Glossary for Retirement Plan Provisions for Private Industry Workers in the United States, 2022

For use starting with the retirement provision publication containing reference year 2022 estimates. This glossary is updated periodically to reflect changes in the National Compensation Survey. Information is applicable to estimates published as of this glossary's release date. Prior versions of the glossary are available on the NCS benefits publications list. Information on survey concepts, data sources, design, and calculation is available in Handbook of Methods: National Compensation Measures.

Retirement plans are classified as defined benefit or defined contribution plans.

Defined benefit plans

Defined benefit plans provide employees with guaranteed retirement benefits based on benefit formulas. An employee's retirement age, length of service, and preretirement earnings may affect the benefits received. Definitions, key provisions, and related terms follow.

Traditional defined benefit formulas

Traditional defined benefit plans provide a stipulated dollar amount at retirement or through a specified formula that includes factors such as career earnings, age, and years of service to provide a known dollar amount benefit.

Percent of terminal earnings. Benefits are based on a percentage of average earnings during a specified number of years at the end of a worker's career (or when earnings are highest), multiplied by the number of years of service recognized by the plan.

Percent of career earnings. Benefits are based on a percentage of an average of career earnings for every year of service recognized by the plan.

Dollar amount. Benefits are based on a dollar amount per month for each year of service recognized by the plan.

Percent of employer contribution. Benefits are based on employer and, occasionally, employee contributions. Benefits equal a percentage of total contributions.

Nontraditional defined benefit formulas

Nontraditional defined benefit plans are newer plan types that include cash balance plans and pension equity plans.

Cash balance plans. For each year worked, employees are credited with a specified contribution and a rate of interest on that contribution, which together will provide a future lump sum value at retirement. The lump sum may also be converted to an annuity.

Pension equity plans. For each year worked, employees are credited with a percentage applied to their final average earnings. Benefits generally are distributed as a lump sum, but may be converted to an annuity.

Eligibility requirements

Age and the period of time an employee is expected to work for the employer (a service requirement) before becoming eligible to enroll in a defined benefit retirement plan. Some plans require employees to satisfy both the age and the service requirements before being able to enroll. An example of a minimum age requirement is 21 years and an example of a minimum service requirement is 12 months.

Frozen retirement plans

Frozen retirement plans are benefit plans that typically are closed to new enrollees and limit future benefit accruals for some or all active plan participants. Some may no longer allow participants to accrue additional benefits. Others may change the plan's prospective benefit formula in such a way as to limit or cease future benefit accruals for some active participants. The length of time is calculated based on the year the plan was modified.

Soft frozen plans. New employees are not allowed in the plan. Benefit accruals may continue for existing participants.

Hard frozen plans. Participants in these plans stop accruing benefits on the date the plan is frozen. The benefit the employee receives is calculated as of the day the plan was frozen.

Normal retirement

Normal retirement is the specific age, length of service, or a combination of both, at which point participants may retire and receive all accrued benefits without a reduction or penalty. In most plans, participants must satisfy a minimum service requirement to be vested in the plan. The typical vesting requirement is 5 years of service; these requirements are not included in the service requirements for normal retirement.

Age and service requirement. The participants' age and service (in years) must each meet the criteria as specified in the plan, and as long as both conditions are satisfied employees may retire without incurring a reduction in benefits.

Age plus service requirement. The sum of participants' age and service (in years) must meet a total minimum number as specified in the plan, such as 80, and as long as the condition is satisfied employees may retire without incurring a reduction in benefits.

Early retirement

Early retirement is the age, length of service, or combination of age and length of service at which plan participants may retire and receive all accrued benefits, minus a reduction or penalty.

Flat percent per year. Reduction in the benefit amount for each year by which early retirement precedes normal retirement. In specific cases, flat percent per year reductions may approximate actuarial reductions, such as early retirement at age 55 with a reduction of 6 percent per year between age 55 and the plan's normal retirement age of 62.

Variable. Reduction that is held constant within age brackets, but differs among brackets, sometimes in approximation of an actuarial table. For example, benefits may be reduced by 3 percent for each year between age 60 and the plan's normal retirement age, and by 6 percent for each year retirement precedes age 60.

