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'Broken' pension system in 'crying need' of a fix

By Marilyn Adams, USA TODAY

WASHINGTON — Most surviving American steelmakers long ago abandoned costly pensions plans. But AK Steel still covers most of its 7,500 workers with a plan that pays retirees a monthly benefit based on tenure and past wages — a coveted defined-benefit plan.

AK has never missed a benefit payment to a pensioner or a payment to fund the plan. That's a source of pride for the 105-year-old Middletown, Ohio, company.

Nonetheless, the assets of the AK pension plan fall \$1.3 billion short of meeting estimated future obligations. The plan's long-term survival isn't assured.

Much of the attention in the raging pension-reform debate in Congress and the executive branch focuses on big companies such as United Airlines and other corporate giants that have used Chapter 11 bankruptcy-court reorganization to dump defined-benefit pension plans on the already overburdened government insurer, the Pension Benefit Guaranty Corp. But it's also cases such as AK Steel — a relative corporate good guy that has seen assets fall short of liabilities even while the company follows the rules — that have reformers fearing a possible financial catastrophe on the scale of the savings-and-loan meltdown 15 years ago.

David Walker, chief of Congress' non-partisan Government Accountability Office, describes the pension system as "fundamentally broken." He's frustrated that policymakers so far have been unable to solve a problem that's been documented over and over.

"There's a crying need," he says.

Business, Congress and the Bush administration agree that the U.S. system of private pensions is badly in need of fixing. What they haven't agreed on is how to fix it. Despite alarming statistics, years of studies and urgent calls for reform from advocates on all sides, Rep. John Boehner, R-Ohio, a sponsor of the pending House bill on pension reform, rates chances of passage by both houses of Congress this year as slim. Senate Majority Leader Bill Frist, R-Tenn., said Monday that the Senate bill might reach that chamber's floor by next week.

If Congress fails to act, "The problem will become much worse," says Bradley Belt, PBGC executive director. "To call upon taxpayers — most of whom don't have defined-benefit pensions — to pay for the benefits of those who do would be fundamentally unfair."

In total, defined-benefit pension plans offered by private employers are underfunded by \$450 billion, up from \$39 billion just five years ago. The PBGC itself has a deficit of at least \$23 billion. PBGC numbers coming out today are expected to paint an even bleaker picture: The high number of failed plans has left it without enough assets to cover future benefits. As more plans fail, the agency's deficit will grow.

In recent years, Huffy bicycles, Big Bear supermarkets, Polaroid, Kaiser Aluminum, Bethlehem Steel, WestPoint Stevens, Archibald Candy and United Airlines have terminated their plans and transferred responsibility for them to the PBGC. What worries PBGC officials now is how many other large companies are out there with ailing plans covering tens of thousands of workers.

The PBGC last year calculated that financially weak companies with a reasonable chance of terminating their

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pensions are \$96 billion short of covering promised benefits.

GM a concern

The PBGC won't say whether General Motors, whose pension plan is the biggest in U.S. industry, is among them. But the PBGC estimates that if financially troubled GM had to terminate its plan soon, it would be underfunded by \$31 billion, an estimate first reported by *The New York Times*. Using a different accounting method, Credit Suisse First Boston estimates the underfunding at \$12.3 billion.

GM, whose plan covers 600,000 participants, disputes those figures but declined to provide its own estimate. It is not required by law to do so. "We don't think it's appropriate to view the pension plan on a termination basis," because GM has no plan to end it, said GM spokesman Jerry Dubrowski.

The U.S. Securities and Exchange Commission, meanwhile, is investigating how GM reports pension-plan liabilities in its financial statements as part of a broader look into the automaker's accounting.

PBGC director Belt fears the mounting pension crisis could approach the scope of the savings-and-loan debacle that pushed the Federal Savings and Loan Insurance Corp. into insolvency in 1989 and cost taxpayers \$200 billion.

If the PBGC, which is supported by insurance-premium payments from pension-plan sponsors, were to sink too deeply into red ink, a giant taxpayer bailout might be the only way to keep millions of pensioners from losing their checks.

UNDERFUNDED COMPANIES

Companies with pension plans that are expected to be underfunded by at least 25% of their market capitalization, as of October 14:

	2005 estimated underfunded amount (in billions)	Estimated market cap. (in billions)	Percent. underfunded
Delta Air Lines	\$5.8	\$0.1	6,791%
Delphi	\$4.6	\$0.3	1,712%
Goodyear Tire & Rubber	\$3.1	\$2.5	125%
Visteon	\$1.0	\$1.0	96%
Ford Motor	\$13.5	\$16.0	85%
General Motors	\$12.3	\$15.8	78%
Unisys	\$1.2	\$2.0	58%
Navistar International	\$1.0	\$1.9	51%
Dana	\$0.4	\$1.0	47%
Maytag	\$0.6	\$1.3	43%
Hercules	\$0.4	\$1.3	28%
Raytheon	\$4.1	\$16.5	25%
Lockheed Martin	\$6.7	\$27.0	25%

Source: Credit Suisse First Boston

Stopgap pension relief for companies expires Dec. 31.

