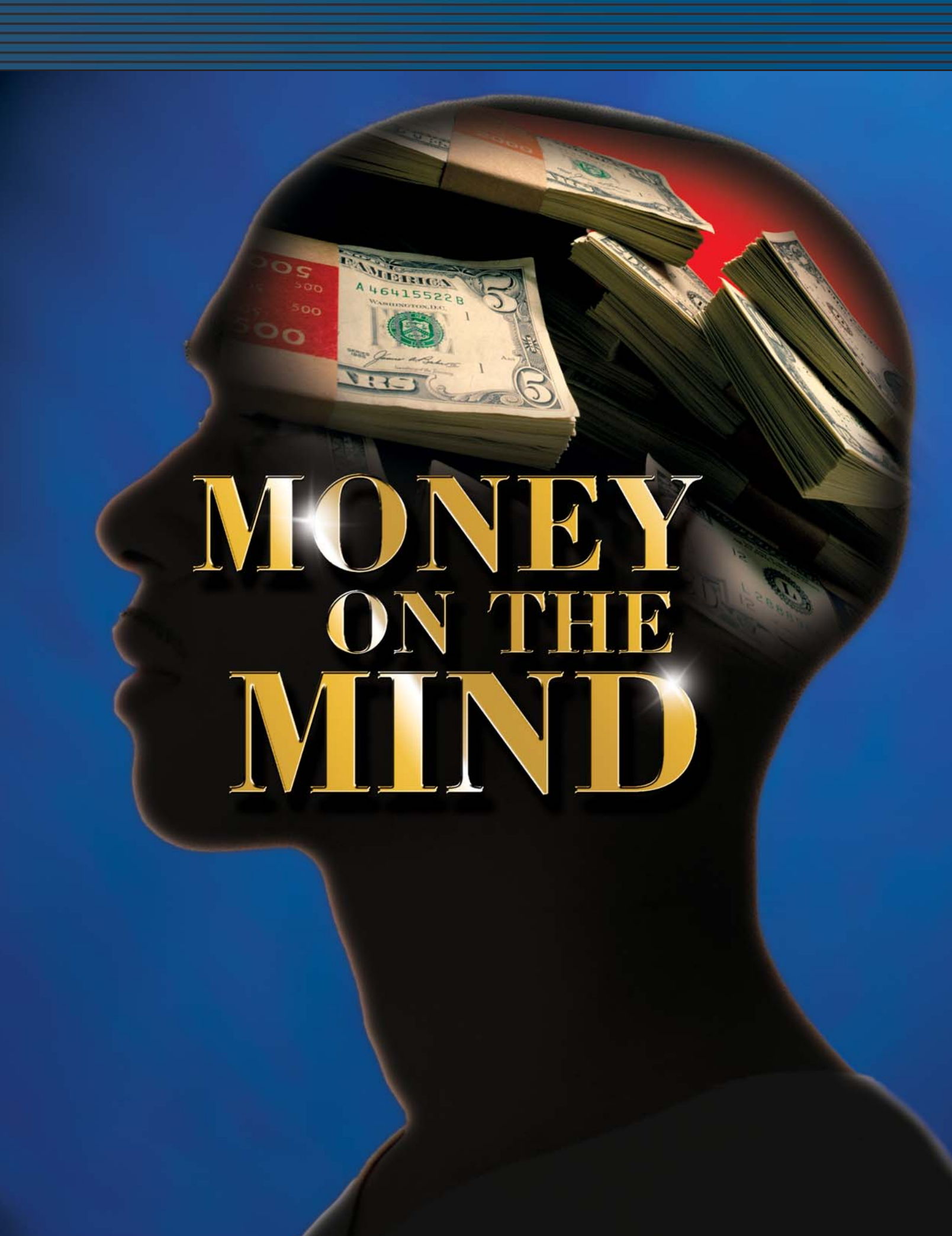
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Racing Toward Retirement

By Tom Schuman

Any piece of newly enacted legislation that contains more than 900 pages might make a few people wary. But if the goal is to be help working Americans more effectively prepare financially for their retirement years – and who can argue against that – then the Pension Protection Act (PPA) of 2006 appears to be a winner for all.

- Automatic enrollment provisions and permanent increases in individual contribution limits will help employees start sooner and save more
- Employers are provided additional legal protections in either dispensing financial advice or utilizing third parties to help employees with their investment decisions. (Employers still operating traditional pension programs will be required to fully fund those plans over a seven-year period)
- Retirement plan providers and financial industry consultants have the doors opened to work more closely with individual employees and assist them in making those proper investment choices
- And, with 900 pages of legislation that also cover areas ranging from college savings and charitable giving, Melissa Proffitt Reese, a partner in the Indianapolis office of Ice Miller, admits that benefit lawyers will be very busy. "Frankly, these kinds of acts take a couple of years for everybody to understand and be in compliance."