Actuarial. Reduction applied to the amount of the normal retirement benefit based on actuarial assumptions, so that on average, the beneficiary receives the total lifetime benefit of equal value regardless of retirement age.

Benefit payment methods

Payments from defined benefit plans may be in the form of a straight-life annuity, a joint-and-survivor annuity, a percentage of the unreduced accrued benefit, or a lump sum.

Straight-life annuity. A periodic payment made for the life of the retiree, with no additional payments to survivors.

Joint-and-survivor annuity. An immediate annuity for the life of the participant and a survivor annuity for the life of the participant's spouse. The amount of the survivor annuity may not be less than 50 percent, or more than 100 percent, of the amount payable during the time the participant and spouse are both alive. The annuity payable for the life of the participant is lower than that for a straight-life annuity; to account for the increased length of time over which payments will be made, this reduction may be a percentage of the straight-life benefit, such as 10 percent, or may be based on the life expectancy of the participant and spouse (an actuarial reduction).

Percentage of unreduced accrued benefit. Under this method, the participant's pension is not reduced to adjust for survivor benefits. The participant will receive an amount equal to the straight-life annuity, and the spouse will receive a proportion of that amount, often 50 percent, should the participant die.

Lump-sum payment. The participant may opt for a full lump sum, with no further benefits received from the plan. If a plan provides for a partial lump-sum payment, the participant receives a reduced annuity as well.

Vesting

Vesting is the period of time a participant must work before earning a nonforfeitable right to a retirement benefit. Once the participant is vested, the accrued benefit is retained even if the worker leaves the employer before reaching retirement age.

Immediate full vesting. An employee is 100 percent vested immediately upon enrollment in the plan.

Cliff vesting. No vesting occurs until an employee satisfies the service requirements for 100 percent vesting, such as 5 years.

Graded vesting (or graduated vesting). An employee is entitled to an increasing share of nonforfeitable benefits, determined by the years of service with the employer, until eventually reaching full vesting. An example would be 50 percent vesting after 3 years of service, 75 percent vesting after 4 years of service, and 100 percent vesting after 5 years of service.

Integration with Social Security

Defined benefit plans may integrate retirement benefits with Social Security benefits. Under this approach, the employer's contribution to Social Security Federal Insurance Contributions Act (FICA) taxes is taken into account when plan benefits are computed. Integration may be accomplished by an offset or a step-rate method.

Offset. Part of a participant's Social Security benefit is subtracted from the benefit otherwise payable by the plan. The maximum allowable offset is 83.3 percent of the Social Security benefit.

Step rate (or Social Security breakpoint). Lower benefit rates are applied to earnings up to the specified taxable Social Security wage base (that is, the earnings subject to FICA tax); higher benefit rates are applied to earnings above the wage base.

Portability

Portability is a participant's ability to maintain and transfer accumulated pension benefits when changing jobs. Portability provisions in defined benefit plans generally cover portability of assets, portability of credited service, or both.

Portability of assets. Participants can withdraw their accumulated pension benefits or transfer them to another retirement arrangement.

Portability of credited service. Participants are allowed to count the years of service with a previous employer when determining benefits from their current employer.

Disability retirement

Disability retirement is retirement resulting from a totally disabling injury or illness prior to eligibility for early or normal retirement. Plans providing disability retirement benefits may have a service requirement, such as 10 years or longer.

Immediate disability retirement. Benefits are available upon the onset of disability or after a waiting period, such as 6 months. Early retirement reductions do not apply to immediate disability benefits; participants' service credits cease to accumulate once immediate disability benefits begin.

Deferred disability retirement. Service credits continue to accumulate and payments do not begin until participants are eligible for normal retirement.

Preretirement survivor benefits

In the case of death prior to retirement (or prior to eligibility for retirement benefits), the surviving spouse becomes eligible for an annuity for the rest of his or her life. At the time of death of the participant, the benefits become fully vested. The amount of annuity is based on the benefit the participant would have been eligible for if retirement had occurred on the date of death.

Defined contribution plans

Defined contribution plans determine the value of individual accounts on the basis of the amount of money contributed and the rate of return on the money invested. Definitions, key provisions, and related terms follow.

Types of plans

Types of defined contribution plans include savings and thrift plans, money purchase pension plans, deferred profit-sharing plans, employee stock ownership plans, individual retirement accounts (IRA, including traditional and Roth), simplified employee pensions, and savings incentive match plans for employees.

