The New York Times

NEW YORK, MONDAY, JANUARY 13, 2003

MANY COMPANIES FIGHT SHORTFALLS IN PENSION FUNDS

BENEFITS AFFECT MILLIONS

Shoring Up Plans Will Require Billions So Some Consider Cuts in Retirement Pay

By MARY WILLIAMS WALSH

After a three-year bear market, many major American companies are spending large amounts to shore up pension plans that have deteriorated, sometimes drastically.

Many companies are also considering ways to reduce their pension obligations to workers, possibly undermining benefits for millions.

The biggest pension shortfall belongs to General Motors, which said on Thursday that its United States pension plans ended the year with a deficit of $19.3 billion, even though the company pumped in $2.6 billion. G.M. also said its pension costs would triple in 2003, severely depressing its profit.

Many other such announcements are expected in coming months.

These problems have little to do with any change in the number of people retiring, or an increase in their benefits. Rather, investments by the pension funds have fared poorly in recent years. As the prices of stocks and other investments have fallen, so has the return on the money set aside for the more than 44 million current and future private-sector retirees who qualify for traditional pensions.

At the same time, unusually low interest rates are further undermining pension plans. The effect of the bond rates is on the financial calculations used to determine the present value of the pension liabilities, not on the pension funds' return. Falling rates make future pension obligations look bigger on current balance sheets. To meet their obligations to workers, and to stay in compliance with pension laws, companies have been forced to set aside more money.

I.B.M. put almost $4 billion into its pension plans last month. Honeywell International said in November that it might have to contribute as much as $900 million more. Johnson & Johnson paid in $750 million last month, and 3M made a $789 million contribution last year. Ford said that it contributed $500 million this month and would probably add another $500 million soon, depending on tax considerations.

Still other companies, including Lucent Technologies, Boeing and Delta Air Lines, have been forced to reduce their net worth to reflect the way their growing pension obligations have outstripped their assets. Along with reducing a business's value, such a step can put companies in violation of their contracts with lenders. Delta, for one, had to renegotiate with its lenders after the action.

Indeed, concerns about the health of pension plans are making it more expensive for businesses to raise money. That is because credit agencies have lowered their ratings on companies, like G.M., whose liabilities have soared. Even companies whose pension plans remain adequately financed, like Lockheed Martin, have begun reporting lower

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earnings as the plans' investment performance has declined.

All this is jarring to investors as well as employees. Although traditional pensions lost some of their luster when stocks were booming and 401(k) plans seemed to go only up, plenty of companies still offer traditional defined-benefit plans — the kind in which companies promise monthly payments from retirement to death. The bear market has taught employees to prize such pensions once again because the market risk is absorbed by the sponsoring company and the benefits are insured by the federal government.

With pensions causing so much disruption, companies and the groups that represent them in Washington are considering a range of damage-control measures that could have a lasting impact on Americans' well-being in old age. Whether the most far-reaching measures are taken will depend on how long the current pension squeeze lasts.

For example, companies are considering changes to their pension plans that would reduce their financial obligations. One possibility is converting traditional pensions to "cash balance" plans, which are less costly. But such plans have incurred criticism because they can strip older workers of some of the benefits they have been promised.

In December, the Bush administration proposed regulations that would make it easier for companies to change to cash balance plans without setting off age-discrimination suits.

Another possibility is eliminating lump-sum payments from plans that offer workers the option of taking their retirement benefits all at once. That would force retirees to take their money as a series of payments over the rest of their lives.

Lump-sum payments are unusually costly for employers now because, again, of the effect low interest rates have on calculating benefit values. When rates are low, lump-sum payments swell, giving today's retirees a premium if they take all their money at once.

"Lump sums are 10 to 20 percent larger now than they would have been" if interest rates had not fallen to current levels, said Ron Gebhardtsbauer, a senior pension fellow at the American Academy of Actuaries.

Eliminating the option, which is offered by medium-size companies more often than large corporations, would anger the affected older workers and would be difficult without violating a federal law that prohibits stripping workers of retirement benefits already earned.

"This is not something you can do casually," said Rebecca Miller, a managing director with RSM McGladrey, a business consulting and tax services firm owned by H & R Block. Her clients are contemplating it nevertheless, she said.

Companies also hope that the government will help. The most widely discussed legislative measure would allow companies to use higher rates than they could in the past when making important pension calculations that are sensitive to interest rates. Allowing the higher rates to be used would shrink companies' pension liabilities, making their plans look healthier. That, in turn, would free them from pouring millions of dollars into their plans in coming months, and it could also hold down the premiums they must pay for federal pension insurance.

Allowing companies to use a higher interest rate in calculating lump-sum distributions would also save companies money but would reduce the amounts paid out to employees.

"The most politically controversial is the rate used for the lump sum," said John C. Scott, the director of retirement policy for the American Benefits Council.

The council, a business group that lobbies on employee benefits issues, is urging Congress to make permanent a temporary interest rate increase it granted companies for use in calculating total liabilities in 2002 and 2003. Without Congressional action, the temporary rate will expire at the end of this year, possibly doubling the amounts some companies will have to put into their pension plans, Mr. Gebhardtsbauer said.

G.M., for example, has said that if interest rates fall by one percentage point, its pension deficit will grow by $7 billion.

Though Congress has the authority to legislate these interest rate changes, Mr. Scott predicted that lawmakers would leave it to the Treasury Department to set the specific rates. That way, he said, they would avoid "the political hot seat" of voting for a rate change that could reduce workers' benefits.

William F. Sweetnam Jr., the tax benefits counsel for the Treasury, said the department was drafting a proposal on pension interest rates that might be included in the budget that President Bush will submit to Congress. He said it was too early to provide details.

Also under discussion in Washington are possible changes in the tax deductibility of pension contributions and in the rules governing how much money companies must pay in.

Such issues may sound arcane, but they touch on the financial well-being of millions of Americans.

Today, about 360 companies in the Standard & Poor's index of 500 large corporations — and many more smaller companies and nonprofit organizations — sponsor one or more pension plans. About 44 million Americans are either receiving pensions or will qualify for them when they retire. (This figure does not include millions of workers who participate in various government pension plans.)

The growing concerns about underfunded pensions do not mean that all plans are in trouble. As recently as 2001, many plans still had surpluses, though many of those surpluses will probably prove to have vanished when companies file financial results for 2002 in the next few weeks.

Even deficits are not a sign of imminent trouble since many workers at companies with underfunded plans will not retire for years, giving their employers time to make up the shortages. The laws requiring companies to shore up deficient plans have considerable wiggle room, allowing contributions to be stretched out over several years. Companies can also, in many cases, contribute to plans with their own stock, as Northwest Airlines asked federal permission to do in November.

To a great extent, the companies with ailing pensions are confined to a few categories: some large corporations with unionized workers, declining old-line industries with many retirees, and once-regulated sectors like power generating, in which government boards formerly built in assumptions about generous pension benefits that today's deregulated markets will not accommodate.

The sickest pension plans, by far, are at steel companies, followed by airlines. Other ailing sectors include the auto industry and its suppliers, the rubber and tire industries, and telecommunications. At worst, having to make a large pension contribution can push a company with insufficient cash flow into bankruptcy.

As the pension squeeze has tightened in recent months, Wall Street analysts have begun to criticize pension accounting rules, which can make such hazards hard to predict.

Today's pension accounting methods "have led to misleading financial statements that paint a rosy picture as the health of defined benefit pension plans deteriorates," said David Zion, an accounting analyst at Credit Suisse First Boston.

The Financial Accounting Standards Board, the leading arbiter of the nation's accounting standards, has been soliciting public comment on whether the rules need changing, and in what ways. A spokeswoman said the board would probably decide by the end of March whether to add pension accounting to its workload.

Eroded

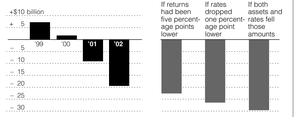
After years of surpluses, pension plans of many companies in the Standard & Poor's 500-stock index are now underfinanced. (Financing levels are defined as the value of plan assets minus projected obligations.)

Source: Credit Suisse First Boston

The New York Times

Varying Returns

The health of any pension plan is greatly affected by interest rates, as well as the ups and downs of the financial markets. (Higher interest rates reduce the present value of future liabilities.) The sickest pension plan of General Motors are a good example.