New ballgame

In 1980, more than 60% of Americans with retirement plans through their employer benefited from traditional pensions, with employers making contributions to an account that provided fixed monthly payments during the retirement years. These are commonly known as defined benefit plans.

Most other employees had defined contribution plans. The most common example is the 401(k), in which employees contribute pre-tax dollars with employers often matching those contributions up to a certain percentage.

Today, the numbers are reversed with 401(k)s and other defined contribution plans outnumbering defined benefit pensions. The gap continues to grow wider.

Major companies such as General Motors, Coca-Cola, IBM, Sears, Nissan, Hewlett-Packard and Motorola have gained headlines for freezing (no new people and/or no new accrual of benefits) their often overly generous pension plans. Numerous other organizations have made the shift away from employer-only retirement contributions to employee-focused programs.

Hershey, the nation's largest candymaker, joined the list in late 2006, announcing it was closing its traditional pension plan to new nonunion hires. The company will increase its current 401(k) match from 60% on the first 5% of employee contributions to a 75% match on the first 6% from the employee.

"There are still a fair amount of defined benefit plans out there, but a legitimate movement in the employment realm to get rid of these plans," Proffitt Reese states. "Defined benefit is defining a promise in the future with an unchartered path on how to get there. That uncertainty is the problem."

Although the exodus goes back nearly 20 years, Bill Yoerger, senior vice president for retirement services with American United Life Insurance Company® (AUL), a OneAmerica® company, notes that defined benefit plans are "still significant in the marketplace." According to data from consultant firm RG Wuelfing & Associates, the assets in defined benefit and defined contribution plans each total approximately $4.5 trillion.

Ideally, Yoerger says there would be a "three-legged stool" in that retirement funding would include Social Security payments,

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as well as employer and employee contributions. Reality, however, has more of the impetus on employees to lead the way in savings – both through their employer and outside the workplace.

Defining the change

Two employers are strong proponents of the continued movement toward defined contribution plans. Thomas Pimmler is president and CEO of Monticello Spring Corp. and Chuck Gillespie is director of human resources for Wheaton Van Lines, based in Indianapolis.

Monticello Spring is a 36-year-old company that specializes in manufacturing compression, extension and torsion springs. The company makes a fixed percentage contribution to the 401(k) program for its 74 employees, something Pimmler calls a "carryover from the profit sharing days." It also has a matching component for the approximately 60% of the employees who make 401(k) contributions.

"The profit sharing didn't work well. Retirement planning needs to be something employees are actively participating in and contributing to," Pimmler comments. "We're currently thinking about reducing the (fixed) contributions and adding to the match."

Wheaton, a mover of household goods since 1945, has approximately 120 employees at its corporate office and 270 agents across the country. The company provides a one-to-one match on the first 5% of employee contributions. That match was instituted when the pension plan was frozen in 2001.

"The cost of running a pension plan is so unbelievably expensive," Gillespie states. "It doesn't make it cost-effective to offer it."

Proffitt Reese adds the administrative costs are something for all employers to consider, no matter the type of retirement plan. "It's not just the contributions, but the compliance. The cost of the benefit itself is just a piece of the overall costs."

Starting out

The 401(k) is the defined contribution plan of choice. Why? From an employer standpoint, the obligations are, just that, very clearly defined. The administrative burden can be lessened through the development of safe harbor provisions, which Proffitt Reese describes as the Internal Revenue Service giving its blessing (due to the plan design) and not requiring the plan to meet all the typical compliance tests.

For employees, their money is essentially portable. In the vast majority of cases, it is not difficult to roll over money from one 401(k) to another or to an individual retirement account (IRA) or annuity.

Employees, however, have to be prompted to make their 401(k) contributions and place the money in the funds that give them the best return on their investment. Yoerger shares what he calls the "classic example" of who has more money at the end of the day: the person who saves a $100 a month from ages 25 to 35 and then stops, or the person who starts at age 35 and continues saving that $100 a month until age 65.

The answer, due to the power of compounding, is the first person – the one who only saved for 10 years. (The goal, of course, is to continue saving throughout a person's working career). "The challenge," he says, "is to get younger workers involved in the plan."

The Economic Growth and Tax Relief Reconciliation Act of 2001, among other provisions, extended the individual contribution limits for most 401(k)s to $15,000 a year ($20,000 for people over age 50). Those increases, set to expire in 2010, were made permanent by the PPA. Many plans allow employees to put in up to 20% of their salary as long as it doesn't exceed the federal limits.

