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Failed Pensions: A Painful Lesson in Assumptions

By MARY WILLIAMS WALSH

Robert M. Bowden retired from his job as accounts manager for a large trucking company with a plan to travel for himself.

But his company's pension plan collapsed this year, and his annual payout was cut to \$24,000 from \$48,000.

Mr. Bowden and other retirees of the company, CNF, see a culprit. In a lawsuit, they accuse the company of failing for many years to set aside enough money in the plan. The company did this, they say, by assuming they would retire much later than they really did. Though the CNF plan offered full benefits to people as young as 55, the company projected people would stick to their desks until they turned 64.

A look at documents made public in the retirees' fight at CNF and at a few other companies, including US Airways and [Bethlehem Steel](#), shows that companies have great leeway to tweak certain crucial assumptions about the future — when their workers will retire, how long they will live, and which way interest rates will move, among others.

A year shaved off an estimate here, a decimal point's difference there can significantly reduce a company's pension obligations on paper. The company can save millions of dollars in pension contributions.

But if a company shortchanges its pension fund year after year and the company then gets into trouble, the plan that looked healthy can fail, seemingly out of nowhere, leaving workers stranded.

"I'm in a financial survival mode," Mr. Bowden said. At 59, he recently refinanced his mortgage in Lake Oswego, Ore., to conserve cash while looking for a cheaper place to live.

Assumptions that the government considers inadequate contributed to the demise of almost all of the roughly 150 pension plans that failed in the last year. Current detailed information about pension plans is not routinely disclosed, however.

The painful lesson for employees comes as companies press Congress for permanent relaxation of some provisions of the pension funding law. One measure, passed by the House in October, would allow companies to make more favorable interest rate assumptions for the next two years while a panel works on broad changes to the pension funding rules.

Two other bills, recently passed by different Senate committees, would extend the interest-rate change beyond two years, and one of them would also suspend a measure intended to punish companies that let their pension plans become severely underfunded. If Congress does not act before a stopgap measure expires at the end of the year, companies will be forced to make large mandatory contributions.

Companies generally contend that the funding requirements are out of step with the current financial environment. CNF has not filed a response to the retirees' suit, and a spokeswoman said the company could not comment on the dispute.

According to a rule of thumb used by actuaries, though, every year's difference between the company's projection and the age at which the employees actually retired might have understated benefits by about \$15 million.

"There are ways companies can kind of game the system, to contribute a lot less money than is realistic," said Jeremy I. Bulow, the Richard Stepp professor of economics at Stanford University's graduate school of business. Essentially, he said, they are trying to get a loan from the government agency that insures pensions, the Pension Benefit [Guaranty Corporation](#), or from their employees. "That's what they're trying to do, and it's very bad news," he said.

To be sure, the world of actuarial science is not the wild, wild West. Companies have been caught gaming pension assumptions in the past and as a result some assumptions are now regulated. Interest rate assumptions are especially powerful in pension calculations, and the most important ones are today a matter of statute — the same statute Congress is now being asked to modify.

Assumptions about employee life spans are also regulated today, after [General Motors](#) was found in 1994 to be assuming its workers would die younger than [Ford's](#). Workers who die young will have collected smaller total pensions, reducing the corporate contributions. Today, all companies are supposed to use a standard mortality table, though some companies are lobbying Congress for more leeway there as well.

For other assumptions — about pay increases, staff turnover, marital status, retirement ages and other factors — there are no hard and fast rules. The law says only that assumptions must be reasonable; that term can mean different things to different people.

US Airways and [AMR's](#) American Airlines, for instance, have found it reasonable in recent years to assume that their pilots will retire when they turn 60, because the Federal Aviation Administration grounds commercial pilots when they reach that age.

"Pilots enjoy flying and typically it's an avocation in addition to being a job," an American Airlines spokesman said. "A lot of pilots would even work past 60 if they could."

After US Airways' pension plan for its pilots failed this year, however, the government looked at the age when they were actually retiring and found that lately, more than half have been retiring well before their 60th birthday. The Pension Benefit Guaranty Corporation is arguing in bankruptcy court that the airline should have assumed that the pilots would retire, on average, at 56. The agency, an unsecured creditor, is in court seeking a portion of the reorganized airline's stock to help cover its cost of paying the pilots' benefits.

Because the government insures pensions only up to certain limits, the US Airways pilots will lose, in total, about \$1.6 billion in anticipated benefits, according to the pension agency.

Documents in the US Airways case also show how powerfully a pension plan can be affected by an assumption that seems only slightly off the mark. An analysis supplied by US Airways' actuary, Towers Perrin, suggests that when the airline assumed its pilots would retire four years later than they really did, it shrank the amount it appeared to owe them by about \$385 million. That, in turn, meant it contributed less to the plan.

