

RETIREMENT Plan Trends



A benefits update

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Employers Skeptical Of New Pension Accounting Rule Proposals

While employers are generally in favor of revising current defined benefit retirement plan accounting standards, most object to several of the changes proposed in a preliminary views paper released by the International Accounting Standards Board (IASB), a survey by human resources consultancy Watson Wyatt Worldwide has indicated.

The international survey of 131 finance and employee benefit directors showed that most employers agree that changes are needed in a number of key areas of defined benefit plan accounting, with 80% of respondents saying that improvements to requirements for the measurement of cash balance and similar pension plans are needed. In addition, 56% of the directors agreed with the IASB that pension

accounting practices should be altered by removing options to defer the recognition of plan gains and losses. At the same time, how-

ever, 80% of respondents said they do not support the IASB's suggestion that all plan experience be immediately recognized in the profit and loss account.

Most of the surveyed employers told researchers their commitment to offering pension plans would not be reduced because of the changes to accounting rules. However, 46% of respondents said the proposed changes to cost recognition and 24% said the changes to the measurement of contribution-based plans could discourage them from offering defined benefit plans in the future.

According to the survey, 38% of employers support, while 50% reject, the proposed introduction of a contribution-based promise, a new classification of benefit that would include cash balance, career average,

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notional defined contribution, and flat dollar/multiplier plans. In addition, 54% of respondents said they consider requiring the measurement of pension obligations to reflect credit risk to be inappropriate, compared with just 29% who said they favor this proposal. A further 53% of the employers expressed opposition to introducing different accounting treatment for inpayment annuities based on how they were defined as they were accumulating, with only 24% indicating they support this change.

Researchers observed that, while the reform of requirements for the measurement of cash balance and similar pension plans is a priority for employers, the IASB has indicated that it will likely devote less attention to this area in the future, instead focusing on changes to cost recognition. The survey also showed that 58% of employers would like to see improvements to requirements for the measurement of final salary and retiree medical benefits, an area that is not mentioned in the IASB paper.

“The IASB’s proposal would make significant changes to the way retirement benefits are accounted for under International Financial Reporting Standards,” said Eric Steedman, a senior international consultant at Watson Wyatt. “With a global convergence of accounting standards on the horizon, these changes could have important implications for publicly traded companies around the world. All employers would be well served to familiarize themselves with the proposals and assess the potential impact of the changes on their existing plans.”

Housing Bubble Could Threaten Financial Security In Retirement

Around one-third of older households in the United States are likely to be less financially secure in retirement as a result of the rise and sudden fall in

average house prices that occurred between 2000 and 2007, according to a study published by the Center for Retirement Research at Boston College.

The study, “The Housing Bubble and Retirement Security,” was written by economists Alicia H. Munnell and Mauricio Soto. The authors noted that housing is the most important asset for most households in the United States: When Social Security and defined benefit retirement plan benefits are excluded, housing makes up half of assets for the typical household approaching retirement (aged 55–64). Even when the present discounted value of benefits from Social Security (42%) and traditional pensions (16%) are included in the calculation, housing still accounts for 21% of the total wealth holdings of households aged 55–64. By contrast, assets held in defined contribution plans make up just 8% and other assets make up 13% of the total wealth of households in this age group.

Meanwhile, average house prices in the United States surged during the housing boom that began in 2000, rising between 40% and 60% by 2006, according to different estimates. The question, the authors said, “is whether a big increase in the price of the typical household’s major asset has provoked a major response in terms of increased debt and consumption spending.”

Aggregate data from the Federal Reserve Flow of Funds indicates that U.S. households have increased their borrowing in recent years, with total debt—most of it in the form of mortgage debt—rising from around 60% of disposable personal income in 1983, to 80% in the early 1990s, and to 120% in 2007. While some of this debt was used for residential investment, the evidence suggests that the housing boom caused people to increase their borrowing, to extract equity from their homes, and to raise their level of consumption, the authors said. The Federal Reserve’s 2004 Survey of Consumer Finances (SCF) showed that around 40% of U.S. house-

holds either reported some form of refinancing or had extracted home equity between 2001 and 2004.

Largely as a result of rising house prices, the study found, the net worth of a typical household nearing retirement rose from about \$48,900 in 2001 to \$56,900 in 2004, and decreased slightly to \$56,800 in 2008. If, however, that same household extracted and consumed home equity between 2001 and 2008, the net worth of the household would have declined to \$43,300 by 2004. If this pattern of extraction and consumption continued, the worth of the household would have fallen to as low as \$34,600 by 2008.

