

Defined Contribution Retirement Plans Become More Prevalent

BY ANN C. FOSTER

Many factors have contributed to the trend in recent years towards retirement coverage under defined contribution plans and away from defined benefit pension plans.¹ Reasons often cited include changes in pension and tax laws and accounting procedures, in addition to employer attempts to curtail escalating pension costs. Another factor underlying the recent participation growth in defined contribution plans has been the rise of 401(k) arrangements, which give employees the opportunity to defer income and taxes by making contributions to their retirement plans.²

Data from the Employee Benefits Survey show that in 1985, 41 percent of full-time workers in medium and large private establishments participated in defined contribution retirement plans compared to 80 percent in defined benefit plans.³ (See chart 1.) By 1993, 49 percent of full-time workers participated in defined contribution plans compared to

56 percent in defined benefit plans.⁴ Starting in the mid-eighties, employers increasingly added 401(k) tax-deferred provisions to their defined contribution plans or established new plans with 401(k) provisions. Between 1985 and 1993, the percent of full-time workers enrolled in plans with 401(k) provisions jumped from 26 to 43 percent.⁵

Types of defined contribution plans

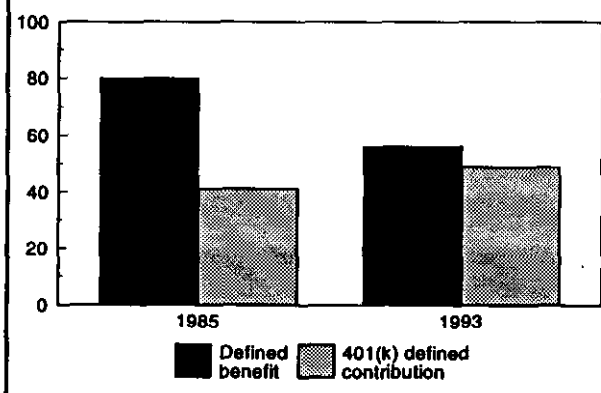
There are several types of defined contribution plans: Savings and thrift, deferred profit-sharing, money purchase pension, employee stock ownership, and stock bonus plans.

Savings and thrift plans. In 1993, 29 percent of full-time employees participated in a savings and thrift plan, making it the most prevalent type of defined contribution plan.⁶ (See table 1.) Nearly all participants (99 percent) were in 401(k) plans.

Savings and thrift plans require a basic employee contribution that invokes an employer's matching contribution. A common matching provision is for an employer to match half of an employee's contribution, up to the first 6 percent of earnings. The vast majority of plans also permit a voluntary contribution, which is a contribution by the employee in excess of the maximum amount matched by the employer. In some plans, an employer may provide additional discretionary contributions based on profitability. Twelve percent of savings and thrift plan participants were in such plans in 1993.

Most savings and thrift plans offer more than one investment choice. These include bond funds, company stock, common stock funds, government securities, guaranteed investment contracts issued by insurance companies, and money market funds. Participants can usually direct their contributions, but may not always be able to choose how the employer contributions will be allocated. Eighty-six percent of plan participants could decide where their con-

Chart 1. Percent of full-time employees participating in defined benefit and 401(k) defined contribution plans, medium and large private establishments, 1985 and 1993



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tributions were invested. Fewer (58 percent) could decide where employer contributions were invested. In 1993, the number of investment choices ranged from two to seven or more, with four being the most common.

Prior to payout at retirement or because of disability or termination of employment, many savings and thrift plans allowed participants to withdraw some or all of their employer's contributions. In 1993, 29 percent of plan participants were able to withdraw their employer's contributions for any reason, while another 18 percent could make withdrawals for hardship reasons, such as medical or educational expenses. As an alternative to withdrawals, employees may be able to borrow from their plans. In 1993, 48 percent of savings and thrift plan participants were allowed to borrow from their account.⁷

Deferred profit-sharing plans. In 1993, 13 percent of full-time workers participated in deferred profit-sharing plans. Of those, 40 percent were in plans that use a specified formula, such as a fixed percent of profits, while 60 percent were in plans in which contributions were made at the employer's discretion. Only 23 percent of participants were in plans requiring employee contributions, while 13 percent were in plans allowing, but not requiring, employee contributions. Twenty-eight percent of plan participants were in plans with salary reduction 401(k) features, while another 6 percent had a choice to receive a portion of the profits in cash, with the remainder being placed in a tax-deferred account.

