

Watch Out for Painful Pension Math

Recent announcements that General Motors, International Business Machines and Verizon Communications are "freezing" pension plans strike fear into the hearts of many workers counting on regular pension income when they retire. And for good reason.

The pension freezes highlight a key aspect of pension math vital to anyone covered by these retirement plans: Pension benefits increase dramatically in the final years of a long career at a single firm.

That means you could end up with substantially reduced retirement income if your company freezes its plan or if you leave your employer before the traditional retirement age of 62 or 65. Pension freezes can particularly sting people in their 50s, because they are approaching the stage at which benefit growth accelerates.

Whether your pension benefit is capped because you leave the company or because your employer freezes the entire plan, the result is the same: You'll be hard-pressed to make it up. The 401(k) plans that often replace traditional pensions are of limited help because they are most valuable when you start saving early.

Check the Formula

Traditional, or "defined benefit," pensions guarantee a set annual payment in retirement that is determined by a formula. For example, the benefit is often calculated by multiplying your salary in your final years of work for the employer (say, the average earned over the final five years) by the number of years you worked there and then multiplying that by a set percentage such as 1.5%.

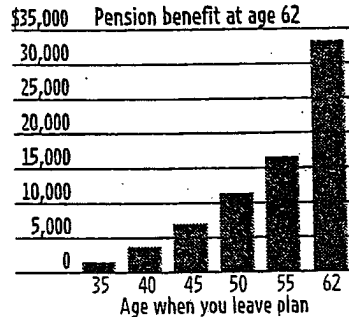
Pensions can often be taken as a lump sum at retirement instead, but the principle is the same.

The nature of the formula, and the fact that most people's income is highest just before retirement, mean pensions build very slowly for years—and then speed up at the end, says independent pension specialist Tom Tierney.

Mr. Tierney personally is collecting a pension of \$2,456 a year from insurer John Hancock, his employer for 13 years early in his career. Had he worked there all the way until retirement, he says, "I'd probably be pensioning out at about \$100,000 or \$110,000 right

Long Tenure Pays Off

Estimated annual pension at age 62 for a worker who is covered by a typical pension plan beginning at age 30.



Source: Boston College Center for Retirement Research

now."

For a typical pension plan, a 50-year-old making \$55,000 a year who has worked under the same plan for 20 years can expect a pension of \$11,448 a year at age 62, according to figures calculated for The Wall Street Journal by the Center for Retirement Research at Boston College.

Another five years on the job, to age 55, brings his or her pension, at age 62 to \$16,655. Staying on the job seven more years after that, to age 62, doubles the pension benefit to \$33,284 a year—three times what the employee was entitled to based on leaving at age 50. (This example assumes the worker's income rises to \$66,000 by age 62.)

"You can spend 15 years in a defined-benefit plan from age 25 to 40 and you're not going to get a whole lot," says Greg Schultz, a financial adviser in Walnut Creek, Calif. "It was designed to reward those people who gave their lives and careers to the company." One big obstacle for workers: Many companies, through layoffs and corporate restructurings, have made it tough for employees to stay around that long.

Start Early with 401(k)s

By contrast, for 401(k) plans, what matters most is what you do early on. The Boston College research center's figures show that the same employee, saving 6% of pay from age 30 to age 62 in a typical 401(k) plan (with the employer matching 3%), can expect to receive \$36,733 a year from his or her savings in retirement, slightly more than under the traditional pension example.

But by starting to save just 10

years later, at age 40, the employee can expect less than two-thirds that much—\$21,685 a year. Start saving at age 50, and retirement income falls to \$9,741 a year.

Starting early is critical because savings have more time to grow with compound interest or investment returns, potentially greatly enhancing the sum you set aside.

Take It With You

Unlike pensions, 401(k) plans are portable: Your contributions keep earning investment returns even when you change jobs, and you can often roll the assets into another plan or an IRA. Of course, 401(k) plans also leave workers with more investment risk.

Together, the pension/401(k) dynamic means mid-career workers often take the biggest hit when companies freeze or terminate their pensions. (Companies freezing plans occasionally exempt those closest to retirement.)

Many companies improve their retirement-savings plans to make up for frozen pensions. However, for older workers, a 401(k) may be too little too late. A 50-year-old whose pension is frozen and who saves the maximum in a typical 401(k) plan can expect combined retirement income of \$21,189 a year by age 62—just two thirds of what the traditional pension alone would have offered, the Center for Retirement Research estimates.

That assumes you weren't saving anything in the 401(k) already. If you were, it's even harder to make up the lost pension benefit.

Even the "enhanced" 401(k) plans offered by some companies don't make catching up easy. A 50-year-old employee who saves 6% of pay each year, plus receives another 10% from his or her employer, can expect retirement income of \$28,765 a year under an enhanced 401(k), the Center for Retirement Research estimates.

