

Introduction to Pension and Retirement Benefits

Introduction to Pension and Retirement Benefits
(A concise, easy-to-read guide)

Benefits

1. What Is a Pension?

Aspect	Description
Definition	A regular payment made to an employee after retirement, usually based on salary and years of service.
Purpose	Provide financial security when an individual is no longer earning a regular wage.
Funding Sources	• Employer-funded – the company pays contributions. • Employee-funded – the employee contributes a portion of wages. • Hybrid – both parties contribute.
Typical Forms	• Defined Benefit (DB) plans – promise a specific benefit amount. • Defined Contribution (DC) plans – promise a benefit based on contributions plus investment returns.

2. Types of Retirement Benefit Plans

Plan Type	Who Bears Investment Risk?	Benefit Calculation	Common Examples
Defined Benefit (DB)	Employer	Formula = <i>Years of Service</i> × <i>Final Salary</i> × <i>Accrual Rate</i> (e.g., 1.5%)	Traditional corporate pensions, public-sector civil service plans
Defined Contribution (DC)	Employee (often shared)	Accumulated contributions + investment earnings	401(k) (U.S.), 403(b), 457(b), Superannuation (Australia)
Cash-Balance Plans	Hybrid – employer guarantees a “notional” account balance	Interest credit (e.g., 5% + CPI) + employer contributions	Often used by companies transitioning from DB to DC

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Hybrid Plans	Shared	Combination of DB guarantee + DC investment	Some municipal pension reforms

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3. Key Components of a Pension System

1. Eligibility & Vesting

- **Eligibility** – Minimum age or service length to join the plan.
- **Vesting** – The point at which the employee owns the accrued benefits (e.g., 5-year cliff, graded vesting).

2. Contribution Rules

- **Mandatory vs. Voluntary** – Some jurisdictions require minimum employer contributions; employees may add optional “salary deferral” amounts.
- **Contribution Limits** – Legal caps (e.g., IRS limits for 401(k) contributions).

3. Benefit Payment Options

- **Lump sum** – One-time cash payment.
- **Annuity** – Fixed periodic payments for life (or joint-life).
- **Combination** – Partial lump sum + annuity.

4. Portability

- Ability to transfer accrued benefits when changing jobs (e.g., rollovers to IRAs or other employer plans).

5. Regulation & Governance

- **Fiduciary duties** – Plan sponsors must act in participants’ best interests.
- **Regulatory bodies** – ERISA (U.S.), Pensions Regulator (UK), OSFI (Canada), etc.

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4. Funding and Actuarial Concepts Benefits

Concept	Meaning	Why It Matters
Actuarial Valuation	Periodic assessment of a DB plan's assets vs. liabilities.	Determines funding status and required contributions.
Funding Ratio	$\text{Assets} \div \text{Liabilities}$ (expressed as a %).	>100% = overfunded; <80% may trigger corrective actions.
Pension Cost	Employer's expense for future benefits	