Kiplinger's PERSONAL FINANCE

MONEY // RETIREMENT

IS YOUR PENSION STILL SAFE?

PROBABLY. BUT NEW RULES COULD MAKE IT HARDER FOR YOU TO GET ALL OF YOUR MONEY. BY MARY BETH FRANKLIN

JOHN SIDORENKO HAS HIT A FEW SPEED BUMPS ALONG his route to retirement. In December 2007, Delphi Corp., the financially troubled auto-parts manufacturer, shuttered the Columbus, Ohio, plant where Sidorenko had worked as an engineer for nearly 31 years. That was two years before he had planned to retire. But thanks to a comfortable nest egg—his pension plus his 401(k) plan—and the fact that his wife, Betsy, continues to work as a school administrator, Sidorenko, 55, could afford to take an early retirement while many of his colleagues searched for new jobs.

Then last September, Delphi froze its pension plan—meaning current employees will keep whatever benefits they have earned so far but will not accrue future benefits (see the box on page 3). Fortunately, Sidorenko's monthly pension checks haven't been affected, at least not yet. "We're assuming his full benefit is safe—for now," says David Kudla, head of Mainstay Capital Management, in Grand Blanc, Mich., and Sidorenko's longtime financial adviser. But if there is a future reduction in Sidorenko's pension benefit, he might have to draw more money out of personal savings.

Meanwhile, Sidorenko is thriving. "It's been better than I expected—not having the stress of the job and having leisure time for projects," he says.

PENSION PROTECTIONS

Most private-sector defined-benefit pension plans are insured by the Pension Benefit Guaranty Corp., which is funded by insurance premiums paid by employers. If a company's pension plan becomes underfunded and the company cannot make up the shortfall, the PBGC takes over and continues to pay retirement benefits up to the limits set by law, which are adjusted each year. For a plan that ends in 2009, the maximum guaranteed pension benefit for a 65-year-old is $54,000 a year; it's substantially less for those who retire at younger ages (see the box below). You are entitled to no more than the maximum amount for your age in the year the plan ends. And the guarantee does not cover early-retirement subsidies.

In 2007, the PBGC took over more than 100 insolvent pension plans. The agency says that more than 80% of retirees in PBGC-administered plans receive their full benefits. But if Delphi terminates its pension plan and turns it over to the PBGC, Sidorenko could lose a chunk of his pension check that exceeds PBGC limits.

Kudla, whose clients include current and former employees of General Motors, Ford, Chrysler and Delphi, says he has been inundated with questions about the safety of their pension plans. "Some people think if their company goes bankrupt, they lose their pension," he says. But traditional defined-benefit pension plans are protected by ERISA (Employee Retirement Income Security Act of 1974). In the event of financial distress, Kudla explains, creditors have no claim on the assets in a company's traditional pension plan or 401(k) plan.

Don't confuse your company's finances with those of its pension plan. They are entirely separate. For example, GM's pension plan appears

2009 Limits

WHAT YOU'D GET

The Pension Benefit Guaranty Corp. insures benefits of retirees in underfunded pension plans. These maximum limits apply to all plans terminating in 2009, even if you do not begin collecting benefits until a later year. For a complete list, go to www.pbgc.org.

Age	Annual maximum
65	$54,000
62	42,660
60	35,100
55	24,300
50	18,900

SOURCE: PBGC

to be well funded for now. Meanwhile, ExxonMobil, which posted the largest corporate profit in history last year, has the most underfunded pension of all the companies in Standard & Poor's 500-stock index. However, ExxonMobil can easily afford to dip into its hefty cash reserves to bring its plan up to adequate funding levels. Many other plan sponsors cannot—and that is the root of the current pension-funding crisis.

FUNDING GAP

Individual investors were not the only ones who lost money in the stock-market crash of 2008. Private pension plans suffered massive losses during the fourth quarter of last year. Plans sponsored by the largest 1,500 U.S. companies went from a surplus of $60 billion at the end of 2007 to a $409-billion deficit at the end of 2008. Mercer, a benefits-consulting firm, estimates that the ratio of pension-plan assets to liabilities fell from 104% at the end of 2007 to just 75% at the end of 2008.

But the market crash is only part of the pension-funding problem. The Pension Protection Act of 2006 reshaped the funding rules for employers who sponsor defined-benefit plans. These rules, which required employers to increase contributions to meet more-stringent pension-funding targets, took effect in 2008 for single-employer plans—just as companies were facing enormous economic challenges to keep their businesses afloat.

THANKS TO HIS PENSION, JOHN SIDORENKO ENJOYS EARLY RETIREMENT WHILE HIS WIFE, BETSY, CONTINUES TO WORK.

RYAN KURTZ

Unless the stock and bond markets improve significantly and quickly, these pension-plan sponsors will have to boost their contributions by an estimated $60 billion this year to make up the shortfall between promised benefits and current assets, according to the Mercer analysis. The money has to come from somewhere, and that increases the possibility that some companies will have to lay off workers, freeze their pensions or go bankrupt. "Money that is needed to save jobs and for capital investment would instead be directed to pension plans as a result of sudden, unprecedented market conditions," warns James Klein, president of the American Benefits Council, a national trade association that represents private employers.

