How Secure Is Your Nest Egg?

Retirement Asset Protection in Unstable Times

These are obviously troubling times for retirement plan investors. Trillions of dollars have been lost on paper in retirement accounts over the last few months, and most models forecast a prolonged economic downturn. Unlike previous market corrections, the Wall Street meltdown has called into question the very stability of financial institutions, making it difficult to determine a strategy to safely shelter precious retirement assets.

There are various protections available to retirement plan accounts to help both plan sponsors and participants understand how to best manage their retirement assets for the long term.

TYPES OF RETIREMENT PLANS

A general understanding of the types of retirement plans is key to the discussion of retirement asset safety. There are two types of plans, *defined benefit pension plans* and *defined contribution plans*. A defined benefit pension plan promises to pay a benefit beginning at a specific retirement age. In this plan, the investment risk is borne completely by the employer. In other words, whether the value of the investment pool goes up or down, an employee's benefit will remain unchanged since the payment is dictated by the terms of the plan.

In the last thirty years, most employers have replaced their defined benefit programs with defined contribution plans, including profit-sharing and 401(k) arrangements. In a defined contribution plan, the participant bears the investment risk, meaning that the ultimate benefit at retirement is based on a combination of the contributions (both from the employee and the employer) and the investment experience in the account.

The timing of the allocation of investment gains and losses depends on the plan's trust arrangement. In a traditional profit-sharing plan, the contributions to participants are pooled together and invested as a single account. These arrangements are valued on a regular basis (usually annually), and gains or losses are allocated as of the specified plan valuation date. For a participant in such a calendar year plan that is valued annually, the posting of current market losses would not occur until the end of December.

In 401(k) plans and many profit-sharing plans, a more common arrangement is for the plan sponsor to establish a separate account for each participant for which the participant makes independent investment decisions. In these arrangements, the valuation is performed on a daily basis by the financial institution. Individual Retirement Accounts (IRAs) are also valued daily.

LONG BEACH OFFICE
111 West Ocean Boulevard
Twenty-Second Floor
Long Beach, CA 90802
Telephone: (562) 435-1191
FAX: (562) 495-1665
Contact Richard Green

IRVINE OFFICE
18201 Von Karman Avenue
Suite 1060
Irvine, CA 92612
Telephone: (949) 271-2600
FAX: (949) 660-5681
Contact Therese Cheevers

www.windes.com

WINDES & MCCLAUGHRY ACCOUNTANCY CORPORATION

Employee Benefit Services

EMPLOYER LEVEL PROTECTIONS

There are several protections afforded assets by the rules that govern qualified retirement plans. Under ERISA, all plan fiduciaries must be bonded (for at least 10% of plan assets) to protect plan participants from any improper use of trust assets by plan fiduciaries. In addition, the plan may be required to increase its bonding to cover any plan assets not held at a financial institution. This bond is only a protection against misuse of funds and does not deal with investment experience.
Assets held in retirement plans (including IRAs) are generally protected from being attached in a personal bankruptcy proceeding. Qualified retirement plan assets also receive additional protection from non-bankruptcy judgments levied against participants.

Once contributed to a trust, contributions are no longer considered assets of the employer and cannot be attached in the case of a plan sponsor filing for bankruptcy or becoming insolvent. The employer is prohibited from using plan assets for its own business purposes and all amounts in the plan must be maintained for the exclusive benefit of the participants. Participants in defined benefit plans covered by the Pension Benefit Guaranty Corporation, a quasi-governmental agency, are additionally insured for their benefit (up to an annually adjusted limit) against plan sponsors that abandon their funding obligations.

FDIC INSURANCE

The Federal Deposit Insurance Corporation is an independent agency of the United States Government that was created during the Great Depression to provide confidence and security to bank investors. Deposit accounts at an FDIC insured bank or savings association are protected against loss from the failure of the institution up to specific limits. Until the recent financial crisis, the amount of coverage depended on the type of account held. Congress has temporarily increased the FDIC limits to a uniform $250,000 per account owner (through December 31, 2009).

For retirement plan accounts, the coverage extends to each beneficial interest under the plan. In a retirement plan where the accounts of many participants are pooled together for investment purposes, the coverage is multiplied by the number of participants. For example, a profit-sharing plan account with fifteen participants would be insured for up to $3,750,000. The coverage for a retirement plan that creates separate self-directed accounts for each participant would be limited to $250,000 per account, up from $100,000.

It is important to note that the FDIC covers deposit accounts, such as checking and savings accounts. It does not, however, cover other financial products that banks may offer, such as stocks, mutual funds, or insurance products. Those investment accounts are likely covered by SIPC coverage as described below. Credit Union accounts receive similar government protection (although at lower limits) through the National Credit Union Administration.

SIPC COVERAGE

The Securities Investor Protection Corporation (SIPC) is not a government agency. Rather, it is funded by member firms and protects the accounts of companies that go out of business up to a maximum of $500,000 per customer, $100,000 of which may be in cash. SIPC coverage is limited to investments registered with the Securities and Exchange Commission. Most institutions that hold accounts authorized to buy and sell investments such as stocks, bonds, mutual funds, etc. are members of the SIPC. Each retirement plan account held at a member firm receives separate coverage. In addition, many financial institutions carry additional insurance for accounts that far exceed the SIPC coverage.

It is important to note that the SIPC does not reimburse investors for the value of securities, but rather replaces shares lost when an institution fails. This can result in changes in the market value of securities while waiting for the processing of a SIPC claim. The SIPC is not meant to be insurance against investment loss, but rather a safety net to replace lost investments due to the failure of one of its member institutions.

MONEY MARKET FUNDS

In bear stock markets, it is common for retirement assets to be shifted into money market funds as a presumed safe haven during uncertain times. During the recent financial crisis, confidence in this strategy was shaken when a prominent money market fund dropped below the typical $1 per share value. To restore confidence, the Treasury Department has established a temporary program to guarantee the value of these funds. The program will cover the shortfall for any fund that is valued less than a dollar per share and will apply to the value of accounts held on September 19, 2008. While there is no limit on the amount of coverage, transactions after that date will not be covered by the program, which will be effective for one year.

OTHER ASSETS

Retirement plans are allowed to invest in assets held outside of banks and brokerage firms, such as real estate, limited partnerships, insurance contracts, and third-party loans. Such assets generally fall outside the protections described above. Plan trustees and self-directed participants are advised to diversify their portfolio of investments so as not to "put all their eggs in one basket" and to limit their exposure due to the failure of any of these investments.

An important area of consideration is when plan assets are held at insurance companies. Many retirement plan investment platforms, especially for 401(k) plans, are provided by large insurance companies. The underlying funds that make up the plan investments are often segregated and typically covered by the SIPC, but other insurance products, such as life insurance and annuities, would likely not be subject to coverage and would be part of an insurer's general account.

In a prolonged down stock market, it can be easy to lose sight of the long-term benefits of investing in securities for retirement. Instability in the markets and shaken confidence in financial institutions will cause many to seek the shelter of more liquid investments. Historically, the patient investor who can weather such downturns will be rewarded with higher returns over the long haul.

Retirement investors are encouraged to investigate the protections available to their own accounts based on their particular investment arrangement. Identification of the financial institution holding qualified plan assets is generally available from the plan's Summary Annual Report or from the plan trustee. Information on the current financial condition of financial institutions is available through the internet or through the plan's investment advisor. To check the participation of an institution in the programs described in this article, see the Retirement Plan Resources. If you have questions, please contact Richard Green at (562) 435-1191 or **rgreen@windes.com**.