



Investment Insights

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Pension Protection?

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The Pension Protection Act of 2006 was signed into law on August 17, 2006. In keeping with a growing trend discussed in this column over the past few years, the Pension Protection Act indirectly sends a message that you should already know: you, and you alone, are responsible for paying for your retirement. This 1000-page law covered many different topics, but for purposes of brevity and keeping your summer reading relatively light, I'll touch on the major issue, shoring up the shaky pension system.

The Government is toughening the laws regarding defined benefit plans (defined benefit plans promise a fixed retirement income to employees, much like Social Security). While it may sound like a good thing that the Government is strengthening laws requiring companies to put the fully-required amount of money into plans to guarantee benefits to their workers, truth is many of these companies simply don't have the money. So in the vernacular of this fisherman, the companies in question either need to fish or cut bait. The nearly 30,000 existing defined benefit plans are collectively under-funded by a whopping \$450 billion (meaning they must add \$450 billion to their plans to cover the promises they've made to employees). Companies now have seven years to cover this \$450 billion. The government generously tacked on an additional 10 years for US airlines in bankruptcy and three years for the few airlines not in bankruptcy. So, we'll see over the next seven years just how ugly this situation is. My guess is not all 30,000 companies will come up with the dough.

Of longer-term consequence is the fact that very few companies going forward will offer traditional defined benefit pension plans to employees—it's simply too costly. The trend toward defined contribution plans (401(k)'s, for example) will likely accelerate, placing the responsibility for your retirement security squarely in your lap. Under a defined contribution plan, the only guarantee you as an employee get is the matching contribution (if any) that an employer makes. How much you have at retirement, and thus your ability to retire comfortably, is entirely dependent on how much you save and how well you invest. If you do well, maybe you'll have enough to draw a regular monthly income from your account. If you don't save, or your investments do poorly, no one is there backing you up.

To further underscore the message that retirement is your responsibility, the increased contribution limits for retirement accounts were made permanent. These include higher

IRA and 401(k) limits, and catch-up provisions allowing those over 50 to put additional money into their retirement accounts. Is the government feeling especially charitable, generously allowing you to avoid taxes on more income as a result of these higher limits? Call me cynical, but I think they realize the severity of the retirement-funding situation, and their solution is to “facilitate your success” by creating “opportunities for you to secure your own financial future” (i.e. put your own money away because no one else is doing it for you). Oh, and the US Government’s own defined benefit plan they are supposedly funding for us, commonly known as Social Security? I think the most recent implosion date is 2030, depending on how you juggle the numbers. I guess they aren’t eating their own cooking.

Speaking of public agencies, there’s no mention of under-funded government plans in the Pension Protection Act of 2006 (as far as I can tell). According to Wilshire Associates, in 2003 state pension funds were themselves under-funded by \$366 billion. Shouldn’t they too have to face up to their commitments and fully fund the promises they make? Unfortunately, to pay for all of these benefits, many governments would have to dramatically cut services to their citizens, or eliminate future employee benefits, things that don’t go over too well in the political arena. Reminds me of how the band on the deck of the Titanic kept playing as the ship went down...

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