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# U.S. pension plans are in lousy shape

No matter where you turn, the pension crisis in the U.S. seems to getting worse, not better. And the word isn't coming from some Wall Street doomsayer. The federal insurer charged with monitoring the health of pension plans – the Pension Benefit Guaranty Corp. (PBGC) -- is raising the red flag like there's no tomorrow.

"The PBGC will protect workers' pensions, but we must have the tools going forward to require companies to meet their obligations," said PBGC Executive Director Bradley D. Belt. "We need fundamental reforms to improve the financial health of the defined benefit pension system, to protect participants' benefits, and to shore up the federal pension insurance program."

The PBGC is charged with a mind-boggling job: Standing behind the pensions of 44 million American workers and retirees in more than 31,000 private sector defined benefit pension plans. So, if Mr. Belt's lament sounds like a cry for help, that's because it is. Take a look at three big forces looming over the PBGC and its pensioners.

### *Force #1: Bankruptcy, the big loop-hole*

Companies – as well as certain courts – have held that pension contributions don't have to be made when a company goes into bankruptcy. That's right: Go bankrupt and you can do away with those pesky pension payments.

United Airlines, for example, announced in August that it wouldn't make $500 million in payments due its pension plans this year. Likewise, US Airways said it's going to walk away from about $100 million.

No matter how you slice it, that's a mountain of cash vanishing from pensioners' pockets. And it's got the PBGC scrambling for solutions.

If a company is not in bankruptcy and fails to make good on its obligations, the PBGC can hammer the company with a lien on its assets. The insurer wants the same prerogative with companies that slip into bankruptcy. An asset lien usually gets a company's attention.

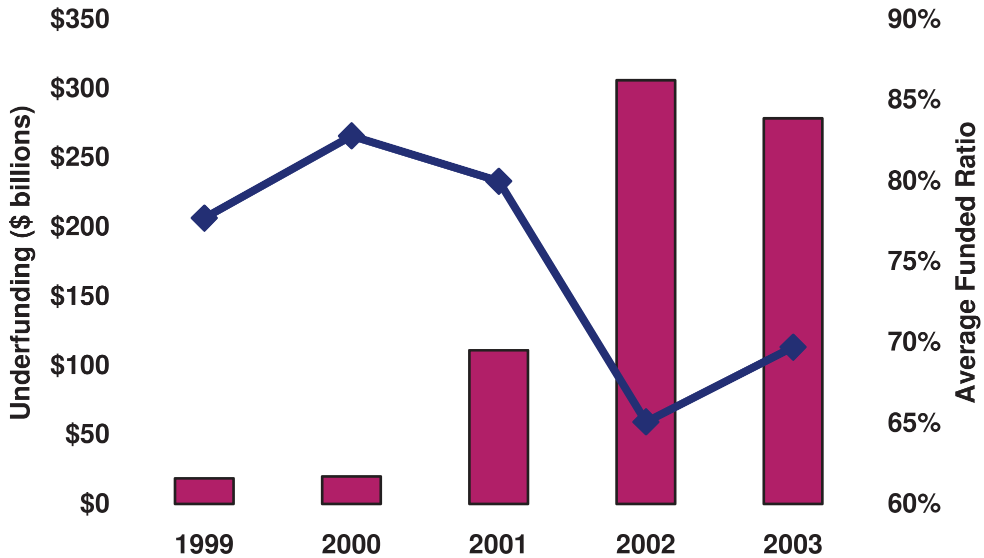
In addition, the PBGC wants companies to notify their pensioners -- within 30 days of a bankruptcy filing -- of the plan's funded status *and* the legal limits of how much PBGC will guaranty in case the plan is axed.

Result? The fixes haven't happened yet so, in the meantime, bankrupt companies will most likely continue their march away from their pensioners. That puts even more pressure on the pension system which is already under big-time stress. Read on …

## *Force #2: A $279 billion headache*

The PBGC's has bankruptcy problems for sure. But the cold hard truth is that the pension funds that are out there are massively underfunded. Take a look …

**U.S. Pension Plans are Massively Underfunded!**




***Source: PBGC***

As you can see from this chart, companies with underfunded pensions reported a staggering $279 billion shortfall last year. And while that's down slightly from 2002's $306 billion, it's *over 2 ½ times worse than 2001* and *over 15 times worse than 1999!* That's crushing pressure and puts the PBGC -- and the pension system as a whole – at big, big risk.

