

Pensions and Individual Retirement Accounts (IRAs): An Overview

June 1, 2022

Congressional Research Service

<https://crsreports.congress.gov>

R47119



Pensions and Individual Retirement Accounts (IRAs): An Overview

A pension is a voluntary benefit that employers can offer to assist employees in providing for their financial security in retirement. Pension plans receive a number of tax advantages and vary along a number of characteristics, such as whether the employer that sponsors the plan is in the public or private sector and whether the benefit is paid according to a specified formula (a defined benefit [DB] plan) or is based on funds that accumulate in a worker's account (a defined contribution [DC] plan). In 2021, nearly three-quarters (71%) of the U.S. civilian workforce had access to, and more than half (56%) participated in, pension plans at their workplaces.

The earliest pensions in what later became the United States were provided by several of the colonies or by the Continental Congress for disabled members of the military. The first private-sector pension plan appears to have been created by the American Express Company in 1875. In the public sector, the earliest pensions were provided by some cities for disabled police and firefighters. The first pension plan to cover general state employees began in Massachusetts in 1911. During this time, pension plans had limited oversight or benefit protections at the federal or state level. In 1963, the bankruptcy of the Studebaker automobile company resulted in a number of plan participants receiving either a fraction of their promised benefits or losing their benefits entirely. The incident became the catalyst for the reform of legislation covering private-sector pensions, leading to the passage of the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406).

Since ERISA, an increasing number of private-sector workers have been covered by DC plans rather than DB plans. In 1984, the number of active participants in the private sector in DC plans surpassed the number of active participants in DB plans and, by 2019, was six times as large. In contrast, state and local government employees continue to be covered mostly by DB plans. More than 97% of current civilian federal employees participate in both a DB and a DC plan.

While pension plans are sponsored by employers, Individual Retirement Accounts (IRAs) are retirement savings accounts workers may establish independently at financial institutions. IRAs serve multiple purposes. Workers, including those without access to pension plans through their employers, may be eligible to save for retirement outside of the workplace through IRAs. Also, a worker can deposit DC savings, or a lump sum payment from a DB pension (if available), into an IRA at job change in a process called a *rollover*. Rollovers preserve the tax advantages of workers' DC savings. IRA-based retirement plans also allow employers to offer their employees a retirement savings option with minimal employer involvement.

In recent years, some states have authorized or implemented state-facilitated retirement savings programs for workers who do not have access to employer-sponsored plans. Most of the state-facilitated programs are IRA-based plans; others include retirement marketplaces and multiple-employer plans.

This report provides an overview of employer-sponsored pensions: both DB and DC plans sponsored by the federal, state, and local governments and employers in the private sector; IRAs (including IRA-based retirement plans); and state-facilitated retirement savings programs. The report provides context for understanding current legislative efforts to improve retirement security.

R47119

June 1, 2022

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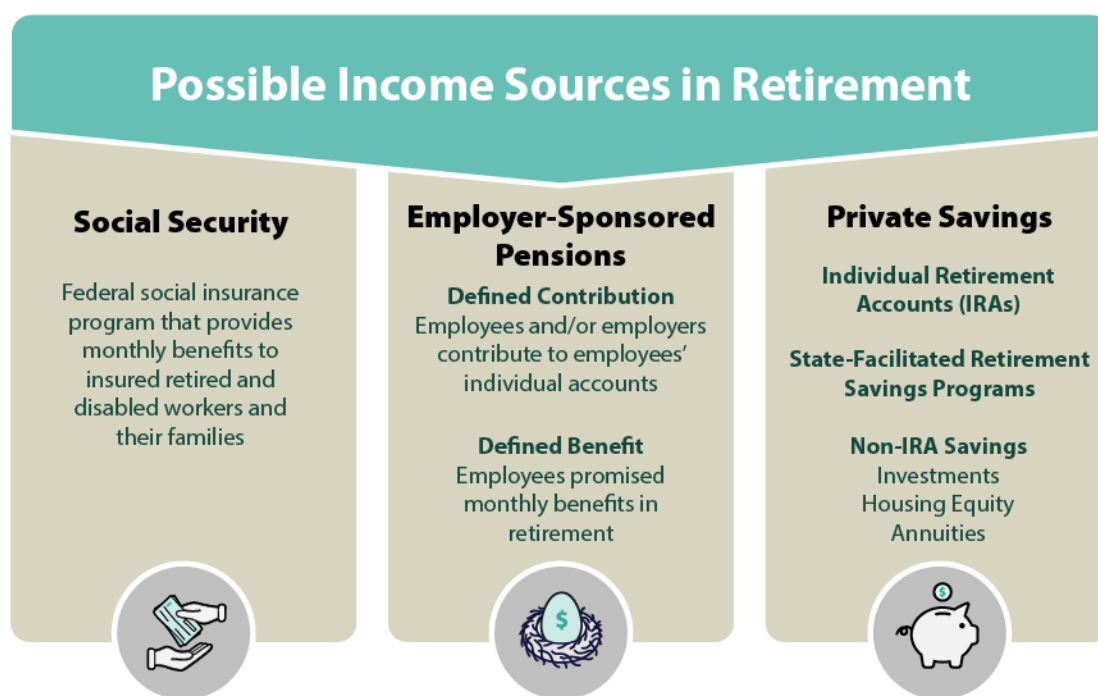
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Introduction

A pension is a voluntary benefit offered by employers to assist employees in providing for their financial security in retirement. Savings in employer-sponsored pensions are one of three possible income sources in retirement, along with Social Security (a federal program that provides monthly cash benefits to most retired or disabled workers and their family members) and private savings.¹ Private savings include Individual Retirement Accounts (IRAs), state-facilitated retirement savings programs, and other non-IRA savings, such as annuities (see **Figure 1**).²

Figure 1. U.S. Retirement Income



Source: CRS.

This report provides an overview of employer-sponsored pensions, IRAs (including IRA-based retirement plans), and state-facilitated retirement savings programs. Pension plans vary along a number of dimensions, such as whether the employer that sponsors the plan is in the public or private sector and whether the benefit is paid according to a specified formula or is based on funds that accumulate in a worker's individual account. In 2021, nearly three-quarters (71%) of U.S. workers had access to, and more than half (56%) participated in, pension plans at their workplaces. Pensions and retirement policy is an area of ongoing congressional interest as lawmakers seek ways to improve the retirement system for both employers and employees.

¹ Social Security also provides benefits for the eligible family members of insured deceased workers. More information about Social Security is available in CRS In Focus IF10426, *Social Security Overview*.

² Annuities are insurance products that provide regular—typically monthly—payments for a specified number of years or for an individual's and spouse's life, if married. Annuities can be purchased either as a lump sum or as an ongoing purchase and either as a standalone product, in a retirement plan, or in an IRA. For example, individuals can convert part or all of their retirement savings for monthly payments for life or use part or all of their regular retirement contributions to purchase annuities that will provide monthly payments in retirements. For more information, see Investor.gov, "Annuities," <https://www.investor.gov/introduction-investing/investing-basics/glossary/annuities>.

History of Pensions

The earliest pensions in what later became the United States were provided by several of the colonies and then by the Continental Congress for disabled members of the military. The U.S. Army pension plan was funded out of general revenue (current benefits were paid from current government revenue) while the U.S. Navy pension plan was funded by prizes from captured ships. The prizes that funded the U.S. Navy pension plan were invested in an effort to provide a consistent source of revenue for the plan.³

The first private-sector pension plan appears to have been created by the American Express Company in 1875. By 1925, about 400 pension plans covering about 4 million employees had been established, mostly by large companies in the railroad and utility industries.⁴ During the Second World War, wage and price controls prevented employers from using higher wages to attract scarce labor. Instead, an increasing number of employers offered other forms of compensation, such as pensions, to recruit and retain employees.⁵

The bankruptcy of the Studebaker automobile company in 1963 resulted in a number of pension plan participants receiving either a fraction of their promised benefits or losing their benefits entirely. The incident became the catalyst for pension reform, eventually leading to the passage of the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406).⁶ When ERISA was enacted, defined benefit (DB) pension plans had more participants than defined contribution (DC) pension plans did, though by 1984, the number of active participants in DC plans surpassed the number of active participants in DB plans and was six times as large in 2019.⁷

In the public sector, the earliest pensions were provided by some cities for disabled police and firefighters. The first pension plan to cover general state employees was in Massachusetts in 1911.⁸ Because government workers were generally excluded from Social Security when it was created in 1935 due to concerns about the constitutionality of the federal government taxing state governments, and because some states already provided pensions for their employees, an increasing number of states created pension plans to cover their employees. By 1950, nearly half of the largest state pension plans had been established.⁹ State and local government employees continue to be covered mostly by DB pension plans.¹⁰ Since the late 1990s, an increasing number

³ As a result of poor investment returns, in 1841, Congress passed legislation that began paying Navy pensions from the general fund of the U.S. Treasury again. See *Public Statutes at Large*, ed. Richard Peters, vol. 5 (Boston: Charles C. Little and James Brown, 1848), p. 440. See Robert L. Clark, Lee A. Craig, and Jack W. Wilson, *A History of Public Sector Pensions in the United States* (Pension Research Council, 2003).