Source: General Motors

The New York Times

The New York Times

NEW YORK, SATURDAY, JANUARY 25, 2003

$8 BILLION SURPLUS WITHERS AT AGENCY INSURING PENSIONS

LARGE DEFICIT IS EXPECTED

Payments to Retirees Continue, but Corporate Bankruptcies Put Benefits at Risk

By MARY WILLIAMS WALSH

The federal agency that insures the pensions of some 44 million Americans has been pounded by a succession of big corporate bankruptcies and has burned through its entire $8 billion surplus in one year.

The agency, the Pension Benefit Guaranty Corporation, provides protection to retirees in case of a failure, much as the Federal Deposit Insurance Corporation protects depositors when a bank fails. Though it can continue to make its current payments, the agency is expected to disclose a deficit of $1 billion to $2 billion at the end of this month.

Its soundness is likely to deteriorate further in the coming months, as more bankrupt companies find themselves unable to fulfill their promises to tens of thousands of present and future retirees. US Airways, United Airlines and Kmart are among the companies struggling to emerge from bankruptcy protection under the weight of large underfunded pension plans.

An awareness of the pension agency's rapidly diminishing strength is already fueling a debate in Washington about whether the guaranteed retirement benefits of millions of Americans are at risk and, if so, who should pay to make them airtight.

Businesses support the agency's operations by paying premiums for each person covered by the insurance, and they are sure to resist any increase. The decisions are difficult. Postpone the increase and the pension system could be imperiled, but increase it too sharply and companies might decide to stop offering pensions altogether.

"You can get this wrong in both directions," said Damon A. Silvers, associate general counsel at the A.F.L.-C.I.O.

Among the remedies being discussed are charging all companies with pension plans higher premiums, requiring them to fund their plans more fully, making the companies with the shakiest plans pay the most and changing the way the agency invests its money.

Traditional company pension plans became commonplace after World War II and are estimated to be the second-largest source of income today for elderly Americans, after Social Security. But employers offer them voluntarily, and over the last decade many have been switching to 401(k) plans, which are simpler and

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generally cheaper to administer because employees set aside the money and decide how to invest it themselves.

For workers, traditional pensions are considered more reliable than 401(k) plans, because pensions provide a predetermined monthly check from retirement to death and are guaranteed by the government.

The Pension Benefit Guaranty Corporation was created in 1974 to take over insolvent pension plans and keep paying benefits when a company could not. A retiree whose plan is taken over keeps getting monthly checks, but the amount may be smaller, because the government limits the amount it insures. The current maximum is about $3,600 a month for those older than 65 at the time of the takeover, and less for those who are younger. As of 2001, the agency had $22 billion in assets and was responsible for paying the pensions of 624,000 current and future retirees. It paid more than $1 billion in stipends that year.

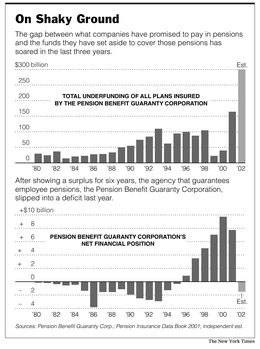
The agency has weathered deficits in the past, its finances worsening when stock prices have fallen or when very large corporations have collapsed. In 1992, after it shouldered $1.4 billion in unfunded claims from Pan American World Airways and Eastern Air Lines, there were warnings that the agency itself might go broke, much as the Federal Savings and Loan Insurance Corporation had done a few years earlier.

Steps were taken to strengthen the agency and make it harder for companies to run their pension plans into the ground. Rising stock prices further bolstered the agency in the latter half of the 1990's, and the findings of a disastrous S.& L.-style collapse died away.

Now, those warnings have returned, as the gap has soared between what companies have promised to pay in pensions and the funds they have set aside to do so. At the end of last year, the gap was estimated to be $300 billion. During the agency's previous crisis, in 1993, the funding gap peaked at $109 billion.

Stock prices are down again, and interest rates are unusually low. Normally, stock prices and interest rates move in opposite directions. When they both go down at the same time, it is particularly painful.

In pension accounting, the lower the interest rate, the greater the future obligations. That is because of the difficulty of setting aside enough money to cover future payments, which loom large if interest is accruing at only a few percent a year, and has nothing to do with any increase in the number of retirees or their benefits.



Difficult decisions loom on how to shore up a retirement fund.

"This is really the first time the P.B.G.C. has been faced with this confluence of events," said Mark A. Oline, a managing director of Fitch Ratings. Mr. Oline monitors airlines, which make up a large part of the pension agency's workload. The last time a three-year bear market coincided with low interest rates was 1939 to 1941, he said, and the agency did not exist then.

"The big question is, if all of a sudden these liabilities have become so enormous, how is this situation addressed?" Mr. Oline said.

Although the Pension Benefit Guaranty Corporation is a government agency, its work is financed entirely by companies, not general tax revenues. Companies pay $19 per person covered each year, or more if a pension fund is underfunded. The basic rate has not changed since 1991.

That means that if the agency's troubles worsen, businesses will be asked to pay higher premiums, put more cash into their own pension plans or both. The agency is also considering a new way of assessing premiums, making the companies with the weakest pension funds pay the most.

Any of those changes would require Congressional action and would be controversial. Already companies are struggling with their own pension deficits, and are finding they must pay millions of dollars to keep their plans compliant with the current rules.

"The well-funded employers don't want to pay a lot of money to bail out the employers whose pension plans have fallen," said Judith F. Mazo, director of research at the Segal Company, a benefits consulting firm, and a member of the pension agency's advisory committee.

At the same time, Ms. Mazo said, the companies with the shakiest pension plans will protest if their premiums go up, saying they obviously do not have the cash. If they did, they would have put it into their pension plans.

For now, most big companies with pension plans are taking the position that the current troubles will pass on their own.

"There is no crisis whatsoever," said Janice M. Gregory, vice president of the Erisa Industry Committee, a group that lobbies on behalf of the largest corporations on pensions and other issues regarding employee benefits.

As members of the Erisa Industry Committee see it, interest rates are sure to rise again. Then the balance-sheet values of future liabilities will shrink, and much of the pension agency's deficit will disappear.

In addition, Ms. Gregory said, businesses anticipate further relief through an initiative by the Treasury Department to change the interest rate that companies use for their pension calculations. In the past, they used the 30-year Treasury bond as a benchmark, but the government announced in early 2000 that it would stop issuing those bonds. Businesses want to switch to a high-quality corporate bond as the benchmark. That rate would be higher, shrinking future pension liabilities.

Such a change would be subject to approval by Congress.

In the meantime, Ms. Gregory noted, the pension agency has more than enough cash on hand to make its current payments. It takes in some $800 million each year in premiums.

"That gives them a cushion to cover any additional new claims that come in," Ms. Gregory said. "The P.B.G.C. is in good shape."

That view is firmly countered by some financial analysts. Zvi Bodie, a professor of finance at the Boston University School of Management who was invited to present his position to the pension agency, wrote an academic paper in 1996 laying out a "possible doomsday scenario" ending with an enormous taxpayer bailout.

Ominously, some of what he foreshadowed has already happened: a sharp and prolonged drop in stock prices, a proliferation of pension-plan underfunding and several large pension defaults.

Professor Bodie says the agency should begin charging premiums based on the riskiness of a company's pension portfolio. He has also spoken to the agency's advisory committee about the merits of investing the agency's own trust fund in fixed-income securities. The agency's board voted in 1994 to permit its trust fund of seized plan assets to be invested up to 100 percent in stocks, but the agency is considering scaling back. The money from premiums is invested in government securities.

Much of the agency's surplus disappeared early last year when it assumed the pension plans of the LTV Corporation, the large steel company. LTV had already been through one bankruptcy and pension trusteeship, in 1986. After LTV reorganized, the pension agency forced it to take back its pension obligations — only to watch the company file for Chapter 11 protection again in 2000.

In March 2002, the pension agency assumed LTV's pension payments for a second time, wiping out $1.6 billion of its surplus. In December, the agency assumed $1.1 billion in unfunded pension claims from National Steel, and later that month, it took over Bethlehem Steel's pension plans, for an estimated $3.7 billion.

Until last year, the agency's largest case was the 1991 takeover of Pan Am's pensions, for $841 million.

