Pension Questions After the Detroit Bankruptcy

How many retirees face the possibility of less recurring income?

Provided by Benedict A. Mitchell Jr.

On July 18, Detroit became the largest American city to file for Chapter 9 bankruptcy. What will happen to the pensions of its 20,000+ retired public employees? There is a possibility they could be reduced – perhaps greatly. In the wake of Detroit's fiscal problems, current and future pension recipients across the country are wondering about the stability and amount of their promised incomes.[1,2]

In Michigan, the fate of the pension checks for these employees may be determined in the courts. While a federal judge is overseeing Detroit's bankruptcy proceedings, Michigan's state constitution states that pension benefits can't be altered. On July 24, the aforementioned federal judge froze assorted state-court lawsuits brought against the city arguing that the bankruptcy filing was unconstitutional (at the state level). As much as Detroit might want to scale back pensions for fiscal relief, it may be prohibited from doing so.[1]

When pensions shrink after municipal bankruptcies, how bad is it? For a sobering example, look at Central Falls, RI, which filed for bankruptcy in 2011. Following that declaration, the city whittled away more than 50% of the pension checks issued to a third of its retirees. For example, the average retired firefighter's annual pension income went from $68,414 to $30,786.[2]

That's certainly drastic, and it may not be replicated in Detroit or in Stockton, CA (the second largest American city to go bankrupt). Stockton is reducing bond payments, but so far has refrained from slashing pensions. (As it happens, the city's biggest creditor is CalPERS, the California Public Employees' Retirement System.) California's state constitution also bars reductions in pension benefits, so Stockton's retired public employees may be waiting on the courts as well.[1]

Municipal pensions aren't the only ones at risk. Polaroid went bankrupt, and as a consequence, its retirees are receiving pension checks courtesy of the federal Pension Benefit Guaranty Corp. (PBGC) – checks that, as MarketWatch columnist Robert Powell recently noted, represent "a fraction of what they were supposed to receive." The biggest multiemployer pension fund in America is that of the Teamsters (the Teamsters' Central States, Southeast & Southwest Pension Plan). When 2012 ended, it held $17.8 billion in assets. Its liabilities were at $34.9 billion.[2]

The worst-case scenario is worth considering – just in case. If you receive a pension or are in line for one, developments like these may give you pause. It might be time to ask "what if" – what options you might have if your pension shrinks.

Suppose your pension income was cut 20-30%. What choices would you make? Would you try to live on less, and maybe move to a region where living expenses might be lower? Would you explore becoming a consultant or a solopreneur, or look into part-time work? Could you find methods to generate passive income, or make financial moves to replace any recurring income that would be lost?

With too many pensions on shaky ground these days, a conversation with a financial professional about these what-ifs is a very good idea.

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Citations.

1 - nation.time.com/2013/07/25/the-wages-of-bankruptcy-stocktons-cautionary-tale-for-detroit/ [7/25/13]
2 - marketwatch.com/story/will-your-pension-disappear-post-detroit-2013-07-24 [7/24/13]