

Each type of pension plan has its own rules. The rules make a difference in how fast you can save the money you need to reach your retirement goals.

Cash balance plans are a new type of pension plan that has emerged in the last few years. They have different rules from both traditional pensions and 401(k)-type plans. Some employers have changed their traditional pension plan into a cash balance plan and others may do so in the future. To see if you have a cash balance plan and to make sure you know how it works, ask your company's human resources department for the Summary Plan Description (SPD).

There are two basic types of retirement plans for employees. One is the traditional pension plan, also known as a defined benefit plan. In this case, the employer puts all the money into the pension account and invests the money. (For more information, refer to AARP's *Money Matters* Tip Sheet on Pensions.) The second type of pension plan is called defined contribution. The most common example is a 401(k). With this type of plan, you decide how much to contribute and you get a tax deduction for the money you contribute. (For more information, refer to AARP's *Money Matters* Tip Sheet on 401(k) plans.)

How Cash Balance Plans Work

The cash balance plan combines some features of a traditional pension, and some features of a 401(k)-type retirement account. Here are the key points:

- Your employer deposits a “pay credit” and an “interest credit” into an account for you every year. For example, your pay credit may be 6 percent of your salary; the interest credit may be 5 percent of your account balance.
- You generally don't have to put any money into the account. The employer invests the money.
- You cannot access to the money unless you are “vested,” meaning that the company cannot take away or reduce the benefit that you've earned. The company must vest you in three years.
- When you leave your job, you are entitled to the

sum of the money that's been put away for you while you worked for that employer.

- You can choose how to take the money—as a yearly payment for the rest of your life, or in a lump sum. If you take the lump sum, you may transfer it into a 401(k) at your new job, or into a Rollover IRA.

Cash Balance Benefits

A cash balance plan is considered a defined benefit plan and must follow general rules that the government sets for these plans. But, there could be a big difference between the amount of money received from a traditional pension versus a cash balance plan.

- The formula in either plan typically gives you credit for each year you work. With a traditional pension, your benefit is based on your *final average* pay. The formula typically gives you more credit for working more years. Typically, your highest earnings are in the final years you work for your employer, so your pension benefit can increase a lot in your years leading toward retirement.
- A cash balance benefit is typically based on each year's pay. You get a certain amount of credit for each year (i.e., 6% of pay), and your account balance gets an interest credit (i.e., the rate of return on a bond).

When Plans Change

If you are currently earning a traditional pension, your employer could change it to a cash balance plan. If that happens, you have a full right to the benefit you have earned to date. However, you may not be able to continue earning a benefit under the old plan formula. Rather, you may start earning a

separate cash balance benefit. If you're early in your career (20s or 30s), you will probably earn a larger benefit from the cash balance plan, and you generally can take with you if you change jobs. But if you are closer to retirement (in your 40s or 50s) when the plan changes, your future accruals under the cash balance plan could likely be smaller. You may have a choice between remaining under the old plan and going into the new one. Some other factors to consider as you decide are:

- How your benefit is calculated under each plan, and the current value of each;
- Whether you plan to stay with your current employer until retirement or change jobs soon;
- How the terms and options compare; and
- How survivor benefits compare. Typically, the plan will payout the full account value if you die while working, whereas a traditional DB plan often pays half the value, and only if you are married.

Research your choice carefully, and know the deadline for making your decision.

Payout Options

Cash balance plans pay out benefits as a single lump sum or as a monthly payment for life. Some good reasons to take the monthly payment:

- It will continue throughout your lifetime.
- You may arrange for your spouse to receive a portion of your benefit if he or she outlives you.
- You don't have to manage the money.

A single lump sum payment may make sense if:

- You want to leave an inheritance or bequest.
- Your health status suggests you may not live long enough in retirement to benefit from a monthly payment.
- You want to invest and manage the money yourself.
- You want to take part of the money as a monthly payment, and invest the rest on your own. In this case, to get the monthly payment, you would need to purchase an annuity. (See AARP's Tip Sheet on Annuities.)

In selecting your payout option, carefully consider the best way to protect the spouse that lives longer.

Your To-Do List:

- Ask HR if you're eligible for a defined benefit pension**, and if you are, request the SPD. Read it to find out:
 - Whether the plan is a traditional pension or a cash balance plan,
 - If you are eligible for a benefit,
 - How benefits are calculated, and
 - Your options for how to receive your benefit.
- Learn more about how cash balance plans work** at www.aarp.org/money.
- Find out how long you need to stay with your employer to earn a right to a pension benefit**, and stay at least that long.
- Learn how being divorced or widowed can affect your retirement benefits** by reading the Women's Institute for a Secure Retirement fact sheets on retirement planning at www.wiserwomen.org.

- With your spouse, review all the pension benefits you've earned.** Make sure you understand how the payout options would affect your incomes if one of you dies. Remember that survivor benefits can be the difference between retirement comfort and poverty.
- If you are changing jobs, consider the pros and cons of these options.**
 - Transfer it directly from your employer to your new job's 401(k) plan or to a Rollover IRA;
 - Keep it with your current employer, allowing it to continue earning interest credits; or
 - Cash it out.
- Read more about cash balance plans and your rights under them.** at www.dol.gov/ebsa/faqs/faq_consumer_cashbalanceplans.html.

This and other tip sheets provide general financial information; it is not meant to substitute for, or to supersede, professional or legal advice.

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