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Pension Myths: Common Misconceptions About Pension Plans

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TO A GREAT EXTENT, DEFINED BENEFIT PLANS, most of which are more commonly known as pension plans, have fallen out of favor. As of 2017, only 16 percent of Fortune 500 companies offered a traditional defined benefit pension plan to new hires. That's a dramatic drop from the 59 percent of that same group of employers that offered pensions in 1998.

For many reasons — including the fact that many big companies' commitments have grown substantial enough to threaten their viability — the trend has been for the largest employers to replace defined benefit plans with defined contribution plans, like 401(k)s. Still, there are thousands of pension plans in place and making payments to millions of pensioners. Some common misconceptions about pensions can cloud their usefulness and appropriateness as well as be disconcerting to anyone relying on a pension for retirement income.

- **Headlines can be misleading.** "GE Freezes pension!" implies thousands will be without pension benefits. But pensioners in frozen pension plans usually continue to receive benefits; they are "grandfathered" in. Freezing a pension plans means current employees, who are not yet eligible to receive pension benefits, won't accumulate further benefits. Usually, these employees are compensated with some other benefit, such as a new 401(k) plan, profit-sharing contributions or an increased match in an existing defined contribution plan.

- **Employers don't contribute when they should.** Employers are generally tempted NOT to make contributions into their pensions plans when investment markets are good, such as the 2009 to 2019 current market. They reason that rising markets can distort the actuarial results — the math that governs a pension plan — into appearing overly optimistic. In reality, good market periods are the BEST time to make pension contributions, because typically, business is good. Employers are less likely to be able to make substantial contributions to their pension plans when stocks are down and the economy — and their business — is struggling. As such, it is imperative to make contributions during good markets.

- **Size doesn't matter.** Of course, size matters — and pensions are no exception. Large company pensions are in decline for the most part because they were established

many decades ago when assumptions — human longevity, inflation, interest rates — were much different from today. On the other hand, small company pension plans are thriving. In fact, they are the fastest-growing segment in the retirement plan market. Why? Because they are quick and nimble, usually designed for contributions to be made over a short period, say, three to five years. Assumptions are less likely to change substantially in that amount of time, allowing for predictable and consistent contributions. The small-company pension plans, called Cash Balance Plans, allow business owners, especially of professional organizations — doctors, lawyers, architects, etc. — to defer from taxation significant amounts of profits while simultaneously transferring corporate funds to personal funds tax-free.

- **All payment options are NOT the same.** If you are a retiring employee of a company with a pension plan, study your payment options carefully. Your decision will last a lifetime and these choices are usually irrevocable. If you are offered an "early retirement" package, be particularly cautious, as the decision you make will have an even greater long-term effect on your retirement income. For example, just because you are offered early retirement, doesn't mean you're ready for retirement. If you will continue to work, you might be better served by taking a lump-sum payment from your pension and rolling it over — tax-free and penalty-free — to a 401(k), a 403(b) or an IRA. Those funds will continue to grow tax-deferred until you are, in fact, ready to retire.

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Retirement planning comes with a multitude of complexities and considerations. Pensions, in particular, are complicated and broadly misunderstood. Business owners with or considering implementing pension plans, as well as employees considering when or how to take pension benefits, should consult a knowledgeable financial advisor before making those decisions.

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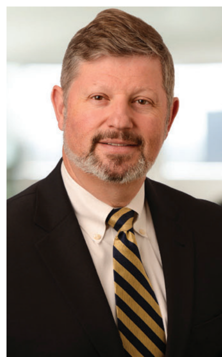

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Rod Diaz serves as manager of the Retirement Plan Services Unit for HBKS® Wealth Advisors. Prior to that Rod served as manager of Retirement Plan Services for McKinley Carter Wealth Services.

Rod was a financial advisor and founding member of a wealth management team within Parker/Hunter. There he built a Corporate and Executive Service group to facilitate stock option exercise programs, employee stock purchase plans and retirement plans. In 14 years this group went from managing five retirement plans to 60 plans.

Rod holds a bachelors degree in Architecture from the University of Notre Dame and an MBA from Carnegie Mellon University. He has also successfully completed the Chartered Retirement Plans Specialist Designation Program (CRPS) and is an Accredited Investment Fiduciary Advisor (AIFA).

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