Family Finances / *By Theo Francis*

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%.

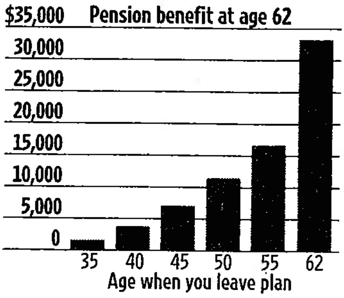
Pensions can often be taken as a lump sum at retirement instead, but the principle is the same.

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 now."

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

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 en ployee can expect less than tw thirds that much—$21,685 a yea Start saving at age 50, and retir ment income falls to $9,741 a yea

Starting early is critical b cause savings have more time t grow with compound interest or i vestment returns, potentiall greatly enhancing the sum you s aside.

Take It With You

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

Together, the pension/401(k) dy namic means mid-career worker often take the biggest hit whe companies freeze or terminat their pensions. (Companies free ing plans occasionally exemp those closest to retirement.)

Many companies improve thei retirement-savings plans to mak up for frozen pensions. However for older workers, a 401(k) may b too little too late. A 50-year-ol whose pension is frozen and wh saves the maximum in a typica 401(k) plan can expect combine retirement income of $21,189 a year by age 62—just two thirds o what the traditional pension alone would have offered, the Center fo 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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