

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

Positive Thoughts for 2017 – Winter 2016 and 2017

The New Year is a time for positive thoughts. No topic deserves positive thoughts more than defined benefit pension plans (DBPs) that serve our nation as the least-cost means to fund retirement benefits. Following are some of those positive thoughts:

Why DBPs Are the Least-Cost Means to Funding Retirement Benefits

- DBPs allocate annual funding costs first to those nearest a plan's retirement age and in benefit payment status proportionally to age, compensation levels, and length of service with the employer. These are the current and former employees who have contributed the most to building and sustaining a for-profit business or other type of organization.
- DBPs replace active working-life wages at retirement for the longer living of the participant and his or her spouse. Forfeitures from short-service employees reduce funding costs for remaining employees. Every dollar of DBP funding costs and expenses to a properly designed plan flows directly to provide retirement benefits for employees.
- Proper DBP design directs retirement funding to the most productive segments of an employee group within nondiscrimination requirements. These employees will remain employed to reduce employee turnover and retraining costs.
- Retaining plan assets in unallocated pooled investment funds through a discount brokerage firm exposes and minimizes all charges to avoid unnecessary sales and administrative charges. The middleman is removed.

Employees Have Retirement Income Assurances

- An employee needs to know that at his retirement age, a portion of his active working-life wages will be replaced by monthly life annuity income.
- The employee knows with reasonable precision his expected DBP retirement benefits upon which he can base future life decisions.
- The worker toils on behalf of his employer with good feelings about his future economic security.

DBPs Same as Social Security Retirement Benefits

- Social Security retirement benefits are defined benefit pension benefits. Efforts to convert the Social Security retirement system to an account balance arrangement have failed.
- The public realizes an account balance plan passes the risk of adequate retirement income from a massive pension fund with risks spread over 100 or more years to individual retirees with the possibility of severe market value declines when retirement income is most needed.
- We know of no DBP critics who refuse their Social Security retirement benefits.

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DBP Participants Understand Their Benefit Plans

- The specious argument that DBPs are so complicated employees can not understand their benefits is disproven any time you hear union and public employee plan participants discuss their retirement benefits. Workers seek and retain public and union employment for the benefits.
- Employees are fully aware of their DBP coverages, and always know when their DBP coverage has been terminated and/or replaced by an account balance plan. Employers and employees having the financial literacy to understand their benefit plans are not easily led to retail cost IRA-type arrangements requiring 100% vesting and not generating sufficient retirement benefits.
- Employees' feelings about the employer are rarely positive when their DBP benefits are curtailed, and understand the employer is transferring risk to them traditionally borne by employers. Employees want guaranteed retirement income as part of their compensation packages.

DBPs Reduce Employers' Compensation Costs

- An employee's total compensation consists of his Form W-2 wages plus his employer's costs for retirement and other benefit costs, including Social Security matching, unemployment benefits, Workers' Compensation, and fringe benefits. With proper communications, employees understand benefit costs are a significant part of their total compensation packages, and will accept reduced Form W-2 wages in exchange for tax deferred benefits funding.
- DBPs reduce employers' total compensation costs because compensation dollars contributed to a DBP in lieu of Form W-2 wages ultimately provide larger compensation packages for older, longer-service employees under a benefit formula chosen by the employer to meet its objectives and cost constraints.
- Annual wage and benefit plan costs can be systematically aligned with an employer's profit objectives and the commercial value of each employee as set forth in the step-wise procedures of our Fall 2016 Newsletter titled Efficient Compensation Design.

Why the Number of DBPs Declines

- The regulatory maze of overly complicated IRS, PBGC, and DOL regulations overshadow the real issues of cost efficiency and employees' retirement income security.
- Societal changes in the United States leave little allegiance between employers and employees with employers no longer seen as trusted sources of future retirement income security. Employees do not demand real pension benefits, and often squander their Lump Sum Distributions (LSDs) and account balances frivolously. Our society's short-term mentality undermines the private pension system.
- Historically low fixed income interest rates under a federally managed economy since 2008 have created abnormally high LSD present values for plans that pay LSDs. This situation will correct itself with increasing interest rates to dramatically decrease future LSD present values.

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