Sure, some sectors are contributing to the mess more than others. The steel industry, for example, with 7 companies and 213,000 pensioners, accounted for $6 billion of the underfunded pie. In the meantime, the airline business – with 11 companies and 444,000 participants -- accounted for a stunning $31 billion. Since the PBGC's inception in 1974, these two industries have made up over *70% of the claims* against the pension insurance program but made up just 5*% of the participants*.

But that's not all. The chart also shows that the average funded ratio improved to just 70% last year. Translation: For every dollar in pension liabilities, company's boasted just *70 cents in assets to cover them*. That's a huge shortfall and is downright awful.

## *Force #3: Pension plans are dinosaurs*

I can remember sitting around the table with my father when I was a boy and asking him what we were going to do when he retired. He sat there for a moment and said, “Well, we’ll probably be living somewhere else and living on my pension. That’s why I have to keep working: To make sure that my pension gets nice and juicy!”

To tell the truth, that conversation – which happened over forty years ago – was one of the last times I heard anyone really talk about a pension. The fact is pensions are quickly going the fate of the dinosaur.

The reasons are pretty simple. In my father’s days, the pension was a way of life. You worked long and hard for a company and the company promised to pay you a stipulated amount when you retired. That’s why pension plans are called “defined benefit plans”: In the end you get a defined amount of money.

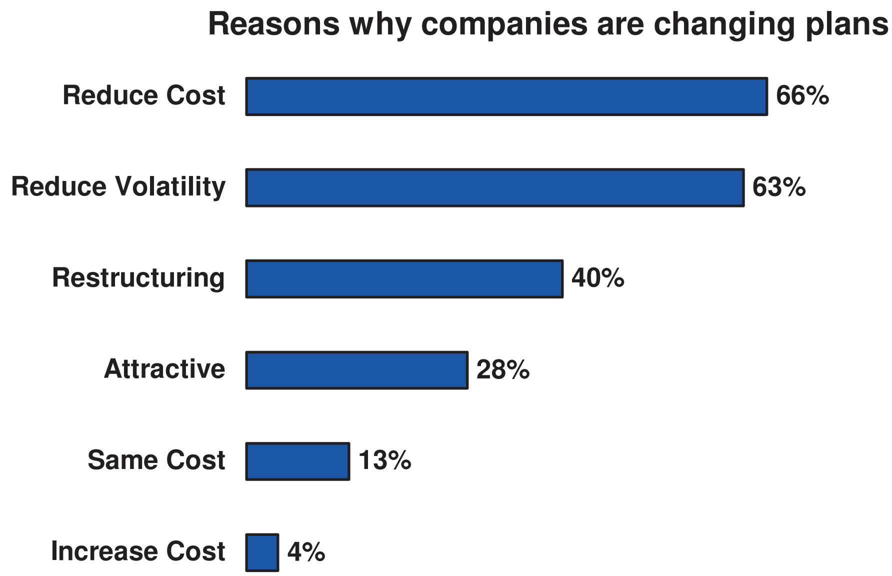
That all changed about twenty years ago. Reason: A tax loop-hole spawned one of the most popular savings vehicles of all time: The 401K. In no time at all, this savings vehicle became a household name.

Unlike its pension brethren, the 401K opts for a “defined contribution” over a defined benefit. It’s pretty straight-forward: Put in money as you work, gain some tax advantages, and maybe get a match from an employer. When they hand you the gold watch, you’re set.

Maybe not. While big obligations for companies, pension plans were a guaranteed way of providing retiring persons with a way to make ends meet. In the new-era of 401Ks – where employees have to force themselves into saving – the end result could be much less prosperous.

And the wave of moving away from pension plans isn’t going to change anytime soon. According to a study by consulting behemoth Deloitte, *more than half* of the companies they surveyed said they were considering – or already have made – changes to their pension plans in the last year.

And the reasons won’t be shockers: Two thirds of those making changes to their pension plans cite costs savings as the big reason …




*Source: Deloitte*

As you can see, a whopping 66% of those making plan changes expect the move to save them money … 63% expect the move will reduce cost volatility linked to the plans … and 40% made the jump as part of rewards package redo.

Translation? Companies continue to move away from pensions for a boatload of reasons, but mainly because of costs. Sure, 401Ks are an alternative, but the "forced savings" feature of pensions is all but vanishing. And that could put future savings of potential retirees at big risk.

## *Bottom line*

There's no doubt about it: Pension funds are quickly fading into the sunset as more and more companies opt out for less expensive alternatives. But that doesn't keep the $279 billion in underfunded pension liabilities from putting massive pressure on an already taxed pension system. The PGBC is sending up the red flag and it's a good idea to heed their warnings now rather than later.