The big pension plan failures show no sign of stopping this year. US Airways' reorganization plans depend heavily on the airline's ability to cope with some $3.1 billion in pension contributions due over the next seven years. The airline has been seeking government permission to stretch the payments out over 30 years.

"The minute you grant that, you'd have all the other airlines lining right up," Mr. Oline of Fitch Ratings said, "and some other industries after that, asking for the same thing."

Business Day

The New York Times

TUESDAY, MAY 6, 2003

Bill Reduces Blue-Collar Obligations For Pensions

By MARY WILLIAMS WALSH

A bill pending in the House of Representatives would allow businesses with union workers to reduce their company pension obligations by billions of dollars, because statistics show that most blue-collar workers do not live as long as other Americans.

The provision, which has gone largely unnoticed in a broad pension bill, is being supported by the United Auto Workers and manufacturing companies whose pension funds now have assets far short of what they are projected to need under previous assumptions about worker longevity.

The measure would allow companies to assume that their blue-collar workers will on average die sooner than pension plans now assume they will. So companies, not having to plan to pay future blue-collar pensions as long as they now do, would not be required to put aside as much pension money as government regulations now require them to do.

But the leader of a panel that developed the actuarial data on which the new provision is based said he had written to the Treasury Department, which regulates pension funds, to express concern that the data were being misapplied.

Edwin C. Hustead, chairman of the actuarial panel, said in an interview he was concerned that the data were being used in an improper way. White-collar workers are shown by statistics to live longer, he said, but the bill would not require companies to factor that into their pension calculations. If it were included, unionized companies with largely white-collar workers would have to set aside more to fulfill their promises to retirees in the future.

In addition, Mr. Hustead said workers' pay had been shown to be a more powerful predictor of life expectancy than whether a worker was blue collar or white collar, but the bill did not recognize that higher-paid workers live longer and therefore require longer pension payouts. Many auto workers and airline pilots are classified as blue collar in the bill, because they are covered by collective bargaining agreements, even though they are highly paid.

Aides to the bill's sponsors said they were unaware that the measure had overlooked these other significant mortality factors. A spokeswoman for Benjamin L. Cardin, Democrat of Maryland, said the congressman's goal was to help preserve the system of traditional pensions. A spokesman for Rob Portman, Republican of Ohio, said the bill was intended to make sure companies "aren't forced to overpay" into their pension funds.

"The pension system is a voluntary system, and if you force companies to artificially put more into their plan than is needed, that is a real disincentive," he said.

The United Auto Workers wrote a letter in support of the provision, according to people with ties to Congress, apparently in

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hopes that the money that companies saved from pensions could be used for higher wages. The Erisa Industry Committee, which represents large companies, helped with the bill but was primarily interested in supporting another measure on the interest rates used in pension calculations, said Janice Gregory, a vice president of the committee.

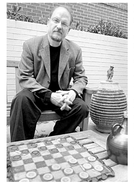
With most pension plans now underfunded, Mr. Hustead and some other actuaries fear that a reduction in contributions could increase the risk of defaults, at a time when companies are already defaulting on their pension plans at a greatly accelerated rate.

"I do not agree that the tables should be adjusted for differences between mortality for blue-collar and white-collar employees," Mr. Hustead wrote to Treasury, which regulates how companies set aside money to cover pension promises.

After spending five years collecting and analyzing data for the new mortality table, Mr. Hustead warned that his panel's findings seemed at risk of being used in a "curious" and "arbitrary" way. He said in an interview that he had not received any response from the Treasury.

The issue of worker life spans can be traced to the early 1990's, when pension plans were also strained, although far less so than today. Companies at that time were free to select any mortality rate when calculating their current pension obligations, and some were discovered to be using unusually high death rates, so as to shrink their pension debt.

In 1994, Congress required all companies with pension plans to use the same mortality table, or set of probability factors for death rates.



Linda Spillers for The New York Times

Edwin C. Hustead helped develop the mortality table.

At the time, the table in common use was from 1983. So the Society of Actuaries, a professional group that engages in research and education, convened a committee to prepare a new table, based on current demographic trends. Mr. Hustead, who is also a senior vice president of the Hay Group, was the chairman.

Normally, actuarial proceedings are quiet affairs that make few waves, but Mr. Hustead said this one was different. "There were some very strong opinions, for an actuarial group," he recalled. "We've done mortality studies in the past, and you go out and do your study, and come back and say, 'Here it is,' and just start using it."

The group decided to create a base mortality table, then test a number of factors to see what effect they might have on the death rates. One test was to examine whether the color of one's collar had any effect. The group defined blue collar as people who were represented by unions or who were paid by the hour — a definition that turns such unlikely workers as unionized athletes, airline pilots, aerospace engineers and even some newspaper reporters into blue-collar workers.

Separately, the committee tested to see whether pensioners' incomes affected their mortality rates.

After analyzing 11 million "life years," the committee could see that the color of the collar and the income level affected life span significantly. Blue-collar workers and the poorly paid both tended to die young. White-collar workers and the well-paid tended to live longer.

But even after trying multiple regressions and hiring an outside panel of academics, the committee was unable to find a statistically valid way of handling those workers who did not fit the patterns — those who were "blue collar," but who also happened to be well paid.

In such cases, Mr. Hustead said, the data showed that money has such power to lengthen human life that it more than offsets the blue-collar life-shortening effect.

But not everyone on the committee wanted this point included in the final report, Mr. Hustead said.

"There were those who wanted to use the higher mortality rates for 'blue collar,' but who did not want to use any lower mortality for 'high paid,' which would be like the auto industry," he said.

In the end, the society published the new table in a report that alluded to its members' difficulties in the treatment of these adjustments.

Its work completed, the society then passed the table to its sister organization, the American Academy of Actuaries, which has the responsibility of representing actuarial interests in Washington.

Dying Sooner, or Later?

Companies finance their pension plans based in part on assumptions about how long their retirees will live. A provision in a bill before Congress would adjust those assumptions to show that blue-collar retirees will not live as long as others, thereby reducing the amount of money companies must put into their pension funds.

DEATHS PER 1,000 HEALTHY MEN FROM AGE 70 TO 71

But other assumptions that may be better indicators of life expectancy — workers who are paid more and have bigger pensions live longer, for example — are not included in the bill. Among them would be many blue-collar workers like auto workers, airline pilots and others covered by union contracts who are well paid

Source: The Society of Actuaries

The New York Times

The academy concluded that what it called the "collar adjustment" was statistically sound. But it rejected the society's adjustment for income level, saying current trends make that adjustment suspect.

Mr. Hustead said he was concerned that the same forces that had caused dissent within his own committee had traveled to the academy. He recalled that one actuary on his committee, who had forcefully opposed any adjustment of death rates by income, had also participated in the academy's deliberations.

"At one time in the middle of this process, I asked him, 'Are you working for one of the auto companies?' " Mr. Hustead recalled. The actuary, Vincent Amoroso, said he was not.

In an interview, Mr. Amoroso said he had, in fact, represented auto companies at the time when Congress was requiring that all companies use the same mortality table. But he said he ended those consulting relationships before the new mortality table was released in 2000.

"I had not had any connection to the auto companies, in a consulting capacity, since 1996," said Mr. Amoroso, who is now with the consulting firm of Towers Perrin.

Mr. Amoroso added that he had volunteered to serve on the Society of Actuaries' committee because he wanted "to make sure that everybody behaves fair."

"It turned out I was just aghast at the raw, political partisanship of it all," he said.

He added that he felt that the committee had an established membership and ingrained habits of mind, and treated him and his ideas as less than welcome because he was "the new kid on the block."

"Who would have thought there would be such a melodrama in a mortality table's construction?"

The New York Times
Money&Business
Sunday, June 22, 2003

Pension Reserve: What's Enough?

Companies Covet Greyhound's Break

By MARY WILLIAMS WALSH

ACCOUNTING is a dismal science, pension accounting even more so. But it is increasingly important to penetrate the fog today, when companies are using complex and sometimes hidden tactics to change the way they pay for their pension plans. For the roughly one in five workers in the private sector whose employers have established pension plans, those changes could significantly affect the way they live in retirement.