A recent study by Fidelity Investments, which operates plans for 12,000 employers and nine million participants, found that the average employee contributes just 6.9% of his or her annual salary. More than a third of eligible employees don't participate at all. Of those that do, many are not contributing enough to gain the full benefit of their employer match and nearly half have account balances of less than $20,000.

Gillespie affirms the constant battle.

"We have a very good percentage of people – 80% to 90% – who are a part of the 401(k), but one of the things I continue to work with is those not contributing up to 5%. They're leaving money on the table," he says. "That's probably one of the hardest things to explain, but people living paycheck-to-paycheck often don't feel they can afford more than 3%. While we have a large percentage of people contributing, we probably don't have enough (people) contributing enough money."

Why the difficulties? Proffitt Reese: "A lot of employees just don't think about these benefits." Yoerger: "A lot of employees want the path of least resistance." Pimmler: "I saw a lack of preparation. People weren't thinking about it."

Additional advice

For employers, providing a solid retirement plan is part of employee attraction and retention efforts. As noted earlier, it is the right thing to do in helping employees save for life after work – but one that does not come without additional expense. The

Continued on page 20

Pension Protection Act of 2006*

*Individual Contribution Dollar Limit Increases***

Type of Contribution	Limit in 2006
401(k)/403(b) deferral	$15,000
401(k) catch-up	$5,000
Traditional/Roth IRA	$4,000
Traditional/Roth IRA catch-up	$1,000
SIMPLE IRA/SIMPLE 401(k)	$10,000
SIMPLE catch-up	$2,500

* Provisions, originally scheduled to expire in 2010, now are permanent

** Subject to annual cost-of-living adjustments

Defined Contributions vs. Defined Benefits

401(k)

	Employers	Employees
Eligibility	Any business	Employees who worked at least 1,000 hours in the past year
Contribution Limits	Combined employer and employee contribution cannot exceed $44,000 ($49,000 if you are 50 or older)	$15,000 ($20,000 if you will be age 50 or older as of 12/31/06)
Vesting	Determined by employer	Determined by employer
Pros	Employer/employee contributions. Match not required	Employee can contribute
Cons	Administration can be expensive	Employer contributions usually take years to vest

Pension Plans

	Employers	Employees
Eligibility	Any business owner or self-employed individual	Employees who worked at least 1,000 hours in the past year
Contribution Limits	No set limit. Contributions are based on actuarial assumption	Employees cannot contribute
Vesting	Determined by employer	Determined by employer
Pros	Older employers looking to put away a lot of money over short time period can do so	You are guaranteed a set payout after retiring
Cons	Can be expensive. Actuary required to determine contribution/ deduction limit. Inflexible	No employee control over investment options. No employee contributions

Racing Toward Retirement

Continued from page 14

last thing employers want, however, and rightfully so, is to be held financially responsible for the individual investment decisions that employees make.

OneAmerica is the 15th largest provider of defined contribution plans in the country with 2,000 qualified retirement plan arrangements, 400,000 participants and $8 billion in assets "Products have become a commodity," Yoerger shares in describing industry changes. "They're daily valued. There are a multitude of mutual fund investment options.

"The questions we get from our employers are more detailed," he continues. "Number one, though, is, 'Tell me what my fiduciary responsibility is.' What we work on is how to reduce that responsibility."

Maura Kautsky, vice president of marketing retirement services for AUL, adds, "The companies we work with look beyond just the products. They see us more as a partner."

One way that providers like AUL/OneAmerica can help reduce that fiduciary burden is through managed accounts. Employees have the opportunity, through telephone or Internet connections, to gain assistance in determining their investment profile (age, risk tolerance, long-range goals, etc.), which can be used in making individual plan choices.

Yoerger notes that these managed accounts are outside tools, backed by financial planners, not direct advice from providers or employers. Kautsky says ongoing use includes an annual (or more frequent) rebalancing of the investors' portfolio, far more preferable than one-time counsel given at the start of a person's investment career.

From the legal perspective, Proffitt Reese says, "Because of fiduciary lawsuits and risks, employers have been reluctant to give advice. They have stepped back and given less information." Changes in the PPA, however, "give some protection to employers."

A prohibited transaction exemption is available if certain criteria are met. They include:

- vendors or employers not being compensated or in any way benefiting from the advice; and
- the use of one of various computer modeling programs in dispensing the advice. "The IRS says, if you utilize those kinds of programs, we bless it," Proffitt Reese offers.

