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EBRI News

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New Research From EBRI:

Pension Freezes: Who's Affected and by How Much?

WASHINGTON—A new analysis by the nonpartisan Employee Benefit Research Institute (EBRI) quantifies how workers are likely to be affected by pension freezes, and how much they would have to save in a 401(k)—whether provided by their employer and/or saved by themselves—to offset the loss of accrued benefits from the pension freeze.

The analysis notes that how an individual worker might be affected by a pension freeze varies widely, based on the unique nature of each pension plan and the terms of each plan that is frozen; the variation in workers' age, and tenure; and future investment results.

However, the report adds, the data "illustrate the general impact of age and tenure: Older, longer-tenure workers tend to be affected by a pension freeze more than younger workers because they do not have as much time left in their working careers in a 401(k) plan to offset the accrual loss from a pension freeze." (See figure, below.)

Written by Jack VanDerhei, Temple University and research director of the EBRI fellows program, the analysis also notes that recent high-profile announcements of pension freezes—including one this week involving General Motors' salaried workers—are part of a pattern that has been going on for several years already. "These decisions have been quite prevalent in recent years, and are part of the well-documented and long-term decline of 'traditional' pension plans," the analysis says. The full analysis appears in the March 2006 *EBRI Issue Brief*, available at www.ebri.org.

The analysis presents its findings in terms of additional compensation (in a 401(k) plan, whether provided by an employer or worker) needed to cover the accruals lost to a pension freeze. In some cases, the pension plan sponsor offsets the pension freeze by increasing its match in the workers' 401(k) plan, but each case is different, and in some cases the lost pension benefit is not replaced.

Some general findings from the EBRI analysis:

- ***For workers in career-average pension plans:*** Workers would have to save a median (mid-point) amount of about 7 percent of their annual salary to replace the lost accrual benefits from a pension freeze, assuming an 8 percent rate of return. Career-average pension plans calculate retirement benefits on the number of years of participation and the average salary during the employee's entire career with the employer.
- ***For workers in final-average pension plans:*** Workers would have to save a median amount of about 8 percent of their annual salary to make up for the pension freeze (assuming an 8 percent return). Final-average pension plans calculate benefits on the number of years of participation and the average salary in the worker's final years (typically three to five) with the employer.
- ***Cash balance plans:*** Workers in cash balance plans would have to save about 3 percent of their annual salary to make up for the pension freeze. While cash balance plans are technically defined benefit

pension plans, they operate more like a 401(k) and benefits are calculated on annual pay and interest credits.

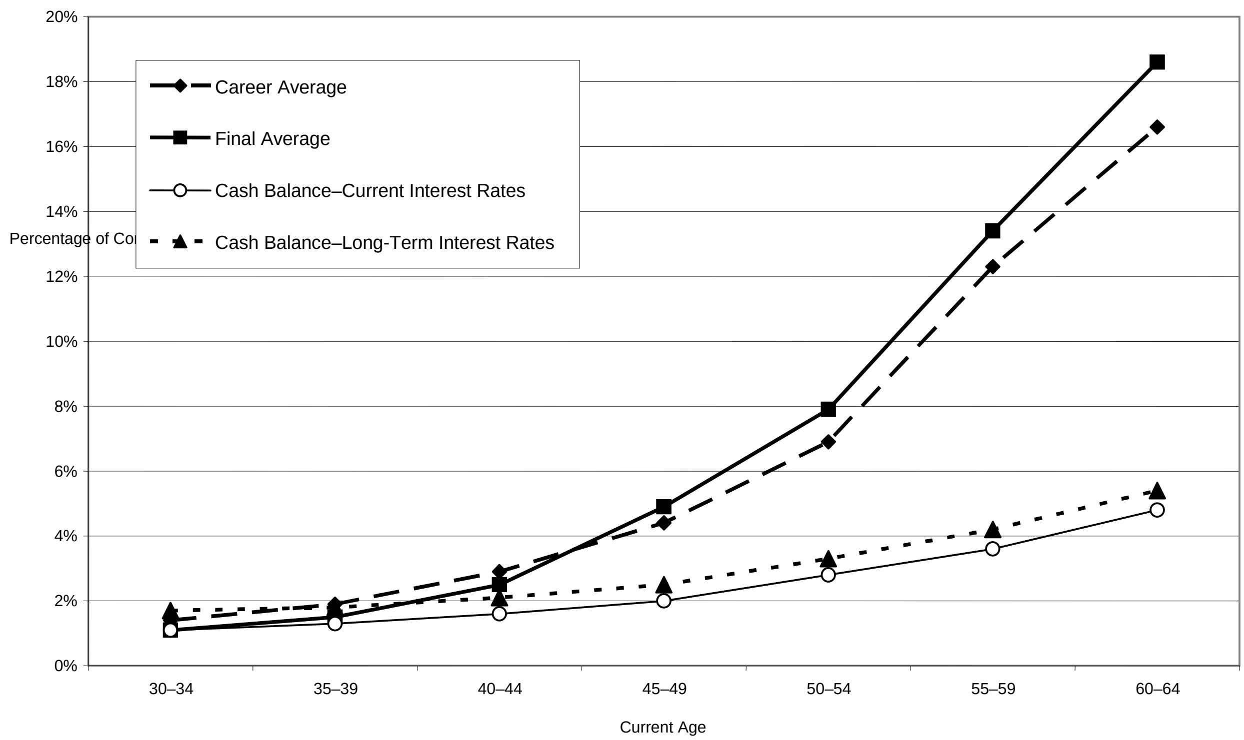
The analysis notes that in all of these scenarios, the contribution rate would be more if a lower rate of return was achieved, and results are estimated based on a 4 percent rate of return.

EBRI, a private, non-profit organization, does not lobby and does not take positions on policy issues.

How Age Affects the Need for Higher 401(k) Savings After a Pension Freeze

This figure from the March 2006 *EBRI Issue Brief* shows the median percentage of annual pay a worker would have to save to offset the impact of a pension freeze in 2006 (assumes 8% annual rate of return)

Full report available at www.ebri.org



Source: Author's tabulations from the EBRI/ERF Retirement Income Projection Model.

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