Just before adjourning last year, Congress approved relief for employers, allowing them an additional few years to meet pension-funding targets. But it did not alter new restrictions that prohibit underfunded pension plans from paying some or all of retirees' benefits as a lump sum. In the plans that permit lump-sum distributions (roughly half of all plans), more than 70% of eligible retirees choose the lump sum instead of a monthly annuity payment, according to the Employee Benefit Research Institute.

"The new law is intended to shore up pensions and put an end to underfunded plans," says Brett Goldstein, a pension administrator and president of The Pension Department consulting firm, in Plainview, N.Y. "However, in a time of financial crisis, the law is actually hurting employees who are relying on their pension as their primary source of income at retirement."

PAYOUT RESTRICTIONS

Under the new law, if a pension plan does not have enough money to pay at least 80% of plan obligations, then

WHEN YOU'RE LEFT OUT IN THE COLD

WHEN SOME OF THE COUNTRY'S BIGGEST EMPLOYERS AND INDUSTRY TRADE associations pleaded with Congress for temporary funding relief, several key unions and employee groups supported their request, hoping it would prevent companies from freezing their pension plans. (A pension freeze means employees keep the retirement benefits they have already earned but do not accrue any further benefits. That minimizes employers' future costs, but it doesn't relieve them from having to make up current shortfalls in the plan's funding.) But pension freezes seem to be picking up steam since last year's stock-market meltdown.

Retirement Income

IMPACT OF A FREEZE

Let's say that a worker joins his company pension plan at age 35, after which the pension is frozen and replaced with a 401(k). The figures below show the percentage of the worker's final earnings that would be replaced at retirement, depending on his age at the freeze.

Plan Type	Age at pension freeze and % of final wages replaced: 35	40	45	50	55	62
Pension	0%	3%	7%	13%	20%	43%
401(k)	44	33	23	15	8	0
Total replacement of final wages	44	36	30	28	28	43

SOURCE: Center for Retirement Research at Boston College.

More than a dozen major corporations, from aircraft-manufacturing giant Boeing to publishing icon Random House, have announced pension freezes effective this year. Because a freeze reduces future retirement benefits for employees, companies often introduce a new 401(k) plan or enhance their existing plan by boosting employer contributions.

That can be a boon for younger workers. Most of them probably wouldn't stick around long enough to benefit from a traditional defined-benefit plan, which typically generates the greatest benefits toward the end of a long career. And older workers nearing retirement are often unscathed by pension freezes because they have already accrued the bulk of their benefits, which are based on a formula that includes years of service and the average of your highest three or five years of salary.

But for mid-career workers in their fifties, a pension freeze can be devastating. Future raises and years of service won't be factored into their pension calculation, causing them to miss out on the most lucrative part of the back-loaded retirement benefit. And they have less time to make up the loss by saving in a 401(k).

For example, the Center for Retirement Research at Boston College found that a pension for an employee who joins a company's pension plan at age 35 and continues to earn benefits until he retires at 62 would replace about 43% of his final earnings. But if the pension is frozen when the employee is 50 and replaced with a 401(k), the worker's retirement-income replacement rate drops to just 28% of final earnings. Even with 401(k) enhancements, retirement benefits decline.

In both cases, Social Security benefits would supplement retirement income. But the worker whose pension was frozen would have to rely more heavily on personal savings to maintain his preretirement income or cut expenses after he leaves his job. Plus, the investment risk shifts from employer to retiree.

What can you do? Financial planner David Kudla says you should focus on the things you can control, such as contributions to your 401(k) and other personal savings. Although he sympathizes with retirement savers who may want to walk away from the stock market forever, he says that's "wrong thinking at the wrong time for long-term investors."

payout restrictions apply. In that case, retiring employees would be allowed to take only half of their pension as a lump sum. The other half would be distributed as a monthly annuity check. If the plan is less than 60% funded, retirees cannot take a lump-sum distribution at all and must accept monthly checks (except when lump sums are $5,000 or less). Restrictions may not apply to some collectively bargained multi-employer plans until 2010.

Pension plans that were less than 80% funded in 2008 have until April 1, 2009, to meet their target funding levels or be subject to payout restrictions, says Ethan Kra, chief retirement actuary for Mercer. "A fair number of plans will be subject to payout restrictions come April 1," Kra predicts.

He suggests that if you are planning to retire this year and you want a lump sum, ask immediately about your plan's funding status for 2008. If it's less than 80% funded, get all your paperwork in order and have your employer cut you a check by March 31—or it may be too late.

New retirees aren't alone in being hurt by the payout restrictions. Workers who have a cash-balance plan—a hybrid that allows you to take a lump sum with you when you change jobs—could also be affected. Younger workers who switch jobs or get laid off this year could have trouble taking a lump sum with them when they leave.

Goldstein recommends that all pension-plan participants ask their plan administrator in writing about the funding status of the pension and whether there are any restrictions on lump-sum distributions. "You can't do anything about the restriction, but if you were counting on a lump sum, you need to know now if you may have to look for other sources of income," says Goldstein. To find out whether your plan is in trouble, go to the Web site of the Pension Rights Center (www.pensionrights.org) and click on the fact sheet that helps you determine your plan's status. ■