Independent assistance

Investment advice, of course, can come from many sources. Independent financial planning companies see the changes in the PPA as an opportunity to partner with employers to reach more individuals. Bison Financial Group, with a main office in Lafayette and satellite in Indianapolis, already offers a MENTOR program that it sees gaining in prominence.

Thea Strand, a vice president and director of business development for Bison, explains that simply getting employees to participate in a 401(k) or other retirement program is not enough. Her company, and the MENTOR program in particular, "targets the working person."

She says, "Many employees feel overwhelmed; there are too many choices to make. Employees need to be putting money away, but they still haven't chosen where that money is going to go. They may not be making the best use of the funds. They may have overlap with their spouse."

With MENTOR, computer modeling is used during individual sessions with employees to provide the analysis needed. Strand gives the example of an individual who had a 33% chance of reaching his or her retirement goals. Following the analysis and a simple reallocation of funds, that likelihood of success increased to 88%.

Bison provides MENTOR services at no cost to employers or employees. It does ask that employers allow interested

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individuals two visits with Bison representatives on company time. The company, while living by the "goodwill first, business second" motto, is also opening the doors to future business with the employees.

MENTOR, which was created to serve not-for-profits and later expanded to all companies, has been in place for two-and-a-half years. The city of Lafayette and Rea Magnet Wire Company are among the users, along with Pimmler at Monticello Spring.

"They came into the picture with the ability to offer individual, one-on-one coaching and counseling to help people decide what their retirement goals are and set out a plan on how to achieve those," Pimmler attests. He says his company works directly with the plan provider to make sure there are balanced fund offerings, "but the biggest piece missing is being able to make suggestions. That's a gap we've been trying to fill for years."

Strand sees the PPA regulations as a shift from "discouraging" to "encouraging" employer participation in financial planning.

Fund choices

The universal automatic enrollment feature has been gaining a great deal of attention. Employees can opt out, but the Fidelity study found an increase in participation from 54% to 76% in plans that already featured the automatic enrollment. The PPA also allows those funds to be directed to low-cost, low-risk portfolios – ones that, however, have higher returns than many of the choices from employees.

Gillespie says Wheaton's retirement fund provider does allow one free consultation at its retail outlets, and he has had some employees taking advantage of that. He also tries to bring in personal financial planners with strong reputations for informal lunch-and-learn sessions.

As far as increasing his role, he cautions, "We, as HR practitioners, are so programmed not to advise. I don't consider myself to be a financial planner. I don't see that to be as effective."

Gillespie is, however, "very fond" of the provisions calling for placement of employee monies in conservative funds that will realize a better return on investment.

"Currently, people are putting 100% in a money market fund and getting 2% or 3%. Unless people talk to them and say to make changes, that money just sits there. Now, that could go into a conservative mutual fund, and they could get at least 4-5%."

Getting the word out

Proffitt Reese notes some of the many other changes in the PPA, including more frequent statements to employees in defined contribution plans and regulations making it easier for workers to divest themselves of company stock that is purchased as part of the retirement plan.

"It's the most dramatic change in disclosure requirements since ERISA (Employee Retirement Income Security Act) really regulated this area for the first time in 1974," she declares. "There are 15 to 20 major changes in notifications or requirements. Employers have to get with their legal counsel and not only change plan documents, but communicate to participants.

"Employee communication is a really important piece to this," she continues. "Employers spend a lot of time and human capital providing benefits." She says additional investments may be necessary to "make the information easily digestible to employees."

Yoerger and Kautsky note that while the changes are phased-in over the next several years, some went into effect as early as January 1, 2007. Additional factors for future consideration are the ever-increasing life expectancy (affecting the payout phases of retirement benefits), the status of Social Security and health care costs, including the growth in health savings accounts.

The relationship between health care and retirement extends to consumerism – wanting individuals to take personal responsibility and make effective decisions. Gillespie says another similarity is their complexity.

Gillespie heard former U.S. House Speaker Newt Gingrich during a visit to Indianapolis late last year. Gingrich talked about his focuses on international affairs/military defense and health care since leaving Congress. The Georgia Republican said health care was much more complex.

"Yet, we as consumers are supposed to understand," Gillespie contends. "Both (health care and retirement) are so complex; it's almost impossible to make informed decisions."

Kautsky agrees, drawing the line at consumer participation in their retirement programs. "Our business is too sophisticated and too complicated at the end of the day for the average consumer. The focus is to prepare people for retirement, and we have licensed professionals to do that."

Employees, employers and professionals are all working toward that same goal, with a new rulebook in place to guide their efforts.

INFORMATION LINK

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