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My Company is Freezing the Pension Plan: What does this mean?

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Fact Sheet
PENSION ACTION CENTER, GERONTOLOGY INSTITUTE
McCORMACK GRADUATE SCHOOL OF POLICY AND GLOBAL STUDIES

My Company is Freezing the Pension Plan: What does this mean?

As employers move away from traditional defined benefit pension plans in favor of defined contribution 401(k) plans, the number of frozen pension plans is rapidly increasing. While most companies would like to rid themselves of their pension plan liabilities, more often than not, employers deem it too costly to terminate their existing plans and pay out all accrued benefits to participants and beneficiaries. As a result, instead of terminating their existing pension plans, many employers are electing to "freeze" their plans. Pension plans may be frozen using a "hard freeze" or a "soft freeze". While both types of plan freezes result in cost savings for a company, a plan freeze also results in the elimination of future benefit accruals for one more groups of employees. This fact sheet will explain the differences between a hard freeze and a soft freeze, as well as discuss other plan freeze considerations and your options going forward.

Does a plan freeze affect my pension benefits?

It depends. If you are actively employed, a plan freeze is likely to eliminate your ability to accrue future pension benefits; however, it does not reduce benefits that you have already accrued. If you are already receiving pension benefits or have separated from service from your former employer with a vested benefit, then a plan freeze will not impact you.

What exactly has been frozen?

When employees are in a defined benefit pension plan, they need to keep an eye on two things that affect their pension: *benefit accrual* and *vesting credit accrual*. Benefit accrual describes the process by which your pension increases over the time you work for a company. Vesting credit accrual describes the process of earning the non-forfeitable right to the pension benefit. (Current law requires that you must be vested after no more than 7 years of service, although 5 years of service is a more common vesting requirement.)

A pension freeze affects **benefit accruals**. This means that your pension will no longer increase in value as of the date of the freeze; the **amount** of the pension will not continue to grow after the benefit accruals are frozen. You will, however, continue to accrue **vesting credit**.

Types of benefit freezes: hard or soft

Hard Freeze

With a hard freeze, all future benefit accruals for existing participants are frozen. This means that the value of your pension benefits will no longer increase after the date of the freeze, regardless of whether you are still working for your employer. Keep in mind, however, that your employer *cannot* take back benefits that you have already accrued. A hard freeze will also freeze entry into the pension plan by new employees. For existing employees, if your pension benefits are not yet vested, a plan freeze will not freeze your vesting service. This means that if you started working for your employer before the plan freeze and you continue working for your employer after the plan freeze, you can become entitled to a pension (valued at the time of the plan freeze) despite the fact the plan is frozen. You will **continue to earn vesting credit while you continue working for the company.**

Soft Freeze

A soft freeze generally only prohibits new employees from becoming participants in an existing pension plan. Unlike a hard freeze, employees who are already pension plan participants continue to accrue pension benefits and vesting service. In other words, pension benefits will continue to increase as normal, though only for those employees already participating in the pension plan as of the effective date of the plan freeze.

When can my employer freeze its pension plan?

Your employer may freeze its pension plan at any time for any reason, though by law they are required to provide you with at least 45 days advance notice prior the effective date of the plan freeze. The notice is called a 204(h) notice, named after the corresponding section of the Internal Revenue Code. If your employer does elect to freeze its pension plan, it may only freeze benefits going forward. Under no circumstances may an employer retroactively freeze a pension plan or reduce pension benefits that have already been earned. If the employer fails to send you the proper notice, the freeze does <u>not</u> affect your benefit and your pension should continue to increase in value.

What are my options going forward?

While there is nothing you can do to prevent your employer from freezing its pension plan, you should pay particular attention to your company's 401(k) or profit sharing plans. Employers often increase employer contributions to such plans to partially offset the impact of a pension plan freeze. Regardless of whether or not your pension plan is currently frozen, you should strongly consider participating in your company's 401(k) plan, particularly if your company makes employer matching or profit sharing contributions to its plan.

Also in the event of a plan freeze it is strongly recommended that you request and obtain a statement from your company that details your frozen accrued benefit calculation. Keep this statement in a safe place until you are ready to commence your retirement benefits. Please also consider reading the ***Protect Your Retirement Income: Documents to Keep and Questions to Ask*** Fact Sheet available on our website.

Do you have any questions about this fact sheet? Call the Pension Action Center at 888-425-6067 or visit us online at pension.umb.edu

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