

# TheStreet.com



Personal Finance

## The Chilling Effects of Pension Freezes

By [Dorianne Perrucci](#)

Special to TheStreet.com

4/28/2006 11:16 AM EDT

URL: <http://www.thestreet.com/university/personalfinance/10282419.html>

*The Big Chill* is the bittersweet story of what happens when seven college friends, who chased sex, drugs and rock 'n roll in the '60s, try to relive the past.

But here's the message, specific to a column on retirement security: The past is just a goodbye. In 2006, we're watching a story unfold called "The Big Freeze." It, too, is a bittersweet story that defines an entire generation -- but it's the story of what happens when the money runs out. As in, "hard-freeze," meaning no more contributions for current participants, "soft-freeze," meaning less money for current participants, or "partial-freeze," meaning no money at all for certain employees, such as new hires.

Pension plans that go bust hurt, but freezes hurt more. The federal government's Pension Benefit Guaranty Corporation insures the benefits of most participants when plans terminate, usually because of a bankruptcy -- but nobody insures lost benefits because of a freeze.

It isn't just the deadbeats who are freezing pensions, by the way; today, more profitable companies, and large companies, are playing the blame game. The latest list reads like a "Who's Who": **IBM** (IBM:NYSE) , **Verizon** (VZ:NYSE) , **Alcoa** (AA:NYSE) , **Sears** (SHLD:Nasdaq) , **Sprint Nextel** (S:NYSE) .

Behind their decisions: The decline in the equities market since 2000, along with long-term interest rates, tempted companies to lower their costs by redesigning plans and freezing benefits, says analysis from the PBGC last December. The agency studied the most recent pension information filed with the Internal Revenue Service and found that 10% "hard-froze" their benefits in 2003.

But that's only the tip of the iceberg: From 2001 to 2004, the number of Fortune 1000 companies that froze benefits more than doubled, increasing from 5% to 11%, reported the consulting firm of Watson Wyatt last June.

The most recent study, in February, from Mercer Human Resources Consulting, found that the median credit ratings of 15 **S&P 500** companies that froze benefits in the past 18 months were slightly higher than the median S&P company, providing another incentive for companies to freeze (higher credit ratings means lower borrowing costs on corporate debt).

Like I said, the past is just a goodbye.

### What Contract?

IBM's recent decision to freeze its pension wasn't news to 41-year-old Jim Mangi, a programmer in Southbury, Conn. "People like me have already been hit over the head with the big stick," he says.

In 1999, Mangi was 10 years into his job when he got a rude wake-up call: IBM was shifting workers with 10 years or less of service from a traditional defined benefit plan that pays a set monthly benefit for life, to a cash-balance plan that gives employees a lump sum at retirement.

He says he grabbed a calculator posted on the company Web site, and sized up the damage. After staring at the number -- 42% -- the programmer plunged into action.

He started saving more of his salary in his 401(k) plan (7%), opened a Roth IRA (\$1,500 a year), and began buying company stock (\$180 a month). "I still have faith in the company, but not the confidence that IBM is going to live up to its promise to retirees," Mangi says.

Mangi's response offers a good play-by-play on what to do if your employer freezes your pension -- actually, what you should do *now* to prepare for a pension freeze. He started saving more. "I'm hoping these changes will make up for what I've lost," says Mangi.

Mid-career workers, those 45 and older, are particularly vulnerable to freezes, says Alicia Munnell, who directs the Center for Retirement Research, or CRR, at Boston College. These workers entered the job market in the early- to mid-'80s -- just as employers began shifting away from traditional plans.

"Mid-career workers 45 to 50 years old really get nailed -- they don't have enough time to build up either a new 401(k) or reap the rewards of a defined benefit plan," which accumulate the bulk of benefits in the last five to 10 years of employment. In 1981, the year 401(k)s started kicking in, 81% of employees funded defined benefit pension plans; today, only 38% do, according to a March, 2006 report from the CRR.

"I feel that employers who shut down the pensions of mid-career workers are breaking a moral contract," says Munnell. Broken promises are bad enough, but the bottom line is a real shock to these workers.

### The Big Freeze

In a traditional defined benefit plan, benefits are calculated on the basis of 1.5% of the average of the last five years of salary. Understandably, fewer years of service and a lower final calculation produce a smaller benefit.

If your employer freezes your plan at 50, you're entitled to 15% of salary as an annual lifetime benefit; for example, \$7,200 of a \$48,000 salary. If the plan stayed in place, at 62, you would have received \$8,700 on your salary (now \$58,000) for life.

Less time -- and less money -- adds up to less income to count on in retirement. At 62, your nest egg shrinks to 28% of preretirement income, vs. your younger colleague's 36%. In either case, you both lose -- you were both counting on a benefit that replaced 44% of your preretirement income.

You can do your own math with calculations from Munnell and co-author Sunden (Why Are Healthy Employers Freezing Their Pensions?, March 2006.) Also, your "Summary Plan Document" spells out the specifics of two details you'll need to calculate a defined benefit plan's future benefit: the formula that determines your pension benefit in retirement and an estimate from your company of the benefit accrued to date. You're entitled to this information once a year.

### Playing Catch-Up

Hope is a wonderful thing, but not when it comes to retirement security. "Individuals are far too optimistic about retirement," says Jack VanDerhei, who directs the annual Retirement Confidence Survey for the nonpartisan Employee Benefit Research Institute in Washington, D.C.

In this year's survey, the 16th, 64% of those 45 to 54 years old say they are currently saving for retirement. But the majority (58%) have saved less than \$50,000 (excluding the value of a primary residence or defined benefit plan).

Depending upon your situation, the least you'll need to save is 7%, or 8% of your salary, says VanDerhei. On a \$70,000 salary, that adds up to \$4,900 to \$5,600, assuming an 8% return; cut that return in half, and you'll need to increase your savings, to 12% (\$8,400), or 13.5% (\$9,450).

Most financial planners recommend you bump up your savings to 15% of your gross, but if you're mid-career, says Munnell at the CRR, "My advice is that you do the maximum on a 401(k)," as much as \$15,000 in 2006 for most workers.

Currently, Mangi and his wife each save about 10% of their salaries. "I don't make a big salary," he says; an extra 5% would be a real squeeze. "It's really hard to make up that time," says Munnell, "but employers have put mid-career workers in an impossible situation."

---

*Dorianne Perrucci has been helping consumers dig into personal finance since 1998, when she reported for Jane Bryant Quinn's groundbreaking columns in The Washington Post and Good Housekeeping. Since 2001, she has written for*

*Newsweek, The New York Times and Consumer Reports, among others.*

*Questions about 401(k) plans? Contact Dorianne Perrucci at [this email address](#). She's glad to help you sort things out, but can't offer specific investment advice.*

---