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EDITORIAL COMMENTARY

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## Profiting From Pensions

### Turnabout is not always fair play

By THOMAS G. DONLAN

[The Great Divide](#)

For several years in the late 1990s, investors ignored an obscure but significant source of earnings in the reports of many major corporations. Most companies with defined benefit pension plans were reporting that their retirement-plan finances were so secure that they didn't need to put any more cash aside. The security, however, was the stock market.

Rising asset prices more than covered rising pension liabilities. With an insouciance sanctioned by accounting rules and tax law, the difference was said to be a profit.

Though times have changed, investors may still be obtuse about pensions. Just as they generated big profits, they should be generating big losses soon.

As Jacqueline Doherty reported in *Barron's* a couple of weeks ago ("[Pay Me Later?](#)"), 240 companies in the Standard & Poor's 500 stock index had underfunded pension plans at the end of 2001, which marked the widest accumulation of shortfalls in a decade. Her story included the views of David Zion, an analyst at Credit Suisse First Boston, who said that he expects the number of S&P 500 companies with underfunded pension plans could hit 325 in 2003.

Yet some companies that should be reporting big losses may not actually do so just yet. Pension reports are merely forecasts of future benefit payments and future earnings on invested pension assets. As such, they are dependent on assumptions about rates of return, life expectancies, retirement ages and other things which honest people can differ about and dishonest people can manipulate.

"Making predictions is hard, especially about the future," as Yogi Berra may have said. And as Warren Buffett observed recently in an aside to his angry comments on accounting for stock options, "Pension expense in corporate America is calculated under wildly varying assumptions, and CPAs regularly allow whatever assumption management picks." Buffet should have added that actuaries also seem to do little to rein in management assumptions.

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If there is a bright side to the whole erratic subject of pension earnings and losses, it's for beneficiaries only. Cash contributions to pension funds go on pretty much as scheduled. Most pension funds of most solid operating companies keep on paying benefits, unless there's a real operating disaster or real skulduggery.

The trouble is that we don't know for sure. Neither investors nor potential beneficiaries receive enough information about pension finances. Disclosure requirements are extremely weak. Companies have 210 days after the end of a plan's fiscal year to file its basic financial report, and the Labor Department has another year to process the data before making it available to the public.

Corporate reports to investors don't even distinguish among the various plans that provide for different groups of workers and executives. Reports to beneficiaries usually are 10 months or more out of date when delivered, and they rarely provide specific numbers about the amount of over- or underfunding in their plan even then, unless the plan is more than 10% underfunded. They will report assets and the change in assets, but not liabilities or the change in liabilities.

One important source of rising pension liabilities at many big companies is a trend toward artificially generous retirement benefits for top executives. Big shots are credited for years of service they never worked, with salaries they never really earned, and they get farewell bonuses in the millions of dollars. Nearly all of these benefits are unfunded, even though the extra benefits are likely to be paid for decades. The projected benefits go directly to the pension liability column without even nodding respectfully to the asset side of the ledger.

Another source of rising liabilities is early retirement for everybody else. A company that needs to slim down its work force may attempt to do it on the back of its pension plan, rather than buying out workers or simply laying them off.

Both trends are rooted in regulation rather than good sense. Businesses small and large used to get nearly limitless tax deductions for contributions to pension plans, but Congress decided that it was abusive to provide a shelter for plans that mostly benefited business owners and executives. Deductions were limited for these "top-heavy" plans.

The unexpected consequence was that businesses kept on making generous provisions for their owners and executives even without the tax shelter. Then, since the top people no longer depended on the plans for the rank-and-file, they no longer cared as much about them.

Many companies, in fact, froze existing defined-benefit pension plans and started up defined-contribution plans such as the 401(k). Even companies that had been relatively lavish with their benefits joined the rush. Some converted their defined-benefit plans into hybrid "cash-balance" plans, which look like defined-benefit plans but lack features that increase benefits for workers who stay in one job for a long time.

More ruthless companies found ways to push out older employees before they hit the last decade of their planned careers, during which their pension benefits would have increased rapidly.

Such changes and their business consequences come as shocking surprises to beneficiaries and investors. It's time that auditors and actuaries forced companies

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to give a good account of their pension plans.

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