Employer contributions were allocated to participants' accounts in several ways, the most common of which is proportional to earnings (52 percent of participants). Other

Table 1. Participation in retirement income benefits programs by full-time employees in medium and large private establishments, 1993

(In percent)

Type of plan	All employees	Professional, technical, and related	Clerical	Blue-collar and service
All retirement plans ¹	78	83	78	78
Defined benefit	56	57	54	56
Defined contribution ²	49	60	54	40
Savings and thrift	29	38	34	21
Deferred profit sharing	13	12	16	12
Money purchase pension	8	13	7	6
Stock ³	3	4	4	2

¹ Includes defined benefit pension plans and defined contribution retirement plans. The total is less than the sum of the individual items because many employees participated in more than one plan.

² Plans with employer contributions, including 401(k) and non-401(k) plans.

³ Employee stock ownership and stock bonus plans.

common allocation methods were those proportional to employee contributions (19 percent) and those based on earnings and service (11 percent).

Features commonly found in savings and thrift plans common allocation methods were those proportional to employee contributions (19 percent) and those based on were not as readily available to participants in deferred profit-sharing plans. For example, about half of participants were enrolled in plans that allowed them to choose investments. Only 21 percent were in plans allowing the withdrawal of employer's contributions and only 23 percent were in plans with loan provisions.⁸

Other types of plans. Eight percent of full-time workers participated in money purchase pension plans in 1993. These plans are funded by employer contributions, most often a percentage of an employee's earnings. Employee contributions are rarely required or allowed. When permitted, however, employee contributions are usually made on a pretax basis. Accounts may not be accessed, by either withdrawal or loan, prior to retirement. These plans are sometimes thought of as pension plans because they often provide a fixed payment to participants at retirement. This is accomplished by using the funds accumulated in an employee's account to purchase an annuity that guarantees a periodic payment for life.

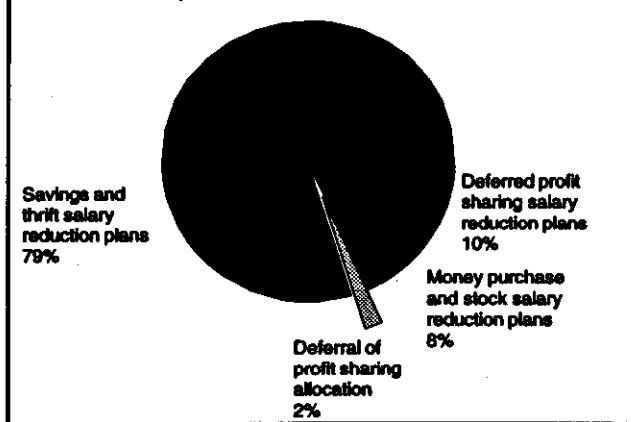
Only 3 percent of full-time employees participated in stock plans in 1993. Of them, less than 0.5 percent participated in *stock bonus plans*, while nearly 3 percent participated in *employee stock ownership plans* (ESOP's). A stock bonus plan specifies employer only or employer and employee contributions to a trust fund that invests in various securities. ESOP's are usually financed entirely by the employer and must be designed to primarily invest in company stock. They also may be the means by which employees purchase their company, with stock periodically distributed to employee accounts as loans used to finance the purchase are repaid.

Cash or deferred arrangements

All defined contribution plans, except ESOP's, may come with cash or deferred arrangements, commonly called 401(k) plans. These arrangements allow participants to choose between receiving currently taxable income or to defer taxation by placing pretax income in a retirement account. If an employee participates in a 401(k) plan, income taxes on the employee's contributions and earnings are deferred until the employee begins plan withdrawal. The employee's contributions are sometimes referred to as employee elective deferrals.

