Kiplinger's PERSONAL FINANCE

Is your pension safe?

Probably. But if the government takes over your plan, you could lose some benefits. By Mary Beth Franklin

The Great Recession has dealt a devastating blow to a wide range of American industries, from carmakers and auto-parts suppliers to retailers and financial-services firms. Employees of those struggling and failed companies are worried not just about their next paycheck but about their long-term financial security as well. A lot of them are asking, is my pension safe? In most cases, the answer is yes. But higher-paid employees and younger retirees could see their benefits cut substantially if their plans are taken over by the federal agency that guarantees most private-sector pensions.

If a company's pension plan becomes underfunded and the company cannot make up the shortfall, the Pension Benefit Guaranty Corp. becomes the trustee and continues to pay retirement benefits up to the limits set by law, which are adjusted each year. For plans that end in 2009, the maximum guaranteed pension for someone who claims benefits at age 65 is $54,000 a year; it's substantially less for those who retire – or whose plan is terminated – at younger ages. The guarantee does not cover early-retirement subsidies or retiree health benefits.

Although the PBGC says that more than 80% of retirees in the plans it administers receive full benefits, John Sidorenko and many of his colleagues won't be so lucky. An early retiree from auto-parts manufacturer Delphi Corp., Sidorenko, 56, will lose about one-third of his pension because of benefit limits in effect when the PBGC took over his former employer's pension plan in July. (Although General Motors agreed to assume the pensions of the union workers of its largest parts supplier, it turned over the pensions of Delphi's salaried retirees to the PBGC.)

The PBGC takeover is major blow to many of the 15,000 white-collar Delphi retirees. But Sidorenko, a former engineer, is still in good shape, thanks to his substantial 401(k) savings and the generous retirement package his wife Betsy, will get from the State Teachers Retirement System of Ohio. Betsy, 56, plans to retire at the end of the year with a full pension, including health benefits, but will continue earning a salary as a school administrator for a few more years.

"John's pension is just a small part of the assets at their disposal," says David Kudla, head of Mainstay Capital Management, in Grand Blanc, Mich., and Sidorenko's long-time financial adviser. "They will still be very well off." 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 plan," he says. "But don't confuse you company's with those of its pension plan. They are entirely separate." Kudla explains that creditors have no claim on the assets in a company's traditional pension plan or 401(k) plan.

FUNDING GAP

While the PBGC stands ready to bail out distressed pension plans, the agency may soon need a bailout of its own. The constant stream of pension terminations over the past few years, including some major airlines and steel manufacturers, has taken a toll on the PBGC's finances. It posted a $35.5 billion deficit for the first half of fiscal year 2009, the largest in the agency's 35-year history. PBGC acting director Vince Snowbarger told Congress that the agency has sufficient funds to keep paying pension benefits for several years, but steps must be taken to address long term deficit.

Just like individual investors, private pension plans suffered massive losses in the recent market rout.

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. (By June 2009, the funding ratio has improved to 82 %.)

The Pension Protection Act of 2006 prohibits underfunded pension plans from paying 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.

Congress and the IRS have approved temporary relief allowing employers an additional few years to meet new pension-funding targets and to use a more advantageous interest rate to calculate pension liabilities. That should help most employers dodge the October 1, 2009, deadline that restricts lump-sum distributions, says Ethan Kra, chief retirement actuary for Mercer. But without broader relief, pension plans could face restrictions on lump-sum payouts next year.

Under the new law, if a pension plan does not have enough money to pay at least 80 % of plan obligations, then payout restrictions apply. In that case, retiring employees would be allowed to only take half of their pensions 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 (except when lump sums are $5,000 or less) and must accept monthly checks. Workers who have a cash-balance plan – a hybrid retirement plan that allows you to take a lump sum with you when you quit or switch jobs – could have trouble taking a lump sum if their pension plan is underfunded.