Retirement funds in danger for millions of Americans

Mike Bryan
6 March 2009

For millions of Americans, the deepening recession has meant a dramatic drop in funds put aside for their retirement. While many have seen the value of these accounts slashed in half, the pensions of others have been rendered virtually worthless as their employers file for bankruptcy. For others, a layoff in the family spells disaster, and saving for retirement is out of the question.

Many older workers have been forced to cash out their 401(k)s to cover mortgages and pay credit card debt and other expenses, with the amount withdrawn sharply reduced from their original investment. For other, particularly young, workers, the prospect of putting aside anything out of their weekly paychecks is out of the question.

While there are many 401(k) plan variations, until recently an employer has commonly matched 50 percent of an employee's contributions up to 6 percent of the employee's income. These funds can be set aside tax free, and are most commonly invested in an assortment of mutual funds.

Now, more and more companies have stopped making matching contributions to these funds. Coming on top of wage cuts, this amounts to yet another reduction in real wages for millions of workers.

In an article posted on CFO.com entitled "Stopping 401(k) Matches: The New No-brainer," Alan Vorchheimer of Buck Consultants is quoted as saying, "this is just so easy.... Almost every company is being forced to consider it.... Let's be candid: the CFOs of a lot of these companies are going to their benefits people and saying, ‘Hey, can we get rid of our match?' "

According to a list compiled by the Pension Rights Center , a rapidly increasing number of companies are answering "yes" to that question. While not comprehensive, from June through December of 2008 the list contained the names of 29 companies.

In the first few months of this year the list of those cutting matching contributions has grown to more than 110. Among the most recognizable names are General Motors, Chrysler, Ford, Motorola, FedEx, UPS, Starbucks, NCR, Sears, US Steel, AMD, *Reader's Digest*, Macy's, Diebold, the *New York Daily News*, Libbey, and Hewlett-Packard.

This corporate assault on 401(k)s, and the dwindling value of these accounts with the collapse of the stock market, show how the shift over the last few decades from defined benefit plans, often referred to as pensions, to 401(k)s now threatens the retirement of millions of workers.

In a brief on "The Financial Crisis and Private Defined Benefit Plans," the Center for Retirement Research (CRR) at Boston College explains why this is the case, and why the majority of companies have moved away from defined benefit plans:

"In 401(k)s, individuals bear the risk. If the stock market collapses, they take an immediate hit to their retirement assets. And those about to retire—who on average held about two thirds of their assets in equities—will be forced to retire on less. In defined benefit plans, however, participants are promised benefits based on years of service and earnings (typically the last five years), and these benefits must be paid regardless of what happens to the assets in the employer's pension plan. In short, participants in defined benefit plans are sheltered from the effect of the financial crisis on retirement assets."

According to a recent study by Fidelity Investments, American workers lost an average of 27 percent of their 401(k) retirement savings in 2008, and they can expect to lose even more this year.

Defined benefit plans, on the other hand, place additional responsibility on plan sponsors, and are also much more expensive to operate—which is why companies have been moving employees out of defined benefit plans into 401(k)s, otherwise known as defined *contribution* plans.

In 1980, of those private sector workers with pension coverage, 60 percent had defined benefit plans only, 23 percent had both defined benefit plans and 401(k)s, and 17 percent had 401(k)s only. By 2006, these percentages had dramatically reversed: 8 percent had defined benefit plans only, 22 percent had both defined benefit plans and 401(k)s, and 70 percent had 401(k)s only.

Fewer private sector workers are covered by some type of employer-provided retirement plan than are public sector workers. In 2006, of workers age 25 to 64, only 45 percent of private sector workers had pension coverage while almost 80 percent of state and local workers had coverage. Public sector pensions are primarily defined benefit plans.

Between October 9, 2007, and October 9, 2008, equity assets in retirement plans dropped by about $4 trillion in value, according to the CRR study. State and local government defined benefit plans dropped by about $1 trillion, private employer defined benefit plans dropped by about $900 billion, private employer defined contribution plans dropped about $1.1 trillion, Individual Retirement Accounts dropped about $800 billion, and federal government thrift plans dropped about $100 billion.

These dramatic shortfalls create particular problems for private employer defined benefit plans. The Pension Protection Act of 2006 contains guidelines by which a plan sponsor must eliminate any shortfall between promised benefits and assets. The CRR study estimates that "firms are going to have to increase contributions by about $90 billion in 2009." Mercer, a global consulting firm, places the underfunding of corporate pension plans at $409 billion.

"This challenge raises the question of firms laying off workers, freezing their pensions, or going bankrupt," states the CRR study.

These shortfalls—amidst the worst economic crisis since the 1930s—make it a near certainty that the federal Pension Benefit Guaranty Corporation (PBGC) will be forced to take over the pension responsibilities of an increasing number of bankrupt businesses.

Created in 1974 by Congress, the PBGC is funded through premiums paid by the companies whose defined benefit plans it insures and through its investments. Since 2001, the PBGC has taken over nine of the ten largest terminated pension plans in its history, including those of United Airlines, Bethlehem Steel, and Kaiser Aluminum.

With $63 billion in assets and obligations to spend $74 billion on pension benefits in the coming years, the PBGC already has an $11 billion deficit. Taking over the pension plan of General Motors alone would more than double that deficit—although the PBGC would also receive assets from GM's pension fund.

Workers whose pension plans have been taken over by PBGC are highly unlikely to receive the entire benefit they expected. The current maximum benefit is $54,000 per year for a person retiring at age 65. There is no cost-of-living adjustment. All of these scenarios, furthermore, are predicated on the PBGC avoiding outright collapse.

Adding to the precarious future of retirement is the fact that it is a rarity for workers to remain at one employer for their entire working life. Since the median job tenure is less than four years, most workers earn limited amounts in either a defined benefit or a defined contribution plan with any one employer.

When workers leave a company and opt to receive single sum distributions of their retirement savings from these plans, fewer than half of those under age 50 save the entire distribution for retirement, as do fewer than half receiving distributions of less than $20,000.

According to a recent Bank of America Retirement Savings Survey, 18 percent of people are pulling retirement assets from their accounts prematurely—in spite of the tax consequences. With the deepening recession, more and more workers will undoubtedly tap into any such funds they have to pay for immediate pressing needs, further endangering their retirement future.