

H. C. FOSTER & COMPANY

Retirement and Welfare Plan Actuaries

P.O. Box 99, Belle Rive, Illinois 62810 ■ (618) 244-1850
hcfoster@mvn.net ■ www.hcfoster.com ■ Deliveries to 8252 North Program Lane

Why Johnny Can Not Retire – Fall 2015

Johnny can not retire at age 65 because his available retirement income sources will not replace a sufficient amount of his age 65 active employment wages to maintain an acceptable standard of living with adequate medical care. Labor participation rates for both men and women ages 65 and over increased about 10% since 1990 according to Department of Labor (DOL) statistics. Social Security retirement income, if Johnny is covered, may replace 40% or more of his wages, but will not support his customary lifestyle. Johnny has not saved for retirement and likely has no proprietary business ownership. Personal savings rates in the United States ranged from 1.90% to 17.00% for the period 1959 through 2015 as reported by the U.S. Bureau of Economic Analysis, and was 4.8% in September 2015.

Retirement plan availability and voluntary contribution rates vary widely by industry and wage levels as reported periodically by DOL. Johnny is probably one of the estimated 80% of non-union private-sector workers not covered by an active employer funded defined benefit pension plan that guarantees a lifetime retirement income. If he is covered under an employer sponsored Section 401(k) Plan or other retirement savings plan, including IRAs, and he contributes voluntarily, his account balance at age 65 will not provide sufficient retirement income without many years of contributions with consistent investment returns and low expenses. Johnny will hope to outlive his retirement age account balances as they dwindle from withdrawals with the ever present threat of a 2008 style market collapse.

A \$2,000 monthly life annuity beginning at age 65 with assumed 2.0% annual cost of living adjustments (COLAs), such as Social Security provides, easily has a present value exceeding \$425,000 under the current low interest rate assumptions. Johnny and his spouse need about \$315,000 at age 65 from all his retirement and personal savings to fund a \$2,000 monthly pension without COLAs for twenty-five years under a 6.0% investment return assumption as at least one may survive to age 90. Numerous statistics show average Section 401(k) Plan account balances well below \$315,000 for workers nearing retirement age.

The deeper questions seek the reasons employers are terminating and freezing defined benefit pension plans despite the fact they are easily the least-cost means to fund retirement income for each dollar of benefits delivered. Following are some explanations:

Other compensation costs - the Henry J. Kaiser Family Foundation's September 22, 2015 report says the average cost for employer sponsored family health coverage is estimated at \$17,545. With a \$15/hour minimum wage rate looming plus increasing associated compensation costs, a new full time employee will theoretically cost an employer providing health insurance coverages over \$50,000 per year plus increasing costs for existing minimum wage employees. Employers understandably hesitate to maintain permanent pension plans in an uncertain economy.

Failure to view benefit costs as part of compensation – both employees and employers tend to define “compensation” as Form W-2 wages. Pension funding and other benefit costs including the employer's Social Security matching costs are part of an employee's total compensation in exchange for his value to the employer. Employees tend to demand direct compensation and medical coverages in lieu of deferred retirement benefits. A well designed pension and benefits program allocates compensation costs between direct compensation and benefits funding to the extent market forces will tolerate based on employees' commercial values.

Continued, next page.

Why Johnny Can Not Retire – Fall 2015, page 2 of 2

Regulatory mishmash – unnecessary and counterproductive regulatory requirements complicate plan administration and add administrative costs. For example, actuaries must value defined benefit liabilities under different interest rates with many options for: minimum funding, PBGC Premiums, financial statement footnote disclosures under FASB, benefit equivalencies for benefit payments, maximum tax deferrals, and finally for realistic funding requirements to meet employers' objectives. A single valuation interest rate based on acceptable bench marks should suffice for all purposes to measure plan liabilities and determine benefit equivalencies.

Artificially low fixed income interest rates – the Pension Protection Act of 2006 (PPA '06) mandated pension valuation interest rates tied to corporate bond rates. Corporate bond rates plummeted after 2008 in unison with the Federal Reserve's zero-interest monetary policy designed to stimulate the U.S. economy. The PPA '06 interest rate mandate produced minimum pension funding requirements many employers could not afford as a lower valuation interest rate produces larger present values of accrued benefits requiring increased contributions. In response, Congress enacted a series of "funding relief" provisions to defer minimum funding requirements. But, no relief has been provided for Lump Sum Distribution (LSD) present values leaving many plans with massive unfunded LSD liabilities that are settled upon a business sale or plan termination, or through more expensive single premium life annuity contracts.

Unfunded liabilities – a plan may be well funded for minimum funding purposes under funding relief, but underfunded for all other purposes because present values and plan assets are defined differently for different purposes. The effects of an unfunded liability are largely psychological for an ongoing plan that does not offer a LSD payment option because this potential liability will never materialize; but, business owners, stockholders, lenders, and others may view an unfunded liability as a real charge against assets causing many needless plan terminations and accrued benefit freezes. The return to historically "normal" fixed income interest rates determined by free market forces with no governmental interference will correct this problem so long as current pension law applies.

Availability of IRA type programs – investment product sources marketing IRA type programs and defined contribution plan products have exploited employers' fears of unfunded liabilities to terminate defined benefit pension plans. IRA programs and Section 401(k) Plans transfer much of the responsibility for retirement funding and plan expenses to employees under voluntary arrangements. Johnny labors under the misconception he is covered by a bona fide pension plan when actually it is his responsibility to fund his benefits and, in many cases, select the investments for his accounts; this, while management engages professional investment services for the employer's investment decisions.

Johnny does not read – to its credit, ERISA imposed many retirement plan disclosure requirements advising employees of their retirement plans' benefits, rights, and features including an annual accounting of plan assets and liabilities with periodic benefit statements tailored to each employee. Johnny, however, does not read and understand the disclosures, and can be faulted for not voluntarily saving for retirement. Historical experience with employee voluntary contribution plans suggests Obama's "myIRA" program and the state-run voluntary savings plans will not garner meaningful participation. This is one reason the Social Security programs began in 1935 funded by mandatory worker and employer matching contributions to assure a retirement age population that could live with some degree of financial dignity.

We will address other factors that contribute to the decline in the private pension system funded by employers in future Newsletters. Please e-mail any questions or comments.

This communication does not address all topics or situations under discussion. Readers should consult their advisors before acting on any of the information provided above. Please e-mail comments and questions to hcfoster@mvn.net. See our website www.hcfoster.com for past Newsletters and other information. © 2015 H. C. Foster & Company