vesting
  - A vested benefit is a benefit that cannot be forfeited even if you permanently stop working.
  - Returning to work after taking time off
    - Breaks in service can lead to forfeiture of benefits
- Keep track of your former employer and let them know how to contact you

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Basic vesting rules

"Vesting" means ownership. It is the process that pension plans use to determine when a participant has earned a nonforfeitable right to their benefits. A vested benefit is a benefit that cannot be forfeited even if you stop working for your employer. Check your Summary Plan Description (SPD) for your plan's vesting rules. Most plans will require you to work for a certain number of years before you vest in the benefit you have earned. Before leaving an employer, make sure that you and the employer agree on your vesting status. If one has not already been provided to you in the previous 12-months, you can request your benefit statement, which will provide information on your earned benefits and vesting status. Below are the current minimum vesting rules under the law.

401(k) vesting:

•Workers are always 100% vested in their own contributions

•Workers are either,

  •100% vested in employer contributions after 3 years (cliff vesting), or

  •Partially vested after two years and becoming fully vested after six years (graded vesting)

    •After two years, 20% vested, three years, 40% vested and so on until fully vested.

Traditional Pension plans

•Workers are 100% vested after five years, or

•Partially vested after three years and becoming fully vested after seven years.

  •After three years, 20% vested, four years, 40% vested and so on until fully vested.

Cash Balance Plan benefits are fully vested after three years.

•Workers must be 100% vested in employer contributions to the plan when they reach "Normal Retirement Age."

  •Normal Retirement Age is the earlier of:

    •The age in the plan rules (the maximum can be 65 and 5 years of service); or

    •The later of age 65 or the 5th anniversary of the date the employee became a participant.

Breaks in Service
Check your Summary Plan Description for the plan's rules on breaks in service. Plan rules vary widely. Below is the basic requirement under the law.

Generally, if you leave a job and do not perform more than 500 hours of service in a 12 month period, you incur a 1-year break in service. If you incur five consecutive 1-year breaks in service, and you have been away from your job for longer than the length of time you worked in your job, any unvested benefits may be forfeited. Remember once you are vested you cannot lose those benefits even if you permanently leave your job. Breaks in service only pose a risk to loss of unvested benefits.

The Summary Plan Description (SPD)
If you leave employment before you retire, you should have a copy of the SPD in effect on your last day of work because your benefits will be determined according to the plan rules that ere in effect on your last day of work. You can obtain the SPD by making a request in writing to your plan administrator.

Keeping track of your former employer
Let your former employer know where you are and know where your former employer can be found. Have you read that they are going out of business or merging with another company? These changes can affect your benefits. Keep records, your pay stubs and old tax returns verify your employment history, and possibly locate a former employer that has moved or changed names.

Spousal Issues

- Marriage and Divorce
  - Pensions are one of the biggest assets in a marriage.
  - Legal representation will ensure the pension is properly valued and divided through a Qualified Domestic Relations Order (QDRO).
- Pre-retirement survivor protection
- Loans
  - Only with spousal consent.

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Helpful Links

- Pension Rights Center Fact sheets: http://www.pensionrights.org/pubs/facts.html
- U.S. Department of Labor, Employee Benefits Security Administration: www.dol.gov/ebsa
  - What you should know about your retirement plan: http://www.dol.gov/ebsa/publications/wyskapr.html
  - The division of pensions through Qualified Domestic Relations Orders (QDROs): http://www.dol.gov/ebsa/publications/qdros.html

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