

How safe is your Pension?

I don't claim to be an expert, but at the same time, my firm has done a substantial amount of research, into retirement plans, particularly in light of the changing economy.

Whether your plan is with a public company or a private firm, you need to be proactive with your retirement program. I've developed a series of questions to check on the safety of your retirement income. For employees of public companies, basic information is included in the firm's annual report. Usually the size of a firm's unfunded pension liability and the size of its past service liability are disclosed in foot notes. More detailed information is available in the financial section of the firm's 10K report filed with the SEC.

For employees of private companies, everyone who was in a qualified plan (one approved by the IRS under the code) has the right to obtain information about his/her pension from the trustees of the plan. They may be either internal or external trustees. The average person may not be able to decipher the information. If you can't, then take it to a pension expert, actuary, lawyer or accountant for an analysis.

The size of a company's liability for retirement payouts is not as important as the assumptions about funding the liabilities. Like a mortgage, these obligations don't exist 100% in the present. Concern yourself with how the company expects to fund its liabilities in the future.

TYPES OF LIABILITIES

1. Unfunded pension liabilities – this is the amount a firm expects to meet over the next 20 – 30 years to supply their vested workers with promised pension benefits. These figures are derived from various actuary assumptions.
2. Past service liabilities – these are created when a company raises its pension compensation. A company may have been planning to provide 40% of compensation as a pension. One year, it may raise that to 45% and treat it retroactively.

TROUBLE SIGNS

1. A poor record on investing – compare the market value of the assets in the pension plan with their book value. If book value is more than market value, the trustees have not been investing wisely. If the fund had to sell those assets today, there would be a loss. I would also get a bit nervous if the fund is still holding some obscure bonds or other fixed income obligations issued at low rates years ago.

With that stated, it's still very important to recognize that:

- Over the last 3 years, the stock market has been extremely volatile.
- What appeared to be a safe investment 2 or 3 years ago, may not be a safe investment today, and:
 1. Even if an administrator is concerned about losses, in some instances, they can't simply dump the stock and take a larger loss if they, in fact, believe the market is going to rebound.
 2. Funding assumptions are overstated – actuaries have a Myriad of estimates and how long it takes to fund pension plans and the rate of return a company will receive.

THE AHERN ADVISORY

in this issue

How safe is your
Pension?



Ahern & Associates, Ltd.

Accredited Member
National Bureau of Certified
Consultants Inc.

September 10, 2010

WHAT TO LOOK AT

1. **The time frame** – this should not be too long. If a firm is funding 40+ years, I would want to know why and how since 10 – 20 years is more customary. **Nobody has a crystal ball and the investment world will certainly be different in, as little, as 10 years from now.** Assumptions made at 40 years may not be realistic.
2. **Rate of return** – if a company assumes the conservative 6% - 7% or less currently, you should feel comfortable. If the assumed rate is 10% or more, I would want to know how it plans to meet the expectation over the long run.
3. **Salary and wage scales** – the company should be assuming an increase in compensation over years. Most plans have such provisions. They must start funding now for future salary increases.
4. **Assumptions about the employee turnover rate** – these assumptions should be consistent with the historically documented turnover of the company. If a firm has a very low turnover rate and assumes a 4% turnover, the company (for most practical purposes) will be unfunded at some time. **Estimates should be conservative.**

What I suggest: assess your own status in a corporate pension plan. See what benefits you are eligible for. Many people have the illusion they're eligible for maximum pension after only a few years. **Truth; no company could afford to fully include people who have such short service records.** They may offer some token pension, for such services, but most people are not fully covered until they have worked for the firm for 10 or even 20 years, and then they may be vested only to the extent of their accrued pension to date, full pension expected at normal retirement.

With so many challenges in the past 2 decades, an individual's pension fund status may be much less than imagined.

Employees of troubled or even bankrupt companies need not worry. Trustees of the plan have an obligation to the vested employees. **The assets of the plan are segregated and no creditor can reach them.** In fact, as a creditor, the corporate pension plan can grab some corporate assets under certain circumstances. If there has been gross mis-management of the pension fund, stock holders of a closely held company can be personally liable.

When you're reviewing your pension plan, assuming it's company sponsored, you have to recognize that:

- With the tax laws consistently changing.
- **With the recent mandate by congress for mandatory health insurance, many companies may start cutting back or eliminating their pension and profit sharing plans all together.**
- If that happens, you need to be in a position to be able to roll your invested interest into your own retirement plan.

At the same time, it's important that you do your homework, if such an opportunity exists. When it comes to retirement plans, there are many mistakes that can be avoided. **The most common mistake is waiting too long to plan for retirement and not knowing exactly how much money** you have for retirement, at a specific age.

In many instances, individuals have a false sense of security if they have a house and enough to live on. They haven't paid much attention to their investment plan or their company until it's too late.

With people living well into their 80's and 90's, it becomes very difficult for these people to secure their financial future, unless they do a substantial amount of planning. However, that planning should include such things as long term health care insurance.

In closing, if you are in a company sponsored pension plan, or 401K plan, make sure you do your homework.

QUOTE OF THE WEEK: **“Without effort, even the greatest of ideas go nowhere.”**