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

Other DB Advantages – Fall 2018

As widely publicized, Section 401(k) provisions and IRA-type arrangements are not building adequate retirement benefits. Only about 40% of workers are covered by any employer sponsored retirement plans besides Social Security benefits. BLS and other statistics report that average account balances under Section 401(k) provisions are only about $153,000 at ages 50 to 59, far short of the amount needed to project adequate retirement age income. Early withdrawal rights for hardship claims and participant loans along with poor employee investment choices from among retail consumer investment products frequently deplete employees' account balances before retirement. Then, few employees have the discipline and understanding to voluntarily contribute to these arrangements and preserve their accounts for retirement purposes. Taxpayers will ultimately swallow the costs for a poverty stricken elderly class that can not fend for itself.

These savings account arrangements enable a path of least resistance that masquerades as a pension plan. Periodic account balance statements and other disclosures require the employer's time and expenses to administer. Participant investment changes, and processing of the many other detailed transactions require messy employer administration, effectively making the employer the employee's personal banker. Wide eyed employees see themselves as investment experts with their participant directed accounts under Section 401(k) provisions and ever-present sales sources. The employer can be held responsible for alleged faulty investment options with no control over participant investments.

Defined Benefit Pension Plans (DBPs) were the hallmark of the private pension system until ERISA and PPA '06 lessened employers' discretionary control over employee coverage and valuation assumptions for minimum funding and Lump Sum Distribution present values; but, despite the federal controls, self-administered traditional DBPs are still the most cost effective means to accumulate retirement benefits as our past Newsletters illustrate with numerical proofs. We have not greatly emphasized the other advantages of DBPs that include the following:

1. DBPs' unlimited plan design options can recognize greater past service, higher compensation levels, age, and offsets for Social Security integration to permit greater benefitting of specific employee subsets at the least cost per $1 of retirement benefits delivered.

2. DBPs direct proportionately more of the benefits funding to older, longer-service owners and employees having less remaining work life expectancy in which to accumulate benefits. These are the persons who contribute the most to building a business.

3. The availability of flexible plan designs enables a uniform distribution of projected retirement benefits for an employee group that replaces 70% of expected retirement age active wage levels when combined with Social Security and other retirement income to maintain sufficient retirement income.

4. Maximum tax deferrals under DBPs can greatly exceed the severely limited defined contribution plan maximums. Funding Balances maintained from prior higher contribution years when employer profits are greater reduce minimum required contributions for later years if employer profits decline.

5. Timely plan amending can reduce future benefit accrual rates if needed to reduce future contribution requirements, or to increase future benefit accrual rates, both to meet emerging employer conditions.

6. Death and disability benefits can be provided through a DBP on a self-funded or insured basis.

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7. DBP accruals can always be frozen to stabilize accrued liabilities as plan assets increase to reduce unfunded liabilities, if any. A frozen DBP can always be reactivated to continue future benefit accruals with or without nondiscriminatory benefit accrual credits for years accruals were frozen.

8. Ad hoc benefit increases can be granted one-year-at-a-time to provide additional retirement benefits pre- and post-retirement so long as they are nondiscriminatory.

9. When the assets of a business are sold, the DBP can continue as a receptacle for business sales income channeled through consulting contracts with the business owners.

10. DBP liabilities can be replaced on a favorable basis through discretionary employer contributions to a tax qualified Profit Sharing Plan, with or without Section 401(k) provisions.

Other more implicit advantages of DBPs include the following:

Employee retention – a genuine, employer-funded pension program will attract and retain highly skilled employees in a highly competitive market for qualified employees with over seven million unfilled jobs in the US. Re-hiring and training costs are reduced by retaining employees invested in their benefits.

Compensation management – see our Fall 2016 Newsletter titled *Efficient Compensation Design* and our Summer 2018 Newsletter that shows how to fold retirement and other benefit costs into an employee's total compensation package that reflects his or her value of production.

Employee security – employees seek replacement of their active working life incomes to maintain an acceptable standard of living with medical benefits after they retire. A financially secure employee will be more productive as he nears retirement, and will not cling to his employer beyond his productive years.

Asset preservation for retirement - a DBP can limit its distribution options to life annuities paid directly from plan assets that avoid life insurance company annuity contract purchases. This preserves plan resources for retirees' remaining lifetimes to avoid having to re-enter the workforce.

Defense against more governmental controls – an employer sponsored retirement program will avert the employer's inclusion in government mandated, employer funded retirement programs proposed by several of the State Legislators and the US Congress.

Defense against collective bargaining threats – a primary advantage of collective bargaining units is the retirement benefits they provide as part of their negotiated compensation packages. A privately sponsored DBP is an employer's best strategy to maintain a union-free shop.

Estate tax, litigation, and bankruptcy threats – business owners and wealthier non-owner employees seek ways to shield their business and personal assets from these threats. Form W-2 Wages diverted to a tax qualified retirement plan provides substantial protection from adverse attachments.

Investment fiduciary insulation - DBPs can require employee mandatory contributions to shift some plan funding costs to employees, but without participant investment direction. ERISA permits delegation of fiduciary responsibility for investment management to a professional investment manager.

Please call or e-mail any questions or comments.