⁴ See Raymond Schmitt, *The Historical Development of the Private Pension System*, Congressional Research Service, 72-77 ED, March 24, 1972, pp. 6-7.

⁵ See Patrick W. Seaburn, "Evolution of Employer Provided Defined Benefit Pensions," Bureau of Labor Statistics, December 1991, <https://www.bls.gov/mlr/1991/12/art3full.pdf>.

⁶ See James Wooten, "'The Most Glorious Story of Failure in the Business': The Studebaker-Packard Corporation and the Origins of ERISA," in *The Employee Retirement Income Security Act of 1974: A Political History* (Berkeley: University of California Press, 2005).

⁷ Active participants are individuals who are earning credit under DB plans or are making, or are eligible to make, contributions to DC plans. See CRS In Focus IF12007, *A Visual Depiction of the Shift from Defined Benefit (DB) to Defined Contribution (DC) Pension Plans in the Private Sector*.

⁸ See Clark, Craig, and Wilson, *A History of Public Sector Pensions in the United States*.

⁹ Clark, Craig, and Wilson, *A History of Public Sector Pensions in the United States*.

¹⁰ See, for example, Urban Institute, *State and Local Finance Initiative: State and Local Government Pensions*, <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/state-and-local-government-pensions>.

of states and localities have modified their pension plans, with many offering hybrid *cash balance* plans or DC plans as alternatives or enhancements to traditional DB benefits.¹¹

Congress passed the Civil Service Retirement Act of 1920 (P.L. 66-215) to provide pension benefits for federal employees. Federal employees were not covered by Social Security when it was created in 1935 and remained outside of it until Congress passed the Social Security Amendments of 1983 (P.L. 98-21), which required all civilian federal employees hired after 1983 to participate in Social Security.¹² As a result, the Federal Employees' Retirement System (FERS) Act of 1986 (P.L. 99-335) created a new retirement plan that is fully integrated with Social Security. The FERS benefit package has three elements: Social Security benefits; the FERS DB pension (which provides smaller benefits than the CSRS standalone DB pension does); and the Thrift Savings Plan (TSP), a DC pension.¹³

Types of Retirement Plans

Pension plans can be classified along several dimensions, such as whether the employee receives a monthly payment in retirement (*DB pensions*) or accrues funds in an individual account (*DC pensions*), whether the plan sponsor is a *private-sector* or *public-sector* employer, and whether the plan is *sponsored by one employer* or *more than one employer*.

Pension discussions also frequently include *IRAs*, which are tax-advantaged accounts for individuals to save for retirement outside of employer-sponsored plans. Often individuals with savings in DC plans, or with lump sum payments from DB plans, roll over their savings to IRAs at job change or retirement. In addition, Congress has authorized several types of IRA-based retirement plans that employers can offer, such as SIMPLE IRAs and SEP-IRAs (described below). In IRA-based plans, employers establish IRAs for employees at financial institutions. Employers may also offer payroll deduction IRAs, which are available to employers who want to provide their employees a retirement savings option while limiting employer involvement. In addition, some states have established state-facilitated retirement savings programs, often IRA-based, for private-sector employees.

Defined Benefit and Defined Contribution Pension Plans

The two types of pension plans based on benefit structure are (1) plans in which participants typically receive their benefits as monthly payments in retirement (DB plans) and (2) plans in which participants' benefits accrue in individual savings accounts (DC plans).

¹¹ A cash balance plan is a type of DB plan in which participants' benefits are calculated using a formula, but the benefit is expressed as an account balance that is paid as an annuity (or lump sum, if offered by the plan). See Alicia H. Munnell, Jean-Pierre Aubry, and Mark Cafarelli, *Defined Contribution Plans in the Public Sector: An Update*, Center for Retirement Research at Boston College, April 2014, https://crr.bc.edu/wp-content/uploads/2014/04/SLP_37-1.pdf; Jean-Pierre Aubry and Kevin Wandrei, *Have Localities Shifted Away from Traditional Defined Benefit Plans?*, Center for State and Local Government Excellence, April 2020, <https://slge.org/wp-content/uploads/2020/04/local-dc-brief-april-2020.pdf>.

¹² The Servicemen's and Veterans' Survivor Benefits Act of 1956 (P.L. 84-881) granted Social Security wage credits for all military service performed before 1957 and brought military service performed after 1956 fully under the Social Security Act. Since 1957, military service has been subject to Social Security payroll taxes and has been counted as covered employment for all Social Security benefits. See CRS Report 98-810, *Federal Employees' Retirement System: Benefits and Financing*.

¹³ See CRS Report 98-810, *Federal Employees' Retirement System: Benefits and Financing*.

Defined Benefit (DB) Plans

In DB plans (sometimes referred to as *traditional* pension plans), participants typically receive monthly payments in retirement based on a formula that uses either (1) a combination of length of service, accrual rate, and average of final years' salary; or (2) a flat dollar amount times the number of months or years in the plan.¹⁴ Some plans offer participants the option to receive their benefits as a lump-sum amount.

Generally, DB plans are meant to be fully funded, meaning that sufficient funds are set aside in order to pay for promised future benefits. Employer contributions to a DB plan consist of benefits earned by participants during the year (called *normal cost*) and a portion of plan underfunding (for example, due to investment losses, called *amortization cost*).

Some DB plans require employee contributions. In 2011 (the most recent data available), 4% of private-sector workers with DB plans were in plans that required employee contributions.¹⁵ In contrast, in 2021, 91% of state and local government workers in DB plans were in plans that required employee contributions.¹⁶ This percentage has steadily increased since 2011, when 79% of state and local employees were in plans requiring employee contributions.¹⁷ The DB plans that cover nearly all federal employees require employee contributions.

Cash Balance Plans

Instead of a traditional DB plan, some companies have established “hybrid” cash balance plans. Cash balance plans combine features of DB and DC plans: Participants' benefits are calculated using a formula, but the benefit is expressed as an account balance that is paid as an annuity (or lump sum, if offered by the plan). About 46% of DB plans in the private sector were cash balance plans in 2019, and 30.6% of DB plan participants in 2019 were in cash balance plans.¹⁸

Defined Contribution (DC) Plans

In DC plans, workers are provided individual accounts funded by their own contributions, contributions from their employers, or both. The funds in the account may accrue investment earnings, which can then be used as a source of income in retirement.

The type of DC plan that an employer may offer depends on the type of employer (for example, the types of plans offered by public-sector employers are different from those offered by private-sector employers), as well as the employer's choices regarding plan features (for example, private-sector employers have a number of types of DC plans they can offer). The plan sponsor

¹⁴ For example, a plan might specify that retirees receive an annual amount equal to (1) 1.5% of their pay for each year of service, where the pay is the average of a worker's salary during a specified number of years (for example, a participant who worked for 30 years, with an average salary of \$100,000 during his or her highest-paid five years, would receive \$45,000 per year in retirement), or (2) \$40 multiplied by the number of months worked in the plan (for example, a worker who worked for 30 years [i.e., 360 months] would receive \$14,400 per year in retirement).

¹⁵ See U.S. Department of Labor (DOL), Bureau of Labor Statistics (BLS), “National Compensation Survey: Employee Benefits in the United States, March 2011,” Table 3, <https://www.bls.gov/ncs/ebs/benefits/2011/ebbl0048.pdf>.

¹⁶ See BLS, “National Compensation Survey: Employee Benefits in the United States, March 2021,” Table 4, <https://www.bls.gov/ncs/ebs/benefits/2021/employee-benefits-in-the-united-states-march-2021.pdf>.

¹⁷ See BLS, “National Compensation Survey: Employee Benefits in the United States, March 2011,” Table 3.

¹⁸ The remainder were in traditional DB pension plans in which the benefit is expressed as a monthly payment in retirement. See DOL, *Private Pension Plan Bulletin*, Table A1, <https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2019.pdf>.

has to make various decisions about plan features. These include, for example, whether to fund the accounts solely with employee contributions, solely with employer contributions, or with both; whether and how much to match employee contributions; and whether to allow distributions before retirement such as through hardship withdrawals or loans.

