What Happens If They Freeze My Pension?
By James Lange

If my company were to freeze my pension, what would happen to my retirement income? It's a valid question, and one that many workers are asking in light of the controversy stirred up by the newly passed Pension Protection Act of 2006. Unfortunately, there are too many variables involved to provide a standard, across-the-board answer. However, here is a specific example developed by Jack VanDerhei, a professor at Temple University and research director at Employee Benefit Research Institute (EBRI):

Assumptions:

1. A worker joined a company as he or she turned 30 and expects to work until age 65.

2. The company provides a "final-average defined benefit" pension plan, which promises employees a benefit calculated by multiplying the number of years worked times the average of the three highest years of pay times 1 percent

3. The worker is now 50 and is earning $70,000

4. The worker's pay goes up by 3 percent every year

Analysis:

Based upon these assumptions, our worker will be making $105,881 when he or she is 64 and the average of our worker's three highest paid years will be $102,827. If the pension plan remained in place, the worker's annual benefit would be **$35,989** (= $102,827 x 35 x 0.01).

If however, the pension plan gets frozen while our worker is 50, his or her high-three average would drop to $67,980 and the years of service would only be 20. This scenario would decrease his or her annual pension benefit, beginning at age 65, to **$13,596** (= $67,980 x 20 x 0.01).

Based on these calculations, our worker is left with a **$22,393** gap per year to make up for that lost pension benefit. According to Van Derhei, this worker would have to accumulate $299,536 in their 401(k) to buy an annuity to fill this gap created by the pension freeze.

In order to accumulate that amount in our worker's 401(k) by the time he or she retires, Van Derhei surmises that, assuming a reasonable asset allocation strategy and expected returns, our worker (and/or employer) would have to contribute 12.87 percent of his or her pay for each of the succeeding 15 years.

As this example clearly demonstrates, for most American workers a pension freeze will result in a substantial setback in their ability to provide themselves and their families with a comfortable retirement," concludes Lange. "It is critical to provide for such a possibility. Open an IRA now and contribute as much as you possibly can. Even if you are one of the fortunate few who receives your full pension, you'll appreciate the extra cash."