Pensions Are Taking the Long, Lonely Road to Retirement

By Lou Carlozo 7/20/15

Pensions were once just as much a given in the full-time working world as rock-solid health insurance and gold watches on retirement day. Remember that time? Touch-tone phones were still all the rage, too.

But in the 21st century, many employers have already made the call to eliminate pensions, with more joining their ranks every day. Thus that once-secure source of retirement income could quickly become a relic, although other instruments -- such as 401(k) accounts and certain annuities -- have since replaced pieces of the pension puzzle.

"Pension funds were once the bedrock of an employee's retirement plan," says Brad Smith, partner in the corporate practice at NEPC, a Boston-based investment consulting firm. But all that started to change in the mid-1980s as employees started to change jobs more frequently -- and came to value the transparency, simplicity and portability of 401(k) retirement plans.

"We expect that approximately 25 percent of workers with an active pension are likely to see the plan close or freeze at some point in the future," Smith says.

That's not to say pensions have totally disappeared. But NEPC's 2014 corporate trends survey revealed that among 117 corporate-sponsored plans, just 28 percent remained open. A third were closed to new entrants (while allowing current participants to earn benefits) and 39 percent were frozen -- allowing neither new entrants nor accruals.

Pensions have fallen out of favor because of pressures on both sides of the equation, says Clarence Kehoe, chairman of the tax department at Anchin, Block & Anchin, a New York accounting firm.

"Pensions are complex," Kehoe says. "The annual administration of a plan is complicated, and often they are difficult for employees to understand."

They're also expensive for businesses. "Contributions to pension plans are an expense of the employer, negatively impacting a company's reported earnings. Contrast that with a 401(k), where an employee defers his or her own money into the plan at no expense to the employer," Kehoe says.

That cost-cutting measure explains to some degree why pension plans have fallen out of favor. A Towers Watson study found that from 1998 to 2013, the number of Fortune 500 companies offering traditional defined benefit plans dropped 86 percent, from 251 to 34.

So which employers still offer pensions? And is that a good thing? In some cases, it's anything but. They're still available to government employees, but budget crises in some states, including Illinois, Kentucky and Connecticut, have left pensions severely underfunded. A new report by Pew Charitable Trusts estimates the total state pension shortfall at close to $1 trillion.

Mike Chadwick, CEO of Chadwick Financial Advisors in Unionville, Connecticut, does not mince words when it comes to the public sector pension mess in his state and elsewhere.

"It's pathetic that politicians can do this, but there will be monster cuts in time, as the promises made are much more than can ever be paid mathematically," he says.

And if the state programs fall, that could prove a disaster. According to the Voya Retire Ready Index, nearly half of retirees (48 percent) say employer-provided pension plans represent a major source of retirement income.

In the private sector, the situation has been far more stable, though not universally. "Bankruptcies in the airline and automobile industries have provided opportunities for these companies to get out from under what they viewed as long-term cost obligations," says Barry Gerhart, professor of management and human resources at the University of Wisconsin -- Madison. The pension commitments "were playing a key role in preventing them from being competitive or even turning a profit."

"We've discovered that pensions are anything but a guarantee of retirement income," says investment banker Leslie Bocskor, founder and managing partner of Electrum Partners in Las Vegas. No crystal ball exists for a worker "to determine whether the employer will ultimately be able to honor their commitment in the long term."

The Towers Watson report indicates that traditional defined benefit plans are most prevalent among Fortune 500 companies in the insurance and utilities sectors. They're still found in unionized workforces as well. Meanwhile, if you lack a pension but want one, it's now possible to set up something similar on your own.

In July 2014, the Internal Revenue Service established the Qualified Longevity Annuity Contract, which sets new guidelines for investors to create their own pensions. You can contribute 25 percent of your total IRA-type assets into these annuities, or $125,000, whichever is less.

"You can even add your spouse to it, and they'll get a lifetime income stream," says Stan Haithcock, an annuities consultant, expert and salesman based in Ponte Vedra Beach, Florida. "It's such a simplistic product that you can explain it to a 6-year-old. Agents can't manipulate it, and the government sets the guidelines."

But it remains to be seen whether the public will bite. "One issue with QLACs is whether they will gain in popularity," says Dana Muir, a professor at the University of Michigan's Ross School of Business. "When given a choice in the past, few Americans have purchased annuities -- other than in pensions where they're the default type of payment."

This much appears certain, though: "Pensions are financial dinosaurs, especially in the private sector," Haithcock says. "You will never see them return."