Employers may have several types of DC plans from which to choose, as outlined below:

- **401(k) plan.** A 401(k) plan allows employees to contribute a portion of their wages to their individual accounts. Employers can also contribute to the accounts as a match of the employee's contributions or as a profit-sharing contribution. Employers must demonstrate that their 401(k) plans benefit a wide variety of employees (and not just well-paid employees) through a process called *nondiscrimination testing*.¹⁹

Additionally, there are several types of 401(k) plans available to certain employers:

- *Safe Harbor 401(k)* plans are available to employers of any size. These plans are exempt from nondiscrimination testing, provided they follow certain contribution rules.
- *SIMPLE 401(k)* plans are available to employers with 100 or fewer employees and are exempt from nondiscrimination requirements. Employers are required to make either (1) matching contributions up to 3% of each employee's pay or (2) nonelective contributions of 2% of each employee's pay.
- *Solo 401(k)* plans cover a business owner with no employees (or the owner and spouse, if applicable).
- **Profit-sharing plans and stock bonus plans.** In a profit-sharing plan, an employer makes a contribution to each eligible participant's account based on a formula established by the employer.²⁰ Employee contributions are not permitted. Profit-sharing plans provide flexibility to employers because they can choose whether to contribute to employees' accounts each year. Profit-sharing contributions do not need to be tied to a company's profits, if any. A stock bonus plan is a type of profit-sharing plan in which employer contributions are paid in employer stock rather than cash. Profit-sharing plans and stock bonus plans may have a 401(k) component, in which case employee contributions are allowed.
- **Money purchase plan.** In a money purchase plan, the employer contributes an amount to each eligible employee's account as a percentage of compensation. Employees are not permitted to contribute to the plan.
- **Employee stock ownership plan (ESOP).** An ESOP is a type of DC plan in which the investments are primarily in employer stock.
- **403(b) plan.** A 403(b) plan (or tax-sheltered annuity plan) is a pension plan offered by public schools, 501(c)(3) tax-exempt organizations, and churches. Investment options for 403(b) plans were originally restricted to annuity

¹⁹ Nondiscrimination tests are used to demonstrate that the plans are being used by both highly compensated employees and rank-and-file employees.

²⁰ For more information, see Internal Revenue Service (IRS), "Choosing a Retirement Plan: Profit-Sharing Plan," <https://www.irs.gov/retirement-plans/choosing-a-retirement-plan-profit-sharing-plan>.

contracts until 1974, after which investments in mutual funds were also permitted.

- **457(b) plan.** State and local governments and tax-exempt 501(c)(3) employers can establish 457(b) plans. While they share many features with 401(k) plans, they differ in some respects—for example, investments in 457(b) plans are limited to purchases of annuity contracts and mutual funds, and some withdrawal rules differ.

Public-Sector Pension Plans

Both private- and public-sector employers offer pension plans to their employees.²¹ Some provisions of the Internal Revenue Code (IRC, Title 26 of the *U.S. Code*) apply to both private- and public-sector plans, while some apply to one. For example, taxes on most distributions are deferred until the funds are received—this provision applies to both private- and public-sector plans. Public-sector employers are more likely to offer DB plans, while private-sector employers are more likely to offer DC plans.

To try to protect the interests of pension plan participants and beneficiaries, Congress enacted ERISA (P.L. 93-406). ERISA covers most private-sector pension plans and is included in both the IRC and in the Labor Code (Title 29 of the *U.S. Code*). State and local pension plans are exempt from ERISA, and thus, ERISA provisions in the IRC (such as funding requirements for DB plans) and in the Labor Code (such as standards of conduct for individuals who make decisions within a plan) do not apply. However, state and local plans are subject to certain pre-ERISA IRC provisions, such as vesting requirements (how long a person must work for an employer to be covered) in place as of September 1, 1974.

State and Local Government Pension Plans

Most public-sector employees are covered by pension plans. Those covered are more likely to be covered by DB plans than by DC plans. In March 2021, 92% of all state and local government workers had *access* to a pension plan, with 86% having access to DB plans and 38% having access to DC plans.²² In the same month, 82% of state and local government workers *participated* in a pension plan.²³

State and Local DB Plans

In FY2020, state and local government entities—including municipalities, townships, counties, school districts, and special districts—administered 5,340 DB plans with 33.2 million participants covering workers such as police officers, firefighters, teachers, and city and state government employees.²⁴ Most participants are in the largest DB plans: 95% of state and local plan participants are in the 210 largest state and local DB plans (119 state, 91 local).²⁵

²¹ Plans sponsored by nonprofit companies are included in the discussion of private-sector pensions.

²² Total does not sum to 100% because some workers have access to both types of plans.

²³ Among state and local government workers, 75% participated in DB plans and 18% participated in DC plans in March 2021. See BLS, *National Compensation Survey: Employee Benefits in the United States, March 2021*, September 2021, state and local government tables, Table 2, <https://www.bls.gov/ncs/ebs/benefits/2021/home.htm>.

²⁴ The fiscal year for most states begins on July 1. See U.S. Census Bureau, *2020 Annual Survey of Public Pensions: State and Local Tables*, <https://www.census.gov/data/tables/2020/econ/aspp/aspp-historical-tables.html>.

²⁵ Center for Retirement Research at Boston College, “Public Plans Data,” <https://publicplansdata.org/public-plans->

While nearly all private-sector workers are covered by Social Security, 28.4% of state and local DB plan participants were *not* covered by Social Security in 2018.²⁶ The states with the largest *number* of state and local government employees not covered by Social Security in 2018 were California, Texas, Ohio, Illinois, and Massachusetts.²⁷ The states with the highest *percentage* of state and local government employees not covered by Social Security in 2018 were Ohio, Massachusetts, Nevada, Louisiana, and Colorado.²⁸ Most noncovered local government employees are police officers, firefighters, and teachers.²⁹

State and local plans are governed by state laws, contract law, and/or state constitutions, which provide protections for accrued and prospective benefits. Accrued benefits in many states are protected from the beginning of employment or once plan vesting requirements have been met. Future benefit accruals for current participants are typically protected in many states as well. Cost-of-living adjustments (COLAs) are generally less protected than benefit accruals.³⁰ Between 2009 and 2018, DB pension systems in most states implemented reforms to improve plan funding, including increased employee contribution rates, reduced benefit levels, and reduced COLAs. Given the pension protections mentioned above, many of these reforms primarily affect new hires.³¹

State and Local DC Plans

In March 2021, 38% of all state and local government workers had access to DC plans and 18% participated in DC plans.³² State and local DC plans had about \$500 billion in assets in 2020.³³ Since the financial crisis and recession of 2007-2009, states and localities have modified their pension plans, with many offering hybrid cash balance plans or DC plans as alternatives or enhancements to traditional DB plans.³⁴ In 2019, 18 states offered retirement benefits other than sole DB plans. Between 2001 and 2018, the proportion of local governments offering retirement benefits outside traditional DB plans increased from 11% to 19%.³⁵

Depending on the employer, state and local DC plan types include 401(a), 401(k), 403(b), and 457(b) plans. Employee participation and contributions may be mandatory or optional, depending on the structure of the plan as determined by the employer.³⁶ A **401(a) plan** may be available to state and local government workers as part of a DB-DC combination plan or a hybrid cash

database.

²⁶ See CRS Report R46961, *Social Security Coverage of State and Local Government Employees*.

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ IRS Publication 963, *Federal-State Reference Guide*, Rev. 7-2020, p. 1, <https://www.irs.gov/pub/irs-pdf/p963.pdf>.

³⁰ American Academy of Actuaries Pension Webinar Series, *Retirement Plan Coverage in America Part Two: Focus on Public Pension Plans*, April 23, 2020.

³¹ Keith Brainard and Alex Brown, *Spotlight on Significant Reforms to State Retirement Systems*, National Association of State Retirement Administrators, December 2018, <https://www.nasra.org/files/Spotlight/Significant%20Reforms.pdf>.

³² BLS, *National Compensation Survey: Employee Benefits in the United States, March 2021*, state and local government tables, Table 2.

³³ See CRS Insight IN11659, *U.S. Retirement Assets in 2020*.

³⁴ Munnell, Aubry, and Cafarelli, *Defined Contribution Plans in the Public Sector*.

³⁵ Aubry and Wandrei, *Have Localities Shifted Away from Traditional Defined Benefit Plans?*

³⁶ State and local government 401(k) plans are legacy plans that were implemented before the Tax Reform Act of 1986, after which the implementation of such plans was prohibited. National Association of State Retirement Administrators, *Defined Contribution Plans Administered by State Retirement Systems or Available to State Employees*, April 2019, <https://www.nasra.org/files/Topical%20Reports/DC%20plans/statewidedcplans.pdf>.

balance plan.³⁷ A **403(b) plan** may be offered to employees of public schools, churches, and certain charitable tax-exempt entities.³⁸ A **457(b) plan** is a voluntary, supplementary DC savings vehicle, often offered to state and local government employees in conjunction with a traditional DB pension.³⁹

Federal Pension Plans⁴⁰

In its role as an employer, the federal government sponsors a number of DB and DC pension plans for civilian federal employees. The vast majority of these federal employees are covered by two DB plans funded through the Civil Service Retirement and Disability Fund: the older, now-closed Civil Service Retirement System (CSRS) and FERS. In addition, most employees are eligible to participate in a DC plan for federal employees, the TSP.