Without comprehensive reform legislation this year, temporary rules will take effect that will increase the contributions companies must make to their plans as well as the insurance premiums they must pay the PBGC. U.S. Labor Secretary Elaine Chao says the price of doing nothing about reform will be "very bad" for plan sponsors.

The pension system in Corporate America is in trouble for many reasons, some within the control of Washington policymakers and some not.

Not the least of the problems is Americans' lengthening life spans. Retirees are living longer than ever and will draw pension checks longer than ever. The biggest generation in history, the baby boom, starts hitting 65 in 2011. Making things worse is that many pension plans let workers start drawing benefits after 30 years of work. For many retirees, that means benefits start in their 50s.

Another factor: Pension funds rely on assets that grow through investments in stocks and bonds. For five years, markets have produced lackluster returns.

Loopholes in the law

But Congress can do nothing about demographics or investment returns. So reformers are focusing on loopholes in the law — and some companies' willingness to exploit them to avoid or reduce payments.

Private pensions are governed by the Employee Retirement Income Security Act, passed in 1974 after the collapse of automaker Studebaker a decade earlier, which left its retirees almost empty-handed.

The law established the PBGC insurance program, which covers benefits up to specific annual dollar limits — up to \$45,600 this year for someone retiring at 65 — and requires companies to pay premiums. Over the years, changes have crept into the law designed to make it easier for firms to comply.

Among the issues that reform proposals address:

- PBGC premiums.** Almost everyone agrees that without higher premiums and stricter funding rules, pension problems will get worse. The Bush administration proposed \$30 per worker per year, up from \$19 now.

- Skipped payments.** Rules allow employers to skip plan payments by applying excess contributions from an earlier year as an offset to the minimum requirement for a later year — even if the plan is underfunded.

"The combination of rules allows companies to go for years on end without putting any money into their pension plans," says Belt.

US Airways, for example, made no contributions to its pilots' pension plan for years before it was terminated in 2003.

- Overpromising.** Employers with underfunded plans are allowed under current rules to sign labor contracts that promise union members larger benefits that the companies can't necessarily afford.

- Secrecy.** Every employer with a troubled plan is required to tell the PBGC each year how underfunded the plan would be if it had to be terminated. But the company is not required to tell the people directly affected: workers and pensioners. The PBGC is not allowed to tell.

- Inadequate funding.** PBGC's Belt says funding rules today simply don't ensure that pension plans are fully funded.

Most controversial is an administration proposal to penalize companies with poor credit ratings and underfunded plans by accelerating their plan payments. The thinking is that those companies are at higher risk for pension default and should be required to do more to keep plans afloat.

'Sky is not falling'

Boehner, the Ohio congressman, says such tough medicine would "kill the patient" and prompt some employers to drop their plans.

AK Steel, for example, says its credit rating has been below investment grade for years, yet it has never missed a payment.

Business groups such as the National Association of Manufacturers acknowledged pension rules require tightening. But they question the administration's alarming projections and say companies with pension problems don't represent the majority.

"Our message is the pension sky is not falling," says NAM spokesman Darren McKinney. "The problem is not as big as some would have you believe."

He says the PBGC's statistics show only 15% of private defined-benefit plans were funded below 70% in 2002, the latest data available.

What seems to gall reformers most is the recent pattern of big companies using Chapter 11 of the bankruptcy code to jettison the debt of underfunded pension plans, then exit bankruptcy and survive. US Airways did it, and United is in the process. Huffy and Big Bear did the same in bankruptcy court.

Now, reformers fear Delta Air Lines, Northwest Airlines and auto-parts maker Delphi, all of which filed Chapter 11 cases recently, will make the same argument to their bankruptcy-court judges.

"People are using the pension system and bankruptcy code as a business strategy," charges Walker of GAO.

AK Steel feels penalized

AK Steel agrees. It has seen plenty of competitors unload their plans. AK says its pension and retiree medical costs make its steel at least \$40 a ton more costly to produce than some of its competitors'.

"We are penalized because we didn't go bankrupt," says Vice President Alan McCoy.

So, AK has been going to its unions during contract talks, asking them to agree to freeze members' pension plans so benefits don't keep growing and so new employees aren't covered. Three unions, representing 20% of AK's unionized workforce, have agreed.

"They told us they needed that relief to stay competitive and stay out of bankruptcy," says Tim Imes, president of the United Steelworkers union in Ashland, Ky., that represents AK workers there. Given pension-plan terminations at Bethlehem Steel, National Steel and elsewhere, the union knew "the monster was real."

AK officials say they still believe in good pensions but can't ignore their competition.

"We are disturbed that the bankruptcy system allows what has happened to happen," says McCoy. "We don't think that's right."

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