Because around 30% of U.S. households nearing retirement extracted equity between 2001 and 2004, the bursting of the housing bubble is likely to affect the retirement preparedness of individual households very differently, Munnell and Soto observed.

“For older households, the housing boom provided some liquidity,” the study’s authors concluded. “But a significant proportion of those entering retirement today—and perhaps over the next several years—will have a fragile balance sheet in a time of depressed home prices and poor financial market returns.”

401(k) Plan Participants Want Help Understanding Fees And Expenses

Most 401(k) plan participants are aware of the importance of fees when making investment decisions, but nearly as many do not know how much they are actually paying in fees and expenses for their 401(k) accounts, according to a study published by AARP Knowledge Management.

Authored by Colette Thayer, Ph.D., the study, “Comparison of 401(k) Par-

ticipants’ Understanding of Model Fee Disclosure Forms Developed by the Department of Labor and AARP,” was based on the results of a survey of 2,106 401(k) plan participants ages 25 and older. The survey asked respondents to consider two model 401(k) plan disclosure forms, one developed by the U.S. Department of Labor (DOL) and an alternative form developed by AARP.

While 85% of the plan participants said they recognize the impact 401(k) plan fees can have on their investment returns, 74% of respondents admitted they do not know how much they are currently paying in fees and expenses. The findings also showed that 84% are involved in making decisions about investments in their 401(k) accounts, with 32% saying they make investment decisions entirely on their own.

The DOL has recently proposed regulations requiring the disclosure of certain plan and investment-related information, including fee and expense information, to 401(k) plan participants and beneficiaries. The DOL has also developed a model form that could be used to disclose this information. After viewing the DOL’s model form, 59% of survey respondents said they would like to receive the form; however, just 35% said it would help them make more informed decisions about their 401(k) accounts, and only 34% told researchers it would help them understand the impact of fees and expenses on their long-term retirement savings.

Results further showed that just 30% of those surveyed agree that the DOL’s disclosure form is easy to read, 33% think it has a clear purpose, 25% find it easy to understand, 24% think the terms used are clearly defined, and 35% agree that it adequately explains how to get additional information.

By contrast, 90% of respondents said they found the simplified disclosure form developed by AARP to be helpful, with around three-quarters agreeing that the form would help them to make more



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A comparison of respondents' reactions to the two forms indicated that employees tend to prefer disclosure forms that contain participant-specific information and actual dollar figures linked to account balances. The analysis further suggested that certain layout and design elements, such as bold type and bullet points, can be used to enhance communication of key information in the form. Using vocabulary that is not seen as complicated and providing clear definitions of financial terminology were also found to help improve participants' understanding.

SEC Alert: The Pitfalls Of 401(k) Debit Cards

The U.S. Securities and Exchange Commission (SEC) has issued an investor alert warning 401(k) plan participants to exercise caution when offered a "401(k) debit card" by their employers.

A 401(k) debit card typically allows plan participants to borrow up to \$50,000 or 50% of the value of their retirement plan, whichever is less, through use of a debit card. But, the SEC warned, a 401(k) debit card is not like a debit card that deducts money from a checking or savings account. Instead, early withdrawals from 401(k) accounts are loans that employees make to themselves out of their own retirement savings.

"More akin to a traditional credit card, you must repay the money you withdraw using the card, along with fees and interest—or you may incur substantial penalties," the alert said.

The SEC advised plan participants to consider a number of factors before using a 401(k) debit card, including the fact that they will have to pay fees and will incur interest on amounts they borrow from their 401(k) accounts. While noting that some of the interest borrowers pay will go back into their 401(k) accounts, the alert pointed out that a so-called "margin" is generally paid to the vendor of the card. The SEC also warned that a number of additional fees may be applied to users of 401(k) debit cards, including an annual fee, a set-up fee, a cash advance fee, and fees for other services, such as express delivery.

Moreover, the alert cautioned, if borrowers fail to pay the money back in the time period required by the plan, there may be significant penalties and tax consequences. Under IRS rules, 401(k) plan participants who borrow from their accounts are typically required to repay the amount of the loan in five years or less, and they must not fail to make payments for three consecutive months. Borrowers who do not meet those conditions will owe taxes on their loan balance, and borrowers under age 59½ will also have to pay a 10% tax penalty.

The alert further advised employees that the amounts set aside to borrow may earn a lower rate of return than the rest of their 401(k) assets. This is because funds the participant might want to borrow are often placed in a money market fund, which typically produces lower returns than other 401(k) plan investment options, such as mutual funds or stocks.

Finally, the SEC warned employees that, unlike the contributions they make to their 401(k) accounts, repayments of 401(k) debit card loans are not automatically deducted directly from payroll. Instead, borrowers must take action to repay the balance.



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