

January 16, 2004

U.S. Insurer of Pensions Says Its Deficit Has Soared

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The federal agency that insures pension plans said yesterday that its deficit had grown from \$3.6 billion to \$11.2 billion in just a year and that it would try to deal with the escalating problem by overhauling its own investments, among other measures.

The agency, the Pension Benefit [Guaranty Corporation](#), said that two consecutive years of record failures by corporate pension plans and continuing adverse market conditions left it with a shortfall much greater than a year earlier, which had been the previous low point in the agency's 30-year history.

People briefed on the new investment plan say the agency intends to reduce its risk in the stock market by investing in assets - including bonds and stock-like instruments - that will mature when it must make payments to retirees. Steven A. Kandarian, the executive director who will soon leave the agency, said that the board had recently voted to change the investment policy but declined to provide details.

Some consultants said the new investment plan could be a model for companies that sponsor pension plans. They have argued that the pension funds of at least some companies are dangerously invested in stocks and may be unable to fulfill their promises to retirees, leaving the government to make good on them.

Zvi Bodie, a finance professor at Boston University, said reducing stock market risk was a long overdue improvement at the agency. "This is like saying, 'Yes, we understand the lessons of the S.& L. crisis,'" said Mr. Bodie, who has been writing about the agency's weaknesses for a number of years and has compared its troubles to the savings and loan disaster of the 1980's. (Stock performance can be unpredictable, and pension payouts are predictable, creating a mismatch, he said.)

The new investment policy is a "recognition that stocks are not a hedge against long-term fixed liabilities," Mr. Bodie said.

Detailed information about individual plans is not disclosed by companies, but pension specialists say that about two-thirds of their assets are typically invested in stocks. This practice allows companies to

post larger investment gains when the stock market is moving up, and accounting rules allow those gains to bolster the corporate bottom line. Companies have so far resisted the argument that stocks are inappropriate investments for pension funds.

But the recent bear market demonstrated that when stock prices fall, companies may be caught without enough money on hand to pay the pensions they owe. Such shortfalls become critical when the company sponsoring the plan is itself in trouble and cannot generate enough cash to replenish the pension fund.

At a briefing for journalists yesterday, Mr. Kandarian noted that the agency was less concerned about the strong, growing companies with underfunded pension plans than with companies whose pension funds are in bad shape and are unstable themselves.

In recent months, administration officials have discussed ways of giving incentives to companies to operate their pension funds with less risk.

"Should all companies be treated the same?" Mr. Kandarian asked. "One thing we've looked at very closely in the administration is whether the system should be more risk-based."

He suggested that rewarding companies that handled their pension plans prudently would create a more equitable system. As things now stand, he said, companies that keep their pension plans healthy are, with their insurance premiums, subsidizing companies that cannot or will not.

"We're taking companies' money that are funding their plans, and using it to cover the companies that are saying, 'Let me borrow from my pension plan, effectively, to see if I can get out of my business problem,'" he said. "At the moment, most of the risk is in the plans of airlines and steel companies."

"But we shouldn't focus simply on the issues of airlines and steel," he said. "A strong industry could become a weak industry 10 years from now. We're thinking of this as a long-term issue."

People briefed on the agency's new investment policy said officials had determined that since companies have large portions of their pension funds invested in stocks, then the agency is, in effect, facing a double risk. The agency's own stock investments could lose money - and the companies whose pensions it insures could also lose money on the stocks in their pension funds.

"You kind of lose twice," said one person briefed on the new investment policy. "If you were a property-and-casualty insurer insuring a beachfront neighborhood, would you also buy property in that neighborhood?"

The agency had 37 percent of its nearly \$35 billion in total assets in stocks at the end of its last fiscal year, ended Sept. 30. The agency reported that it earned \$3.3 billion on its investments last year, or a return of about 10.3 percent. That was more than enough to cover the agency's \$2.5 billion in payments to retirees last year. But the payments to retirees are expected to grow in the coming years, and stock

market gains cannot be counted on to cover these required cash outlays every year.

By changing its investment approach, the agency will give up the chance of earning the high returns stocks can provide. Instead, it will earn smaller, but far more predictable, returns that can be calibrated to cover its obligations.

About half of the agency's total investment portfolio comes from the companies that default on their pension obligations. When that happens, the agency takes over the assets that are left in the pension fund, and puts that money toward paying the pensions owed to the company's retirees. These assets are combined with those taken from other failed pension plans. Currently, the government invests this money primarily in the stocks of established companies.

The agency has a separate investment portfolio solely in fixed-income securities; this is the money the agency receives as premiums from the companies that sponsor pension plans. The investment requirements of this fund are set by statute and cannot be changed by the agency or its board, which is composed of the secretaries of the Treasury, Labor and Commerce Departments.

In addition to disclosing a record deficit yesterday, the agency said the weakness that has afflicted corporate pension funds for the last two years has spread to America's union-led pension plans, which have not been a problem for the government until now.

The government said most of the risk posed by union-led pension plans is concentrated in two sectors, trucking and construction. Three of the 10 union plans showing the biggest deficits at the end of 2002 were run by the International Brotherhood of Teamsters, according to government data released yesterday. The government said no more-recent data on the Teamster plans were available.

Mr. Kandarian said the agency's deteriorating financial condition "underscores the need for comprehensive reforms" of the pension law. The Bush administration has been calling for major changes in the pension laws and regulations for much of the last year. But such changes must be made by Congress, whose members have squabbled over the best approach. Many members want to lighten the burden on companies, fearing that if the rules are tightened, companies will stop offering pensions entirely. The administration has argued that unless the rules are tightened, more and more plans can be expected to fail, leaving taxpayers on the hook.