Business Week Online

October 24, 2008 Friday

Why Pensions Are Probably Safe:
The federal pension-guarantee fund has lost money, but it appears healthy enough to backstop any market losses by traditional corporate plans

BYLINE: Nanette Byrnes

If you're retired, you're probably getting pretty worried by now. The stock market's gyrations [BusinessWeek.com, 10/23/08] are painful for all, but some of the most dramatic numbers are the losses being reported by pension funds.

According to benefit consulting firm Mercer, traditional pension plans sponsored by large U.S. companies have seen their funding fall by almost $100 billion this year. And if corporate bond yields, which are used by most companies to measure the value of their plan liabilities, were to return to more typical levels, that number could increase to more than $400 billion.

Those concerns will bring Charles Millard, director of the Pension Benefit Guaranty Corp. , the government-sponsored insurer of pension plans, to Capitol Hill on Friday, Oct. 24. His testimony before the House of Representatives' Committee on Education & Labor will center in part around the $3 billion in stock market losses the PBGC itself has sustained since last October.

Underwater Pension Plans

A recent analysis by UBS Investment Research (UBS) estimates that 236 companies in the Standard & Poor's 500-stock index have pension plans that are underwater -- their assets are less than their obligations -- though many just barely so. On its critical list were 20 companies with pension plan assets equal to or greater than the market cap of the parent company, among them General Motors (GM) and Ford (F). The PBGC currently manages 3,800 plans.

Those are all big numbers. But it's unclear whether Congress will do much about them. The committee's main focus seems to be the PBGC's investment strategy, which the chair of the Education & Labor Committee, U.S. Representative George Miller [D-Calif.], has described as a controversial shift from fixed-income securities such as U.S. Treasuries to more risky securities like real estate.

Still, experts say retirees with traditional defined-benefit pensions have little to worry about. If you're reliant on a 401[k], there is reason to be concerned. Here are some answers to the questions all this raises for those near or in retirement:

If a company's pension plan sustains big losses, will that affect the checks being received by current retirees?

It should not, says Mark Johnson, former director of American Airlines' (AMR) pension plan, which had assets of $14 billion in 2001 when he took early retirement. He is now a consultant with ERISA Benefits Consulting of Grapevine, Tex. Companies may have to contribute more to the plans to meet their obligations, but participants' benefits won't be cut.

However, there's a good chance that more companies will be freezing these plans in the near future, Johnson argues, because of the drop in asset value. New accounting rules for pensions could well mean many companies have to put additional cash into their plans to shore them up quickly. That would accelerate a long-term trend away from these plans, where companies make the contributions, and toward 401[k]-type plans, where employees make pretax contributions and their employers may kick in some matching amount.

What if the bank or financial company that sends me my pension check each month is in trouble or bought? Could that affect my income?

No. They are only the processor of your payment. Your former employer is the one that funds your pension, and pension-plan assets are separate and distinct from all other assets of both your former employer and the third-party check processor.

Should I worry about the fact that the PBGC has lost $3 billion?

If you are one of the 1.3 million people whose employer has gone bankrupt and your plan has been taken over by the PBGC, you might find that $3 billion figure disconcerting. But "people shouldn't be worried," says Jeffrey Spiker, a spokesman for the agency. The PBGC has assets of $60 billion, plenty to pay current obligations. Although it has lost money on its equity portfolio, the agency has made money on bonds, where its investments traditionally have been focused.

From last October to the end of August, Spiker says, the PBGC is down about $1.2 billion, or 6%, "which is not bad for this environment." Also, interest rates have been dropping fast, which lowers the agency's calculation of liabilities. So fast, in fact, that the PBGC is likely to come out of this downturn with a $2 billion smaller deficit than it had last year.

What happens if things get so bad at my employer that it goes into bankruptcy and the PBGC takes over my plan -- will my benefits drop?

For most people, benefits won't change after a transfer. But in some cases your check can shrink after a PBGC plan takeover. Benefit increases made within five years of the PBGC accepting the plan will not be honored. Also, you can be penalized if you decided to retire before 65. The maximum the PBGC will pay per person is set each year by Congress. For pension plans terminating in 2008, the maximum is $51,750 per year for those who retire at age 65, up from $49,500 for 2007.

What if my company is running a big pension deficit and I think they may freeze the plan? Is there anything I can do to maximize it ahead of time?

Unfortunately, no. "Defined benefit plans are not interactive. You can't increase your contribution," says Johnson. "You're along for the ride."

What do I do if I only have a 401[k]?

Retirees relying on 401[k]s are feeling the pain, without a doubt -- especially if they were heavily invested in international stocks, or any stocks for that matter. But Johnson advises they don't panic. "Over time it will come back, the markets always come back," Johnson says. "If you sell stocks and buy all bonds, you're locking in those losses. You've turned them from paper losses to real losses."

Still, if you're actually relying on 401[k] distributions to pay the rent, you do have a real problem. Minimize that as much as you can, says Johnson, either by using other assets first, or maybe by taking on part-time work, if that's possible.

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