



Retirement in focus: Defined benefit or defined contribution?

Understanding the terms

Defined Benefit Retirement Plan

A defined benefit retirement plan is one under which a retiree has a guaranteed benefit set by a formula. Contributions to the plan while working are set by the plan and funds are pooled and managed as a group. The participant's retirement benefit is guaranteed regardless of the portfolio performance. Under a defined benefit plan, participants are protected from the ups and downs of the market.

Defined Contribution Retirement Plan

A defined contribution retirement plan is one under which the retirement benefit is determined by how much was invested or contributed (the participant's defined contribution) and how well those investments paid off. Such contributions may come from the employer only, the employee only, or some combination – it depends on the plan. The contribution may be set by the plan or by participant choice. Management of the investments may be done by the plan or by the individual participant. There is no guaranteed retirement benefit in a defined contribution plan. Under a defined contribution plan, a participant's benefit is subject to the ups and downs of the market.

Frequently asked questions

Q: Why do some people prefer a defined benefit retirement plan?

A defined benefit plan is preferred by people who don't want to or have the time and expertise to think about how to invest and want a guaranteed benefit when they retire. For those who don't "play the market," a defined benefit plan offers peace of mind and a sure bet.

Q: Why do others prefer a defined contribution plan?

A defined contribution plan is preferred by people who feel comfortable working with investments or have high confidence in a particular investment manager. They want a more "hands on" interaction with their benefits. They depend on their skills in the market to bring a stable retirement benefit.

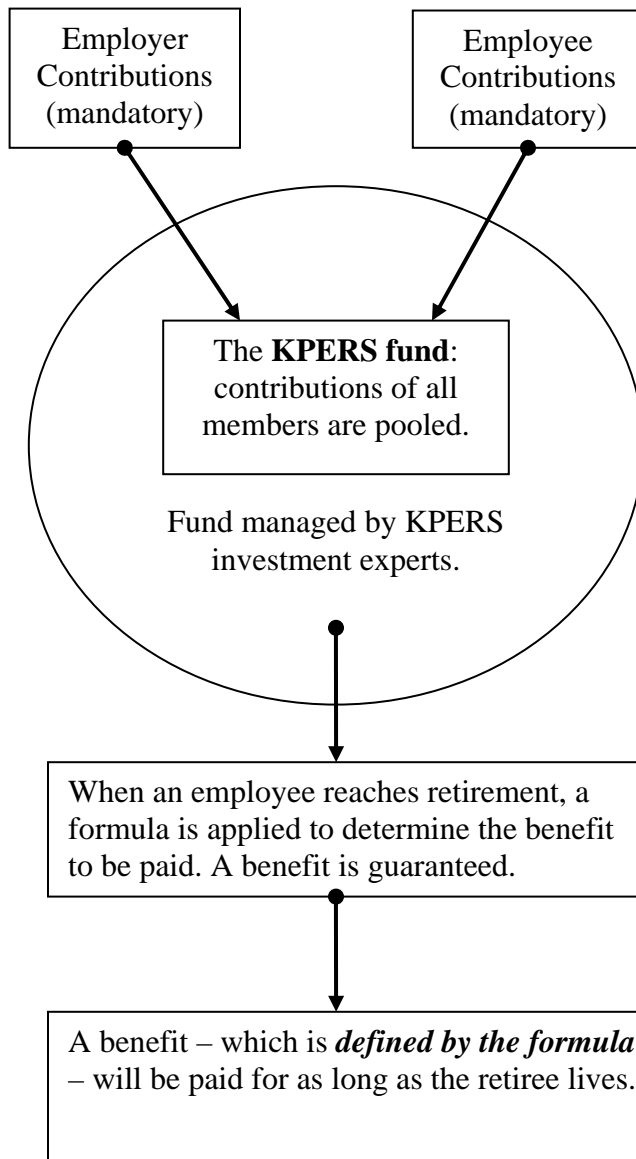
Q: I want to know I'm secure in retirement, is there ever a reason to want a defined contribution plan?

Defined benefit plans, with their guarantees, are very careful with the money they are investing. The annual rate of return on those investments is sometimes less than the market return overall but it also tends to be a stable return over time. A look at the boom of the 1990s followed by the serious recession of 2000 through 2004 shows that large gains can be wiped out relatively quickly. If those losses should coincide with your desired retirement date, you may be in trouble. A defined benefit plan insulates the participant against market swings. If your biggest concern is the security of knowing that you can retire with a sure bet, then you want a defined benefit plan. If you have some discretionary income, you might like to have the option of an additional defined contribution plan to use as a kind of "savings account."

Q: They say the return on investment in a defined contribution plan is so much better, why would I want to stay with defined benefit?

The return is a *potential* return! Depending on your investment strategy, you could also lose a lot of money. Remember, what you have at retirement is the result of your investment strategy and the higher the potential returns, the higher the risks. One bad year close to your retirement age can wipe out the earnings of your boom years. Imagine getting ready to retire in 2008 and seeing your investments fall by 50% or more. **Remember – past performance is not a guarantee of future earnings!**

KPERS Defined Benefit plan



Defined Contribution retirement plan

