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Pension Loopholes Helped United Hide Troubles

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Loopholes in the federal pension law allowed United Airlines to treat its pension fund as solid for years, when in fact it was dangerously weakening, according to a new analysis by the agency that guarantees pensions. That analysis is scheduled to be presented at a Senate Finance Committee hearing today.

A second report, by the comptroller general, found that most companies that operate pension funds are using the same loopholes. Those loopholes give companies ways - all perfectly legal - to make their pension plans look healthier than they really are, reducing the amount of money the companies must contribute.

United's pension fund failure is now the biggest since the government began guaranteeing pensions 30 years ago. Most companies are able to keep their pension plans going, despite the chronic, hidden weakness, because they are generating enough cash to meet their obligations to current retirees. Only when a company files for bankruptcy, as United did in December 2002, and terminates its pension plan, as United has, does the government step in and make the plan's true economic condition apparent.

"We saw similar practices and events at [Enron](#), but unfortunately, this time it's perfectly legal," said Senator Charles E. Grassley, the Iowa Republican who is chairman of the finance committee. He said he had scheduled today's hearing because he wanted to find ways to keep pension disasters like the \$10 billion failure at United from happening at other companies.

"The rules are full of serious holes that need to be fixed as soon as possible," Senator Grassley said. "No one should make the mistake that this is an airline-only problem. The reality is that companies everywhere have used the same arcane pension-funding rules" to shrink their contributions.

Many analysts believe that the federal Pension Benefit [Guaranty Corporation](#) will one day require a bailout because it has been forced to pick up a number of large failed private pension plans. The more big defaults there are in the meantime, the more the eventual bailout will cost.

The federal pension law was enacted in 1974 after a number of scandals in which companies went bankrupt and their workers discovered there was little or nothing set aside to pay the pensions they had been promised. The law was supposed to make pension failures a thing of the past by requiring companies to set aside money in advance - enough each year to pay the benefits the work force earned that year.

The law also required that if a pension fund got into trouble, its sponsor was to quickly pump in more money, warn its employees about the problem and pay higher premiums to the federal pension insurance program.

United did none of those things, even as its pension fund withered, because its calculations were making the fund look healthy. The fund is made up of four individual plans for various groups of employees.

United's calculations followed the letter of the law until July 2004, when the airline announced that it owed \$72.4 million to its pension fund but would not make the contribution. By that time, the company had filed for bankruptcy protection.

The \$72.4 million would have done little good by then, because the pension guaranty agency told the bankruptcy court that the pension fund had a shortfall of \$8.3 billion.

In its analysis, the Pension Benefit Guaranty Corporation found that in 2002, when United was determining how much it had to contribute to its four plans, it calculated that the plans for its pilots and its mechanics each had more money than needed. It further calculated that the plans for its flight attendants and its managerial workers were close to being fully funded, and did not need any special attention.

On the basis of those calculations, United, a unit of the UAL Corporation, made no pension contributions that year.

Those numbers are on file with the Labor Department. But they do not square with the pension numbers United provided to the Securities and Exchange Commission. That agency requires companies to calculate pension values in a different way. At United, that method showed the four pension plans to be only 50 percent funded; that is, they had only half as much money as they needed to make good on United's promises to its workers.

Pension calculations done for S.E.C. filings have nothing to do with the rules for calculating contributions. But had United been required to use the S.E.C. pension numbers to determine its contribution that year, it would have had to pump money into the plans quickly. The pension law requires companies to make special catch-up contributions any time their pension funds fall below an 80 percent funded level, or even when they fall below 90 percent funded, if they stay at those levels for several years. A plan that was only 50 percent funded would be considered a real emergency.

But the law allowed United to say its pension plans were fully funded, or nearly so, and, therefore, no more money was needed. United's employees were not informed that anything was amiss, as the law requires of badly weakened plans. Nor did United have to pay the higher premiums to the pension guaranty agency that the law expects.

The discrepancy between a company's pension report to the S.E.C. and the Labor Department is but one example of the problems. At today's Senate hearing, David M. Walker, the comptroller general, is expected to testify that companies have so many ways of tweaking their pension calculations that they almost never have to make the special catch-up contributions that Congress required of plans that are slipping.

A recent study by the Government Accountability Office, which Mr. Walker runs, examined eight years of records for the nation's 100 largest pension funds, and found that only six plans in the entire group ever had to pay the special contributions in that period.

For two of the plans, it was already too late by the time the special contributions came due. Years of insufficient contributions had taken their toll, and those plans collapsed and were taken over by the government.

The G.A.O. study attributes some of the misleading pension math to the use of inappropriate actuarial assumptions in projections and some to a process called "smoothing," in which actuaries attempt to eliminate short-term volatility by spreading changes over several years.

But the pension agency's analysis of United's case shows that the rules for tracking contributions made in prior years have also caused a great deal of trouble. The rules allow companies that put in more than the required minimum in any given year to keep the excess amount on their books and to use it to offset their required contributions in years when cash is tight.

These excess contributions from the past are kept in a running tab called a credit balance.

The trouble is that at United, as at many companies, money contributed in the 1990's was invested in assets that lost value during the bear market that began in 2000. But the pension rules allow companies not only to keep their pension credit balances on the books at the original amount, but they are even permitted to allow their credit balances to compound in value at some interest rate determined by the plan's actuary.

When United's calculations finally began to show that contributions were quickly needed, in 2003, the airline was able to satisfy the requirement with just a small amount of cash and lots of bookkeeping entries from its credit balance.

Senator Grassley said he believed many companies were "booking phony investment gains to hide that workers' pensions are going down the tubes."

He said he hoped the hearing would lead to legislation that would eliminate the loopholes that made such maneuvers possible.

In a later session today, the finance committee is scheduled to hear from executives of some of the major airlines, and from the leaders of some of the unions for airline employees.

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