Savings and thrift plans. Employees may contribute a predetermined portion of earnings (usually pre-tax) to an individual account. Employers may match a fixed percentage of employee contributions or a percentage that varies by length of service, amount of employee contribution, or other factors. Contributions are invested as directed by the employee or employer. Although usually designed as a long-term savings vehicle, savings and thrift plans may allow withdrawals and loans before retirement.

Money purchase pension plans. Fixed employer contributions, typically calculated as a percentage of employee earnings, are allocated to individual employee accounts each year. Employers also may make profit-sharing contributions to these plans at their discretion.

Deferred profit-sharing plans. The employer contributes a fixed or discretionary amount of company profits to employees' accounts. The employer contribution is based on the profits of the company and may be zero. The contributions may be spread equally among all employees or may be based on the employee salary. Unlike a savings and thrift plan, a deferred profit-sharing plan does not require employees to contribute to their account in order to receive the employer's benefit.

Employee stock ownership plans (ESOPs). The employer pays a designated amount, often borrowed, into a fund that is then invested, primarily in company stock. Any debt incurred in the purchase of the stock is repaid by the company. Stock is then distributed to employees according to a formula. (Available in private industry only.)

Individual retirement accounts (IRAs). An IRA is a retirement savings plan. There are several types of IRAs: traditional IRAs, Roth IRAs, simplified employee pension (SEP) IRAs, and savings incentive match plans for employees (SIMPLE) IRAs.

Traditional and Roth IRAs are established by individuals who are allowed to contribute earnings up to a set maximum dollar amount. SEPs and SIMPLE are retirement plans established by employers.

Simplified employee pensions (SEPs). An individual retirement account (IRA) is established for each eligible employee at local financial institutions. The employee is immediately vested in employer contributions and generally directs the investment of the money. Employers have flexibility in the amount they contribute as long as the total of employer and employee contributions do not exceed the annual limit set by the Internal Revenue Service (IRS) or 25% of total employee compensation, whichever is less.

Savings incentive match plans for employees (SIMPLE). This type of plan is limited to employers with fewer than 100 employees and who also do not have any other qualified retirement plan. SIMPLE can be either part of a 401(k) plan or established as IRAs. Employers must either make matching contributions of up to 3 percent of compensation or make a 2 percent nonelective contribution to all eligible employees. Participants who are 50 years or older may make additional pre-tax employee contributions into a SIMPLE.

Methods of contributions

Methods of contributions can include employee or employer contributions, detailed below.

Employee contribution methods

Pre-tax contributions. This type of contribution is a feature of many savings and thrift plans and other defined contribution plans that allow employees to make contributions to deferred compensation plans through salary reduction agreements before federal and state taxes are deducted from pay. Distributions from a plan funded by pre-tax contributions are taxable at distribution.

Post-tax contributions. This type of contribution combines features of a Roth IRA plan and a 401(k) or 403(b) plan. Under these plans, employees are allowed to make part or all of their retirement plan contributions after taxes have been deducted, similar to the way a Roth IRA plan works. Post-tax contributions and their earnings are not subject to income tax upon distribution.

Amounts up to Internal Revenue Code (IRC) limit. The IRC provides for dollar limitations on benefits and contributions under qualified defined contribution plans. The IRC limit on employee contributions was $20,500 in 2022, $19,500 in 2021 and 2020, and was $19,000 in 2019. To see a historical list of IRC limits, see the Internal Revenue Service's cost-of-living adjustments for retirement items PDF.

Employer contribution methods

Methods employers may use for contributing to defined contribution plans include specified matching percent, fixed percentage of profits formula, and a percentage of employee earnings.

Specified matching percent. This feature is common in savings and thrift plans. The employer matches a specified percentage of employee contributions. The matching percentage can vary by length of service, amount of employee contribution, and other factors.For example, the employer will specify a percentage match of 50% up to a maximum employee contribution of 6%.

Two-tiered matching percent. The employer matches a percentage that varies by employee contribution. For example, the employer will match 100% up to a maximum employee contribution of 3%, then will match 50% up to the next 2% of employee contribution.

