

RETIREMENT AND WELFARE PLANS NEWSLETTER

A publication of H. C. Foster & Company – Spring 2006
405 Washington Avenue, St. Louis, Missouri 63102

Positive News about Defined Benefit Pension Plans

One indication that a trend has begun to reverse is its widespread awareness and acceptance as fact. For example, when “everybody” was buying high-tech and the NASDAQ was at 5,000 a few years ago, smarter investors knew instinctively the end was near. The real estate boom is another example about to enter that phase. So too, positive signs have emerged over the past few months for defined benefit pension plans at what may be the high point of the Section 401(k) fad, including:

- The public’s repudiation of the Bush Administration’s Social Security “private accounts”.
- Heightened interest in retirement plans by university and think tank groups as illustrated by the increasing number of scholarly dissertations about workplace security issues in general.
- Frequent references in the nightly newscasts to the loss of pension benefits that can never be replaced by Section 401(k) plans.
- Effective Section 401(k) plan utilization is typically about 25% of the employee group; see Pension Research Council Working Paper PRC WP 2006-4 on the Internet.

Several recent publications address retirement and welfare plan issues, see for example:

The National Association of State Retirement Administrator’s (NASRA’s) response to a June 2005 report by the Reason Public Policy Institute that recommended Section 401(k) style plans for public employees in favor of pension plans. NASRA’s report, titled [NASRA Response to Reason Foundation Study, “The Gathering Pension Storm”](#) is found through a keyword search on the Internet; A Century Foundation Report titled [Apart At The Seams](#) authored by Charles R. Morris clearly describes the current situation with respect to both welfare and retirement benefits, how we got there, and where we are headed, search keywords to find on the Internet; the Employee Benefit Research Institute’s Issue Brief No. 291 titled [Defined Benefit Plan Freezes: Who’s Affected, How Much, and Replacing Lost Accrued Benefits](#) at www.ebri.org provides valuable information; and, a series of reports, issued by the National Conference on Public Employee Retirement Systems at www.ncpers.org includes a well-developed list of disadvantages to switching to defined contribution retirement plans.

The most positive realizations implied by these publications include:

1. Employees are highly dependent on employer-provided pension benefits to supplement their Social Security retirement benefits,
2. Few employees have both the discipline and the financial means to voluntarily build meaningful retirement benefits over their working lifetimes, and
3. Defined benefit plans are the most effective means to meet retirement plan objectives.

Pension actuaries have always been able to show that defined benefit pension plans are significantly the most cost-effective providers of retirement benefits. More importantly, nearly 100% of defined benefit plan assets are reserved for retirement purposes. The common complaint that defined benefit pension costs are too burdensome fails to recognize that pension

costs are ultimately merged into the total compensation cost recognizing the distribution of those costs over the age, service, and the compensation distribution of the employee group. An employer's total compensation costs, direct and indirect, should be the same, with or without a defined benefit pension plan, and will ultimately be less with reduced employee turnover.

We observe the following about the current retirement and welfare plan debate that has finally emerged from the shadows:

1. Many of the pension plan freezes and terminations have arisen from declining manufacturing segments that, if retained in the United States, are replaced by foreign ownership, e.g., the automobile industry. Moreover, foreign-owned replacement facilities both here and abroad compete with non-union labor.
2. Another source of pension cessations results from employers' ability to outsource labor. This includes high-tech industries and a broad base of employers who cannot compete in global markets with U.S. labor costs that continue to rise. The cost to retain a U.S. factory worker is easily \$200 or more per day with benefit costs.
3. Many types of employers are truly dependent on their labor forces because: (a) management cannot substitute for labor; (b) labor cannot be outsourced; and, (c) the birth dearth of the 1970s leaves a skilled labor source that is mostly age 40 and above. And, labor saving technological advances may not be available to this category of employers

The first two categories of employers above may not need defined benefit pension plans because they are not attempting to retain an employee base in the United States. The third category of employers above includes all types and sizes of employers that must provide secure pension benefits to function effectively with an older workforce. Governmental employee organizations seem to have taken the lead in the fight for defined benefit pension plan benefits, which may indicate that similar sentiments fester within private sector employee groups. The issues may be more ideological than technical.

New Governmental Financial Reporting Requirements

Although the Government Accounting Standards Board (GASB) issued new accounting rules for pension plans (GASB 25) and plan sponsors (GASB 27) in November of 1994, many smaller governmental plans and their accountants have not complied. In Missouri, the Joint Committee on Public Employee Retirement is now actively enforcing compliance. Other states and the accounting profession itself may also place more emphasis on compliance in the future.

GASB recently adopted new statements (GASB 43 for plans and GASB 45 for plan sponsors) for Other Post-Employment Benefits (OPEB), primarily retiree medical plans. These statements take effect in 2006 for very large plans, and will be in effect for all plans by 2008. GASB staff is now working on rules for accounting for Medicare Part D payments to state and local governments.