A number of smaller DB and DC plans have been established for certain employees within various agencies. There are a few additional plans that provide federal pensions to a non-trivial number of civilian federal employees. The Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS) are DB plans that cover Foreign Service Officers (FSOs) based on their date of hire in a similar way to CSRS and FERS. The Federal Reserve also operates its own DB and DC plans on behalf of its bank and board employees and certain other employees.⁴¹

Defined Benefit Plans for Civilian Federal Employees

Most civilian federal employees who were first hired before 1984 are covered by CSRS. CSRS was created by the Civil Service Retirement Act of 1920 (P.L. 66-215). Under CSRS, employees do not pay Social Security taxes or earn Social Security benefits but may be eligible for a standalone DB annuity if they make required contributions and meet age and years of service

³⁷ MissionSquare Retirement, “401(a) Money Purchase Plan,” <https://www.icmarc.org/products-and-services/401%28a%29-defined-contribution-plans.html>. PRRL, “The State of Public Sector DC Plans: A First Look at the PRRL Database,” February 25, 2021, https://www.nagdca.org/wp-content/uploads/2021/02/PRRL-Study_The-State-of-DC-Plans_A-First-Look_FINAL.pdf.

³⁸ IRS, *IRC 403(b) Tax-Sheltered Annuity Plans*, <https://www.irs.gov/retirement-plans/irc-403b-tax-sheltered-annuity-plans>.

³⁹ IRS, *457(b) Plans for State or Local Governments: Key Characteristics*, <https://www.irs.gov/retirement-plans/457b-plans-for-state-or-local-governments-key-characteristics>. IRS, *Comparison of Governmental 457(b) Plans and 401(k) Plans: Features and Corrections*, <https://www.irs.gov/retirement-plans/comparison-of-governmental-457b-plans-and-401k-plans-features-and-corrections>.

⁴⁰ For additional information on pension plans for civilian federal employees, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*. Military servicemembers are covered by a separate retirement system, which is not discussed in this report. For details on retirement benefits for military servicemembers, see CRS Report RL34751, *Military Retirement: Background and Recent Developments*.

⁴¹ The Central Intelligence Agency Retirement and Disability System (CIARDS), which covered certain special category employees, has been closed to new entrants since 1984. Special category CIA employees first hired in 1984 or later are covered by FERS (like other CIA employees).

The last time that an audit of all “federal pension plans” (using a definition of *pension plan* subject to reporting requirements under P.L. 95-595) was in 1996 by the Government Accountability Office (GAO). This GAO investigation identified 34 federal DB plans and 17 federal DC plans. Some of these identified plans provide retirement coverage for federal entities that do not employ federal employees (e.g., employees of the Tennessee Valley Authority [Tennessee Valley Authority Retirement System]) or for individual employees (e.g., the former heads of the GAO [Comptrollers’ General Retirement Plan]). See GAO, *Public Pensions: Summary of Federal Pension Plan Data*, AIMD-96-6, February 16, 1996, <https://www.gao.gov/assets/aimd-96-6.pdf>.

conditions.⁴² Monthly CSRS retirement benefits are calculated based on a formula that multiplies years of service, the average of the highest three consecutive years of basic pay, and an accrual rate set out under statute.⁴³ Most civilian federal employees first hired in 1984 or later are covered by FERS, which was created under the Federal Employees' Retirement System Act of 1986 (P.L. 99-335). All federal employees who are enrolled in FERS pay Social Security taxes and earn Social Security benefits along with a monthly DB annuity under FERS that is calculated using a formula similar to CSRS but replaces a lower amount of earnings than does the CSRS benefit due to smaller benefit accrual rate.⁴⁴ The Office of Personnel Management administers CSRS and FERS, although employing agencies handle pre-retirement paperwork and provide retirement counseling to employees. According to the FY2020 Actuarial Report of the Civil Service Retirement and Disability Fund, at the beginning of FY2020, there were 70,000 active CSRS employees, 2,474,000 active FERS employees, 1,717,000 CSRS annuitants, and 966,000 FERS annuitants.⁴⁵

Two additional federal pension plans run by the State Department provide retirement benefits to FSOs.⁴⁶ These plans are authorized under current law: FSRDS was created by Section 18 of the Foreign Service Act of 1924 (P.L. 68-135); FSPS was created by the Foreign Service Act of 1980 (P.L. 96-465). Similar to the distinction between CSRS and FERS, FSRDS is the older retirement system that is not integrated with Social Security and provides a standalone DB pension for FSOs first hired before 1984. FSPS, which is integrated with Social Security, provides a retirement benefit package to FSOs hired in 1984 or later. FSRDS and FSPS also have eligibility requirements and benefit calculations set out under current law.⁴⁷ According to the FY2020 Actuarial Report of the Foreign Service Retirement and Disability Fund, as of June 2020, there were 33 active FSRDS employees, 15,208 active FSPS employees, 9,209 FSRDS annuitants, and 7,220 FSPS annuitants.⁴⁸

Under general authority provided by Title 10 of the Federal Reserve Act of 1913 (P.L. 63-43), the Federal Reserve operates its own pension plan—the Federal Reserve System (FRS)—for employees of Federal Reserve Banks, the Office of Employee Benefits, the Federal Reserve Board of Governors, and the Consumer Financial Protection Bureau. The FRS provides a DB benefit, and covered employees also participate in Social Security. Unlike CSRS, FERS, FRDS,

⁴² For details on CSRS eligibility requirements, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*.

⁴³ For details on the calculation of CSRS benefits, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*.

⁴⁴ For details on FERS eligibility requirements and benefit calculations, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*.

⁴⁵ Office of Personnel Management, *Annual Report of the Board of Actuaries, Civil Service Retirement and Disability Fund, Fiscal Year Ended September 30, 2020*, February 2021, p. 16, <https://www.opm.gov/about-us/budget-performance/other-reports/fy-2020-csrd-fund-annual-report.pdf>. Counts of annuitants include both retirees and survivors. FY2020 data are the most recently available program data from the Office of Personnel Management.

⁴⁶ Other employees of the State Department (i.e., civil service employees) are covered by CSRS or FERS, depending on their date of hire.

⁴⁷ For FSRDS, see 22 U.S.C. Chapter 52, Subchapter 8, Part I (i.e., 22 U.S.C. §§4041-4069); for FSPS, see 22 U.S.C. Chapter 52, Subchapter 8, Part II (i.e., 22 U.S.C. §§4071 et seq.).

⁴⁸ U.S. Department of State, *Foreign Service Retirement and Disability Fund, Actuarial Report for the September 30, 2020 Valuation Fiscal Year Ended September 30, 2020*, December 8, 2020, Table 1.1, p. 4. Counts of annuitants include both retirees and survivors. FY2020 data are the most recently available program data from the State Department.

and FSPS, the FRB DB plan does not require any contributions from covered employees. As of January 1, 2020, there were 23,675 active FRB employees and 21,085 FRB annuitants.⁴⁹

Defined Contribution Plans for Civilian Federal Employees

Federal employees enrolled in either CSRS or FERS may also contribute to the TSP, a DC pension plan similar to the 401(k) plans provided by many private-sector employers. However, only employees enrolled in FERS are eligible for employer matching contributions under TSP. Newly hired FERS employees are automatically enrolled in TSP and contribute 5% of their pay, though they have the option to decline participation or change the amount of their contributions. TSP participants may contribute up to the lesser of (1) their salary or (2) the DC contribution limit.⁵⁰ Employees covered by FERS receive an automatic 1% contribution and a match equal to 100% of the worker's first 3% of basic pay and 50% of the next 2% of basic pay.⁵¹

Also similar to CSRS and FERS, FSDRS employees may contribute to TSP, but only FSPS employees are eligible for TSP employer matching contributions. The Federal Reserve also operates its own DC plan: the Thrift Plan, which is distinct from TSP. Employees covered by FRS are eligible for employer matching under the Thrift Plan.

Private-Sector Pension Plans

Private-sector pension plans, which include those sponsored by nonprofit companies, are subject to ERISA and the tax code. ERISA sets standards that private-sector pension plans must follow with regard to (1) plan participation (who must be covered); (2) minimum vesting requirements (how long a person must work for an employer to be covered); (3) fiduciary duties (how individuals who oversee the plan must behave, such as operating the plan in the sole interest of plan participants); and (4) DB plan funding (how much employers must set aside to pay for future benefits).

Most pension-related legislation is targeted to private-sector plans, which are governed by ERISA, unlike public-sector plans.