One business that is having trouble funding its pensions is Greyhound Lines, the bus company, which has gone through years of labor strife and bankruptcy. Several years ago, it quietly managed to get permission from Congress to stop putting more money into its drivers' pension fund. In essence, the Greyhound provision lets the company act as if its pension plan is fully funded, when in fact it is not. Greyhound argued that it had special circumstances, and that if it obeyed the funding rules it would end up with far too much money locked away in the pension trust. Its drivers' union agreed.

No other company has anything like Greyhound's exemption — yet. But as pension deficits widen and big contributions come due, Greyhound's little-known exemption is just the kind of solution that many employers last after.

Companies in several industries say that rules requiring big contributions to underfunded pension plans must be changed. The shortfall for **General Motors** is so daunting that on Friday it said it will have to sell $13 billion in bonds, with most of the proceeds going to reduce deficits in its American pension plans.

In Washington, varying relief mechanisms are being sought, but all would have the same effect: to reduce the amounts that employers set aside today for benefits due in the future.

The long-term effects of that could be harmful. Federal officials have spent the last quarter-century prodding companies to fully fund their pensions, lest they say that ballooning pension deficits show a need for more contributions, not exemptions.

In their quest for pension relief, the major airlines have hired Richard A. Grafmeyer, the same lobbyist whom Greyhound used to secure its break in 1997. Mr. Grafmeyer is also a former deputy staff director of the Senate Finance Committee and a former deputy chief of staff of the Joint Committee on Taxation. He has declined to discuss the matter.

Greyhound, meanwhile, is seeking to expand its own break and to make it permanent, because the original exemption is set to expire in 2010. Now, as in 1997, Greyhound says special treatment is necessary because its plan covers an unusually old group of workers, whose life expectancies are shorter than national norms for all pension participants. Workers who won't live long enough to cash many pension checks don't require very big pension contributions.

Other business and labor groups are calling for pension measures that would bring relief by adjusting mortality tables, allowing pension plans more time to account for investment losses, reducing pension-insurance premiums and changing the interest rate that is used in computing pension liabilities.

BILLIONS of dollars are at issue, but teasing out the details is difficult because current, specific data on individual pension plans was made secret by an act of Congress in 1994.

The absence of facts has not chilled the debate. Proponents of pension relief say the economic recovery itself may be at stake.

"Companies cannot commit to building new plants, launching new research projects or hiring new employees if that cash is needed to fund pensions," wrote Glen A. Barton, the chairman and chief executive of **Caterpillar** and a member of the Business Roundtable — an elite group of corporate chief executives — in a recent letter to each member of Congress. Treasury Secretary John W. Snow is a former chairman of the Roundtable.

But from the other side come warnings that the funding rules need to be tightened, not loosened. Giving one company a break can "give other financially distressed companies a blueprint for how to 'borrow' from their pension plans," said Steven A. Kandarian, executive director of the federal agency that insures pensions, in Senate testimony in January.

In the worst case, the United States Treasury — in other words, the taxpayers — would have to step in, because traditional pensions are guaranteed by the federal government, and the pension insurance agency is itself in poor shape and unable to absorb large claims indefinitely.

Weakening funding rules increases the risk to the government's insurance program, pension analysts say. The rules were enacted by Congress in 1974 and tightened in 1987 and 1994.

"The reason these funding rules were put into place was to protect the government insurance system, so the premiums wouldn't be too high and so the taxpayer wouldn't have to bail this out," said Richard A. Ippolito, a former chief economist of the Pension Benefit Guaranty Corporation, the agency that insures pensions.

For Greyhound, as for many other companies, the pension troubles began with deregulation. When the intercity bus business was opened to competition in 1982, Greyhound suddenly found itself going head to head with low-cost rivals that had no pension benefits to cover.

Greyhound demanded concessions in 1983; the drivers went on strike. A contract agreement settling the strike, which lasted seven weeks, freed Greyhound from ever having to make any more pension contributions. The drivers themselves made the next year's contribution. Greyhound was also allowed to close the plan to new drivers.

"There was no funding of the plan from that point forward," said Greg Herbold, the president of Amalgamated Transit Union local 1700. "But everybody kept accruing benefits."

In traditional pension plans, workers accrue, or build up, bigger pensions with each year of service, amassing the largest portion just before they retire. Greyhound's drivers earned their maximum pension after 30 years of service.

In 1990, there was another, much longer strike. Greyhound, threatening to end the pension plan entirely, won another concession from the drivers when the strike ended in 1993: if the pension plan needed money, the workers would pay, in effect, by allowing their accruals to stop. Benefits would be frozen, no matter how many years drivers stayed behind the wheel.

For Mr. Herbold and the other drivers in the plan, the threat of a pension freeze set a clock ticking. Drivers with less than 30 years of service could only hope that they would achieve their maximum benefits and retire before the plan became underfunded and accruals were frozen. They did not know when that might happen. Once a worker has earned pension benefits, an employer cannot legally take them away.

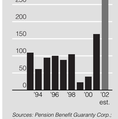
For a few years, stock-market gains kept the plan adequately funded, and it appeared that all drivers would qualify for full benefits.

But in 1994, Congress changed the rules for pensions. Regulators had found that some companies were making assumptions of very high mortality rates for their workers. By assuming that employees would not live long enough to cash many pension checks, the companies could shrink their mandatory contributions, saving money.

Congress cracked down, requiring all companies to use a standard mortality table. For Greyhound, the effect was "shocking," said Randy Hardock, a lawyer at the Washington firm Davis & Harman who succeeded Mr. Grafmeyer as Greyhound's lobbyist in 2000. Using the standard mortality table required Greyhound to fund its pension plan as if it were funding the benefits of new, young employees, he said, when in fact the only drivers in the plan were those hired before 1983.

Cause for Concern

The gap between what companies have promised to pay in pensions and the funds they have set aside has risen sharply in the last three years.



Sources: Pension Benefit Guaranty Corp.; Pension Insurance Data Book 2001; independent estimate

The New York Times

"THESE are very old people in this plan, and they've been dying, in fact, 30 percent faster than the mortality table is saying," Mr. Hardock said. "If you have to fund your plan as if people are going to live for 15 or 20 years, and in fact they're only living 10 or 11 years, you just end up with too much money" in the pension fund.

When Mr. Grafmeyer was Greyhound's lobbyist, he helped to secure the sponsorship of Representative Charles B. Rangel, Democrat of New York, for a provision letting Greyhound treat its pension plan as 90 percent funded, even if its assets fell to just 85 percent of future obligations.

Normally, a pension plan that dips below 90 percent for an extended time is considered underfunded, and the company must make special, accelerated contributions.

Janice A. Mays, chief counsel for the Democrats on the Ways and Means Committee, said Mr. Rangel had sponsored the measure because he believed that the participants would be poorly served without it. "By helping this plan, you are not causing any risk to the participants,"

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Susana Raab for The New York Times

Richard A. Ippolito, former chief economist of the federal pension insurance agency, says easing pension funding rules is a gamble.

she said. "You're actually helping the plan to survive."

Greyhound's exemption was inserted into a broad 1997 tax bill, written without mentioning Greyhound or pensions directly. Asked why the measure was drafted that way, Mr. Hardock acknowledged that it helped to prevent a "me too" problem, in which other companies with underfunded pensions might spot Greyhound's exemption and clamor for the same thing.

Indeed, many businesses and unions are saying this year that the standard mortality table is behind many pension problems, and are calling for permission to adjust it.

But Greyhound's pension plan administrator, Paul Owsley, a former driver who is an employee of the pension trust, was skeptical of contentions about the mortality rate of Greyhound's bus drivers and a lessened need for contributions.

"Our oldest participant now is 102 years old," he said. "The average age is well over 80. These longer life expectancies have put the plan in jeopardy, because they draw money out of the plan." Currently, the Greyhound plan pays about $75 million a year to pensioners, he said.

In any case, the 1997 exemption did not bring enough relief. When stock prices started to tumble in 2000, the gains that had kept the plan afloat since 1983 began to evaporate.

Paying for Yesterday's Workers

Companies like Greyhound, where a shrinking work force must support many retirees, often develop pension shortfalls.

PENSION PLANS	TOTAL PARTICIPANTS IN 2000	APPROXIMATE EMPLOYEE TO RETIREE* RATIO
Greyhound drivers	14,877	1 to 11
Bethlehem Steel workers†	99,475	1 to 5
General Motors hourly-rate workers	520,026	1 to 3

The major airlines also have worrisome deficits in their pilots' pension plans, but for different reasons. The pilots' plans offer unusually rich benefits, which airlines say they have trouble sustaining because high fuel prices and a slump in travel have caused huge losses.

