Money matters Pensions

Are you earning a pension benefit now, or have you earned one from a former job? Traditional pension plans are a dying breed, but millions of workers are still earning a right to one. You need to know if you're one of them.

How They Work

A traditional pension, called a "**defined benefit**" plan, rewards long-term employees with a regular, usually monthly, pension payment when they retire. Find out if your employer offers a pension plan by contacting the human resources department. If you have a pension, request the **Summary Plan Description** (SPD) that details the plan rules. However, pension plans for government employees follow different rules.

How Pensions Are Funded:

- The employer typically makes all the contributions;
- The employer invests the money to be able to pay out promised benefits; and
- A federal agency, the **Pension Benefit Guaranty Corporation** (PBGC) will pay a pension to employees of firms that close their pension plans, but the amount may be less than what was promised by the employer.

The Summary Plan Description: A Guide to Your Pension Plan

The U.S. Department of Labor requires employers to provide their employees with this explanation of how their pension plan works. If you're in a plan, you should request and read the SPD, and ask human resources staff to answer any questions you have about it.

Read through the SPD to find out:

- If you qualify for a benefit;
- Your options for how to receive your benefit;
- What benefits you might lose if you take a lump sum rather than an annuity;
- How Social Security benefits might reduce your pension amount; and
- How long you need to stay to earn a right to a benefit. Plan to stay with your employer at least as long as your benefit continues to grow.

How Benefits Are Determined:

- Most plans require you to work a certain number of years—typically five—to earn a right to, or to vest in, a benefit.
- The amount of your pension is based generally on your years of employment and your salary in your final years.
- Your earned benefit is guaranteed. But the sponsor has a right to change or discontinue the plan at any time, as long as the company provides notice required by law to the employees.
- If the plan is discontinued, you won't earn any more benefits.

The Payout

Most employers have traditionally paid out a monthly check for life beginning at retirement but some permit you to take the benefit as a single lump sum. Also, if you have a vested benefit and you change jobs, your employer can require you to take the money with you if it's $5,000 or less.

There are good reasons to select a monthly pension, rather than a lump sum:

- You'll get a monthly check for life. If you're married, your benefit typically defaults to a joint-and-survivor pension that your spouse would receive if he or she outlives you. (To change this, your spouse would have to sign a consent form.)

AARP

- You don't have to manage or invest the money.
- You may get to keep other retiree benefits, like periodic pension increases and retiree health.

On the other hand, a lump sum could make sense for you, because it:

- Makes it easier for you to leave an inheritance;
- Gives you the full benefit upfront if your health status suggests you may not live very long in retirement; and
- Allows you to buy an annuity of your own choosing with a portion of the money immediately or down the road.

Many people get diverted from their retirement path because they spend their pension money when they change jobs. If you do this, you'll lose the value of the money now, plus the value of the earnings on the money in the years before you retire. If your employer lets you cash out your pension benefit when you change jobs and you choose to do so, transfer the money to the new employer's 401(k) or open a rollover IRA. Also, transferring the pension money to one of these other accounts will make it easier to keep track of all your retirement benefits.

A word of caution if you divorce: every state views pensions as a joint asset. However, the division of the benefit doesn't occur automatically, and not all lawyers know how to deal with the issue. You and your spouse should make joint decisions about pension assets.

Is Your Pension Safe?

In the last decade or so, the number of private-sector employees covered by a traditional pension plan has plummeted from about half to about 20 percent. In many cases, announcements that a plan was frozen or shutting down came with little or no warning, leaving some employees with unexpected reductions in benefits at the time of termination. Starting in 2008, a new law requires employers to provide employees with more complete and current information about the health of their pension plan. Your employer is already required to provide you with two notices that could indicate a problem: a "participant notice," if the pension plan is funded below 80% or 90% in recent years, and a "Summary Annual Report" with information on issues such as the return on your pension plans' investments. Ask your human resources department for them.

Your To-Do List:

- ☐ **When considering a new job,** look carefully at the benefits. Ask for information in writing to compare your current benefits versus what the new job offers.
- ☐ **Ask your employer how much your benefit is worth now,** what it would be if you stayed a few years longer, and what it would be if you stayed until retirement age. Starting in 2007, employers with traditional pension plans are required to give vested employees a statement of their benefits. However, they're also required to give you such a summary once a year, if you ask for it in writing.
- ☐ **Get legal advice if you are divorcing,** with regards to your or your spouse's pension.
- ☐ **Get advice on the best way to collect your pension**—an annuity or a lump sum. For tips on choosing a financial professional, see AARP's Tip Sheet "Working With a Financial Planner."
- ☐ **If you think you earned a pension from a previous job but you can't reach the company,** contact the PBGC at www.pbgc.gov or 1-800-400-7242.
- ☐ **Find out if your pension plan is financially healthy** by contacting the Pension Benefit Guaranty Corporation at www.pbgc.gov or 1-800-400-7242.
- ☐ **Order other Money Matters Tips Sheets** to share with friends at www.aarp.org/orderfinancialpubs.