Most employees (84 percent) under 401(k) arrangements are in plans with employee contributions rather than free-standing plans without them. Almost all employees in 401(k) plans with an employer match, were in salary reduction plans. For 79 percent of them, a savings and thrift plan was the vehicle for salary reduction and for 10 percent

Chart 2. Percent of full-time employees participating in cash or deferred arrangements, defined contribution plans with employer contributions, medium and large private establishments, 1993



it was a deferred profit-sharing plan. Another 8 percent had other vehicles such as a money purchase pension plan or stock plan. (See chart 2.)

An alternative available to some profit-sharing plan participants is a deferral of profit-sharing allocation. This gives participants the choice of receiving the allocation immediately or deferring it and postponing taxation until distribution. Two percent of employees in defined contribution plans with an employer contribution participated in such plans.

The data in this report are from the Bureau of Labor Statistics' Employee Benefits Survey of medium and large private industry establishments. The survey covers establishments with 100 or more workers. Only data for full-time workers are presented.

For more information on 401(k) and other defined contribution plans, contact Ann C. Foster at (202) 606-6284; Fax (202) 606-7856.

—ENDNOTES—

¹ In defined contribution plans, an account is established for each participating employee. Generally the employer, and often the employee as well, make fixed (or defined) contributions to the account. Benefits at retirement are not predetermined, but depend on contributed amounts and any investment earnings. In defined benefit plans, predetermined formulas are used to calculate retirement benefits, which are usually based on salary and number of years of service.

² It should be noted that a small part of the decline in defined benefit plan coverage stems from the 1988 Employee Benefit Survey expansion to include all service industries. Defined benefit pension coverage has traditionally been more prevalent in goods-producing than in service-producing industries. For more information, see *Employee Benefits in Medium and Large Firms, 1988*, Bulletin 2336, Bureau of Labor Statistics, 1989.

The term 401(k) refers to the section of the Internal Revenue Code that allows employees to choose to have a portion of their compensation (otherwise payable in cash) invested in a qualified defined contribution plan on a tax-deferred basis. In the Employee Benefits Surveys, similar arrangements authorized under section 403(b) of the Internal Revenue Code are also tabulated as 401(k) plans.

³ Some workers have coverage under both a defined contribution and defined benefit plan, thus, the total may exceed 100 percent. For additional information see *Employee Benefits in Medium and Large Firms, 1985*, Bulletin 2262, Bureau of Labor Statistics, 1986.

⁴ Data for 1993 used in this article were obtained from *Employee Ben-*

efits in Medium and Large Private Establishments, 1993, Bulletin 2456, Bureau of Labor Statistics, 1994.

⁵ Nearly all of these employees participated in defined contribution plans. Defined benefit provision plans with such features are rare in the private sector.

⁶ The Employee Benefits Survey only collects detailed information on defined contribution plans (with or without 401(k) features) with an employer contribution. For this reason, employees participating in freestanding plans are not included in table 1.

⁷ For more information on savings and thrift plans, see Ann C. Foster, "Employee Participation in Savings and Thrift Plans, 1993," *Monthly Labor Review*, March 1996, pp. 17-22.

⁸ For more information on profit-sharing plans, see Edward M. Coates, III, "Profit Sharing Today: Plans and Provisions," *Monthly Labor Review*, April 1991, pp. 19-25.

⁹ For 401(k) plans with no employer contributions, the Employee Benefits Survey participants as those making contributions. For plans offering cash or deferred arrangements, whether or not workers actually made pretax contributions.

¹⁰ For information on small private establishments, see *Employee Benefits in Small Private Establishments, 1994*, Bulletin 2475, Bureau of Labor Statistics, 1996. For more information on benefits provided to state and local government workers, see *Employee Benefits in State and Local Governments, 1994*, Bulletin 2477, Bureau of Labor Statistics, 1996.