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Many Corporate Pension Funds Assumed Outsize Gains

By MARY WILLIAMS WALSH

The first comprehensive examination of the pension funds of the nation's biggest corporations shows that nearly half made assumptions about their investment returns for 2002 that would be deemed too aggressive by federal regulators, starting this year.

Of the 100 companies examined, 45 used an annual rate of return of more than 9 percent, the proposed standard for this year. Eight of the companies assumed that their pension funds would have returns of 10 percent or more. In fact, though, almost all the pension funds examined lost money last year.

The companies that used the highest estimates included [Northwest Airlines](#), [General Motors](#) and [Honeywell International](#).

The optimistic assumptions about returns on fund investments translated into billions of dollars for corporate America's collective bottom line in 2002, according to the study, by the actuarial firm of Milliman USA.

During the stock market boom, when pension funds were growing steadily each year, these assumptions did not prompt much concern. Because such funds invest for the long term, and may experience short-term fluctuations, an assumed rate of return provides a way to smooth out the impact on the company's financial performance.

"I've had more questions on the assumed rate of return in the last six months than I had for 15 years before that," said John W. Ehrhardt, a consulting actuary and principal of Milliman and author of the new study. "The auditors are looking at this much more closely. Nobody, in the post- [Enron](#) environment, wants to have any questions asked about their financial statements."

The Milliman survey showed that America's biggest companies last year assumed an average rate of return of 8.92 percent for their pension investments. Mr. Ehrhardt said many companies are lowering their assumptions for 2003.

"I wouldn't be surprised to see an average of 8.5 percent," he said, adding that he considered that rate "reasonable," given long-term investment trends.

Accounting rules do not offer companies detailed instructions for picking each year's rate, but the rates should reflect the long-term investment performance of the types of assets in their pension funds.

Berkshire Hathaway, which has been widely praised for its realistic pension accounting techniques, used an assumed rate of return of just 6.5 percent, the second lowest of the 100 companies surveyed. Only Merrill Lynch was lower, at 6 percent.

Milliman's study also shed light on how quickly corporate pension plans shrank as financial markets soured. Milliman surveyed the 100 largest American companies that offer traditional, defined-benefit pensions to their workers. It found that these companies together enjoyed a substantial pension surplus in 2000, but by the end of last year, they were only 82 percent funded, on a collective basis.

A company's pension funding ratio indicates the extent to which current assets will cover projected future payments to retirees.

The study used data taken from the companies' 2002 financial reports, which calculate pension activity with methods intended to show general trends to investors. These calculations differ from those used to show employees and retirees whether their companies were setting aside enough to pay their pensions.

Mr. Ehrhardt said the pension deficits underscored by the survey were not a sign of any impending pension defaults by the companies. "I don't think this is a benefits-security issue yet," he said.

Rather, he said, the study offered strong evidence that growing numbers of companies would have to make substantial cash contributions to their pension funds in the coming months. He said these expected contributions should not cause consternation among investors, except for companies that were not generating enough cash to cover the mandatory payments.

"A pension plan is a very good benefit," he remarked, "and companies should expect to have to pay for it."

Mr. Ehrhardt also said that as companies bring their assumed rates of return in line with the realities of the securities markets, corporate bottom lines are likely to be reduced, because some of the illusory profits that accounting rules permit will melt away.

Noting that the average rate used by the 100 companies was 8.92 percent, on that basis the pension funds gave those companies a collective income increase of \$3.3 billion. Had the companies used an average rate of 7.92 percent instead, he said, they would have wiped out that increase and reduced their collective

pretax earnings by a further \$5.7 billion.

Though 10 percent returns now seem far-fetched after three poor years of stock market performance, eight of the largest corporations used such assumptions, while posting investment losses in their funds ranging from 2.9 percent to 13.5 percent, according to Mr. Ehrhardt.

The company with the biggest discrepancy between its assumed rate of return on pension assets and its real return was Northwest Airlines. Northwest assumed its pension assets had a 10.5 percent gain last year, but the funds actually lost 13.5 percent on investments.

Starting this year, federal regulators have said that they will audit the financial statements of any companies that use rate-of-return assumptions greater than 9 percent for their pension funds. Any company unable to persuade the auditors that a higher rate is valid will be required to restate earnings.

Northwest has already said that it will use an assumed rate of 9.5 percent for its pension investments in 2003. A spokesman, William Mellon, said the airline decided to use the rate "after consultation with outside experts and consideration of historic rates of return."

"We are comfortable with a 9.5 percent rate of return," Mr. Mellon added.

General Motors, which has America's largest corporate pension fund, also used an assumed rate of return of 10 percent last year and will use 9 percent in 2003.

"We feel that that's an appropriate rate of return, based on our track record as of the last 15 years," a General Motors spokesman, Jerry Dubrowski, said.