

# Introduction

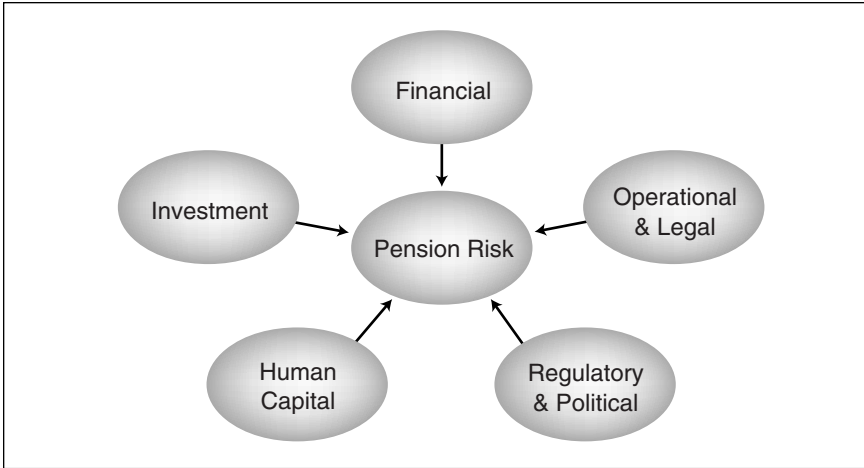
**M**anaging retirement plans is an ongoing process. Regardless of the type of plan you manage—from profit sharing to traditional defined benefit program—you have to familiarize yourself with the rules of the plans as well other issues including investment risk and legal requirements (see Figure 1.1).

Managing retirement plans can be a difficult and daunting task for a number of reasons. Not only are the number and variety of plans ever increasing, but the day-to-day management itself is complex. This book will help you navigate the process, whether you are self-managing within your organization, outsourcing the total retirement plan management to outside vendors, or a combination of the two.

## Overview of Retirement Plans

A retirement plan, in the employer model, is multifaceted:

- *Employee relations.* First and foremost, the employer is holding an asset of the employee—whether it is a 401(k) account balance or the accrued benefit in a defined benefit plan.
- *Asset management.* Employers must invest these assets in a productive manner. Specific rules regulate.
- *Retiree relations.* If your retirees and other inactive employees still participate in your plan, you must continue to take their needs into consideration as you manage the plan. These people no longer have a



**FIGURE 1.1 Strategy map**

Source: Argus Consulting Ltd.

### HISTORY OF RETIREMENT PLANS

Retirement plans are a by-product of the Industrial Age. Kaiser Wilhelm was the first to enact a social insurance plan that would cover workers in turn-of-the-century Germany. Railroads were the first industry in the United States to embrace retirement plans. In both cases, the initial goals were identified as providing retirement income for workers after they have completed a useful working life.

Before the industrial age, there was no need for this “continued income” after retirement for the following reasons:

1. *Agrarian culture.* With the vast majority of the workers engaged in producing “food” for our society in a very wide distributed system, there was no central control/depository system to facilitate a savings vehicle.
2. *Mortality.* People did not live very long lives and however long they lived, they worked until they died. Medical science was not such that people lived past their useful working lifetime.
3. *Social structure.* Monarchy-based systems did not encourage personal asset accumulation; in fact, monarchies encouraged social welfare through noblesse oblige.

After the industrial revolution, larger businesses such as railroad companies or steel mills and others that encouraged the development of the middle class had the means to provide long-term security plans. Price controls during World War II also contributed to the increased use of retirement plans as a part of the overall compensation package as companies who were unable to increase direct pay looked to other means to attract qualified workers. Further social changes, including the increased power of unions, pushed retirement plans into the mainstream.