PENSION PLANS	TOTAL PARTICIPANTS IN 2000	APPROXIMATE PILOT TO RETIREE* RATIO
United Airlines pilots	14,409	2 to 1
American Airlines pilots	13,293	3 to 1
US Airways pilots	7,168	4 to 1

*Includes widows and widowers of retirees and separated workers entitled to benefits in the future.

†Plan as of 1999. It was taken over by the government in December 2002.

Sources: Labor Department filings

The New York Times

Unless Greyhound made a contribution, the plan's actuary warned two years ago, it would be noncompliant by 2003. But Greyhound still had a labor agreement saying that it did not have to make contributions.

Complicating matters, Greyhound by that point had been acquired by **Laidlaw** Inc. of Canada. Laidlaw has its own problems; it sought bankruptcy court protection from its creditors in 2001, two years after the takeover, and plans to emerge from its court-supervised reorganization on Monday. Laidlaw's filings with the Securities and Exchange Commission warn that any pension contributions "could have a materially adverse effect on the financial condition of Greyhound."

To slow the pension fund's deterioration, Greyhound became an issuer in 2002. By that time, a vast majority of the drivers — about 14,000 — had beaten the clock, fulfilling their 30 years and retiring with maximum benefits. Only about 800 drivers covered by the plan were on the road, striving for their 30 years, too.

One of them is Mr. Herbold, a 27-year Greyhound veteran. For him, the freeze halted his benefit growth three years shy of qualifying for the maximum benefits — just as he was about to earn the biggest part.

Not surprisingly, Mr. Herbold has strong feelings about this, and about pension policy in general. Enforce the funding rules too rigorously, he said, and the country will end up with weak companies that default on their pension promises and stronger companies that refuse to offer pensions.

"We're going to create this whole class of people 30 years from now that's going to be dependent on the government, because corporate America has decided that it's not their responsibility. It's going to be a big, huge problem," he said.

For the remaining drivers to get their maximum benefits, Greyhound would have to lift the freeze. But Greyhound's labor contract says that this cannot be done unless the pension plan climbs back up to 115 percent funding. That is extremely unlikely — unless the rules change.

Laidlaw's government filings say Greyhound and the union are trying "to negotiate a method for avoiding contributions." A pension bill already passed by the House contains a provision to let Greyhound deem its pension plan to be 90 percent funded in perpetuity, no matter how low the real percentage falls. It would also exempt Greyhound from the standard mortality table.

When told about this, Mr. Owsley, the plan administrator, expressed surprise. "They don't tell us anything, so I don't know what they're driving at," he said.

Such a measure, Mr. Owsley said, could ruin the pension fund. "With a flat stock market," he said, "when you're not taking anything in and you're paying out $75 million a year, it doesn't take too many years before you're in trouble."

Mr. Hardock disagreed, saying he was "very confident" that the expanded relief measure would not jeopardize the pension plan.

WOULD it really be so bad to bend the pension rules for just one troubled company, long enough to let 800 bus drivers earn the pensions they expected?

Even if the plan failed, the government would step in and start issuing the 14,000 pension checks. The pension agency's coverage has limits, but the drivers' benefits are not extravagant — the top annual payment is around $20,000 — so all would get their benefits if the federal agency took over the plan. The pension plan has a deficit of about $42 million, according to Laidlaw's most recent filings — hardly enough to swamp the pension insurance agency.

What scares federal regulators is not the Greyhound case, but the likelihood that larger companies will use it as a precedent.

As airlines run up enormous losses, the Air Line Pilots Association, as well as several airlines, are advocating industrywide pension relief. So far, they have won sympathy from some lawmakers, but no sponsors for an airline pension relief bill. The failure of any pilots' pension plan would add hundreds of millions of dollars to the government's obligations; together, America's passenger airlines had a pension shortfall totaling $26 billion at the end of 2002.

Already, the pension agency is working with $7.1 billion in pension debt that it took on from bankrupt steel companies last year. The steel pensions alone nearly wiped out the agency's entire surplus. The agency has operated with a deficit before, but if the problem grows, it will have to find new sources of revenue.

Always on the minds of pension policy makers is **General Motors**, whose $25 billion worldwide pension deficit is larger than its market capitalization of $21.8 billion. G.M. is participating in the push for pension relief but says that it can handle all of its pension obligations.

"It's like a gamble," said Mr. Ippolito, the pension insurance agency's former chief economist, of pension relief. If favorable market conditions return, everybody — companies, workers and taxpayers — will win. If not, everybody loses.

"Constituents want relief right now, and it's tempting for Congress to give out all these benefits," Mr. Ippolito said. "But if you tell all these people they don't have to put money into these plans, the problem will come down the road, somebody else is going to be asked to pay for it." □

Business Day

The New York Times

MONDAY, AUGUST 14, 2003

Catherine Lovett for The New York Times

Capt. Dave Davis, 56, a pilot with Delta Air Lines, has told the company that he will retire early and take as much of his pension as he can in cash instead of waiting for monthly checks.

A Lump-Sum Threat to Pension Funds

By MARY WILLIAMS WALSH

When the government took over the pilots' ailing pension plan at US Airways earlier this year, some of them lost thousands of dollars of benefits and the ability to take their money as a single payment.

So pilots at **Delta Air Lines** were already on edge about their pensions when they learned that their company was taking the precautionary step of putting aside tens of millions of dollars to fully fund a retirement trust for dozens of top executives. The Delta pilots have a pension fund, too, but theirs is now in the red.

"One of my friends called me up and said: 'We've got to think about retiring, don't we? These people could just bankrupt the company and leave us alone,'" recalled Capt. Dave Davis, who is 56.

After thinking it over, he told Delta that he would retire on Sept. 1, a little more than three years early, and take as much of his pension as possible in cash immediately.

Some pilots at **American Airlines** are also weighing whether to forgo the promise of larger benefits in the future to take what they can now.

"They're faced with the decision, Is it best for them to cut and run or not?" said Stan Spiewak, a financial planner in Downers Grove, Ill., who specializes in advising pilots who work for American.

Though little chronicled, a rush by individuals to pull cash out of a weakened fund represents a hidden risk to pensions. Their accelerating withdrawals can work like a bank run, draining so many assets that the plan's solvency can be threatened.

If sudden withdrawals reduce the plan's finances below a certain level, the company can be required to make large catch-up contributions in a short time. In the worst case, the plan could fail and, even with government insurance, workers and retir-

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Continued From First Business Page

ees could lose benefits.

This threat is increasing as plans become underfunded and more companies than in the past allow employees to be paid in a lump sum at retirement. Polaroid experienced a run on its pension fund before the fund failed last year.

Officials of the Pension Benefit Guaranty Corporation, the government agency that insures the plans, say they are monitoring the pension funds of two companies where worried employees are withdrawing their benefits, further eroding weakened plans. A spokesman for the insurance agency declined to identify the companies, citing concerns about the possible effect on their stock prices.

Employees have wrestled with similar concerns at other companies that have shrunk drastically, like **Lucent** and **Xerox**, and must generate cash to pay the pensions of large numbers of retirees.

A Delta spokesman confirmed that pilots have been taking lump-sum distributions but said he did not know the amounts, or the effect this has had on the pension fund's solvency. Lucent says its work force has decreased so much that the number of pension-eligible employees today is too small to pose a threat to the pension fund. Xerox, which recently lost an appellate court challenge to the way it calculates lump-sum distributions from its pension plan, declined to comment on the issue yesterday.

Roughly 44 million Americans are covered by defined-benefit pensions — the kind that pay a predetermined benefit and are government insured — and a little more than half allow people to take lump-sum payouts, according to the Employee Benefit Research Institute.

Decisions about when to retire and whether to take benefits monthly or in a single check are difficult, forcing people to consider when they will die and whether they are skilled enough investors to make a payout last. Financial planners say that even though the money can usually be rolled over without incurring tax, many people are better off taking benefits as an annuity — typically, a series of monthly payments from retirement until death — because it reduces the risk of squandering money or outliving the funds paid out in a big check. Annuities can also offer some income to a surviving spouse.

But when an employee must factor in an ailing pension fund and the possibility of retiring early, the calculations multiply.

