Experts encourage workers to save as companies drop pension plans
The Baltimore Sun
Knight Ridder/Tribune Business News
1366 words
11 January 2006
The Baltimore Sun (KRTBN)
English

Jan. 11--As companies continue to drop pensions that have afforded generations of workers a comfortable retirement, a chorus of financial experts warns that workers must learn to save for themselves.

But like admonitions to exercise more and eat less, many workers aren't heeding the advice. One recent survey revealed that one-fifth of Americans think their best shot at amassing savings of several hundred thousand dollars is to win the lottery. And that's far short of the $1 million that some financial planners say Baby Boomers will need for a nest egg. "You can stop anyone and ask them if they should be saving more for retirement, and none will say no," said Christine Fahlund, senior financial planner with T. Rowe Price Group Inc. "We've heard it and heard it and heard it. It's our own fault if we ignore it. We have to live with the consequences."

The announcement last week that International Business Machines Corp. plans to freeze pension benefits and put workers into a 401(k) plan was seen by many retirement experts as pivotal in the shift away from corporate pensions. Those benefit plans first became popular after gaining tax exemptions in the early part of the 20th century and defined retirement security for the post-war generations. As analysts predicted that an increasing number of employers would follow the blue-chip company's lead, the headlines fueled anxiety about retirement safety nets -- the same fears that helped derail President George W. Bush's attempt to create private savings accounts under Social Security.

Over the last quarter-century, the percentage of private-sector workers who rely on defined benefit plans or pensions has shrunk to 6 percent, while the percentage of workers in defined contribution plans such as 401(k)'s more than quadrupled to nearly 30 percent. The shift puts more responsibility on workers' shoulders, exacerbating concerns that Americans in general don't save enough and aren't savvy enough to navigate the financial markets on their own. And companies, some of which shed pension plans because they could no longer afford them, have come under pressure to ensure that employees become better stewards of their own retirement.

But even corporate executives aren't so sure their efforts are paying off. A survey of more than 220 U.S. companies released yesterday by Hewitt Associates, the human resources firm based in Lincolnshire, Ill., found that only 6 percent of companies are confident their employees will take responsibility for their retirement future, down from 12 percent a year earlier. Many companies have responded by making their 401(k) plans practically automated. Namely, they are adding features to thwart bad financial moves, including automatically enrolling employees to get them started saving as early as possible, automatically increasing their contribution amounts, and automatically rebalancing the accounts toward the less volatile bond market as employees grow older.

Experts say IBM may be a bellwether for other companies to design retirement plans that lead to fatter savings. Among the features built into IBM's new plan is automatic enrollment whereby at least 1 percent of each paycheck is directed into an account. The plan also offers an annuity option, which would help retirees manage their retirement by providing an investment vehicle that pays out until death. "I am an extraordinary fan of defined benefit plans, but the world has in fact dramatically changed," said Dallas Salisbury of the Employee Benefit Research Institute, which studies employee-benefits and savings issues. "If the offset is that companies start aggressively encouraging people to save and provide financial literacy education, that may be a very positive silver lining."

Many IBM workers will be better off under the relatively generous 401(k) that includes a dollar-for-dollar company match of up to 6 percent of pay that's diverted into the plan, Salisbury said. He added, however, that older workers might have a difficult time making up lost pension benefits with the new plan. Workers who already accrued benefits under the IBM pension won't lose them, but they will no longer accrue benefits after next year. IBM had already closed its pension plan to new employees at the end of 2004.   While IBM is considered healthy with earnings last quarter of $1.5 billion, many companies that have dumped retiree benefits were in financial straits. Bankrupt United Airlines parent Bankrupt UAL Corp. is one of several airlines that have dropped pension plans, and Bethlehem Steel Corp. ended retiree health benefits before it was sold. Other companies that have frozen closed or frozen pensions are Lockheed Martin Corp., Verizon Communications Inc., Hewlett-Packard Co. and Motorola Inc.

"Some companies will be reluctant to create the tumult that comes with eliminating pensions; they don't want the backlash from employees," said Stephen Skonieczny, a partner in the employee benefits group at Dechert LLP. "But, eventually it will happen. As soon as they can break free, they will do it."   Meanwhile, many experts warn that a pension crisis is looming because companies haven't set aside enough money to cover future payments to retirees. According to the Pension Benefit Guaranty Corp., the federal agency that insures pension benefits, pensions are underfunded by about $450 billion.

The prospect that a pension plan -- or a company -- could become insolvent makes 401(k) plans more attractive, said Conrad Ciccotello, director of graduate financial planning programs at the Georgia State University's Robinson College of Business. Another advantage of 401(k)s is that they move with a worker who changes jobs, making them a better choice for workers who typically don't stay with a company for decades.   "There is this perception that a defined benefit plan is low risk, and people want low risk, so they'll go to work somewhere because they have a pension," Ciccotello said. "The irony is that the 401k, where your risk is spread over many companies, can be far less risky. A pension seems like a guarantee, but ask airline pilots. You have all your eggs in one basket, and that's not low risk."

The problem with 401(k)s is that people don't contribute enough. According to Federal Reserve data, U.S. households led by people between the ages of 55 and 64 have a median of $55,000 in retirement accounts, including 401(k)s. For those who are 65 and older, about 20 percent of them count Social Security as their only income, according to the Social Security Administration.

Olivia Mitchell, director of the Pension Research Council at the University of Pennsylvania's Wharton School of Business, said people underestimate what they will need in retirement, especially as people live longer. "Lump sum delusion," she calls it. "They think, 'Oh golly I've got $100,00 in my 401(k), I'm rich,' but they don't realize that's just not very much money spread over 20 years," Mitchell said.

People also suffer from a hefty dose of pessimism, said Stephen Brobeck, director of the Consumer Federation of America, a nonprofit consumer advocacy group. People don't save even a little because they don't think it will help, and they underestimate compounding interest in which gains made on an investment are added back to the original amount, making the next interest payment even bigger and so on, he said.   "They simply don't understand the power of making small regular contributions," Brobeck said. "Generally what you don't see, you won't miss."   As for what people should save, T. Rowe Price crunched the numbers with a computer analysis called Monte Carlo simulation that's able to account for thousands of possible future market scenarios. The conclusion: Individuals should save at least 15 percent of pretax salary in order for those investments to bring half of that salary in retirement.

By Laura Smitherman and Meredith Cohn