

Managing in Tough Times: Downsized—Job Loss and Retirement Plans¹

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Introduction

Job loss can create many complications and generate many questions. Individuals may worry about maintaining their current standard of living as well as what budget cuts need to be made. In addition, individuals will need to focus on finding a new job.

Furthermore, individuals will also need to be aware of the status of benefits from their recent jobs. There are some common questions you may have with respect to your retirement plan(s). The following information will help you to be better prepared to answer these questions for your specific situation.

- Will my retirement plan investments be safe?
- What will happen to my current retirement benefits?
- Can I use my retirement funds if needed without penalty?

Will My Retirement Plan Be Safe?

In many instances your funds should be safe, even if you are laid off or your company shuts down. Employers must follow federal guidelines when setting up retirement plans for employees. These guidelines are enforced with penalties for non-compliance. However, this is not to say that your benefits are guaranteed. Only Defined Benefit Plans are insured.

The issue of retirement plan safety can arise in the event of a company filing bankruptcy. If you had a savings plan which owned stock in your company, this is likely to lose a great deal of value. However, this would not impact the value of your plan outside of investments in your company. If an employer files bankruptcy, immediately contact your plan administrator to discuss what you need to do. The name of your plan administrator is on the latest copy of your summary plan description. This document outlines your benefits and how they are calculated. You could also find this information by contacting the company's human resources or personnel department. Finally, you can also obtain assistance from the IRS, or the PBGC (explained later in the Defined Benefits Plan section). If you contact one of these agencies, you will need to know your employer's identification number (EIN), a nine-digit number found on your W-2.

Always monitor the trustworthiness of your employer and plan administrator. To assist with this, the Employee Benefits Security Administration (EBSA) publishes a list of 10 warning signs. These are indicators to look for that could indicate financial difficulties for your retirement plan. This publication and can be found at http://www.dol.gov/ebsa/Publications/10warning_signs.html.

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EBSA administers the Employee Retirement Income Security Act of 1974 (ERISA). ERISA is an important piece of literature—passed to protect the retirement assets of millions of Americans, it provides certain rights and protections to retirement and health plan participants and their beneficiaries. One critical right is that funds you have contributed to your plan are always yours and cannot be taken away. This does not mean that the funds you choose in your retirement cannot lose money, because they can. It means that the money that you have contributed cannot be reclaimed by your employer, an investment firm, or any other organization. Additionally, if you suspect that your retirement benefits are being misused, you should contact your nearest EBSA office. Contact information is listed at the end of this article.

The remainder of this discussion is divided into the two main types of plans: [Defined Benefit Plans](#) and [Defined Contribution Plans](#). Each of these sections discusses the second question as to the possible outcomes there are for your plans. If you do not have a defined benefit plan, feel free to skip this section.

What Happens: Defined Benefit Plans

A defined benefit plan is a plan in which you are assured a specific benefit upon retirement, based on your years of service and average salary from the company. These are also referred to as formula-based pensions. Plan contributions are done only by the employer, with the amounts being defined ahead of time.

While, most defined benefit plans do not include options for early withdrawal under any circumstance, there are a few plans that do allow for early withdrawal. Most have rules about how and when the money can be distributed. Additional requirements may include a set date to start receiving payments, or a certain age threshold for annuity and lump-sum payments. Some plans have a maximum number of years of service that will count towards receiving benefits, typically 30 years.

There will be a process for benefit distribution. You should ask your company about rules and procedures and fill out the proper paperwork.

ASSUME a defined benefit plan provides 1% of final salary for each year of service and that an employee was laid off after working 15 years with a specific company and was earning \$50,000 a year as his final salary. At this time, he would be entitled to \$7,500 (15% of \$50,000) once he attained age 65.

ALTERNATELY, assume the same employee retires at age 65 after 30 years of working with this same company and is now earning \$60,000 a year. He would then be entitled to \$18,000 (30% of \$60,000) for life in retirement. As you can see, having stayed with the company longer allowed the employee to attain more years of service and retire on a higher salary, providing him with more money in retirement.

You are required to fill out paperwork before receiving any distributions. After filing the paperwork, funds will be distributed to you, but the payment schedule may vary. Some plans will process requests at set times during the year. Other plans will process your lump-sum distributions or set a schedule of payments immediately.

An individual will still receive benefits if fired. However, the yearly amount will be less than if they had stayed with the company longer. For example, someone may have had to work for as long as 30 years to reach this maximum benefit.

In a defined benefit plan, the plan administrator generally files certain documents with the IRS and the Pension Benefit Guaranty Corporation (PBGC). Once the PBGC approves the termination (fired or retired—both are generally referred to as termination of employment), benefits are generally distributed. The distribution is typically distributed either in a lump sum, or as an annuity within one year of termination. An employee may not have access

to these funds quickly. Therefore, these funds may not be of great help in the short-run if one is facing a layoff.

The federal government might also insure your benefits, even if the company files for bankruptcy. Defined benefit plans are insured by the PBGC, which is a federal corporation. This insurance protects the employee so that if the employer is no longer able to fund the plan or the plan cannot pay the promised benefits, the PBGC will assume responsibility of the plan and will pay benefits up to a maximum guaranteed limit.

