

RETIREMENT Plan Trends



A benefits update

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Congress Approves Emergency Pension Relief Bill

On December 11, 2008, Congress passed an emergency package of pension-related provisions and pension-related technical corrections in response to two pressing economic concerns: 1) the inability of many pension plans to meet new funding obligations and 2) the hardship incurred on retirees if forced to take required minimum distributions. The Worker, Retiree, and Employer Recovery Act of 2008 provides pension plan funding relief; includes long-awaited corrections to the Pension Protection Act of 2006 (PPA); and suspends required minimum distributions (RMDs) for 401(k) plans, IRAs, and similar retirement accounts for 2009.

Advocacy groups for employers with traditional pension plans had alerted legislators that the recent

drop in value of their assets has made it increasingly difficult to maintain the funding levels set by the PPA. They warned that a failure to relax the rules could lead to frozen plans and business cutbacks.

Under the new law, defined benefit retirement plans that fall

below the targeted funding percentages set up by the PPA (92% for 2008, 94% for 2009, and 96% for 2010) will be required to make subsequent contributions up to the specified funding percentage for that year, but they will not be obligated to up the funding percentage to 100%, as had been required under the PPA. In addition, the rules were changed to allow for smoothing of unexpected gains and losses in assets over a two-year period, rather than using only the current fair market value of assets to determine funding levels. Especially in a slowing economy, smoothing can help lower the immediate cost of meeting certain funding levels.

To ease the former restriction on benefit accruals for plans that are less than 60% funded in the current year, the new law allows plans to use

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The new law requires all qualified plans to permit rollovers out of the plan for non-spouse beneficiaries starting in 2010.

their adjusted funding target attainment percentage (AFTAP) from the previous year to determine their funding status. Revising a previous rule that prohibited plans that fall below the 60% funding level from making accelerated benefit distributions, the new law permits lump-sum distribution payments of \$5,000 or less.

The new law relaxes funding restrictions for multi-employer plans that are considered to be in endangered or critical status. Multi-employer plans may elect to freeze their current funding certification based on the previous year's status. The new law also provides a three-year extension of the funding improvement and rehabilitation period for plans in the critical or endangered status, from 10 to 13 years, and for those in the seriously endangered status, from 15 to 18 years.

For plans with 500 or more participants, the new law adjusts the threshold used to identify at-risk plans, to which the PPA imposes additional funding requirements, to help some plans avoid at-risk status. For small plans with 100 or fewer employees that have an alternate valuation date for the determination of contributions and restrictions, the Treasury and the IRS are authorized to establish special rules.

The new law clarifies the withdrawal rules related to automatic enrollment arrangements and extends them to include SIMPLE IRAs and SARSEPs. A number of adjustments in the new law also provide some relief for hybrid plans.

To help individuals who have recently experienced declines in the balance of their retirement savings, the new law temporarily waives required minimum distributions (RMDs)—normally mandatory after age 70½—for IRAs and qualified defined contribution plans. The suspension of RMDs is in effect for 2009 only; RMDs for 2008 are not waived.

Clarifying the provision of the PPA that allows rollovers from qualified plans to non-spouse beneficiaries, the new law requires all qualified plans to

permit rollovers out of the plan for non-spouse beneficiaries starting in 2010. Plan sponsors must also provide the rollover notice to non-spouse beneficiaries. It is important to note that, under current law, there is no non-spouse rollover available from IRAs.

James A. Klein, president of the American Benefits Council, described the passage of the legislation as “a crucial first step to ensure stability in pension plan funding next year.” The new law, Klein said, “will help mitigate the artificially inflated funding obligations brought about by unprecedented market volatility and help avoid triggering a requirement for many employers to restrict pension benefits.”

Instead, Klein added, “those funds will be available for job retention, job creation, and capital investment.” Looking forward to 2009, Klein also called upon the 111th Congress and new administration “to pursue further efforts to stabilize pension plan funding during these difficult economic times.”

However, Mark Ugoretz, president of the ERISA Industry Committee (ERIC), an advocacy group representing the benefits interests of major employers, argued that the new legislation may not go far enough. In particular, he asserted that the law does not provide enough relief for plans that fall below the currently acceptable funding corridor of 90%–110%, thus triggering significantly higher funding requirements. To help ease the pressure on these plan sponsors, he called for an expansion of the corridor to 80%–120%.

“Ultimately, the bill does not provide adequate relief, falling short of addressing or even reflecting the dramatic downturn in the markets,” Ugoretz said. “There is a short window of opportunity until early next year before companies start cutting jobs and business investments to make up for massive pension contributions that would otherwise be corrected as the country moves out of the current recession.”

Freezing A Traditional Pension Plan May Add To Employers' Costs

While many companies are freezing or terminating their defined benefit retirement plans, employers considering switching from a traditional pension plan to a 401(k) or other type of defined contribution plan should carefully consider the impact the change will have on the retirement security of their employees and on their own administrative costs, according to a study published by the National Institute on Retirement Security (NIRS).