Pension funds do not have to disclose current information about their financial strength, so employees are forced to make guesses about the security of their benefits. Gauging the reliability of an annuity also means figuring out whether one's employer is likely to survive for the next two or three decades.

"Suppose someone is 55 and he's worked all his life for Delta, developing what he thinks is a substantial pension," said Jack Blaz, a retired pilot and former contract negotiator for the pilots' union. "He's scared to death that this is all going to disappear in a puff of smoke. That's why the lump sum is the holy grail for us."

Delta's pilots can take only half of their total benefits as a lump sum, but at some other airlines, like American, pilots can take their entire benefit immediately. American officials declined to discuss the rate of withdrawals from the pilots' pension plan.

Conversations with pilots at Delta and other major airlines indicate that many of them are rejecting the promise of future riches in favor of retiring early and taking smaller payouts. Delta pilots are retiring and pulling money out of their plan this year at about twice the usual rate, said Mark A. Mischker, chairman of the Air Line Pilots Association's retirement committee at Delta.

Though Delta told employees this week that it would suspend future contributions to the guaranteed pension plan for top executives, it did not rescind the plan, which has already received $45 million.

"Most guys feel like they'd better grab the money and run because they don't have the assurance that these companies are going to keep paying the pensions that they did have," Captain Blaz said.

A generation ago, a run on a pension fund would have been improbable. The ability to take money out in a single payment was generally limited to executives. The rank and file took theirs as annuities.

The Internal Revenue Service took action 20 years ago, requiring companies to offer lump-sum payments to the rank and file if they did so for executives. Things did not change immediately; some companies merely bumped the executives into separate pension plans.

But over the years, the idea began to take hold that the individual — not the company — ought to be the one saving for retirement. Self-directed retirement plans like the 401(k) proliferated, saving companies money and getting participants accustomed to tracking their benefits as a single account balance in their own names.

From there, it was just a short step to letting employees withdraw that balance.

The most notorious run on a pension fund happened in 1987 at LTV Steel, where fleeing salaried employees depleted the pension fund to just $7,000, leaving more than $250 million worth of promised benefits outstanding.

That disaster prompted Congress to regulate pension distributions more closely, barring lump-sum withdrawals unless a pension fund had liquid assets of at least three times the prior year's payouts. In the 1990's, pension funds were generally healthy and the new rule was thought to have eliminated the risk. But now the risk is back.

Employees have taken readily to the idea of getting a big check. Study after study has shown that when offered the choice, most spurn the annuity and go for a single payout.

Companies also benefited before market conditions changed because paying out all at once meant extinguishing long-term pension debt. The recent Xerox decision involved complaints that the company was paying lump sums that were smaller than the real value of the benefits the retirees had earned.

But the grafting of individual rights onto a collective pension trust has brought risks that have become apparent only as pension funds have weakened. Every participant in a pension plan does not, in fact, have a separate balance, as they do in a 401(k) plan. So if large numbers of participants decide to retire early and withdraw what they see as "their" money, they will, in fact, be pulling out funds that were pooled for everybody.

That is what happened at Polaroid.

"I don't think lump-sum payments were introduced to benefit one group of people at the expense of another, and yet there you have it," said Ann Liebowitz, a retired Polaroid vice president who lost benefits worth roughly $8,000 a year when that plan failed.

Ms. Liebowitz retired in 1995 and took her pension as an annuity, the only option at the time. But the plan was redesigned three years later, allowing employees to begin taking their benefits as single checks.

The change was billed as an improvement, letting people take their benefits with them if they changed jobs. The new design also made the plan less costly for Polaroid. But when Polaroid slid into bankruptcy in autumn of 2001, the lump-sum option helped fuel a run on the plan.

"The company was going downhill and people were leaving in droves," Ms. Liebowitz recalled.

Over the first six months of 2002, 675 Polaroid employees bailed out, taking one-time checks that drained the pension plan of $81 million. Falling stock prices battered the plan even more. By the time the government took over the plan that July, it had only about two-thirds of the assets it needed to meet obligations of $981 million.

A plan's shortfall at the time it fails is one of many factors the government considers when determining how much of each person's benefit it will pay. As a result, people like Ms. Liebowitz, who were receiving annuities, had their benefits cut. Some retirees lost more than she did, and some less, but none of them would have lost as much as they did if Polaroid had not opened the floodgates to one-time payouts.

While the run was on, Ms. Liebowitz and about 20 other retired officers of Polaroid, including two former chief executives, tried to make the company suspend lump-sum distributions.

"We thought they had a fiduciary obligation to maintain the assets of the plan to the benefit of the greatest number of people," she said. "We engaged counsel, and they engaged counsel, and then there was the battle of the lawyers."

Polaroid refused to stop the distributions, and the Pension Benefit Guaranty Corporation ultimately took over the failing plan. Polaroid has since emerged from bankruptcy as a privately held company. Its employees no longer have a pension plan, just 401(k) accounts.

The run at Polaroid, and the risk now at airlines and other companies, is being made worse by a technical issue that turns lump-sum distributions into a much larger obligation than the companies accounted for when making contributions to their plans.

This is because a company must use a different interest rate to calculate a plan's obligations than it does to calculate how much an individual can withdraw.

Low interest rates mean that the value of future obligations look very large in today's dollars. This basic financial principle, when applied to lump-sum calculations, means that employees approaching retirement in the current low-rate environment are entitled to unusually large upfront payouts.

But the interest rate that companies must use to calculate their overall liabilities is different, and currently higher. As a result, companies are not making pension contributions aggressively enough to cover a spate of lump-sum withdrawals.

Both rates were set by statute years ago, and the difference did not seem to matter in times when plans were healthy and few people were taking lump-sum distributions. But now it does matter.

The implications of this are not lost on members of Congress, who could change the statute to close the gap between the rates. Companies have been lobbying hard, not only to bring the two rates together, but also to make the new, single rate a higher one. That would reduce both pension contributions and payouts, saving companies money.

This approach is extremely unpopular with people approaching retirement, whose distributions would be reduced. A compromise, which would phase in such a change, has been incorporated into a pension bill expected to be considered in the House, after Congress returns from the August recess.

By that time, Captain Davis will have claimed his single check and retired. So will some of his colleagues, he said. Every day, someone calls to discuss the stay-or-go quandary, and the conversation always returns to the executives securing their own pensions.

"Prior to that, we never really thought of how our pension was funded," he said.

At a recent pilots' meeting, Captain Davis had the chance to approach Delta's chief executive, Leo Mullin, and ask what the pilots were to make of the millions going to the executive pensions, given the rickety state of their own plan.

"He hemmed and hawed a little bit, and said, 'Well, the best way to protect your pension is to see that we stay out of bankruptcy;'" Captain Davis said. "I realized that I'd just lost my only hope. Now I feel like it's every man for himself."

How Polaroid's Fund Failed

In the first half of last year, assets in Polaroid's pension plan declined by more than $200 million because stock prices fell and departing employees pulled money out of the plan. Though details about the fund's liabilities at the beginning of 2002 are not available — and the fund could have had a shortfall even then — the fund was short more than $300 million by the end of July 2002 when the government took it over.

Source: Pension Benefit Guaranty Corp.

The New York Times

Fears on solvency bring withdrawals, which could bring insolvency.

The New York Times

NEW YORK, SUNDAY, OCTOBER 12, 2003

STATES AND CITIES RISK BIGGER LOSSES TO FUND PENSIONS

BOND SALES CAN BACKFIRE

Taxpayers Face Picking Up Tab as Governments Try to Keep Promises to Retirees

By MARY WILLIAMS WALSH

Many state and local governments, facing ballooning pension promises to police officers, firefighters, teachers and other public employees, are rushing to sell bonds to cover the shortfall. That strategy has sometimes backfired in recent years, leaving taxpayers on the hook for even more debt.

States and municipalities are drawn to bond sales because they bring instant cash, easing budget pressures without further tax increases or reductions in retirement benefits.

But critics say the bonds could prove costly for some officials using them — and for the local taxpayers. The cities and states have to pay a fixed rate of interest on the bonds, and are essentially betting they can earn a higher rate of return by investing the proceeds in their pension funds.

But recent investment losses have already left some cities and states on the hook for a mounting debt, covering not just the retirement money for their workers but also the interest on the bonds. New Orleans, Pittsburgh and New Jersey have all placed losing bets in recent years.

