EMPLOYER PENSION PLAN
FREQUENTLY ASKED QUESTIONS
(This FAQ will be updated periodically)

Q: **What is a <u>Defined Benefit</u> Plan**?

A: A **<u>defined benefit</u> pension plan** is a type of pension plan in which an employer/sponsor promises a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending directly on individual investment returns. Traditionally, many governmental and public entities, as well as a large number of corporations, provided defined benefit plans, sometimes as a means of compensating workers in lieu of increased pay. A defined benefit plan is 'defined' in the sense that the benefit formula is defined and known in advance.

Q: **In these tough economic times, are the pension plans provided by Upper Merion Township funded appropriately**?

A: Yes. For the police **<u>defined benefit</u>** pension plan, as of the 1/1/13 Act 205 Report, the plan is 87% funded on a market value basis. Thus, the plan's financial health being 87% funded on a market value basis is well above average.

For the non-uniformed pension plan, the Township makes a contribution into each eligible employee's **<u>defined contribution</u>** 401(a) account balance; and after the Township makes the contributions, there is no further obligation or liability to the Township. Employees are also required to make a contribution into their own account balance and also are responsible for their own investment strategy.

Q: **Is it important to fund the <u>Defined Benefit</u> pension plan each year**?

A: Yes. It is important that the actuarially required contribution (ARC) be contributed to the pension trust each year, for several reasons. First, if a plan does not fully fund the ARC, the plan is likely to become underfunded, which means that the plan's assets will not cover all of the plan's current and future liabilities. Postponing payments will only increase the ARC in future years, because the ARC will now consist of both the normal cost and a portion of the unpaid liabilities from past years, also called the unfunded actuarial accrued liability (UAAL).

Q: **How are employer contribution rates determined for <u>Defined Benefit</u> plans, each year**?

A: The amount of money needed to contribute each year can be determined through an actuarial analysis. The plan actuary determines the cost associated with new benefits earned in that year (normal cost) plus any additional amount that might be required to make up for shortfalls that have developed in the past. Thus, to ensure that the plan will have enough assets to pay future benefits, it is important that the annual required contribution (ARC) be contributed to the pension trust each year.

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Q: **How are retirement benefits earned in a Defined Benefit plan**?

A: In most traditional defined benefit plans, all eligible employees are automatically enrolled in the pension plan. Typically, after an employee has worked a certain number of years, his or her right to receive a pension benefit becomes "vested" meaning that he/she has a legal right to receive benefits. Years of service before "vesting" are included in the calculation of the pension benefit in retirement.

The amount of monthly income an employee receives under typically determined by the years of services with the employer, the employee's salary at the end of his/her career, and a fixed multiplier that is determined by the plan. For the sake of this example, the plan may provide a benefit multiplier of 2.0%. So, for example, an employee works 30 years and has a final average salary of $50,000, this employee's annual pension income will be $30,000 (50,000 x 30 x 2.0); which would be a monthly pension benefit of $3,000.

Q: **UMT has two (2) types of retirement plans**; h**ow do I determine which retirement plan to enroll**?

For both the **Defined Contribution** and **Defined Benefit** plans, enrollment is mandatory and will be set up by the Payroll Coordinator. All non-uniformed employees will be enrolled in the Defined Contribution plan and all uniformed employees (i.e., Police Officers) will be enrolled in the Defined Benefit plan.

Q: **What is a Defined Contribution Plan**?

A: A **defined contribution plan** is a type of retirement plan in which the employer, employee or both make contributions on a regular basis. Individual accounts are set up for participants and benefits are based on the amounts credited to these accounts (through employer contributions and, if applicable, employee contributions) plus any investment earnings on the money in the account. Only employer contributions to the account are guaranteed, **not the future benefits**. In defined contribution plans, future benefits fluctuate on the basis of investment earnings.

Q: **What type of retirement plan is a 401(a)**?

A: **A 401(a) plan** is a money-purchase retirement savings plan that is set up by an employer. The 401(a) plan allows for contributions by the employee, the employer, or both. Contribution amounts, whether dollar-based or percentage-based, eligibility, and vesting schedule are all determined by the sponsoring employer. Funds are withdrawn from a 401(a) plan through lump-sum payment, rollovers to another qualified plan, or through an annuity.

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With a 401(a) plan, employers are able to create multiple 401(a) plans, each with different eligibility criteria, vesting schedules and contribution amounts. For this reason, the 401(a) plan is commonly used by employers to create incentive programs to help retain employees.

Q: **What is the vesting schedule for the <u>Defined Contribution</u> plan**?

A: The vesting schedule for the **<u>defined contribution</u>** plan is as follows:

6 years of service	=	100%
5 years of service	=	80%
4 years of service	=	60%
3 years of service	=	20%

Q: **What is the vesting schedule for the <u>Defined Benefit</u> plan**?

The vesting schedule for the defined benefit plan is 12 years of continuous employment in accordance with Act 600.

Q: **What are the benefits of participating in a 401(a) plan**?

A: -You reduce your current income taxes while you boost your retirement investments.
-You can dollar-cost average through convenient payroll deductions.
-You have the ability to rollover your savings to another public sector employer's 401 plan (portable) a tax-sheltered 403(b) annuity plan, a 457 plan, or an IRA if you change employers.

Q: **How are contributions to the 401(a) <u>Defined Contribution</u> plan determined**?

A: Contribution rules are generally determined by your employer. A common method combines employer and mandatory employee contributions.

- Contributions you make are mandatory or voluntary. Mandatory contributions are generally pre-tax (picked-up), which reduces your current taxable income. Voluntary contributions are after-tax, up to 25% of your compensation (an IRS limit for total contributions to the plan also applies – see below).

- Contributions your employer makes are typically a fixed dollar or percentage amount, or a match of your contributions.

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- Your employer's contributions may have a vesting schedule, which determines your "ownership" of those contributions and associated earnings and how much of your account may be paid to you when you separate from service. (You always fully own your contributions and associated earnings.)
- IRS rules limit the total contributions made to your account, including both your employer's and your contributions. The 2013 total contribution limit is $51,000.

Q: **When can I withdraw assets from my 401(a) account?**

A: You are eligible to withdraw funds from your 401(a) account under the following circumstances:
- When you retire
- When you leave your job for any reason

While still employed and **<u>if</u>** your employer plan allows, the following additional withdrawals may be available to you up to twice per calendar year:

- Voluntary after-tax contributions (if plan allows
- After age 59 ½ for employees who are 100 percent vested (401 Profit Sharing Plans only)

Q: **What is a 457 retirement plan**?

A: **<u>The 457 retirement plan</u>** is a non-qualified tax-deferred compensation plan that allows you to increase your savings toward retirement. You determine the pre-tax amount that you want to defer (up to the IRS maximum) and how it is to be invested. Assets are held in one or more group annuity contracts for the exclusive benefit of you and your beneficiaries

Contributions are made to an account in your name for the exclusive benefit of you and your beneficiaries. The value of the account is based on the contributions you make and how those investments perform over time.

A 457 plan is designed to supplement your retirement income. While a pension and/or Social Security may go a long way, they are **<u>unlikely</u>** to be enough. Saving to your 457 plan can help you maintain your desired standard of living.