The issue brief, "Look Before You Leap: The Unintended Consequences of Pension Freezes," was written by policy analysts Ilana Boivie and Beth Almeida. Citing research from the Government Accountability Office (GAO), the authors noted that almost half of all private sector defined benefit retirement plans have been closed to new entrants and that most of these employers subsequently introduced a defined contribution plan offering far less generous benefits than a traditional pension plan.

Freezing defined benefit plans can, according to Boivie and Almeida, have grave consequences for workers. While acknowledging that the precise impact of the move from defined benefit to defined contribution plans depends on the specific provisions of the plan and its benefit formulas, they noted that mid-career and older workers, in particular, can experience sharp reductions in retirement income as a result of the switch.

Moreover, the authors said, freezing a traditional pension plan and transitioning to a defined contribution plan can actually increase costs for plan sponsors, especially if they continue to operate two separate plans. Citing studies

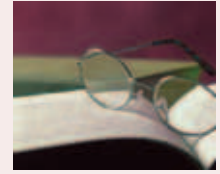
comparing the economic efficiencies of defined benefit and defined contribution plans, they observed that far greater contributions from employers and employees are generally needed to maintain the same level of benefits from a defined contribution plan as from a defined benefit plan.

What's more, Boivie and Almeida continued, the economic efficiency of the frozen defined benefit plan tends to erode over time, largely because freezing a plan prematurely accelerates the age profile of the plan, thus forcing changes to the plan's investment mix.

The authors also pointed out that accounting rules may require pension plans, especially those in the public sector, to cover unfunded liabilities, which occur when the value of the assets in the pension's trust is lower than the plan's benefit obligations. These liabilities can be expected to grow once the plan is frozen to new entrants and the payroll base over which benefit payments may be distributed decreases. Furthermore, unexpected events, like a sudden decline in the value of the fund's assets in an economic downturn, can exacerbate the problem of unfunded liabilities.

As a result of freezing a traditional pension plan, employers may also find that retention and recruitment has become more difficult in the wake of the transition, Boivie and Almeida said. Research suggests that moving from a defined benefit plan to a defined contribution plan can hamper recruitment, and it may even result in higher turnover rates, labor shortages, increased training costs, and lower levels of productivity.

Given the additional costs that may be associated with freezing defined benefit plans, particularly for public sector employers, and the prospect of a much reduced level of financial security for retirees as a consequence of the switch, the authors advised plan sponsors to consider the long-term ramifications before making the move to a defined contribution plan.



Freezing a traditional pension plan and transitioning to a defined contribution plan can actually increase costs for plan sponsors, especially if they continue to operate two separate plans.

Worker Characteristics Influence Decision To Offer Retirement Plans

An employer's decision about whether or not to sponsor a retirement plan is determined largely by the characteristics of the employees, with organizations employing younger, less-educated, and lower-earning workers being less likely than other organizations to offer retirement benefits, according to a study released by the Investment Company Institute (ICI).

Written by economists Peter Brady and Stephen Sigrist, the report, "Who Gets Retirement Plans and Why?" examined the most influential factors in an employer's decision to provide retirement benefits to employees and attempted to identify which types of employees are more likely to prefer a compensation package that combines cash and pension benefits and which categories of workers tend to prefer compensation in the form of cash alone.

Based on data from the 2004 Survey of Consumer Finances, the authors noted that households headed by individuals in their twenties are far less likely to report that they are saving for retirement than older people, as this group is more focused on saving for liquidity, education, a home, or future purchases.

Even among older households, saving for retirement does not appear to be a priority among those with incomes below the 25th percentile. For lower income workers, in particular, the study found, the incentives to save for retirement are minimal. Because Social Security

benefits can fund a level of consumption in retirement that is equal to the amount a low-income worker consumed prior to retirement, reducing current spending to save for the future is seldom a priority, researchers said.

Thus, Brady and Sigrist observed, "the higher the percentage of pre-retirement consumption that can be funded in retirement with Social Security benefits, the less an individual would desire to accumulate other assets for retirement, and the less likely it is that the individual would demand compensation that included pension benefits."

Comparing the characteristics of employees who do and do not have access to workplace retirement plans, the study found that workers with retirement benefits are more likely than other types of workers to be in full-time and full-year employment, to have higher levels of education, and to be in their prime years for earning and saving.

For example, the 2007 Current Population Survey showed that just over one-quarter of workers aged 21–29 were employed by a company that offers retirement benefits, while some 60% of workers aged 45–64 have access to a retirement plan. The findings also indicated that employees with a high school education or less were far less likely than workers with higher levels of education to participate in an employer-sponsored retirement plan, even when available.

"If employees do not desire to save for retirement, they will likely value a dollar of cash compensation more highly than a dollar of retirement benefits, as there are restrictions placed on accessing these funds prior to retirement, and tax penalties are typically associated with early withdrawals," the authors concluded.



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