Almost all pension funds have suffered sizable losses over the last three years. Government pension plans can dig themselves into deeper holes because, unlike corporate pension plans, they are not bound by federal requirements to maintain a certain level of funding. Some have no reserves at all: they just pay as they go, out of revenues.

With money tight, municipalities are looking for financial help. This year, pension bonds will account for nearly 5 percent of all new municipal bonds, up from less than 1 percent in each of the last five years.

In the first nine months of this year, Illinois, Oregon's school boards, New Jersey's economic development authority and more than a dozen towns and counties sold $13.3 billion in bonds for pension purposes, almost as much as the total sold for pensions throughout the 1990's, according to Thomson Financial.

More sales are coming. Wisconsin and Oregon each plan one before the end of this year, and Kansas has authorized a sale. West Virginia, home of the nation's weakest public pension plan — according to a study by Wilshire Associates, the state teacher's plan has only $1 for every $5 is owes — is fighting a court battle to sell $3.9 billion of the bonds without first holding a referendum. In California, a planned $1.9 billion bond sale for state employees' pensions contributed to the fiscal uproar that led to the recall of Gov. Gray Davis.

Other officials have weighed the risk and declined. "It's really tough

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to justify," said Robert C. North, the chief actuary for New York City's five employee pension plans. For years, Mr. North said, investment bankers have been urging the city to sell bonds to pay for its pension promises, and every time, he argues against it because he believes there are sounder and cheaper ways of financing pensions.

"On a risk-adjusted basis, the only people who can make money on this are the investment bankers," Mr. North said.

This risk is not always made sufficiently clear, critics say, by financial consultants who stand to make money from the bond sales.

New Orleans recently found out just how deep a hole it had dug for itself by selling bonds in late 2000 to finance the pensions of 820 retired firefighters. In May, city officials asked the manager of the bond sale, UBS Financial Services, for a progress report and were shocked to learn that the deal was expected to cost the city $270 million over time.

"We were thinking that we were going to make money on it," said Suzy Mague, fiscal officer for the New Orleans city council.

City officials say their rosy expectations were created by PaineWebber, the lead underwriter, when it described the bond transaction. (PaineWebber, which collected a $3 million fee for its role in the bond sale, has since merged with UBS.)

"It was basically presented to us as, 'Look, this is really the way to go. Even if you use the worst estimates, you still break even,'" said Scott Shea, a former city council member who served on the budget committee at the time.

According to Ms. Mague, PaineWebber said New Orleans would probably have to pay about 8.2 percent interest on the bonds. PaineWebber predicted that the city could expect to earn 10.7 percent a year, on average, by investing the proceeds, mostly in stocks, a prediction based on returns from 1983 to 1999 — a period that encompassed the greatest bull market in history.

A spokeswoman for UBS said that the company did, in fact, include less favorable projections in its presentation, and did not suggest that 10.7 percent, or any other rate of return, was guaranteed.

Mr. Shea said he asked PaineWebber about risk. "I frankly don't recall anybody telling me, 'Look, if the market tanks, you'll be in worse shape than if you had never sold the bonds,'" he said.

New Orleans issued bonds worth $171 million in December 2000, and almost immediately, the stock market tanked. Instead of returning 10.7 percent a year, the investments have suffered losses of about 3 percent a year.

By June, only $98 million was left — enough to pay the firefighters' pensions for just a few more years. When the money runs out, the city will still have to pay their pensions — about $17 million a year — but then it will also have to pay interest on the bonds of $16 million a year.

Pittsburgh, likewise, sold $294 million of bonds in 1996 and 1998 to buttress a skimpy pension plan for its workers. Before that, the city was spending about $21 million a year from its operating budget to keep the plan afloat.

After an initial spurt, the pension plan slumped again when stock prices fell. Today, Pittsburgh is paying a total of $26 million a year to shore up the plan and to pay its bondholders. Two credit-rating agencies recently said they were reviewing Pittsburgh and might lower its rating because of its indebtedness.

New Jersey had similar results after issuing $2.8 billion of bonds in 1997. The sale was the largest of its kind then and made headlines by generating $53 million in fees for various securities and law firms.

In the first two years, the deal looked good. New Jersey earned more than double the break-even amount. Then the markets turned. As of June, the pension plan's five-year average return was 1.9 percent, nowhere near enough to cover the pension costs and the bond interest, which this year totaled $890 million.

"This money didn't build a road or a bridge, but we still have to pay it," John E. McCormac, the state treasurer of New Jersey said. The bonds are not callable, so the state cannot easily refinance at a lower rate.

Officials may look past unhappy outcomes like these in part because market conditions have improved. Stocks are rising. Interest rates are very low, and officials see an opportunity to lock in debt at historically attractive rates. They can also allay workers' fears that no money has been set aside to cover their promised benefits.

Even Orange County in California is considering an issue, despite lingering concerns over its bankruptcy proceedings in 1994.

The county got into trouble after taking on undue investment risk, something that critics of the new issues fear will happen again as states reach for higher returns. New Jersey, for example, has restricted pension investments to stocks and bonds, but is now reviewing its portfolio and whether to hire an independent money manager, as other states commonly do.

The state's auditor has recommended investing a small amount in alternative investments, perhaps real estate, venture capital or other instruments that may provide greater returns, at greater risk. No decision has been made. Some state employees oppose the change, saying the risks are too great.

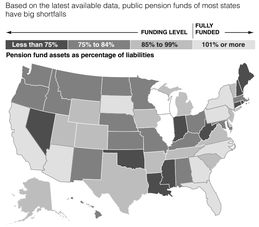
Their view is supported by some government finance specialists and academics, who argue that speculative investments, even stocks, are unsuitable in pension funds. They say that people retire on predictable schedules, and it is safest to invest conservatively, in bonds that will mature when people need the money.

Depending on market conditions, though, the current crop of bonds could pay off handsomely for the governments issuing them.

An Illinois official says that the state's $10 billion bond issue was based on an assumption that the money would earn 8 percent to 8.5 percent annually. Illinois will pay 5.07 percent interest on the bonds. "As long as the actuaries are right," said a spokeswoman for the state budget bureau, "we should be safe."

Trouble Spots

Based on the latest available data, public pension funds of most states have big shortfalls



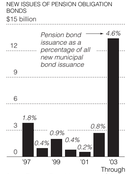
Illinois was less than 75 percent funded before a recent bond issue. Current figures for Illinois and Wisconsin were unavailable.

Source: Wilshire Associates

The New York Times

Surging Debt

State and other local governments are increasingly selling bonds to cover their pension promises. This year's new issues for pension obligations account for nearly 5 percent of all new municipal bonds issued, up from less than 1 percent in each of the previous five years.



Source: Thomson Financial

The New York Times

The New York Times

NEW YORK, WEDNESDAY, NOVEMBER 12, 2003

Failed Pensions: A Painful Lesson in Assumptions

By MARY WILLIAMS WALSH

Robert M. Bowden retired from his job as accounts manager for a large trucking company with a plan to travel for himself.

But his company's pension plan collapsed this year, and his annual payout was cut to $24,000 from $40,000.

Mr. Bowden and other retirees of the company, CNF, see a culprit. In a lawsuit, they accuse the company of failing for many years to set aside enough money in the plan. The company did this, they say, by assuming they would retire much later than they really did. Though the CNF plan offered full benefits to people as young as 55, the company projected people would stick to their desks until they turned 64.

A look at documents made public in the retirees' fight at CNF and at a few other companies, including US Airways and Bethlehem Steel, shows that companies have great leeway to tweak certain crucial assumptions about the future — when their workers will retire, how long they will live, and which way interest rates will move, among others.

A year shaved off an estimate here, a decimal point's difference there can significantly reduce a company's pension obligations on paper. The company can save millions of dollars in pension contributions.

But if a company shortchanges its pension fund year after year and the company then gets into trouble, the plan that looked healthy can fail, seemingly out of nowhere, leaving workers stranded.

"I'm in a financial survival mode," Mr. Bowden said. At 58, he recently refinanced his mortgage in Lake Oswego, Ore., to conserve cash while looking for a cheaper place to live.

Assumptions that the government considers inadequate contributed to

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the demise of almost all of the roughly 150 pension plans that failed in the last year. Current detailed information about pension plans is not routinely disclosed, however.