Many people point to the failure of the automobile manufacturer Studebaker's pension plan in the mid-1960s as a pivotal moment in pension plan history. Directly out of this highly visible pension failure came federal action to regulate pension plans. In 1974, the watershed legislation called the Employee Retirement Income Security Act (ERISA) was passed and signed by President Gerald Ford in one of his first acts as president. From that point on, pension plans have been regulated on the federal level. Briefly, ERISA added significant provisions to protect workers and beneficiaries such as minimum vesting schedules, minimum funding standards, stringent fiduciary standards, and limitations on prohibited transactions. It also increased reporting requirements and established an insurance program for defined benefit plans (Pension Benefit Guaranty Corporation).

At the time of ERISA, defined benefit plans were the predominant retirement plan at larger employers; in fact, for most people, the term *pension plan* is synonymous with a traditional defined benefit pension plan. The number of defined benefit plans peaked in the mid-1980s with over 170,000 plans. However, due to many factors, including changes in legislation, the number of defined benefit plans has dropped to under 30,000. Now the vast majority of plans are defined contribution plans where the participants bear the investment risk.

Many critics point to two reasons for this sudden decline:

1. Pension plans were used in legislation to balance the federal budgets (increasing complexity with no real added value).
2. By limiting benefits to highly paid managers, this reduced the business owners' incentive to continue sponsoring plans for their rank and file employees.

Finally, in the last several years with significant volatility in the equity markets and prolonged period of economic uncertainty/recession, we may be witnessing the last rites of the traditional pension plan.

#### 4 A MANAGER'S GUIDE TO STRATEGIC RETIREMENT PLAN MANAGEMENT

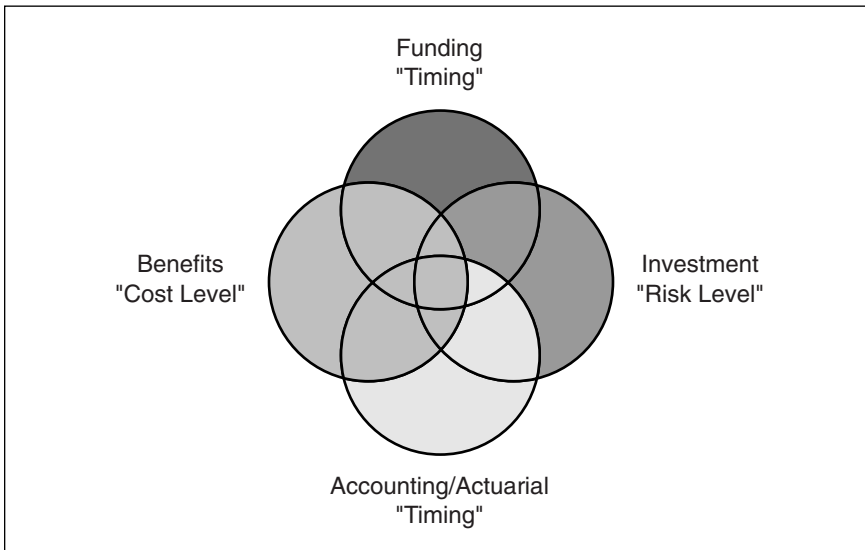
direct tie with the employer, but an indirect one through the retirement plan.

- *Systems integration.* Payroll and plan management systems must communicate with each other in an effective manner. As employers make changes to one, the impact on others needs to be considered.
- *Legal and tax issues.* Our government encourages creation of retirement plans by providing substantial tax benefits both to the employer and employee. However, to continue to get these benefits, the employer must maintain the plan in compliance with an enormous amount of tax and legal requirements.

Whether the chief financial officer or vice president of human resources is managing the plan, he or she needs to keep all of these facets in mind.

As with any management task, there are several levers that a manager can use to apply pressure to get a desired result (see Figure 1.2).

In this book, we will examine the specifics of the plan in which managers can strategically affect the outcome of the retirement plans. You won't become an expert in ERISA legislation, but as one of my clients said, the book will "give you the questions you need to ask." Going further, our goal is to empower you by providing an explanation of the levers you can use to impact the real outcome of your plan. Only you know the right answers for you, your employer, and your employees. But first, you have to know what questions to ask.



**FIGURE 1.2 Retirement plan corporate governance tools**

Source: Argus Consulting Ltd.