Private-sector pension plans are classified by whether they are sponsored by one or more than one employer:

- A **single-employer plan** is sponsored by one employer.
- A **multiple-employer plan** has more than one participating employer but is *not* maintained as part of a collective bargaining agreement. These plans are generally treated as single-employer plans for the purposes of pension funding rules and federal disclosure requirements.
- A **multiemployer plan** is sponsored by more than one employer and maintained as part of a collective bargaining agreement.

Single-employer plans, multiple-employer plans, and multiemployer plans can be either DB plans or DC plans. Private-sector DB plans are subject to funding rules found in ERISA, which outline

⁴⁹ CRS email communication with FRB, April 28, 2021.

⁵⁰ Contribution limits are available at IRS, "Retirement Topics—Contributions," <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-contributions>.

⁵¹ Participants are fully vested in the 1% agency automatic contributions to the TSP after three years (two years for congressional employees and executive-branch political appointees). See CRS Report RL30387, *Federal Employees' Retirement System: The Role of the Thrift Savings Plan*.

requirements for how much an employer must contribute to the plan each year.⁵² Typically, an employer's required contribution consists of the present value of benefits earned by participants in the year and a share, as determined by the law, of past amounts of underfunding (such as from a plan's investment losses).

Private-Sector DB Pension Plans

ERISA provisions in the IRC outline funding requirements for private-sector DB plans to ensure that plans generally have sufficient funds from which to pay participants' earned benefits. Separate funding rules apply to (1) single- and multiple-employer plans and (2) multiemployer plans. The Pension Benefit Guaranty Corporation (PBGC) insures private-sector DB plans. PBGC is a government corporation that pays participants' benefits in the case of (1) employer bankruptcy in the case of single-employer plans or (2) plan insolvency in the case of multiemployer plans.

Single-Employer DB Plans

Most private-sector DB plans are single-employer plans.

Generally, plans must be fully funded. If a plan is underfunded, it must become fully funded over time. This can be done through various methods, including increases in employer contributions or changes to funding rules, such as increases in the discount rate that plans use to calculate benefits or increases in the time period over which plans can amortize their losses.

A plan sponsor that has a fully funded DB plan can terminate the plan by purchasing annuities from an insurance company for all participants. Employers can also purchase annuities for a portion of the plan participants without terminating the plan (known as *de-risking*). This is designed to accomplish two goals: (1) relieve the employer of having to make up for potential investment losses in the future, and (2) reduce their per-participant premiums owed to the PBGC (described later in this report).⁵³

Community Newspaper Plans. Community newspaper plans are those maintained by certain private community newspaper organizations that are family-controlled and have been in existence for 30 or more years. Section 115 of the Setting Every Community up for Retirement Enhancement Act of 2019 (SECURE Act, enacted as Division O of the Further Consolidated Appropriations Act of 2020; P.L. 116-94) provided special funding rules for pension plans operated by certain community newspapers that had no benefit increases for participants after December 31, 2017.⁵⁴

Multiple-Employer DB Plans

Private-sector multiple-employer DB plans are fairly uncommon. In 2019, Department of Labor (DOL) data indicated that there were 202 such plans (representing 0.4% of private-sector DB plans) covering 1.8 million participants.⁵⁵ The most widely known type of multiple-employer DB

⁵² DC plans do not have funding rules.

⁵³ As described later in this report, when an underfunded DB plan terminates due to, for example, employer bankruptcy, PBGC becomes the trustee of the plan and pays the participants' benefits up to a statutory maximum.

⁵⁴ For these plans, the SECURE Act increased the interest rate to 8% and extended the amortization period from seven to 30 years.

⁵⁵ See DOL, *Private Pension Plan Bulletin*, Table B1.

plan is the Cooperative and Small Employer Charity plan. These plans covered 539,000 participants in 2017.⁵⁶

Cooperative and Small Employer Charity (CSEC) Pension Plans. CSEC pension plans are generally multiple-employer pension plans established by certain cooperative and charitable organizations. Plans that meet the criteria to be CSEC plans follow special funding rules.

The Cooperative and Small Employer Charity Pension Flexibility Act of 2013 (P.L. 113-97) established funding rules for and provided a definition of CSEC pension plans.⁵⁷ Among other provisions, this act permanently exempted these plans from the Pension Protection Act's (P.L. 109-280) funding rules and outlined minimum funding standards for CSEC plans.⁵⁸ Plans must indicate if they use the CSEC-specific funding rules in their required annual reporting to DOL.

Multiemployer DB Plans

While most private-sector DB plans are single-employer plans, about 3% are multiemployer plans (as of 2019).⁵⁹ Multiemployer DB plans covered 11.2 million union participants in 2019. They are commonly sponsored by employers in unionized industries such as construction, manufacturing, and transportation.

Workers in multiemployer plans might work for a number of employers over a career and would continue to earn pension benefits—provided those employers were signatories to the collective bargaining agreement. Multiemployer pension plans pool risk so that the withdrawal of a few employers from the plan typically does not place the plan in financial jeopardy.

Since 2001, the financial position of multiemployer plans has generally worsened, becoming, on average, 42% funded in 2019.⁶⁰ In 2018, about 10%-15% of participants were in plans that were likely to become insolvent within 19 years.

Most recently, the American Rescue Plan Act of 2021 (P.L. 117-2) contained a provision authorizing federal financial assistance to qualifying financially troubled multiemployer plans.

For more information about multiemployer plans, see CRS Report R43305, *Multiemployer Defined Benefit (DB) Pension Plans: A Primer*.

Pension Benefit Guaranty Corporation (PBGC)

PBGC is a government corporation established by ERISA (P.L. 93-406). It was created to protect the pensions of participants and beneficiaries in private-sector pension plans by paying participants' benefits up to a statutory maximum if the pension plan is unable to do so. PBGC insures only private-sector DB plans and is chaired by the Secretary of Labor, with the Secretaries of the Treasury and Commerce serving as board members.

PBGC is required by ERISA to be self-supporting and receives no appropriations from federal general revenue. ERISA Section 4002(g)(2) states that the "United States is not liable for any

⁵⁶ See the Appendix of CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*.

⁵⁷ The sponsors of two single-employer DB plans are included as CSEC plans.

⁵⁸ The Pension Protection Act outlined new funding standards for pension plans. See CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*.

⁵⁹ See DOL, *Private Pension Plan Bulletin*, Table B1.

⁶⁰ In the 1990s, multiemployer DB plans were generally well-funded: Except for 1996, these plans were funded at 90% or better. See PBGC, *PBGC 2019 Data Tables*, Table M-9, <https://www.pb.gc.gov/sites/default/files/2019-pension-data-tables.pdf>.

obligation or liability incurred by the corporation,” and some Members of Congress have expressed reluctance about providing financial assistance to PBGC. The most reliable source of PBGC revenue is the premiums set by Congress and paid by the private-sector employers that sponsor DB pension plans. Other sources of income are (1) assets from terminated single-employer plans taken over by PBGC, (2) investment income, and (3) recoveries collected from companies when they end underfunded pension plans.

PBGC operates two distinct insurance programs: one for single-employer DB plans and a second for multiemployer DB plans. PBGC maintains separate reserve funds for each program. In the case of a single-employer DB plan in financial distress, PBGC becomes the trustee of the plan and continues to pay participants’ benefits up to a statutory maximum. PBGC does not become trustee of multiemployer plans. An insolvent multiemployer plan does not have sufficient resources from which to pay promised benefits. PBGC provides financial assistance to insolvent multiemployer plans in the form of loans, although PBGC does not expect the loans to be repaid. As in the case of single-employer plans, participants in insolvent multiemployer DB plan receive their benefits up to a statutory maximum. The statutory maximums differ between single and multiemployer plans. For more information on PBGC, see CRS Report 95-118, *Pension Benefit Guaranty Corporation (PBGC): A Primer*.

PBGC also operates the Special Financial Assistance (SFA) program for multiemployer DB plans. Section 9704 in Title IX, Subtitle H, of the American Rescue Plan Act of 2021 (P.L. 117-2) provides financial assistance to qualifying financially troubled multiemployer DB plans. Eligible plans may apply for SFA through December 31, 2025. If approved, the amount of SFA that an eligible plan receives is the amount needed to pay participants’ full plan benefits through the 2051 plan year. For more information about SFA, see CRS In Focus IF11765, *Special Financial Assistance to Multiemployer Plans*.

Private-Sector DC Plans

Over the past five decades, private-sector employees have become less likely to be covered by DB pensions and more likely to be covered by DC pensions.⁶¹ This general shift occurred for a number of possible reasons. First, employer costs are generally higher for DB plans than for DC plans, because the benefit in a DB plan is typically funded entirely by the employer, while a smaller portion of the typical DC plan benefit is from employer contributions. Second, from an employer’s perspective, contributions to DC plans tend to be a more predictable cost than contributions to DB plans are. This is because employer contributions to DB plans may include additional contributions to make up for investment losses, whereas in DC plans employer contributions are typically based on a set formula that uses employee compensation.

