Kiplinger's
PERSONAL FINANCE

RETIREMENT PLANNING 2007

Create a pension backup plan

By Mary Beth Franklin

AFTER 22 YEARS WITH FORD MOTOR CO., HANK Neumayer is thankful that he is covered by his company's pension plan and hopes his job—and his benefits—will last for another eight years, when he'll qualify for early retirement. But he's not counting on it. Although Ford has not indicated that it will freeze its pension, Neumayer is saving aggressively just in case his anticipated benefits don't materialize. That's probably wise because Ford has a pension shortfall of more than $12 billion and plans to cut more than 25,000 jobs over the next five years.

Scores of high-profile companies that once guaranteed generous checks to retirees are freezing their pensions, meaning they cap employees' future retirement benefits based on what they have earned so far. Some are closing their pension plans to new hires, too. "I know what I've got so far is safe," says Neumayer, 44. "But it's only about half of the $5,000-a-month pension I'd get if I were to continue and retire in my early fifties."

On the plus side, Ford plans to reinstate the company match to its 401(k) plan in June, paying 60 cents on the dollar up to 5% of an employee's base salary. Many employers are increasing their matching contributions to compensate for cutbacks in pensions and retiree health benefits. Ford's white-collar workers are paying 30% more for their health insurance this year than they did in 2006, and the company will stop providing health insurance for Medicare-eligible salaried retirees over 65 starting next year. That announcement didn't surprise Neumayer. "I'd have to be a fool to think that they are going to pay for my health care forever," he says.

HIRED HELP

TO MAKE UP FOR A POTENTIAL SHORTFALL IN retirement income, Neumayer, who lives in Louisville, Ky., invests aggressively inside his 401(k) plan. But the field auditor for Ford dealerships doesn't go it alone. He hired a financial adviser to manage his retirement account.

Thanks to a special discount arrangement that Ford employees and retirees have with Mainstay Capital Management, in Grand Blanc, Michigan, Neumayer pays about 0.3% for the service. On his balance of more than $500,000, that equals about $1,600 a year. Financial advisers usually charge three to six times that much to manage private clients' investments and often impose minimum balance requirements of $100,000 or more.

Neumayer has been so pleased with the performance of his 401(k) investments, which have consistently outperformed Standard & Poor's 500-stock index, that he and his wife, Amy, turned all their other investments over to Mainstay chief executive David Kudla. "Working with Dave has completely changed my financial picture for the better," says Neumayer. "I don't do a thing but open my 401(k) statement out of curiosity."

Such managed accounts are likely to become more common as employers embrace changes authorized by the recent Pension Protection Act, which encourages companies to offer investment advice to their 401(k) participants, through individual advisers or recommended asset allocations based on computer models. "While employees can't control what happens to their pensions, they can control how much they save and how it is invested," says Kudla. "If the assets are managed well, they could more than make up for the difference."

A study by the Employee Benefits Research Institute last year found that if the pension plan of a 50-year-old worker earning $70,000 a year is frozen and replaced with a 401(k) plan, the employee would need to accumulate nearly $300,000 to purchase an immediate annuity that would fill the gap created by the pension freeze.

A GROWING TREND

GENERAL MOTORS, THE NATION'S LARGEST automaker, announced last year that it would close its pension plan to workers hired after Jan. 1, 2001. Workers hired before that date remain in the pension plan but will get reduced retirement benefits under a new formula. GM is just the latest in a long list of financially strapped companies to alter its pension plan over the past couple of years. And scores of profitable corporations have hopped on the bandwagon, either excluding newly hired employees from participating in their pension plans, known as a soft freeze, or ending further pension accruals for workers already on the job, known as a hard freeze.

What would make companies such as IBM and Verizon, which reported after-tax earnings last year of $9.5 billion and $6 billion respectively, take such drastic action? Simply put, it's an attempt to remain competitive…