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Fact Sheet

PENSION ACTION CENTER, GERONTOLOGY INSTITUTE

JOHN W. McCORMACK GRADUATE SCHOOL OF POLICY AND GLOBAL STUDIES

Understanding the Specialized Language of Retirement Plans

Whether you are a participant in a defined benefit plan or a defined contribution plan, the realm of pension benefits can be tricky and confusing to navigate. Some of the terminology used might be unfamiliar to the average person. This glossary of common terms associated with retirement plans is meant to serve as a helpful resource for plan participants.

ACCRUAL

The process of accumulating funds for a pension benefit.

ACCRUED BENEFIT

The total amount a participant has earned for a pension. It is usually expressed in a monthly or yearly dollar amount which a participant would receive at the his/her normal retirement age.

ACTUARY

A professional mathematician who computes pension costs, risks, etc., according to probabilities based on statistical records.

ANNUITY

Regular payments of income, usually monthly, over a specified period of time, often for life. Defined benefit plans usually pay benefits in this form.

BENEFICIARY

The person that a plan participant designates to receive pension benefits if the participant dies first.

BENEFIT CREDIT

see Credited Service

BENEFIT SERVICE

see Credited Service

BREAK IN SERVICE

Refers to when a pension participant does not work long enough to be credited for his/her work during a plan year or years. Usually results when a participant works less than 500 hours in a plan year.

“CASH OUT”

Withdrawing your funds from your individual retirement account. As opposed to rolling over the funds into another investment vehicle or leaving the funds behind, withdrawal can trigger taxation and penalties.

CLIFF VESTING

A pension plan rule that provides all-or-nothing vesting: that is, a person is 100% vested after a specified period of time, usually five years. (Compare graded vesting)

CONTRIBUTORY PLAN

A plan to which employees as well as employers make payments.

CREDITED SERVICE

Generally means the years a plan counts in computing the dollar amount of a benefit. It is sometimes called “benefit credit,” “benefit service,” or “participant service.”

DEFERRED VESTED BENEFIT

A benefit that is not forfeitable [i.e., is vested] but that is not immediately payable when a person leaves employment. It is deferred to that future time when the participant is eligible to receive it, usually at normal retirement age or early retirement age.

DEFINED BENEFIT PLAN

A pension plan that pays a specific benefit, usually based on age at time of retirement, rate of pay, and length of service. The employer or plan sponsor bears the responsibility of having funds available to pay the plan's promised benefits.

DEFINED CONTRIBUTION PLAN

A pension plan in which a defined amount is contributed to the plan by the employer, the employees, or both. The eventual payout depends on the size of the contributions and the success of the underlying investments. Employees bear the risk that the accrued benefits at retirement will be adequate. The most common type is the 401(k) plan

EMPLOYEE BENEFIT PLAN

A broad term that encompasses both pension plans and welfare benefit plans.

EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 (ERISA)

The federal law, which took effect in 1976, that regulates private pensions

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

A defined contribution plan in which contributions to the plan are in shares of the stock of the employer.

FIDUCIARY

A person responsible for managing a plan and its assets. His/her duty is to protect the interest of the plan participants and beneficiaries.

FREEZE

A frozen pension occurs when plan administrators amend a plan to discontinue benefit accruals. This means that the workers affected by the freeze stop earning additional benefits from the point of the freeze forward. Companies are allowed to freeze pension plans, but cannot take away benefits that workers have already earned. For more information please read the [factsheet](#) written by the Pension Action Center, explaining pension freezes (compare “termination”).

GRADED VESTING

A pension plan rule providing for vesting gradually over a period of years. For example, a person would be 20% vested after three years, 40% after four years, etc., until she or he is 100% vested after seven years.

HARDSHIP WITHDRAWALS

Some, but not all, defined contribution plans allow a withdrawal of funds due to hardship. A hardship withdrawal must satisfy an immediate and heavy financial need of the employee, and the employee cannot have another financial source to alleviate this need. Various consequences are triggered once an employee elects to receive a hardship withdrawal from his/her defined contribution fund.

IN-SERVICE WITHDRAWAL

A withdrawal made from a plan account by the holder before a triggering event occurs. The most common triggering event is age. Many withdrawals are subject to a tax penalty if a withdrawal occurs before a certain age.

INDIVIDUAL BENEFIT STATEMENT

A document that employers are required to provide participants showing their earned benefits under the pension plan, as well as their vesting status. Under the Pension Protection Act of 2006, traditional pension plans are required to give employees this statement every three years, or notify them annually that statements are available. Employees in a retirement savings plan, such as a 401(k), should receive account statements quarterly, if they are in a plan where they

have control over their investment choices, that is, a “self-directed account”. If they are in a plan where employees do not have control over their investment choices, they should receive an account statement once a year.

INDIVIDUAL RETIREMENT ACCOUNT (IRA)

An individual account or annuity set up with a financial institution, such as a bank or a mutual fund company. Depending on the type of IRA, funds can be tax-free or tax-deferred.