"In every dimension that was possible, they made the most aggressive actuarial assumptions they could," Mr. Bulow said in an interview. He submitted testimony on behalf of the government in the US Airways case.

Towers Perrin declined to comment on its retirement-age assumptions, citing its policy not to discuss matters before the courts. US Airways, in court documents, stands by its assumption that pilots will retire at 60 in the future. It notes that the defunct pension plan has been replaced by a new benefits package that will reward pilots who keep working as long as possible.

The airline also argues that the government is forcing it to make an inappropriate assumption about interest rates in its calculations, in an effort to grab a larger portion of its stock. The judge is expected to resolve the dispute in the coming weeks.

The retirement age was also a factor in the costly demise of Bethlehem Steel's pension plan. Bethlehem's actuary, [Aon Consulting](#), assumed the work force would retire at age 62, even though the company offered pensions to much younger workers, as long as they had 30 years of service. Other actuaries said that assumption was highly questionable, and that it was an important factor in the Bethlehem plan's record \$3.7 billion shortfall when it failed.

A spokesman for Aon said the firm could not comment on a client's affairs. Bethlehem itself has been liquidated. The government estimates that Bethlehem's work force has lost, over all, about \$400 million in promised benefits.

At CNF, the pension troubles grew out of the freight company's decision, in 1996, to spin off its unprofitable Consolidated Freightways unit. Consolidated, a unionized long-haul trucking business, was losing money in the mid-1990's, dragging down the parent company's performance. CNF was meanwhile building up a separate nonunion trucking business that was profitable. By 1996 the two divisions were competing head to head in some markets.

When it spun off Consolidated, CNF had to split its pension fund and put some of the money into a new fund for the departing work force. Such transactions are regulated; companies must certify to the Internal Revenue Service that they are transferring enough money to cover the benefits the departing workers have earned.

Mr. Bowden and his fellow retirees said that when CNF calculated their benefits, it assumed that most of them would retire at 64. But many Consolidated managers retired in their late 50's, they say, to take advantage of generous early retirement benefits the company offered to people whose age, plus years of service, added up to 85.

Steven M. Tindall, the retirees' lawyer, said that by using a higher retirement age in its calculations, CNF was able to put less money into the spun-off pension plan.

"We think this is a way the company saved some money," said Mr. Tindall, a partner in the law firm of Loeff, Cabraser, Heimann & Bernstein in San Francisco.

He and the retirees also said that CNF used an inflated interest rate in its calculations, further reducing the amount it put into their pension fund. Born weak, the new pension fund was then underfunded each year, they believe, because CNF continued to administer it using inappropriate assumptions.

Consolidated's retired managers, like Mr. Bowden, said they had no idea this was happening until it was too late. They said they were never even told the pension fund had been separated from CNF, much less that it was withering away.

Chester Madison, a group operations manager for Consolidated, said that just before he retired, in August 2002, he asked about the pension plan and was told it was "fully funded." Two weeks later, Consolidated filed for bankruptcy. Four months after that, he and the others began receiving letters saying the plan had failed. It had less than half the assets needed to pay their benefits.

"You feel betrayed," said Mr. Madison, whose monthly pension check has been reduced to about \$1,700 from \$4,100. He has been looking for a job to make up the difference. "Not too many people are going to hire you when you're 58 years old," he said.

Even Consolidated's retired president, Thomas A. Paulsen, was surprised. At age 59, with 36 years of service, he had earned a pension of \$9,755 a month. When the plan failed, his check was reduced to \$1,876. He believes CNF spun off Consolidated with insufficient resources, to "send the old dog out to

die."

Employees at all levels are supposed to get basic information about their pension plans once a year, but it is difficult, if not impossible, to check the validity of the underlying assumptions. Companies are not required to disclose current, detailed information about their pension plans. They do list three actuarial assumptions in the footnotes of their annual reports, but retirement age is not among them.

More details about pension plans are on file at the Labor Department, but those records are generally at least two years out of date. And even if an employee goes to the trouble of getting the numbers, they are difficult to decode without a complete understanding of the company's demographics.

Mr. Bowden recalled that CNF hired him in 1967, when the company was expanding rapidly and hiring lots of baby boomers. They were entitled to early retirement, and the plan failed just as they were claiming it. The government's pension insurance has limits to begin with, but those limits are reduced even more for those who retire before age 65.

"There's hundreds of thousands, maybe millions, of people, who believe that the P.B.G.C. will guarantee their pensions, and it's not the case at all," said Robert Newell, a retired Consolidated vice president. His monthly pension has been reduced to \$2,025 from \$5,357.