

SPECIAL REPORT

Legislation won't save defined benefit pensions

By [William L. Watts](#), MarketWatch

Last Update: 12:01 AM ET Jun 22, 2006

WASHINGTON (MarketWatch) -- Congress is taking its time in completing work on legislation designed to shore up the nation's ailing pension system, but don't expect the final product to be the miracle salve that slows Corporate America's ongoing disenchantment with defined-benefit plans.

Instead, higher premiums designed to stop the fiscal bleeding at the Pension Benefit Guaranty Corp., the system's federal insurer, and tougher funding rules designed to bring lagging pension funds in line with their long-run obligations are likely to accelerate a long-running move away from such "traditional" pensions toward 401(k)s and other savings vehicles that shift risk away from employers to individuals.

"I think any initiatives ... that tighten the funding rules are going to make it so that these defined-benefit plans might be less appealing over time to corporate America. But that trend is already in place," said Greg Kelly, a Washington-based policy analyst with Susquehanna Financial Group.

Established trend

Indeed, not only are troubled automakers, airlines and steelmakers shucking promises to workers and former employees or attempting to minimize their pension obligations, healthy companies, such as Verizon and IBM have also moved to freeze pensions as they seek to shift the burden of retirement savings to employees.

The number of active, private-sector workers covered by defined-benefit plans has been on the decline for some time. The number of PBGC-insured plans peaked at more than 114,000 in 1985, declining to 31,238 in 2004, according to the Employee Benefit Research Institute.

In a defined-benefit plan, a retiree receives a set, or "defined," amount based on years of service and salary level. The employer is responsible for investing the money and ensuring that future obligations are met. Such pensions have often been abandoned in favor of defined-contribution plans, such as 401(k)s, that require the employee to bear the risk.

Meanwhile, a wave of high-profile bankruptcies has left the federal government's pension insurer, the Pension Benefit Guaranty Corp., in the red to the tune of more than \$22 billion. The agency, which is funded solely by premiums collected from firms with defined-benefit plans, has sufficient cash flow to meet its

obligations for now. But the possibility of more trouble in the airline and auto sectors has raised fears that the nation's pension system might one day require a taxpayer-funded bailout on the scale of the savings-and-loan debacle of the 1980s.

'The rules are the problem'

The PBGC was created in 1974 by the Employment Income Retirement Security Act, or ERISA. The law established a complex set of rules that dictate a company's contributions to its pension plan. Before the stock-market bubble burst in 2000, most plans appeared to be fully funded under the criteria. But the declining stock market and a fall in interest rates showed that the once-sanguine funding outlook had been an illusion.

"Nobody here broke the law. They followed the rules. And so the reason the pension legislation is important is that the rules themselves are the problem," said Douglas Holtz-Eakin, the former director of the Congressional Budget Office.

It was apparent that many companies had been banking on higher interest rates and a non-stop bull market to ensure that they would be able to meet future pension obligations.

David Zion, an accounting analyst with Credit Suisse First Boston, said in an April research note that while the recent rebound in interest rates and a stronger stock market had helped reduce the overall gap, 319 S&P 500 firms' pension plans remained underfunded at the end of 2005.

Add in outrage over companies renegeing on long-held promises to their workers to pressures for additional restructuring of the airline industry and the actuarially terror-inducing prospect of bankruptcy for General Motors, and it's no surprise lawmakers see an urgent need to overhaul the pension-funding system now. The House and Senate late last year each passed large, complicated bills designed to shore up the PBGC while requiring companies to move quickly to correct massive funding shortfalls.

Search for a cure

But critics fear the legislation that's likely to come out of ongoing House-Senate negotiations may not provide a lasting cure.

House and Senate negotiators have been working for months to resolve differences between the two bills. Divisions lay less along partisan lines than along constituent divides, with some lawmakers seeking to water down provisions that would significantly increase funding pain for industries such as automakers, while others seek breaks for other troubled sectors, including the airlines.

Both bills would require companies with pension plans considered to be "at risk" to boost funding levels, but they diverge when it comes to defining the term. The

House version requires companies to boost contributions if its plan is found to be less than 60% funded. The Senate version takes a stricter approach, and would require companies with poor credit ratings to boost their contributions.

Both versions require companies to pay bigger premiums to the PBGC, and require companies with underfunded pension plans to make up the difference within seven years.

The White House warned last year that neither the Senate nor the House version was strong enough, and President Bush has threatened to veto any bill that doesn't address the long-term funding shortfall.

When House-Senate negotiations began last March, lawmakers initially eyed April 15 as a target date for resolving their differences. After that artificial deadline came and went, congressional Republican leaders insisted work would be finished by the time lawmakers leave at the end of this month for the weeklong Independence Day recess.

But an ongoing conflict over how to define when a pension plan would require heftier contributions continues to stymie talks. Leaders say they'll still have a bill, but are reluctant to say when.

The question of how to address underfunded airline pensions remains another rub. The Senate bill includes a special provision that gives airlines 20 years to make up shortfalls; the House version offers no break for carriers.

The White House has opposed provisions that would give airlines a break, but it's not clear that Bush would veto a final package that includes such a provision.

Earlier this month, Northwest Airlines CEO Douglas Steenland warned lawmakers that the airline, which remains in bankruptcy, would have little choice but to terminate its pensions and shift the burden to the PBGC unless Congress acted to pass pension legislation that included softer funding rules for the airlines.

Meanwhile, Delta Air Lines Inc.'s (DALRQ) : Delta Air Lines, Inc. decision Friday to request the termination of its pension plan for pilots could further complicate talks, analysts said.

Delta CEO Gerald Grinstein, in a letter to lawmakers announcing the move, urged Congress to press toward changing pension laws to favor the airline industry even if it couldn't save the pilots' pension.

"The unfortunate reality is that even if a pension reform bill containing airline relief passes, unless the pilot plan is terminated Delta cannot successfully restructure and emerge from bankruptcy -- necessary achievements if we are to preserve tens of thousands of jobs and provide ongoing service to tens of millions of customers in local communities and around the world," he wrote.

Top lawmakers said the move was unlikely to have a significant effect on the negotiations.

"We're going to finish the pension bill. Don't ask me when, but we're going to finish it," House Majority Leader John Boehner, R-Ohio, told reporters.

Negotiators must also reconcile differences over how the bills treat so-called hybrid pension plans, the use of credit-ratings in determining whether plans are underfunded, and how to phase in the new requirements.

Special provisions for certain industries, particularly the longer funding window for airlines, have critics up in arms.

"This unjustified move will only delay the inevitable failure of their pension plans, while providing a precedent that will make it harder to deal with any politically powerful industry," wrote David John, a senior research fellow at the Heritage Foundation, a conservative think tank.

Budget experts say much also rides on how any final piece of legislation treats other pension-funding practices, such as smoothing and credit balances.

Under current rules, companies can "smooth" out fluctuations in the market value of their pension plan's holdings over five years. Credit balances occur when firms overpay into their pension plans. Under current rules, companies with a credit balance can later forgo contributions.

Critics argue that those rules let troubled companies skip making needed payments even if they're plans are significantly underfunded. Both bills seek to restrict the use of credit balances by companies with underfunded pensions.

In the end, uniform rules that require all companies to mark assets and liabilities to market and put real resources into the gap are necessary to address the shortfall and stave off future woes at the PBGC, Holtz-Eakin said.

"This is one where going into the [House-Senate negotiations] I think it was a coin-toss at best as to whether they had on-net improved the outlook for PBGC in particular and, by definition, to the degree which plans were going to be put to them as well," he said.