

## *Week 4 - DQ 1*

*What are the differences and similarities between a defined contribution plan and a defined benefit plan? As an employee, explain why you would rather have a defined contribution plan or a defined benefit plan? What experience do you have with pension plans in your organization or an organization that you are familiar with? As an employer, explain why you would rather offer a defined contribution plan or a defined benefit plan to your employees?*

### *Response #1*

In a defined contribution plan, the employer agrees to contribute to a pension trust a certain sum each period based on a formula. The employee gets the benefit of gain from the assets contributed to the pension plan. A defined benefit plan outlines benefits that employees will receive when they retire. The employees are the beneficiaries of a defined contribution trust, but the employer is the beneficiary of a defined benefit trust.

A defined benefit plan would probably be more beneficial for an employee if they plan on staying with a company for many years. The benefits of the plan would be outlined and guaranteed. A defined contribution plan has no guarantee of benefits, just guarantee of contribution. A defined contribution plan is more beneficial for employers because it is cheaper and cost no more than 3 percent of payroll compared to 5 or 6 percent of payroll for a defined benefit plan.

I contribute into a defined contribution plan that is like a 401k. Right now the plan is not doing well because of the stock market, however, I hope that it will turn around and do much better in the coming years leading up to my retirement.

## *Response #2*

Employers often assent to contribute to a pension trust a certain sum each period, based on a defined contribution or defined benefit plan's formula. A defined benefit plan's formula may include items such as the length of employee service and the compensation level. On the other hand, a define contribution plan's formula could also include the length of employee service and the compensation level, but it may also considers factors such as employer's profits and age. A defined benefit plan outlines the benefits that employees will receive when they retire. A defined contribution plans defines only the employer's contribution without outlining the ultimate benefits paid out to the employees. I would rather have a defined contribution plan because the benefits are guarantee and they go directly to my retirement instead of going to the employer. In other words, I will be the beneficiary not the company. In addition, with a defined contribution plan such as 401K the money is guaranteed but not so with a define benefit plan in which the money is tie to how well the company safeguard its assets. Knowing that my employees are a very important part of my organization, I would rather offer a define contribution plans because they it offers better benefits to them, is less risky, and cheaper. My company is currently offering this type of plan.

## *Response #3*

Defined contribution plan is the amount that the employer allows to place in a pension trust. The contribution is formulated and the defined contribution plan will relate only to the employers contribution. This type of plan doesn't provide you with a set amount that can be claimed upon retirement. The defined benefit plan has a set amount that the employee will receive upon retirement. The set amount is not formulated but will be based upon the number of years they are with the organization. The difference between the two plans is that in the define contribution plan, the beneficiaries are the employees in contract with the defined benefit plan the beneficiary is the employer. I personally would choose the defined benefit plan as it will have a promised retirement amount when I am ready to retired. It's like a set amount that I know I can count on versus on having to estimate on a figure.

#### *Response #4*

A defined contribution plan and a defined benefit plan are both are two types of pension plans offered by an organization to employees. In the defined contribution (DC) plan the employers determine the upfront amount and contributions paid during a period. The amount an employee receives is determined by his/her contributions with variables such as age, length of service, upfront contributions, etc affecting the receivable amount. The defined contribution plan is easier for employers to compute because a company only has to determine how much upfront costs are to be paid. The market rate does not affect the organizations contributions and the accounting for the DC plan is simple. An example of a DC plan is 401K. In my early twenties I had a 401K in which I had a percentage of my income contributed into my 401K account and my employer matched a certain percentage. Unfortunately, I did not make the deadline in rolling my account into another IRA, 401K account so I received a payment in which a huge chunk of taxes was taken out.

The defined benefit (DB) plan is more complex for employers because the stated benefit at the time of retirement is specified therefore companies have to compute the formula using the time value of money (TVM). This is risky for employers because they have to make sure that they made the legal, contributed retired promise to the employees no matter the market rate, economic conditions, etc. This is beneficial to employees because they know what their retirement funds will be and can plan accordingly.

If I were an employer I would definitely offer the DC plan because it the accounting is simple and the risk is assumed by my employees. Honestly, I have never heard of defined-benefit plans until this week's readings.