The painful lesson for employees comes as companies press Congress for permanent relaxation of some provisions of the pension funding law. One measure, passed by the House in October, would allow companies to make more favorable interest rate assumptions for the next years while a panel works on broad changes to the pension funding rules.

Two other bills, recently passed by different Senate committees, would extend the interest rate change beyond two years, and one of them would also suspend a measure intended to punish companies that let their pension plans become severely underfunded. If Congress does not act before a stopgap measure expires at the end of the year, companies will be forced to make large mandatory contributions.

Companies generally contend that the funding requirements are out of step with the current financial environment. CNF has not filed a response to the retirees' suit, and a spokeswoman said the company could not comment on the dispute.

According to a rule of thumb used by actuaries, though, every year's difference between the company's projection and the age at which the employees actually retired might have understated benefits by about $15 million.

"There are ways companies can kind of game the system, to contribute a lot less money than is realistic," said Jeremy I. Bulow, a professor of economics at Stanford University's graduate school of business. Essentially, he said, they are trying to get a loan from the government agency that insures pensions, the Pension Benefit Guaranty Corporation, or their employees. "That's what they're trying to do, and it's very bad news," he said.

To be sure, the world of actuarial science is not the wild, wild West. Companies have been caught gaming pension assumptions in the past and as a result some assumptions are now regulated. Interest rate assumptions are especially powerful in pension calculations, and the most important ones are today a matter of statute — the same statute Congress is now being asked to modify.

Assumptions about employee life spans are also regulated today, after General Motors was found in 1994 to be assuming its workers would die younger than Ford's. Workers who die young will collect smaller total pensions, reducing the corporate contributions. Today, all companies are supposed to use a standard mortality table, though some companies are lobbying Congress for more leeway there as well.

For other assumptions — about pay increases, staff turnover, marital status, retirement ages and other factors — there are no hard and fast rules. The law says only that assumptions must be reasonable; that term can mean different things to different people.

US Airways and AMR's American Airlines, for instance, have found it reasonable in recent years to assume that their pilots will retire when they turn 60, because the Federal Aviation Administration grounds commercial pilots at that age.

"Pilots enjoy flying and typically it's an avocation in addition to being a job," an American Airlines spokesman said. "A lot of pilots would even work past 60 if they could."

After US Airways' pension plan for its pilots failed this year, however, the government looked at the age when they were actually retiring and found that lately, more than half have been retiring well before their 60th birthday. The Pension Benefit Guaranty Corporation is arguing in bankruptcy court that the airline should have assumed that the pilots would retire, on average, at 56. The agency, an unsecured creditor, is in court seeking a portion of the reorganized airline's stock to help cover its cost of paying the pilots' benefits.

Because the government insures pensions only up to certain limits, the US Airways pilots will lose, in total, about $1.6 billion in anticipated benefits, according to the pension agency.

Documents in the US Airways case also show how powerfully a pension plan can be affected by an assumption that seems only slightly off the mark. An analysis supplied by US Airways' actuary, Towers Perrin, suggests that when the airline assumed its pilots would retire four years later than they really did, it shrank the amount it appeared to owe them by about $385 million. That, in turn, meant it contributed less to the plan.

"In every dimension that was possible, they made the most aggressive actuarial assumptions they could," Mr. Bulow said in an interview. He submitted testimony on behalf of the

Companies can game the system to reduce pension obligations.

government in the US Airways case.

Towers Perrin declined to comment on its retirement-age assumptions, citing its policy not to discuss matters before the courts. US Airways, in court documents, stands by its assumption that pilots will retire at 60 in the future. It notes that the defunct pension plan has been replaced by a benefits package that will round pilots who keep working as long as possible.

The airline also argues that the government is forcing it to make an inappropriate assumption about interest rates in its calculations, in an effort to grab a larger portion of its stock. The court is expected to resolve the dispute soon.

Retirement age was also a factor in the costly demise of Bethlehem Steel's pension plan. Bethlehem's actuary, Aon Consulting, assumed the work force would retire at age 62, even though the company offered pensions to much younger workers, as long as they had 30 years of service. Other actuaries said that assumption was highly questionable, and that it was an important factor in the Bethlehem plan's record $3.7 billion shortfall when it failed.

A spokesman for Aon said the firm could not comment on a client's affairs. Bethlehem itself has been liquidated. The government estimates that Bethlehem's work force has lost, over all, about $400 million in promised benefits.

At CNF, the pension troubles grew out of the freight company's decision, in 1996, to spin off its unprofitable Consolidated Freightways unit. Consolidated, a unionized long-haul trucking business, was losing money in the mid-1990's, dragging down the parent company's performance. CNF was meanwhile building up a separate nonunion trucking business that was profitable. By 1996 the two divisions were competing head to head in some markets.

When it spun off Consolidated, CNF had to split its pension fund and put some of the money into a new fund for the departing work force. Such transactions are regulated; companies must certify that they are transferring enough money to cover departing workers' benefits.

Mr. Bowden and his fellow retirees said that when CNF calculated their benefits, it assumed that most of them would retire at 64. But many Consolidated managers retired in their late 50's, they say, to take advantage of generous early retirement benefits the company offered to people whose age, plus years of service, added up to 85.

Steven M. Tindall, the retirees' lawyer, said that by using a higher retirement age in its calculations, CNF was able to put less money into the spun-off pension plan.

"We think this is a way the company saved some money," said Mr. Tindall, a partner in the law firm of Lieff, Cabraser, Heimann & Bernstein in San Francisco.

He and the retirees also said that CNF used an inflated interest rate in its calculations, further reducing the amount it put into their pension fund. Born weak, the new pension fund was then underfed each year, they believe, because CNF continued to use inappropriate assumptions.

Consolidated's retired managers, like Mr. Bowden, said they had no idea this was happening until it was too late. They said they were never even told the pension fund had been separated from CNF, much less that it was withering away.

Chester Madison, a group operations manager for Consolidated, said that just before he retired, in August 2002, he asked about the pension plan and was told it was "fully funded." Two weeks later, Consolidated filed for bankruptcy. Four months after that, he and the others began receiving letters saying the plan had failed. It had less than half the assets needed to pay their benefits.

"You feel betrayed," said Mr. Madison, whose monthly pension check has been reduced to about $1,790 from $4,100. He has been looking for a job to make up the difference. "Not too many people are going to hire you when you're 58 years old," he said.

Even Consolidated's retired president, Thomas A. Paulsen, was surprised. At age 59, with 36 years of service, he had earned a pension of $8,755 a month. When the plan failed, his check was reduced to $1,876. He believes CNF spun off Consolidated with insufficient resources, to "send the old dog out to die."

Employees at all levels are supposed to get basic information about their pension plans once a year, but it is difficult, if not impossible, to check the validity of the underlying assumptions. Companies are not required to disclose current, detailed information about their pension plans. They do list three actuarial assumptions in the footnotes of their annual reports, but retirement age is not among them.

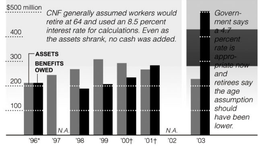
More details about pension plans are on file at the Labor Department, but those records are generally at least two years out of date. And even if an employee goes to the trouble of getting the numbers, they are difficult to decode.

Mr. Bowden recalled that CNF hired him in 1967, when the company was expanding rapidly and hiring lots of baby boomers. They were entitled to early retirement, and the plan failed just as they were claiming it. The government's pension insurance has limits to begin with, but those limits are reduced even more for those who retire before age 65.

"There's hundreds of thousands, maybe millions, of people, who believe that the P.B.G.C. will guarantee their pensions, and it's not the case at all," said Robert Newell, a retired Consolidated vice president. His monthly pension has been reduced to $2,025 from $5,357.

Overly Optimistic?

When CNF spun off its Consolidated Freightways unit in 1996, it calculated Consolidated's pension fund liabilities using assumptions that tended to make the benefits owed look smaller. Over the years, those assumptions did not change substantially. Early this year, the pension fund collapsed and was taken over by the government, which has estimated that the fund's burden is far higher than the company had calculated.



*CNF used a 7.1 percent rate. †CNF lowered retirement age to 62.

Sources: Court filings; pension plan annual reports filed with the Labor Department

The New York Times