JOINT AND SURVIVOR BENEFIT

A pension benefit to the surviving spouse if the worker or retiree died first

MATCHING CONTRIBUTION

An employer with a defined contribution plan may elect to match a percentage of an employee’s contribution to the plan. For example, an employer may elect to contribute 50 cents for every dollar contributed by the employee.

MULTI-EMPLOYER PLAN

A collectively bargained pension plan to which more than one employer contributes. It usually covers a specific industry or trade; for example, carpenters’ union, or food and commercial workers’ union.

NORMAL RETIREMENT AGE

The age specified by a pension plan as the earliest at which an employee can retire without taking a reduction in pension benefits.

PARTICIPANT

Someone who is or may be eligible to receive plan benefits. A “member” of a plan.

PLAN ADMINISTRATOR

The individual or company responsible for managing the plan. Many employers contract out this job to a benefits specialist.

PLAN YEAR

The 12-month period that the pension plan uses in its calculations. It may be a calendar year, fiscal year, or anniversary year of the beginning of the plan.

PORTABILITY

The ability, when a worker ends employment, to take accrued benefits and transfer them to an individual retirement account (IRA) or another pension plan.

PROFIT SHARING PLAN

A defined contribution pension plan in which the sponsor's contribution may depend on its profits; sometimes referred to as a discretionary contribution plan.

QUALIFIED DOMESTIC RELATIONS ORDER (QDRO)

A state court order or a court approved property settlement agreement that says a pension plan is to pay a share of a pension to an "alternate payee," usually the employee's former spouse.

QUALIFIED PLAN

A plan that meets Internal Revenue Service requirements to qualify for deductibility of plan contributions.

RETIREMENT EQUITY ACT

The Retirement Equity Act of 1984 was created to provide equality and protection for the spouses of employees. It requires that people who are married when they begin receiving their pension must receive their benefit in the form of a Joint and Survivor Annuity unless the spouse voluntarily gives up this right. This protection applies to any retirement plan that pays benefits in the form of a monthly annuity. The law also added survivor benefit protections for widows and widowers whose spouses died before reaching retirement age.

ROLL OVER

The term used to describe the process of moving retirement funds from one investment vehicle to another. For example, instead of cashing out your 401(k) account when you leave your employer, an employee may choose to roll over the funds from the 401(k) into another investment vehicle such as an individual retirement account (IRA).

ROTH IRA

This investment account requires you to pay taxes on the contributed money up-front, when it is first invested. However, once invested, the principal and earnings grow tax-free. At retirement, you are not required to pay taxes when you withdraw money from the account. (Compare Traditional IRA)

SUMMARY PLAN DESCRIPTION (SPD)

A summary in plain understandable language, of a pension plan's terms, including information on eligibility, benefits, and claims procedures.

SURVIVOR'S BENEFIT

See Joint and Survivor Benefit

TERMINATION

Ending a pension plan. The termination of defined benefit plans is regulated by the Pension Benefit Guaranty Corporation, which guarantees vested benefits up to certain maximum levels. Vested benefits under those maximum levels should not be lost due to plan termination. For more information, see www.pbgc.gov.

TERM CERTAIN

One of several payment options sometimes available when a person elects to receive benefit payments. This form of payment pays benefits to the retiree for his or her lifetime, but only pays benefits to a survivor if the retiree dies within the term specified, and only for the balance of that term. For example, John Smith elects a 10-year term certain in 2014 and designates his daughter as the beneficiary. If he dies before 2024, his daughter will receive the benefits through 2024. If he dies after 2024, no benefit will be paid to his designated beneficiary.

TRADITIONAL IRA

Provides a tax break up front. You do not pay taxes on the money you invest in the account. Once invested, the principal and earnings grow tax-free. At retirement, you pay taxes as you withdraw funds.

VESTED

Term that means a worker has satisfied plan requirements so that he/she is eligible for, and entitled to, benefits.

YEAR OF SERVICE

A term used to describe a plan year of employment that counts in determining participation, vesting, and accrued benefits.

401(K) PLAN

A defined contribution voluntary savings plan, named for the section of the tax code which established it. Employees contribute a portion of their pre-tax salary and employers may match some or all of their employees' contributions.

403(b) PLAN

This tax sheltered annuity plan is only available to public schools and various 501(c)(3) tax-exempt organizations. Similar to 401(k) plans, employees contribute deferred salary into an individual account. These funds are not taxable until distributed. However, a 10% penalty is incurred if funds are distributed before the employee turns 59 ½.

Do you have any questions about this fact sheet? Call the Pension Action Center at 888-425-6067 or visit us online at pension.umb.edu

About This Fact Sheet

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Disclaimer

This fact sheet is intended to provide general information about pensions and other retirement benefits and should not be used as a substitute for a consultation with an attorney or other legal professional. Individuals should always consult a legal or financial advisor to discuss the facts and circumstances of their specific situation.

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