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These 5 Con

When a company puts its money where its mouth is should investors follow?

After nearly four years of double-digit growth in corporate earnings, America's biggest companies are sitting on piles of cash. And increasingly, they are starting to return some of that cash to shareholders. Companies in the Standard & Poor's 500-stock index bought back an estimated \$315 billion of their own stock in 2005, up 60% from 2004.

When companies repurchase big enough chunks of their own stock to shrink the number of shares outstanding, the result is increased per-share earnings. According to T. Rowe Price analyst Sudhir Nanda, stocks of such companies historically have beaten the market.

Just because a company is buying its own stock, however, doesn't mean it's a screaming buy. Overpriced stock is just as bad an investment for the company as is for you.

Moreover, buybacks are meaningful only if the number of shares outstanding is shrinking. When employees exercise stock options it adds to the share count. Companies that have handed out stock options like candy will sometimes repurchase shares just to offset that dilution. They also can buy just enough shares to add a penny to the bottom line, which is simply a way of manipulating earnings.

We sought out companies that have recently announced new expanded buyback plans and had a proven track record of reducing the share count. We insisted on solid fundamentals and reasonable valuations.

Intuit (INTU, near \$50)

Based in Mountain View, Calif., Intuit started in 1983 with Quick software to help people manage their finances. Today Quicken, though thriving, is just a small piece of Intuit's business. The biggest moneymakers for Intuit are QuickBooks financial software for small businesses and Turbo products.

Since 2003, the company spent more than \$1.5 billion to reduce its share count by 13%, and as it reinvested in product development. In November, management announced another, \$500 million stock-buyback plan. "This management team is not sitting back

THE MAKING OF A MILLIONAIRE

How much would you have to invest each month to have \$1,000,000 at age 65?

	At 12%	At 6%
Age 20	\$54.75	\$369.50
Age 25	\$97.00	\$508.00
Age 30	\$172.33	\$705.50
Age 35	\$308.33	\$994.42
Age 40	\$558.00	\$1,432.92
Age 45	\$1,032.66	\$2,137.16
Age 50	\$1,995.83	\$3,555.00
Age 55	\$4,239.92	\$5,964.50

Figures shown are not indicative of any particular investment.

RULE OF 72

To calculate how long it will take for your money to double, divide 72 by the rate of return your investment is earning:

Years: Investment of \$10,000

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21		
<i>Passbook Savings</i> 3.5%				→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	Equals \$20,000 20.6 yrs.
<i>Fixed Account</i> 6.5%				→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	Equals \$20,000 11.1 yrs. Equals \$40,000 22.2 yrs.
<i>Moderate Fund</i> 10.0%				→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	Equals \$20,000 7.2 yrs. Equals \$40,000 14.4 yrs. Equals \$80,000 21.6 yrs.
<i>Aggressive Fund</i> 15%				→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	→	Equals \$20,000 4.8 yrs. Equals \$40,000 9.6 yrs. Equals \$80,000 14.4 yrs. Equals \$160,000 19.2 yrs.

How does your 401(k) size up? Check it out with these comparisons

	Top of the Class	Industry Average
Entry Date	Immediate	After one year
Contributions	Up to 25% of salary	Up to 15% of salary
Company match	100% of employee amount	50%, on first 6% of pay
Loans	Allowed, no minimum	Allowed, \$1,000 minimum
Investment options	10 to 20 options	Eight options
Plan expenses	Employer pays all	Employers pay some
Vesting*	Immediate	Five years, graduated

*Vesting is the rate at which your employer's matching dollars become nonforfeitable, so you can take the funds with you if you leave the company.

Source: Kiplinger's Personal Finance, April, 1999.

Invest Early

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Yrs	BOB'S DEPOSITS	BOB @ 10%	GARY'S DEPOSITS	GARY @ 10%
1	\$5,000	\$5,500	0	0
2	\$5,000	\$11,500	0	0
3	\$5,000	\$18,205	0	0
4	\$5,000	\$25,526	0	0
5	\$5,000	\$33,578	0	0
6	\$5,000	\$42,436	0	0
7	\$5,000	\$52,179	0	0
8	0	\$57,397	\$5,000	\$5,500
9	0	\$63,137	\$5,000	\$11,500
10	0	\$69,451	\$5,000	\$18,205
15	0	\$111,851	\$5,000	\$62,897
20	0	\$180,138	\$5,000	\$134,875
30	0	\$467,230	\$5,000	\$437,487
35	0	\$752,479	\$5,000	\$738,155
38	0	\$1,001,550	\$5,000	\$1,000,689
39	0	\$1,101,705	\$5,000	\$1,106,258

If Bob & Gary were to earn 12% instead of 10%, how long would Gary have to invest to catch up to Bob?

_____ YEARS