

SPECIAL REPORT

U.S. pension peril grows with bankruptcies

Time running out for government agency as firms drop retirement

By [August Cole](#), MarketWatch

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SAN FRANCISCO (MarketWatch) -- In 2002, a bankrupt Bethlehem Steel stunned 100,000 workers with the news it would no longer back their pensions.

It was the biggest default in a brutal year during which companies dropped responsibility for 157 pension plans onto the Pension Benefit Guaranty Corporation, the little-known federal agency that insures private retirement packages.

The trend has since accelerated. Another 467 companies, including giant employers like United Airlines, have joined those who can't -- or won't -- honor pledges to retirees.

In just four years, the number of monthly checks PBGC sends to retired workers has swelled from 344,770 to 683,000, doubling annual payouts from \$1.54 billion to \$3.69 billion and turning the PBGC's budget from a tidy \$10 billion surplus in 2000 into a \$23 billion deficit last year.

The growth in PBGC obligations is under sharp attack from union leaders, who see it as an assault on Corporate America's long-standing pact with employees, and has raised alarms in Washington over who is going to pay for this.

"The bottom line here is we're talking about a taxpayer bailout," said David John, a Heritage Foundation researcher. "It's inevitable."

Executives who have steered corporations through bankruptcy don't see it that way, arguing they are serving the best interests of their company.

Congress, mindful that the PBGC backs about 44 million Americans' pensions, is rushing to pass legislation before the July 4 summer recess to shore up the agency's sagging finances. The agency warns it might have to take over \$108 billion in underfunded pensions, while its overall potential liability for insured single-payer plans has ballooned to \$450 billion.

Meanwhile, the problem continues to grow. Delta Air Lines ([DALRQ](#)) :

Delta Air Lines, Inc.

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[DALRQ](#) **0.75, +0.01, +0.7%**) said this past week it plans to terminate its underfunded pilots' pension plan as part of its bid to get out of bankruptcy, as did US Airways ([LCC](#) :

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[UAUA](#) **29.99, -0.13, -0.4%**) on their recent sojourns through bankruptcy court. [See full story.](#)

The market is now closely watching bankrupt Northwest Airlines ([NWACQ](#) :

Northwest Airlines Corp Cl A

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[NWACQ](#) **0.57, +0.01, +0.9%**) to see if they, too, move to ditch their pensions.

Meanwhile, management at Delphi Corp. ([DPHIQ](#) :

delphi corp com

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[DPHIQ](#)**1.65, -0.06, -3.5%** , General Motors Corp's ([GM](#) :

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[GM](#)**26.45, +0.55, +2.1%**) biggest parts supplier, is fighting to salvage its employees' retirement packages as a matter of principle as it struggles through Chapter 11 restructuring.

Originally the PBGC aimed to protect workers' pensions from corporate meltdowns. Thirty-two years later, it has become a tool for executives trying to ease long-term burdens on companies working to get out of bankruptcy.

Former PBGC director Bradley Belt, a strong proponent of reform who left the agency in May, said Northwest and Delta must have had huge pension payments in mind when they sought Chapter 11 bankruptcy last September, right before those payments came due.

"Their business decisions are being driven in a significant way by their pension obligations," Belt said.

Surplus to deficit

Created in 1974 by the Employee Retirement Income Security Act, the PBGC gets most of its money from premiums paid by companies supporting pension plans. But there are no accounting rules requiring those plans be fully funded. That, combined with falling stocks, low interest rates over the past few years and the growing scope of pension plan defaults, has drained the agency.

"The PBGC was put together to handle normal risks," said Olivia Mitchell, a professor at The Wharton School and director of the Boettner Center for Pensions and Retirement Research at the University of Pennsylvania. "I don't think anybody really expected ... there would be entire swathes of American industry that would have the bottom fall out."

Which is precisely what happened to the steel and airlines industries. There are now fears a similar fate might befall the struggling U.S. auto industry, another huge employer.

