New Year, new tier

Building a future on lower wages, fewer benefits

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A new UAW-General Motors contract codifies and concentrates trends that already have been roiling the American workplace on separate tracks:

- Buyouts.
- Two-tier pay and benefit plans that bring in new workers at much lower wages (that often stay that way).
- Reduced or drastically changing benefits for first-tier workers.
- Dismantlement of "traditional" pension plans, replaced by 401(k)-style plans.
- Shifting of the responsibility for long-term investment and risk decisions from companies to employees.
- Lump sum pay increases instead of cost-of-living raises.

With those trends in mind, and 2007 closing out, it seemed a good time to talk to a fee-only expert — David Kudla of Grand Blanc's Mainstay Capital Management — on how workers should manage their new responsibilities and opportunities.

Q: Tier-two seems to be the new war cry in corporate America — hiring newer, cheaper employees who get fewer benefits.

What should tier-two employees do? How do they need to think and act differently than their parents, or even their tier-one co-workers?

A: Many companies are now offering new employees 401(k) plans in place of traditional pension plans.

Some companies are now making contributions to an employee's 401(k) plan in lieu of providing health care benefits in retirement (as in the new GM tier-two employee benefit plan).

Bottom line: more of the responsibility for a secure retirement now rests with the employee. Therefore, new employees need to start planning, saving, and investing wisely for retirement from day one.

Q: Since that shift is going on, what's the best way to protect yourself, or your family, in this new financial landscape?

A: The first and most important step for employees is to develop a comprehensive retirement income and investment plan, taking full advantage of any retirement savings programs and benefits the company makes available.

The plan should be updated periodically, evaluating "what-if" scenarios that may arise in the near or distant future.

Q: You've said in the past that people can actually do better, long term, with a 401(k) rather than a traditional pension. Is that still true?

A: It is — and more so today than in the past.

Many companies are freezing pension benefits. Others, like GM, have reduced the pension benefits that will be earned by some employees going forward.

David Kudla

The Kudla file

David Kudla, 45, is chief executive officer and chief investment strategist of Mainstay Capital Management in Grand Blanc, Michigan.

The firm is a fee-only, independent, Registered Investment Advisor managing approximately $700 million in assets.

Kudla has a master's degree in management from Stanford University and master's and bachelor's degrees from the University of Dayton.

Mainstay advises hundreds of clients on their 401(k)s, investments, weighing buyout offers, and other financial matters.

Details: www.mainstaycapital.com or (866) 444-6246.

But a well-managed 401(k) account can produce a larger, more flexible income stream in retirement than the best traditional pension plans still out there.

Additionally, employees own the assets in their 401(k) account. Assets in a pension plan are always at risk of a Pension Benefit Guarantee Corp. takeover in the event of a bankruptcy or other financial problems.

Another advantage? Assets in a 401(k) or IRA can be passed on to heirs. A pension "guarantees" the payout of benefits stops with the last surviving spouse.

Q: Old-school tier-one employees are still around. But more and more are being eased out with buyouts or seemingly pushed out with early retirement deals.

How can senior, high-earning employees, hourly or salaried, best prepare themselves?

A: We have counseled hundreds of clients on employee buyout offers, and we are getting ready for the next round of GM buyout offers scheduled for early 2008.

Many of our clients have been pleasantly surprised to learn how well-prepared they were financially to accept an offer and retire early.

For the employee who hasn't planned well to that point, however, there are essentially three options: save more, work longer or improve his or her expected investment performance.

It comes as no surprise that most people prefer to focus on the third option.

Q: College students seem to be leaving school with wheelbarrows of debt. What's the best way to get a new graduate started on the right foot?

A: With a job.

Seriously though, everyone should borrow responsibly and manage their debt as effectively as they manage their investment portfolio.

That's not to say that the goal is to pay down debt as fast as possible. If the interest rate on the loan is low, prepayments or completely paying off the loan may not be advisable.

We often encounter this question on home mortgages.

Why pay off a tax-deductible mortgage that has a 6 percent or 7 percent interest rate with assets from an investment account that is delivering 10 percent or more in average annual returns?

Depending on the individual's personal situation, it may make more sense to simply keep making the payments, and keep pocketing the difference.

Q: Frozen pensions, buyouts, tier-two pay scales, and health care cutbacks. All of these trends have changed the American workplace and the old employment contract, written or not.

What new trends do you see looming ahead that haven't already been mentioned?

A: A continuing transition by companies from traditional pension plans to cash balance plans and 401(k) plans.

Automatic enrollment, automatic contribution levels, and increased contribution limits for retirement savings plan participants.

A continuing shift of health care expenses from the company to retirees and active employees.

Some of these trends benefit employees, some clearly don't. The end result is that there are a myriad of decisions and retirement risks that today's employees face that employees a generation ago didn't have to worry about.

The burden for this kind of planning sits squarely on the individual's shoulders.

They have two choices. Either educate themselves and prepare to effectively manage all of these issues — or hire a professional who can do it for them.