Third, DC plans may be easier to administer than DB plans are. DB plan actuaries determine the value of benefits earned by participants in a year and how much the plan must set aside to fund those benefits, incorporating factors such as likely retirement ages and mortality rates. DC plans do not use any of these actuarial projections.

For some employees, DC plans may be preferable to DB plans because DC plan account balances are portable. When individuals change jobs, they can transfer (i.e., roll over) their account balances to IRAs or, often, to their new employers’ plans. In contrast, DB plan benefits are not portable, and the benefit formula typically takes into account the number of years a worker has worked for an employer. Employees who change jobs and might earn benefits in several plans do

⁶¹ For an illustration of this shift, see CRS In Focus IF12007, *A Visual Depiction of the Shift from Defined Benefit (DB) to Defined Contribution (DC) Pension Plans in the Private Sector*.

not accumulate the same benefits as employees who stay with one employer and remain in a single plan. On the other hand, workers have more decisions to make in DC plans, such as the amount to contribute, investments to choose, and how much and how often to withdraw funds in retirement. In addition, retirees with DC plans face the risk of outliving their assets. Retirees receiving DB plan benefits do not face this risk; DB plan payments continue for the life of the participant and, if applicable, the spouse.

As a result of the shift, some have noted that the growth of DC plans since 1974 may have resulted in a greater share of private-sector workers receiving income from retirement plans.⁶² The reasons may include (1) lengthy vesting provisions that may have prevented some individuals in DB plans from qualifying for benefits and (2) the overall lower costs of DC plans, which may have resulted in more employers offering these plans.

Private-Sector Single-Employer and Multiemployer DC Plans

Single-employer DC plans are the most common type of pension plan.⁶³ The types of plans that employers offer include profit-sharing and stock bonus plans—typically with a 401(k) component—ESOPs, and, for nonprofit employers, 403(b) plans. Plans may include a Roth component, which allows employees to make contributions with after-tax income and tax-free withdrawals in retirement.

In DC plans, workers traditionally needed to actively choose to participate, though many DC plans have adopted *automatic enrollment* provisions in which new employees are enrolled in the plan but have the option to decline participation (also referred to as *opting out*).⁶⁴

Multiple-Employer DC Plans

Multiple-employer plans (often called MEPs) can be attractive to employers because administrative expenses can be shared, potentially leading to lower costs. In addition, certain fiduciary duties can be handled by the sponsor rather than the employers. Prior to 2019, employers in a multiple-employer plan had to have a common business interest (such as an organizational relationship), referred to as a *common nexus*. These plans are referred to as *closed MEPs*. In addition, the entire plan could be disqualified if one participating employer violated a qualification requirement, called the *unified plan rule* (informally referred to as the “one-bad-apple” rule).

In an effort to increase the number of employers offering pension plans, in July 2019, DOL published a rule that, while leaving in place the common nexus requirement, expanded the definition of *associations* so that more associations could sponsor multiple-employer DC plans (referred to as *Association Retirement Plans*, or ARPs). The rule also clarified the definition of

⁶² See Investment Company Institute (ICI), “A Look at Private-Sector Retirement Plan Income After ERISA, 2015,” December 2016, <https://www.ici.org/doc-server/pdf%3Aper22-08.pdf>.

⁶³ In many respects, single-employer and multiemployer DC plans are similar, so this report does not focus on them separately.

⁶⁴ Prior to the widespread adoption of automatic enrollment, about 30% of employees eligible for a DC plan opted out. See, for example, these reports with data prior to the widespread adoption of automatic enrollment in DC plans: Patrick Purcell, *Retirement Plan Participation and Contributions: Trends from 1998 to 2006*, Congressional Research Service, January 2009, https://ecommons.cornell.edu/bitstream/handle/1813/78093/RL33116_20090130.pdf; and Vanguard, *How America Saves 2009: A Report on Vanguard 2008 Defined Contribution Plan Data*, August 2009, p. 20, <https://www.pionline.com/assets/docs/CO68397126.PDF>.

employer so that certain employer groups and professional employer organizations (PEOs) are employers within the meaning of ERISA and could sponsor multiple-employer DC plans.⁶⁵

The SECURE Act (P.L. 116-94; December 20, 2019) eliminated the requirement that employers that participate in a multiple-employer plan must have a business connection. As a result, unrelated employers are now able to join multiple-employer 401(k) plans.⁶⁶ The SECURE Act authorized a new type of open MEP called a Pooled Employer Plan (PEP) organized by a Pooled Plan Provider (PPP).⁶⁷ Additionally, the SECURE Act eliminated the one-bad-apple rule.

The SECURE Act also permitted individual DC plans that share similar features (such as trustees, administrators, and investment options), referred to as a *Group of Plans*, to file a single, consolidated return.⁶⁸

Church Plans

Pension plans established and maintained primarily for the benefit of employees of (1) churches or (2) conventions or associations of churches are referred to as *church plans*.⁶⁹ Church plans can be either DB or DC plans and are exempt from ERISA coverage, which means they are not subject to funding rules, nondiscrimination tests, fiduciary obligations, and PBGC insurance. One rationale for this exemption stemmed from a constitutional concern: A 1973 Senate report notes concern that “the examination of books and records that may be required in any particular case as part of the care and responsible administration of the [PBGC’s] insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities.”⁷⁰ While church plans can choose to be covered by ERISA (thus becoming *electing* church plans), those that do not (called *non-electing* church plans) must follow certain pre-ERISA requirements in the IRC.⁷¹

The definition of what constitutes a church or association or convention of churches for the purpose of ERISA coverage has been the subject of litigation. For example, the Supreme Court ruled in 2017 that the pension plans of certain religiously affiliated nonprofits that operate hospitals and other health care facilities qualified as church plans.⁷²

⁶⁵ See Employee Benefits Security Administration, “Definition of ‘Employer’ Under Section 3(5) of ERISA—Association Retirement Plans and Other Multiple-Employer Plans,” 84 *Federal Register* 37508-37544, July 31, 2019. The rule left the commonality requirement in place, as that could not be changed by regulation.

⁶⁶ Currently, 403(b) plans may not form multiple-employer plans. Several bills in the 117th Congress include a provision that would permit them to do so.

⁶⁷ One advantage of a PEP is that it can file a single Form 5500 instead of one for each participating employer.

⁶⁸ One issue with the Group of Plans is whether they would be able to have a single audit or if each plan would be required to have separate audits. See Austin R. Ramsey, “Audits Are Cause for Pause in DOL Group Retirement Plan Proposal,” *Bloomberg Law*, September 17, 2021, <https://www.bloomberglaw.com/bloomberglawnews/daily-labor-report/X4BB75BK000000>.

⁶⁹ See 29 U.S.C. §1002(33).

⁷⁰ U.S. Congress, Senate Committee on Finance, *Private Pension Plan Reform*, 93rd Cong., 1st sess., August 21, 1973, S. Rpt. 93-383, p. 81.

⁷¹ See IRS, “Issue Snapshot—Qualification Requirements for Non-Electing Church Plans Under IRC Section 401(a),” <https://www.irs.gov/retirement-plans/issue-snapshot-qualification-requirements-for-non-electing-church-plans-under-irc-section-401a>. In addition, non-electing church plans may be subject to state law in the states in which they operate. See Groom Law Group, “View from Groom: After Advocate—Practical Considerations for Church Plan Sponsors,” June 13, 2017, <https://www.groom.com/resources/view-from-groom-after-advocate-practical-considerations-for-church-plan-sponsors/>.

⁷² See CRS Legal Sidebar WSLG1837, *Supreme Court Delves into What Constitutes a “Church Plan” under ERISA*.

Because the plans are not subject to ERISA funding rules, there have been instances where participants in church plans have lost part or all of their DB pension benefits promised. Because these plans are not covered by PBGC, participants may be unable to recover their benefits.⁷³

Individual Retirement Accounts (IRAs)

IRAs are tax-advantaged savings accounts that, in most cases, are unconnected to individuals' workplaces. IRAs were first authorized by ERISA (P.L. 93-406) for two reasons: (1) to encourage workers without access to employer-sponsored plans to save for retirement and (2) to allow workers with employer plans to roll over their savings and retain tax advantages.⁷⁴ Though eligibility was originally limited to workers without pension coverage, subsequent legislation expanded eligibility to nearly all workers.

Congress has authorized two types of IRAs: traditional and Roth. Contributions to traditional IRAs may be deductible from taxable income (depending on household adjusted gross income and workplace pension coverage), and withdrawals are included in taxable income. Contributions to Roth IRAs are not tax-deductible, but qualified distributions (those made after age 59½, death, or disability from an account that is at least five years old) are tax free. An individual can move traditional IRA savings to a Roth IRA in what is referred to as a *conversion*.⁷⁵

Most inflows to traditional IRAs are from rollovers of pension plan savings from employer-sponsored plans rather than from contributions. Rollovers preserve the tax benefits of retirement savings. In 2018 (the latest year for which data are available), about 97% of inflows to traditional IRAs were from rollovers, while about 52% of Roth IRA inflows came from rollovers and conversions.⁷⁶ For more information on IRAs, see CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer* and CRS Report R46635, *Individual Retirement Account (IRA) Ownership: Data and Policy Issues*.

