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Warning of Pension-Plan Shortfall Raises Pressure for Financial Fix

By JOHN D. MCKINNON
Staff Reporter of THE WALL STREET JOURNAL

SHAKY GROUND

GAO Sees 'High Risk' At U.S. Pension Insurer[1]
07/24/03

Read the full text[2] of the Pension Benefit Guaranty Corp.'s executive director's testimony before the House Committee on Education and the Workforce.

The government agency that insures 44 million workers' retirement benefits said the nation's pension system is in worse financial shape than previously believed, a politically charged warning at a time when economic uncertainty, unemployment and rising fears about the loss of manufacturing jobs overseas already are stoking debate in Washington.

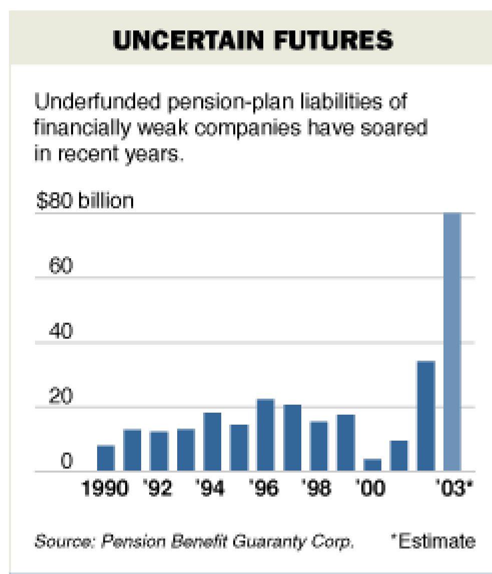
It raises the prospect that companies could be forced to contribute more to the government insurance plan, that benefits to retirees could be reduced and even that taxpayers ultimately could have to bail out the pension-guarantee program. But some experts say the agency is overstating the problem in order to force companies to pay it higher premiums.

Pension Benefit Guaranty Corp., the agency established in 1974 to pay benefits to workers whose pension plans go bust, estimated that by the end of this month, financially troubled companies, or those with below investment-grade credit ratings, will have pension plans whose promises exceed their assets by $80 billion. The agency's previous estimate for these companies' so-called level of underfunding was $35 billion. Overall, the agency says, all private employer pension plans are $400 billion short of assets needed to keep promises they've made.

The new numbers are sure to raise pressure for rules and laws aimed at forcing companies to shore up finances of defined-benefit-retirement plans. Such plans promise that retired workers will receive a certain payment, often based on years of service and wages. By contrast, many employers offer defined-contribution plans, such as 401(k) plans, in which companies credit certain sums to workers for tax-free investment until they retire and can collect the money. The government doesn't insure defined-contribution plans.

The Bush administration wants Congress to approve legislation that would ease the pension burden on companies for two years, allowing for the economy to turn around. After that, the administration is proposing a transition period of three years that would end with tougher, long-term rules for determining pension-contribution requirements. Democrats such as Rep. George Miller of California are calling for greater disclosure of existing problems, so workers can judge for themselves how likely they are to receive the benefits they've been promised.

Business groups, meanwhile, are pressing Congress for changes that could permanently ease their pension burden. They want rule changes that allow them to replace the 30-year Treasury rate as the basis for determining a plan's future liabilities with a higher rate that is a blend of corporate bond rates. Such a higher rate could lower companies' pension liabilities by billions of dollars, critics say.



Some experts say Pension Benefit Guaranty is exaggerating the pension-system problems. Much of the current funding woes are due to temporary factors such as low interest rates and stock-market setbacks that have lowered the value of pension-plan assets. As markets turn around and interest rates rise, as they have done recently, a lot of companies with underfunded plans will be flush again, those experts say, and the PBGC's balance sheet will look better.

In testimony before the House Committee on Education and the Workforce Thursday, Pension Benefit Guaranty's executive director, Steven Kandarian, defended his estimates, saying that companies' public disclosures often understate the dimensions of their problems because of lax reporting rules. As the agency has taken over troubled plans in the steel, airline and retail sectors in the past year, officials have noted that many have turned out to be much more severely underfunded than the companies had publicly reported. Bethlehem Steel, for example, reported its pension fund was 84% funded -- a relatively healthy condition. But when the agency took over the plan, it found it was actually 45% funded, with a shortfall totaling $4.3 billion, Mr. Kandarian testified Thursday. Bethlehem officials didn't respond to requests for comment.

"In the worst case, PBGC's deficit could grow so large that the size of the premium increase necessary to close the gap would be unacceptable" to healthy companies, Mr. Kandarian said. "If this were to occur, Congress could call upon U.S. taxpayers to pick up the cost of underfunded pension plans through a federal bailout." In July, the General Accounting Office, Congress' financial watchdog, put the pension agency on its list of "high risk" programs that need more oversight.

Pension Benefit Guaranty insures $1.5 trillion in promised pensions and is responsible for paying current and future benefits to nearly one million people in defined-benefit plans that have been terminated. As of July 31, the agency, which is financed by employers' premiums and assets of plans it takes over, said its obligations exceed its assets by $5.7 billion.

Some of the system's problems are deeply-rooted and chronic, Pension Benefit Guaranty and others say. Defined-benefit plans are most common in mature industries, such as manufacturing. Many of those industries are contracting, as evidenced by job losses in manufacturing in recent years. As a result, companies in those industries often can no longer support their pension plans; in some steel-company plans that the agency has taken over, only one out of every eight pension participants was an active worker, Mr. Kandarian said.

"We're watchful," said David Certner, the director of federal affairs for AARP, the advocacy group for older Americans. "You would expect PBGC to be in a bad financial situation right now" given low interest rates and the still-hurting stock market. "The bigger concern," he added, "is making sure that companies are adequately funded going forward, to prevent that kind of bailout situation."

Pension accounting rules also have allowed companies to chronically minimize their obligations in regulatory disclosures for years, in ways that have allowed unseen obligations to mount. Companies are required to disclose details of their pension funds only to the Internal Revenue Service, and information from these filings is generally available to the public only with a two-year lag. Publicly traded companies do provide once-a-year snapshots of their pension obligations and the assets set aide to cover them, but this won't appear until the annual reports come out.

Another problem with the current system is that unions and management keep promising bigger benefits, but companies don't have to back up the promises with funding for years, even while Pension Benefit Guaranty is insuring those benefits, says Daniel Halperin, a Harvard University pension expert.

In his testimony before the House committee, Mr. Kandarian also noted that the recently terminated US Airways pilots plan reported that it was 94% funded, based on the federal rules. But when PBGC lifted the lid, it found the plan was only 33% funded, on a more realistic basis, with total underfunding of $2.5 billion. "It is no wonder that the US Airways pilots were shocked to learn just how much of their promised benefits would be lost," he said.

Congress is seeking to resolve the various concerns. So far, the House Ways and Means Committee has rejected the Bush administration's get-tough plan. Instead, it has proposed a change to the funding rules that businesses prefer, one that could shrink liabilities and therefore contributions, at least temporarily. The Senate Finance Committee is expected to weigh in within the next few weeks on the same issue. It is likely to side with businesses too, but only as a short-term solution -- say, for the next two to three years. "The permanent solutions are too controversial and not well thought out," Finance Chairman Charles Grassley of Iowa said Thursday. "We'll have to do it a different way."

--Ellen Schultz and Shailagh Murray contributed to this article.

Write to John D. McKinnon at john.mckinnon@wsj.com[3]

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