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STAY TUNED ... to Spring News Cycle

by Hank Boerner

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STAY TUNED … to Spring News Cycle: Corporate Retirement Plans; PBGC

By Hank Boerner

Stay Tuned! is designed to be a heads-up commentary for corporate IROs and IR consultants, a look into a crystal ball of emerging trends. What's coming at you in 2005? Much more discussion about pensions, retirement, Social Security reform, demographic trends and their impact on the corporate bottom line.

One method we use for monitoring and ranking events is organized content analysis — watching and calibrating the flow of news, information, commentary and opinion. **Stay Tuned** brings you the essence of this monitoring.

We're closely watching a perennial issue that is now the 800-pound gorilla in offices of public policymakers: the aging of the American worker, often retiring earlier and living longer, as a force creating pressure on government and corporate pension schemes. Important demographic changes include the phased-in retirement of the massive baby boom generation (those born 1946-1964), 76 million strong and twice the number of annual births over preceding decades. The boom is creating problems for Social Security.

While much of the political commentary on retirement funding is on the future of the Social Security system, the drumbeat of negative news about private pensions has been building. What happens politically with these issues could affect your company's finances.

Stay Tuned … to developments at the Pension Benefit Guaranty Corporation, the federal government's equivalent of FDIC insurance for bank depositors. PBGC is both a financial guaranty insurer, similar to a provider of catastrophic risk insurance, and an annuity provider, similar to a life insurance company. If an insured corporate plan goes belly up, PBGC owns the problem, along with remaining assets and all liabilities for current and future beneficiaries of a plan. (PBGC has become an aggressive creditor in recent years in bankruptcy courts, seizing assets for underfunded plans.)

PBGC is now operating with a $23 billion deficit, much of it due to recent pension fund failures in the airline industry. Earlier failures in the steel industry created legacy issues the agency will deal with for years to come. Corporations pay premiums to PBGC based on assets in their traditional pension plans; in the event of a crisis, those premiums could skyrocket in the months ahead (if the premium system is not changed).

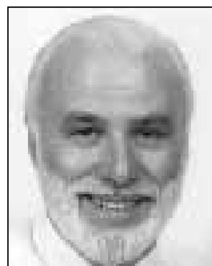
While we've heard mostly bad news about the condition of corporate plans, Bear Stearns accounting analyst Patricia McConnell, CPA, has pointed out some potentially good news for IROs and CFOs. In total, the S&P 500 companies had "a stellar year" in 2003 and seem to be on track for another good year in 2004. Rising market values should mean corporate pension plan assets are also rising. In fact, McConnell predicted the possibility of S&P 500 companies plans achieving an "overfunded" position, with surpluses beyond their pension liabilities. The current debate could then diminish with regard to corporate plans.

Looking at contributions of large-cap companies to cover pension liabilities, the S&P 500 companies paid $39 billion in contributions into plans last year, down from $73 billion in 2003. In terms of the current "pension tension," McConnell posed a key question: Are we heading for *relapse* or *recovery?* Her estimates are that the fair value of plan assets could rise to a total of $1.189 trillion by 2006, with obligations at $1.171 trillion. In 2006, corporate contributions would be an estimated $39 billion with net cash flow to the S&P 500 plans of at least $41 billion. (The Bear Stearns pension forecast model was used for estimates.)

Long-term answers to *relapse* or *recovery* are both political and economic: 44 million workers and retirees are now insured by PBGC, and if a significant number of plans fail, adding to the 1 million workers already on PBGC's payment schedule, U.S. taxpayers could well pay for an S&L-type bailout. Keep in mind, well-managed corporations with solid financials could also be assessed short term to shore up the overall system — perhaps resulting in a hit on your company's earnings.

Wharton/University of Pennsylvania professor of insurance Olivia Mitchell said many finance executives are not familiar enough with their company's pension fiduciary obligations and risk factors — the liability side of pension plan operation. "Suddenly, senior executives are realizing that they have a fiduciary responsibility in a field they never paid much attention to," Mitchell added.

What does PBGC have to say about its situation? Recently, Credit Suisse First Boston's David Zion, who leads the firm's accounting and tax research team, interviewed PBGC head Brad Belt. Said Zion: If the PBGC agency takes over US Airways' remaining pension fund, this could trigger 2005 congressional debate on an S&L-type takeover. PBGC's Belt outlined other issues that could impact IROs.



Hank Boerner

Stay Tuned to:

- "System flaws" being addressed: Current funding rules don't ensure that corporate plans are well-funded; company premiums don't cover expected losses or reflect risk; there is a lack of transparency overall.
- Key reforms, which could include requirements for greater transparency/disclosure, ensuring adequate funding or benefit promises and a shift to risk-based premiums for corporate plan sponsors, which could place significant financial burdens on companies with underfunded and/or underperforming plans. Companies could be required to accurately measure and disclose pension fund costs and fulfill the promises they've made to workers.
- The disappearance of some corporations' ability to hide costs, shift risks (to taxpayers) and abrogate promises made to employees.
- Companies providing a more thorough discussion of pensions in the MD&A, quarterly and annually.

Investors should care about the financial status of a company's plan, advised Belt — ignorance is not bliss. Equity owners need to understand that the funding requirements of a plan may absorb a significant amount of future earnings.

Any other reforms that may be on the agenda in 2005?

Stay Tuned … to the corollary issue of rising health-care costs for retirees. How long can companies afford to pay for retiree medical coverage? While the current PBGC debate swirls around pension payments, many retirees count on their company plan for health-care benefits — and these are not covered by PBGC insurance.

In November 2004, General Motors cautioned that it expected its health-care costs to rise 10 percent this year, which would cost the company $170 million for retirees. Hearing this, Moody's swiftly moved to cut the large carmakers' debt rating. This is a signal that a significant shift is taking place in third-party views of corporate pension plan funding.

Stay Tuned … to the emergence of tiered pension schemes for new workers. Industry leader IBM just closed its pension plan to new employees and will now give new workers a 401(k) plan. While the company is "still committed to defined-benefit pensions," a spokeswoman told *The New York Times,* the decision to shift to worker-directed plans for new hires would put IBM in line with pay and benefits offered by competitors.

Are these harbingers of changes to come in corporate America? **Stay Tuned** to the wave of retirees at the head of the baby boomer pack (the first turn 60 in 2006) and their short- and long-term effects on retirement plans of all kinds! IRU

Hank Boerner is managing director-New York of Rowan & Blewitt. The opinions expressed here are his own. He welcomes questions, comments and notes at hank@pb.net.