IRA-Based Retirement Plans

Most individuals with IRAs independently established and contributed directly to them through financial institutions or because they rolled over savings from employer-sponsored plans. However, some individuals have IRAs because their employers established IRA-based retirement plans. IRA-based plans include payroll deduction IRAs, Salary Reduction Simplified Employee Pension Plans (SARSEPs), Simplified Employee Pensions (SEPs), and Savings Incentive Match Plan for Employees (SIMPLE) IRAs. Among other factors, these plans vary in the degree of employer involvement.

Data from year-end 2020 indicated that assets in SARSEPs, SEPs, and SIMPLE IRAs totaled an estimated \$710 billion, or 5.8% of total IRA assets.⁷⁷

⁷³ See, for example, Groom Law Group, "Church Plan Litigation—Out of the ERISA Woods into the State Law Forest," December 28, 2021, <https://www.groom.com/resources/church-plan-litigation-out-of-the-erisa-woods-into-the-state-law-forest/>.

⁷⁴ Congressional discussions cited increasing mobility of the workforce as reason for this provision. Prior to rollovers into IRAs, employees who changed jobs may have been able to transfer assets from one employer plan to another, provided both employers agreed to the transfer. See *Congressional Record*, vol. 120, part 4 (February 26, 1974), p. 4300.

⁷⁵ At the time of conversion, the individuals must include the amount of the conversion in his or her taxable income.

⁷⁶ CRS analysis of data in ICI, "The US Retirement Market," Third Quarter 2021, Table 11.

⁷⁷ CRS analysis of data in ICI, "The US Retirement Market," Third Quarter 2021, Table 10.

Payroll Deduction IRA

In a payroll deduction IRA, an employer establishes a program through a financial institution. Employees open either traditional or Roth IRAs and authorize the employer to deduct pay from their paychecks to fund the IRAs. Contributions may not exceed the IRA contribution limit (\$6,000 in 2022; \$7,000 for individuals aged 50 and over). Employer involvement is minimal and is limited to transmitting employees' authorized contributions to the financial institution that holds the employees' IRAs. Employers do not make any contributions to employees' IRAs.⁷⁸

Salary Reduction Simplified Employee Pension Plan (SARSEP)

Under a SARSEP, employees elect to enter into a salary reduction agreement, in which part of their compensation is contributed to their SEP-IRAs. Starting in 1997, employers were no longer permitted to establish SARSEPs. SARSEPs could be established only by employers with 25 or fewer eligible participants.⁷⁹

Some SARSEPs established before 1997 are still in existence and must continue to follow SARSEP requirements.⁸⁰ In addition, an employee hired in 1997 or later by an employer that operates a SARSEP may participate in the SARSEP.

Employee contributions may not exceed the lesser of (1) \$20,500 in 2022 or (2) 25% of the employee's compensation. Employees aged 50 and older may make catch-up contributions up to an additional \$6,500. Employers may make non-elective contributions to their employees' SEP-IRAs.⁸¹ Employer and employee contributions (excluding catch-up contributions) may not exceed the lesser of (1) 25% of the employee's compensation or (2) \$61,000 in 2022.⁸²

Simplified Employee Pension (SEP)

Under a SEP, employers set up and contribute to employees' traditional IRAs (referred to as SEP-IRAs).⁸³ Employers of any size, including self-employed individuals, may establish SEPs. Employer contributions to an employee's SEP-IRA are excluded from the employee's gross income and may not exceed the lesser of (1) 25% of the employee's compensation or (2) \$61,000 in 2022. Employers may decide whether and how much to contribute each year by the tax filing deadline. If an employer decides to contribute, it must do so proportionally for all employees who worked for the business during the year for which contributions are made.

⁷⁸ For more information about payroll deduction IRAs, see IRS, "Payroll Deduction IRA," <https://www.irs.gov/retirement-plans/plan-sponsor/payroll-deduction-ira>.

⁷⁹ In addition, state or local governments or any of their political subdivisions, agencies, or instrumentalities, or tax-exempt organizations could not establish SARSEPs.

⁸⁰ For example, if an employee's elective deferrals equal 25% of compensation, then the employee would not receive an employer contribution. For more information about SARSEP requirements, see IRS, "Salary Reduction Simplified Employee Pension Plan (SARSEP)," <https://www.irs.gov/retirement-plans/plan-sponsor/salary-reduction-simplified-employee-pension-plan-sarsep>, and IRS, "Retirement Plan FAQs Regarding SARSEPs," <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-sarseps>.

⁸¹ Non-elective contributions are those made to an employee's account regardless of whether the employee contributes to his or her own account.

⁸² See IRS, "SEP Contribution Limits (Including Grandfathered SARSEPs)," <https://www.irs.gov/retirement-plans/plan-participant-employee/sep-contribution-limits-including-grandfathered-sarseps>.

⁸³ For more information on SEPs, see IRS, "Simplified Employee Pension Plan (SEP)," <https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employee-pension-plan-sep>.

Employee contributions (and, thus, catch-up contributions) are not permitted in SEP-IRAs.

Savings Incentive Match Plan for Employees (SIMPLE) IRA

Small employers (i.e., those with 100 or fewer employees who received at least \$5,000 in compensation from the employers for the preceding year) may establish SIMPLE IRA plans.

Employees may contribute up to \$14,000 in 2022. (Employees aged 50 and older may make additional catch-up contributions up to \$3,000.) Each year, employers are required to contribute (1) *matching contributions* up to 3% of an employee's compensation or (2) *nonelective contributions* of 2% of compensation for each eligible employee.⁸⁴ Employers that establish SIMPLE IRA plans may not operate any other retirement plans for their employees.⁸⁵

State-Facilitated Retirement Savings Programs for Private-Sector Workers

While Congress addresses retirement security at the national level and establishes federal pension law and savings incentives, several states have enacted or implemented state-administered retirement savings programs to increase retirement plan access and savings among private-sector workers. Additional states are considering similar programs.⁸⁶ States have taken a variety of approaches to these programs, such as payroll deduction IRAs, retirement marketplaces, and multiple-employer plans.⁸⁷

In some state programs, employer participation (with some exceptions) is mandatory. In other state programs, employer participation is voluntary. Typically, eligible employees of participating employers are automatically enrolled in state programs but can opt out at any time.

- **Payroll deduction IRAs.** Payroll deduction IRA programs are the most common state-facilitated program. The four state-administered payroll deduction IRA programs in place as of the date of this report (California, Connecticut, Illinois, Oregon) automatically enroll employees. Because of the automatic enrollment feature, these plans are sometimes referred to as *automatic, or auto, IRAs*.

For more information, see CRS In Focus IF11611, *State-Administered IRA Programs: Overview and Considerations for Congress*.

- **Retirement marketplaces.** In a retirement marketplace, employers and individuals (including, for example, sole proprietors and “gig” workers) can purchase savings plans through different state-approved providers. For example, the State of Washington operates a retirement marketplace.⁸⁸

⁸⁴ For purposes of the 2% nonelective contribution, the compensation taken into account must be limited to \$290,000 for 2021 (\$285,000 for 2020), subject to COLAs.

⁸⁵ For more information on SIMPLE IRAs, see IRS, “SIMPLE IRA Plan,” <https://www.irs.gov/retirement-plans/plan-sponsor/simple-ira-plan>.

⁸⁶ See, for example, John Scott, “Pennsylvania and Hawaii Consider Auto-IRA Savings Opportunities for Private Sector Workers,” Pew Charitable Trusts, January 18, 2022, <https://www.pewtrusts.org/en/research-and-analysis/articles/2022/01/18/pennsylvania-and-hawaii-consider-auto-ira-saving-opportunities-for-private-sector-workers>.

⁸⁷ For more information on state retirement initiatives, see Georgetown University's Center for Retirement Initiatives, at <https://cri.georgetown.edu/states/>.

⁸⁸ See Retirement Marketplace, <https://retirement-marketplace.com/>.

- **Multiple-employer plans.** In a multiple-employer plan, unrelated businesses may jointly sponsor a 401(k) plan. For example, Massachusetts's state-administered multiple-employer plan permits eligible small nonprofit organizations to join the plan.⁸⁹ The Office of the State Treasurer and Receiver General acts as sponsor of the plan and performs most administrative and investment responsibilities.

Tax Treatment of Retirement Plans

To encourage preparation for retirement, Congress makes certain tax advantages available to employers and individuals. Contributions to retirement plans may be excluded from or deducted from an individual's or an employer's taxable income, investment earnings in the plan may accrue on a tax-deferred or tax-free basis, and distributions from the plan may or may not be included in taxable income.