Currently, the PBGC has enough money to make its payments. But some forecast the agency will be completely depleted within 15 to 20 years.

According to Belt, the agency's business model is unsustainable over the long term. "We need to recognize we are not facing a current liquidity crisis," he said. The agency is managing \$56 billion in assets and has the cash flow to pay benefits. For now, at least.

"But ultimately, the hole has to be filled," Belt said.

Top 10 claims in PBGC history

1. United Airlines	\$6.6 bln	2005
2. Bethlehem Steel	\$3.7 bln	2003
3. US Airways	\$3.0 bln	2003, 2005
4. LTV Steel	\$2.0 bln	2002
5. National Steel	\$1.1 bln	2002
6. Pan American Air	\$841 mln	1991
7. Weirton Steel	\$689 mln	2004
8. TWA	\$668 mln	2001
9. Kaiser Aluminum	\$566 mln	2004
10. Eastern Airlines	\$553 mln	1991

Data: PBGC

From the boardroom of a bankrupt company, abandoning pension obligations is typically portrayed as a do-or-die decision.

"As difficult as this was, it was certainly better than liquidating the company," Glenn Tilton, chairman of United Airlines parent UAL Corp., told a San Francisco audience in October.

Delphi Corp. Chairman and Chief Executive Robert "Steve" Miller, a restructuring specialist who led Bethlehem Steel through its turnaround and now sits on the board of United Airlines, said liquidation was the stark choice faced by the nation's second-biggest airline.

Though bankruptcy provides a legal framework for shedding costly retirement plans, critics argue that executives are abusing the law to pull off otherwise impossible corporate

turnarounds.

"That's just flat untrue," Miller said, noting U.S. bankruptcy law sets a high bar for any company trying to prove it can no longer support its retirement plans. "You cannot just willy-nilly get out because you feel like it," he said.

Miller pointed out that distressed companies don't always turn over their pensions to the PBGC. Bethlehem Steel aside, he said he'd saved the pensions at 9 out of the 10 companies he led through restructurings.

"As far as I'm concerned, hell no, the pension does not have to go," Miller said. And that carries over to his role at Delphi. "A bedrock principle of the reorganization we are doing at Delphi is to preserve our accumulated benefits and not turn this over to the PBGC," he said.

For employees, the change at a company can be a stark one as new hires arrive without ever knowing that compact between employee and employer. Instead, the weight of managing retirement risk falls on a worker's shoulders with defined contribution plans like the 401(k).

"Now from day one, they have to take an active role in planning for retirement," said United Airlines flight attendants union spokeswoman Sara Nelson Dela Cruz, who is involved in training. "The employee is responsible for their retirement."

The United flight attendants union was the only one to aggressively fight the termination of its pension plan.

The United Airlines pension default last year was the largest in the history of the agency, ahead of Bethlehem Steel. The bailout covered 120,000 workers and took on \$10 billion in obligations. The PBGC loss totaled \$6.6 billion, more than twice US Airways and well ahead of the \$3.7 billion hit from Bethlehem Steel, bringing the PBGC's current deficit to about \$23 billion.

Those numbers pale compared with the \$108 billion deficit staring down the agency.

"If plans have some indication that they may terminate or they may not succeed, that could just skyrocket out of control," said Rep. George Miller, D-Calif., who has many United Airlines employees in his district.

But there are glimmers of hope. As interest rates rise and stock market returns improve, that gap could shrink or disappear altogether. But that's out of the agency's control.

"What we do know is we can fully expect that there will be additional terminations going into the PBGC. That adds to their deficit and makes it less secure," said Rep. Miller. "Obviously, then you have to try get more money from companies or from the taxpayers to keep that fund solvent."

Government bailouts haven't been in the headlines for years but the memory of the Federal Savings and Loan Insurance Corp.'s insolvency in 1986 and eventual demise is still strong.

Staying afloat

The airline industry's meltdown after the Sept. 11, 2001 attacks and the outbreak of Severe Acute Respiratory Syndrome, or SARS, in 2003 nearly ruined the industry.