What Happens: Defined Contribution Plans

A defined contribution plan allows employers (typically through the form of a percent match of the employee contribution or a form of profit sharing) and employees to contribute to a savings plan which will have various investment choices. A defined contribution plan does not have a set amount that will be paid upon retirement or termination; rather, the amount one would have at that time would be based on how much was contributed to the plan and how it was invested. Thus, the term defined contribution refers to the fact that the amount going into these plans is specified, although the amount available is subject to the value of the investment. Two popular versions of these plans are the 401(k) and profit-sharing plans. Defined contribution plans are more likely than defined benefit plans to allow for early distribution of benefits. These plans usually offer a lump-sum distribution when you leave your employer. However, ERISA does not require that plans provide lump-sum distributions, so this might not always be the case. Also, note that those lump-sum distributions could affect your ability to receive unemployment compensation. You should seek financial assistance or check with your state's unemployment office before deciding what action you will take.

Unfortunately, defined contribution plans are not protected by the PBGC. The value of these plans is based on the current fair market value of the securities held in the plan. For more information on investing, check out *Investing for Your Future* on the eXtension.org Web site by going to http://www.extension.org/pages/IFYF_Study

[Guide](#), or see the UF/IFAS FYCS *Young Investor* Web site at <http://fycs.ifas.ufl.edu/younginvestor/>.

So what happens when your employment ends? In a defined contribution plan, the plan administrator will submit retirement plan and tax information to the IRS. This process may delay plan termination and subsequent payment of any benefits. You should contact your plan administrator for information on status and length of time well before you expect to receive your money

Vesting

Once an employee has been terminated, it is important to determine whether that employee's retirement plan was "vested," and, if so, how much was "vested."

FOR EXAMPLE, if an employee has \$100,000 in their retirement account and they are 80% vested when they leave the company, that employee is entitled to \$80,000 from their employer.

When an employee is vested, they are eligible to keep the employer contributions made to the plan along with theirs; otherwise, they can only keep theirs. An employee will keep the amount of money that they already are vested in. This means that if you are only partially vested, you still get a portion of it. This would be based on the percent that the person is partially vested. An employee is always 100% vested in all of his or her salary-deferral contributions. This is also true for Simplified Employee Pensions (SEP) plans and Savings Incentive Match Plans for Employees (SIMPLE) plans employer plan contributions. An employee becomes vested after attaining a certain number of years of service, which can be determined by referring to the retirement plan document.

The Catch-22: Early Withdrawal and Rule 72-t

Rule 72-t is the catch-all rule that imposes a tax penalty for the majority of early withdrawals from retirement accounts. The rule states that you will

incur a 10% tax penalty when withdrawing from a retirement plan earlier than the age of 59½. This is a vital factor to consider and one which should be avoided at all costs—paying a 10% tax penalty could set you back years on your retirement planning. Additionally, the amount withdrawn is subject to income tax and would result in additional taxes owed when you file your next annual tax return. The amount you would owe for taxes may already be withheld when you receive your early distribution. However, if it is not, then you must put this money aside so that you have it available when the tax bill comes due the following April.

One major exception to this rule as of this writing is if you leave or are forced to leave your job during the year you turn 55 or after. Other exceptions can be found on the IRS Web site at http://www.irs.gov/retirement/article/0,,id=103045_00.html.

FOR EXAMPLE, assume you have a \$100,000 balance in your 401(k). The penalty on a \$100,000 early withdrawal would be \$10,000. There would also be regular income taxes due on this \$100,000. So, if you are in the 35% tax bracket, you would also have to pay \$35,000 for income taxes.

Keep in mind that not all plans are subject to Rule 72-t. It is important to check your summary plan description to see whether your plan allows for early withdrawal, and what the penalties might be for you.

Rollovers

After you leave your employer, you may keep your money in your current plan, or roll over the money into a similar qualified plan. There are two ways to do this: the *direct method* will have money go from one account to the other, while the *indirect method* will send you the money first for you to put into the account. There are no current tax consequences for a direct transfer. When done indirectly, however, 20% of the account balance is withheld for tax purposes.

This is because the taxes for this disbursement will be part of your annual income tax return. This amount will be paid back to you after you deposit the full account balance in a new eligible retirement plan within 60 days. (Note: the 20% withholding is not required when the full account balance is less than \$200.) If done correctly, an account rollover allows you to keep the tax benefits on the account without having to pay taxes for transferring the funds.

Conclusion

One of the most important things to do upon leaving a job is to review your retirement plan documents. Two key documents are the *summary plan description* and the *individual benefits statement*. Call your plan administrator to determine how the situation affects you and your retirement accounts. Before you request retirement funds from the plan, you should talk to your employer, bank, union, and/or financial adviser for practical advice about the long term, and about tax consequences. It helps to know in advance the rules of the plan and how job loss will affect your retirement accounts. Save all documents that pertain to your employer's retirement plans. These are especially valuable in the event that you are laid off, or your plan manager misuses your account funds. If you have further questions, or would like to do additional research, you can visit the agency Web sites below for more information:

- Pension Benefit Guaranty Corporation
PBGC – www.pbgc.gov
or call 1-800-400-7242
- Employee Benefits Security Administration
EBSA – <http://www.dol.gov/ebsa>
or call 1-800-444-3272
- Internal Revenue Service
IRS – www.irs.gov or
<http://www.irs.gov/localcontacts/index.html>
for your nearest IRS office

References & Resources

- Withdrawing Pension Money if You are Laid Off: Attorneys and Lawyers for Employment Lawsuits | EmploymentLawFirms.com [Online]. Retrieved from <http://www.employmentlawfirms.com/withdrawing-pension-money-if-laid-off.cfm>
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