## Understanding Private Pension Plans and Annuities for Your Retirement

**4 MIN. READ**

According to the United States Department of Labor's 2018 Form 5500 Annual Report, there are [139.8 million people](https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf) participating in private pension plans. Of that number, 96.4 million are active1. Meaning they are contributing on a regular basis to that plan.

The private pension (also called “personal” pensions) concept, for use as part of a retirement strategy is not new. The American Express Company created the first private pension plan [in 1875](https://www.workforce.com/news/the-history-of-retirement-benefits). It was slow to catch on though. In fact, only about [25% of non-agricultural employees](https://www.bls.gov/mlr/1991/12/art3full.pdf) in 1950 were involved in some type of private pension system.

Eventually, the value of [preparing for retirement](https://fta-ria.com/how-do-i-know-whether-im-retirement-ready/) through private pensions consisting of annuities was more widely accepted. By the late 20th century, private pensions began to gain traction. Today, they are widely accepted throughout the country, across nearly all industries.

### Private Pension Plans: An Overview

A private pension is most often type of investment called an annuity. Annuities are insurance contracts that make regular payments to you either immediately or at some point in the future. You can purchase an annuity to help grow or protect your retirement savings provide a guaranteed income stream. The guaranteed income stream is your private pension. There are also pension plans employers make available to their employees. There are 2 types of employer plans, defined benefit and defined contribution. Finally, Social Security is a public pension. Meaning it is administered by the US government. In reality, employees are paid back from the Social Security tax on their lifetime wages.

All US workers are eligible to take advantage of Social Security. Most people work for companies that provide some type of retirement plan. There are distinct differences between employer plans and private pensions. They are described below.:

* **Defined benefit plan**: This plan guarantees a certain benefit for a specified period of time. The employer is responsible for setting aside enough money to cover all eligible employees. If the employer is unable to make the required payments, the benefit the employee receives may be reduced.
* **Defined contribution plan**: This plan offers a tax-qualified method that involves saving and investing. The employee contributes part of their salary to their individual plan. The contributions are invested in a defined group of investment options. When the employee retires, they are able to use the balance in the plan as an added income stream. The employee is responsible for making the contributions and selecting the investment options.
* **Annuity or private pension**: This plan contractually guarantees (based on the claims-paying ability of the issuer of the policy payments to the policyholder. The policyholder pays the issuer a pre-determined amount of money upfront in exchange for a stream of payments at some future date. The insurance company is responsible for investing the lump sum premium and paying you a stream of income.

### Types of Annuities

An annuity is an insurance product which has the ability to pay you an income stream for your entire life. Those payments are made at regular intervals, typically monthly. There are a few different types of annuities, all with their own features. Our retirement planners can help you find the one that is right for you to help you meet your financial goals.

The three types of annuities are:

* **Fixed**: A Fixed Annuity locks in the interest rate at the time the annuity is purchased. No matter what the market interest rate is, the interest rate on a fixed rate annuity remains constant throughout the life of the contract. The insurance company issuing the annuity bears the risk of making the payments to the beneficiary.
* **Indexed**: An Indexed Annuity pays the policyholder an interest rate based on the performance of a specified market index. For example, the S&P 500 index might be the performance index used to determine the interest rate of the annuity. Indexed Annuities offer a greater potential upside compared to a Fixed Annuity. When the market index outperforms the fixed rate, the policyholder benefits. Indexed Annuities do have a minimum rate floor no matter how the specific index performs which limits the downside risk. The insurance company bears the risk of making either the minimum payment or the higher payment based on the index performance.
* **Variable**: A Variable Annuity pays an interest rate based on the performance of an investment portfolio selected by the policyholder. In some cases, the insurance company may offer the policyholder a model portfolio that automatically rebalances on a predetermined schedule. While there is no guaranteed interest rate, a Variable Annuity has both a [risk of loss](https://fta-ria.com/why-losses-hurt-so-much/) and potential for gain – the type of variable annuity selected will determine the amount of potential loss or gain. The policyholder bears the risk associated with a Variable Annuity, not the insurance company.

### Annuity Pros and Cons

As with any financial product, annuities have pros and cons. The terms may be tailored, depending on the [retirement needs](https://fta-ria.com/what-questions-should-i-ask-about-retirement-planning/) of the policyholder. Let's dive into the pros and cons more closely.

Annuities offer options for adjusting the product terms to best fit the specific needs of the policyholder. The various terms that may be modified are:

* The length of the payout period.
* The structure of the payout.
* The timing when changes in the payout structure.
* The ability to withdraw a percentage of the initial investment without penalty.

The disadvantages associated with annuities include:

* A high cost. Policy riders typically increase the cost of the annuity. Policy riders are integral to tailoring the annuity to fit your financial needs and goals.
* Annuities are not liquid investments. They should not comprise too big of a percentage of your retirement assets.
* Annuities can be very complex. A financial advisor may be needed to help you find the right one.

At [COMPANY NAME], we are committed to helping you achieve your retirement financial goals. Our skilled, knowledgeable financial planners will help you navigate the sometimes-complex landscape of private pension plans to find what works for you. It’s never too early to start planning your retirement, [contact us today](https://fta-ria.com/contact/) to schedule an appointment.

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\*unless some of it is a variable annuity.

1 The definition of active participants includes individuals who are eligible to elect to have the employer make payments to a 401(k) type plan (even if individuals are not contributing) and nonvested individuals who are earning or retaining credited service under the plan. For more information, please see the Instructions for Form 5500 at [https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and- compliance/reporting-and-filing/form-5500](https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-%20compliance/reporting-and-filing/form-5500).

**Meta Title:**

What is a private pension? | Preparing for retirement

**Meta Description:**

A private pension could help you prepare for your life after retirement. What is it? What are the benefits? Are there any downsides? What about annuities? Get the answers you need here.

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