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Companies Fight Shortfalls in Pension Funds

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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 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.