Pension plans are generally *tax qualified*, which means that the plan receives certain tax advantages provided it meets IRC requirements.⁹⁰ Depending on the plan, these requirements include determining when participants have a legal right to their benefits (vesting schedules) and determining the amounts employers must contribute to the plans they sponsor (funding requirements).

IRAs and IRA-based plans also receive certain tax advantages but are not considered tax-qualified plans. IRAs must follow requirements outlined in Title 26, Sections 408 and 408A, of the *U.S. Code*.

DB Pension Plan Tax Treatment

Employer contributions to DB plans are tax-deductible expenses in the year they are made. Employee contributions to DB plans are not excluded from taxable income (i.e., they are made with after-tax income).⁹¹ Relatively few private-sector DB pensions require employee contributions. In 2011 (the most recent data available), 4% of private-sector workers with DB plans were in plans that required employee contributions.⁹² In contrast, in 2021, 91% of state and local government workers in DB plans were in plans that required employee contributions.⁹³ Both CSRS and FERS for federal employees require employee contributions.

DB plan payments to participants in retirement are included in their taxable income except for any portions that are attributable to employee contributions.

DC Pension Plan Tax Treatment

Employer contributions to tax-qualified DC plans are tax-deductible.

⁸⁹ See Commonwealth of Massachusetts, "CORE Plan for Nonprofits," <https://www.mass.gov/core-plan-for-nonprofits>.

⁹⁰ Nonqualified plans (also referred to as nonqualified deferred compensation plans) are typically for corporate executives to enable them to save above the tax-qualified plan contribution limits. Nonqualified plans often have some tax advantages, such as the deferral of income taxes until the funds are received by the individual.

⁹¹ State and local plans with employee contributions often *pick up* employee contributions, effectively making them employer contributions and therefore excluded from the employees' taxable income.

⁹² See BLS, "National Compensation Survey: Employee Benefits in the United States, March 2011," Table 3.

⁹³ See BLS, "National Compensation Survey: Employee Benefits in the United States, March 2021," Table 4.

Employee contributions can be made on a pre-tax or an after-tax basis. Most contributions are made on a pre-tax basis, and taxes are *deferred*, which means that taxes are not paid until distributions are made from the account. Upon withdrawal, pre-tax contributions and any investment earnings are included in taxable income.

Contributions to DC plans that are made on an after-tax basis—such as *designated Roth contributions* or *after-tax, non-Roth contributions*—are not excluded from taxable income.⁹⁴ Distributions from designated Roth accounts and those attributable to after-tax, non-Roth contributions are made on a *pro-rata* (or proportional) basis combination of contributions and earnings.

Qualified distributions (those made after age 59½, death, or disability, from accounts that are at least five years old) from designated Roth accounts, which include contributions and any investment earnings, are tax free in retirement. Withdrawals attributable to after-tax, non-Roth contributions are not included in taxable income, but investment earnings attributable to those contributions are included in taxable income.

IRA Tax Treatment

IRA tax treatment is similar to DC plan tax treatment. Traditional IRAs are funded by workers' contributions, which may be tax deductible (depending on the IRA owner's household income and workplace pension coverage). Taxes are paid on both contributions and any interest earnings when funds are distributed. Contributions to Roth IRAs are made with after-tax funds, and qualified distributions are not included in taxable income. Investment earnings accrue free of taxes.

Effect on U.S. Treasury

Provisions in the tax code that create revenue losses for the U.S. Treasury (e.g., through exclusions and deductions from income) are referred to as tax expenditures. Examples include excluding employer contributions for employee health care, the tax deduction for mortgage interest on an individual's residence, and the variety of tax deductions and exclusions related to retirement plans and savings. Unlike, for example, the mortgage interest deduction, which represents a permanent loss to the Treasury,⁹⁵ retirement-related tax expenditures, in most cases, represent a *deferral* of taxes.

- Income taxes are deferred on contributions to traditional DC plans and traditional IRAs. Investment earnings also accrue on a tax-deferred basis. Distributions from these accounts are included in taxable income.
- Benefits earned in DB plans are also not taxed until received in retirement.
- While contributions to designated Roth accounts within DC plans and Roth IRAs are *not* excluded from taxable income, investment earnings accrue on a tax-free basis.⁹⁶

⁹⁴ Employer matching contributions for an individual who makes designated Roth contributions are always made on a pre-tax basis.

⁹⁵ See CRS In Focus IF11540, *The Mortgage Interest Deduction*.

⁹⁶ See Peter Brady, "The Tax Benefits and Revenue Costs of Tax Deferral," ICI, 2012, pp. 29-34, https://www.ici.org/pdf/ppr_12_tax_benefits.pdf.

The tax preferences for retirement savings are one of the largest federal tax expenditures. The Treasury Department estimated the following tax expenditures in FY2022:

- \$73.4 billion for DB plans,
- \$102.9 billion for DC plans, and
- \$19.9 billion for IRAs.⁹⁷

The Joint Committee on Taxation (JCT) estimated the following tax expenditures in FY2022:

- \$131 billion for DB plans,
- \$199.5 billion for DC plans, and
- \$27.2 billion for IRAs.⁹⁸

The difference in the estimates may be due to differences in assumptions and methodologies. Unlike, for example, the student loan interest deduction, which is a one-time deduction and relatively easy to calculate, taxation on retirement plan contributions is deferred until a future date, and the actual tax expenditure depends on many factors, such as the rate of return on investments and the difference in marginal income tax rates at the time of contribution and withdrawal for any given individual. Some researchers have identified issues with the calculation methods used by Treasury and JCT and have proposed alternative methods.⁹⁹

⁹⁷ See U.S. Department of the Treasury, “Tax Expenditures,” Table 1, <https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2023.pdf>. Treasury also estimated a tax expenditure of \$33.2 billion for self-employer plans, which refer to Keogh plans (IRA-based plans for self-employed individuals).

⁹⁸ See JCT, “Estimates of Federal Tax Expenditures for Fiscal Years 2020-2024,” <https://www.jct.gov/publications/2020/jcx-23-20/>. JCT also estimated a tax expenditure of \$15.1 billion for Keogh plans.

⁹⁹ For example, see Judy Xanthopoulos and Mary Schmitt, “Retirement Savings and Tax Expenditure Estimates,” Retirement Saving Association, September 2016, https://www.asppa.org/sites/asppa.org/files/Comm_2016/16.09%20ARA%20Report%20-%20Retirement%20Savings%20and%20Tax%20Expenditure%20Estimates%20FINAL.pdf. The authors state that current tax expenditure measures overstate costs for provisions that defer taxes compared to provisions that permanently reduce taxes (e.g., a tax credit). The authors suggest that estimates should be made for groups based on contribution level, age, and income to measure the effects of tax deferral (i.e., the benefit that results from taxpayers facing a different tax rate in retirement compared to when the contributions are made) and the benefits of future earnings (assuming a 4% rate of return).

Appendix. Selected CRS Resources on Pension Plans and Individual Retirement Accounts

The following CRS resources provide additional background on the different types of pensions discussed in this report.

- CRS In Focus IF12008, *Private-Sector Pensions in 2019: Number of Plans, Participants, and Amount of Assets*
- CRS Insight IN11659, *U.S. Retirement Assets in 2020*

Private-Sector Defined Benefit Plans

- CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*
- CRS Report R43305, *Multiemployer Defined Benefit (DB) Pension Plans: A Primer*
- CRS Report R45187, *Data on Multiemployer Defined Benefit (DB) Pension Plans*
- CRS Report R45311, *Policy Options for Multiemployer Defined Benefit Pension Plans*
- CRS In Focus IF11765, *Special Financial Assistance to Multiemployer Plans*

Private-Sector Defined Contribution Plans

- CRS In Focus IF12007, *A Visual Depiction of the Shift from Defined Benefit (DB) to Defined Contribution (DC) Pension Plans in the Private Sector*
- CRS Insight IN11721, *Data on Retirement Contributions to Defined Contribution (DC) Plans*

Federal, State, and Local Government Pension Plans

- CRS In Focus IF10243, *Civilian Federal Retirement: Current Law, Recent Changes, and Reform Proposals*
- CRS Report 98-810, *Federal Employees' Retirement System: Benefits and Financing*
- CRS Report RL30387, *Federal Employees' Retirement System: The Role of the Thrift Savings Plan*
- CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*

Individual Retirement Accounts

- CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*
- CRS Report R41476, *Ownership of Individual Retirement Accounts (IRAs) and Policy Options for Congress*
- CRS Insight IN11722, *Data on Contributions to Individual Retirement Accounts (IRAs)*

- CRS In Focus IF11611, *State-Administered IRA Programs: Overview and Considerations for Congress*

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