Fixed percentage of profits formula (Discretionary matching). This feature appears in deferred profit-sharing plans. Profit sharing plan employer contributions can be a fixed percentage of profits or discretionary. Profits may include those for the entire company or just those in a specific business unit. If the employer contributes a fixed percentage of total annual profits to the plan, it is based on a predetermined formula. For example, the predetermined formula could be that no matter what the level of profits, 5 percent of the total profit is contributed to the plan. In a different example, the predetermined formula could have the employer set aside a reserve amount of profits (for example, $1 million) and pay only a fixed percentage of any profits above this amount into the employees' defined contribution plan. If the employer contribution is discretionary, the contribution is not based on a predetermined formula. In that case, the employer must decide on the amount of the contribution.

Percentage of employee earnings. The employer contributes a fixed percentage of each employee's earnings to his or her individual account. This feature is common in money purchase pension plans.

Automatic enrollment

Automatic enrollment is a feature of some savings and thrift plans. As soon as eligibility requirements are met, employees become covered under a plan, but have the right to decline coverage at any time. A minimum default employee contribution and default investment vehicles usually are set, but employees may choose to contribute a different percentage and change investments.

Automatic enrollment provision. Workers are automatically enrolled in the retirement plan once they meet eligibility requirements unless they explicitly opt out.

Automatic escalation. Employee contributions are automatically increased at a predetermined rate over time, raising the contribution rate as a share of earnings. Employees may choose to contribute a different percentage.

Default contributions. The plan specifies the initial level of employee contribution. Employees may elect to contribute a percentage of earnings different from the default rate.

Maximum potential match. The plan indicates the maximum percentage of employee contributions that are matched by the employer either by employee election or through automatic escalation. Once this maximum is realized the employee may elect to contribute above that limit but employer contributions are capped.

Investment choices

Defined contribution plans either allot or provide choice of investment options, including the following.

Company stock. Employees receive equity in the company that sponsors the defined contribution plan.

Common stock fund. This is a professionally managed fund invested in the common stock of a variety of companies.

Fixed-interest securities. These securities include bonds and other nonfederal instruments that pay a fixed interest rate over a predetermined period.

Diversified investments. These are professionally managed funds that are invested in more than one type of equity or debt instrument.

Money market fund. This is a professionally managed mutual fund that invests in short-term Treasury bills, certificates of deposit, or corporate bonds. The fund managers sell shares to investors, who receive regular payments of interest.

Lifecycle fund (or target date fund). This is a balanced fund designed to become more conservative as the investor approaches retirement by moving from equity funds to fixed-income mutual funds.

Withdrawals, loans and transfers

Prior to retirement employees may want to use retirement funds for a variety of purposes. The IRS allows and plans may include provisions for accessing these funds. In some cases, there are stipulations of the purposes for using the funds.

Withdrawals. Prior to normal payout (usually at retirement), defined contribution plan participants may be allowed to withdraw all or a portion of the employer funds from their accounts.

Hardship withdrawals. Employees usually are not penalized when money is withdrawn as a result of a hardship, often defined as the death or illness of a family member, educational expenses, sudden uninsured losses, or a need to prevent eviction from one’s primary residence.

Loans. Defined contribution plans may allow participants to borrow employer funds, with interest, from their accounts. Loan amounts often are limited to a portion of the account balance. They usually have to be repaid within 5 years, but longer payment periods may apply for home purchase or renovation loans.

Transfers or rollovers. A direct payment of plan benefits from a defined contribution plan into an IRA or another employer’s plan. In a direct transfer or rollover, the employee is not taxed on the payment until it is withdrawn or distributed later.

Other retirement benefits

Payroll deduction IRA. This plan is established by the employer on behalf of the employee, but with no employer contributions. The employee can open either a traditional (tax deductible) or Roth (contributions are made after taxes but accumulate tax-free until retirement) plan with a financial institution, and the employee authorizes a payroll deduction by the employer. As long as the employer's involvement is minimal, the plan is not treated as an employer-sponsored retirement plan and it is not subject to the legal requirements of such plans.

Savings with no employer contributions. These are cash or deferred arrangement plans used to fund savings and retirement plans authorized by section 401(k), 403(b), or 457 of the Internal Revenue Code. The employees' contributions can be pre- and post-tax.