United Airlines, ATA Airlines, Air Canada, Delta Air Lines, Northwest Airlines and Aloha Airlines all sought bankruptcy protection from their creditors while they slashed costs and rebuilt their shattered finances. US Airways even filed for bankruptcy twice before being rescued in a takeover by smaller America West.

Steel industry turnarounds pushed the limits of how much the PBGC could, and should, endure. Bethlehem Steel's pensions plainly showed the weight being shouldered by current employees.

Those plans, which left the PBGC to cover \$3.7 billion of its \$4.3 billion deficit in 2002, covered retirement packages held by 95,000 current and former employees.

Of the 95,000, only 13,000 were still active workers, according to the PBGC. The rest were retired employees (67,000) or former employees (15,000) entitled to benefits when they retire.

Earlier that year, LTV Corp.'s 82,000-strong pension plans were absorbed by the PBGC. It included 53,000 retired workers, more than those still on the job.

This fits a broader pattern of retirees now far exceeding the number of active employees needed to cover their benefits, according to the Heritage Foundation's David John.

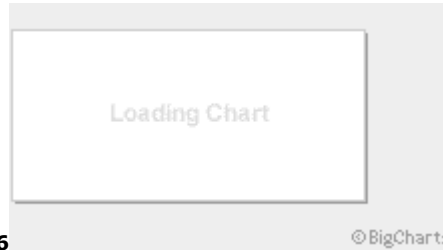
"What you will see is that you have fewer and fewer younger workers that are being covered by the traditional pensions," he said.

Some blue-chip companies are taking defensive measures by stopping the accumulation of benefits in their plans. IBM, for example, froze its employees' pensions earlier this year, offering a defined contribution plan, or 401k, in its place. General Motors took this step for its white-collar workers, too, as did Verizon Communications ([VZ](#)):

verizon communications com

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Beyond the courts

But the apparent ease with which troubled companies can now cast off costly pension plans is troubling to companies still meeting their obligations, especially when they are direct competitors.

For example, American Airlines is still squared off against US Airways and United Airlines, both of which ejected their pension plans while in bankruptcy. The situation gets even worse if bankruptcy court judges allow Northwest and Delta to ditch their pension plans.

"It is certainly a legitimate issue and concern on their part that they will have to compete against rivals that have been able to offload their ongoing labor costs on the federal pension insurance program," said PBGC's Belt. "It also should be noted that the pension insurance program is not a mechanism that is designed to make the company more competitive."

But that's what happened, creating an escape for companies desperately seeking to shed costs.

"In United's case, and we're going to see this in the case of Delta and Northwest, there is no way they can compete worldwide with the cost of that pension plan hanging over their head," said the Heritage Foundation's David John.

And in such cases, a bankruptcy court judge will always put the interests of a company ahead of the beleaguered PBGC.

"The actions that they've [United] taken are completely legal, but make a PBGC bailout inevitable," said John.

According to the Center on Federal Financial Institutions, the PBGC's coffers may be fully drained by 2020.

Lawmakers, pressured by constituents with their retirement at risk, are working to change the laws that determine how big a premium companies must pay and how long they have to shore up their plans.

Legislation aimed at fixing underfunded pensions through measures like higher premiums could backfire if they make PBGC insurance too costly. Meanwhile, laws allowing more time to fund plans are being discussed in Congress.

Earlier this year, the PBGC started charging a company \$30 per employee to insure their retirement benefits. That increase, from \$19, was the first since 1991.

Delphi's Miller said he considers the annual PBGC premium to be very low.

"The political dilemma is, if you run those rates up very high, then solvent, healthy companies will resent being taxed to pay for the relatively few industries that have been the principal source of the PBGC having to pay up," Miller said. "By and large, I consider that guarantee to be a real bargain given the lack of discipline companies have to observe in having a defined benefit program." ■

August Cole is an editor for MarketWatch in San Francisco.