Pension dumping

Pension Dumping: The Reasons, the Wreckage, the Stakes for Wall Street. By Fran Hawthorne, New York, NY, Bloomberg Press, 2008, 288 pp., $27.95/hardback.

Traditional pension plans, often referred to as "defined benefit" plans, are becoming less common in today's work environment. According to the BLS National Compensation Survey, participation for private industry workers in defined benefit plans dropped from 35 percent in 1990–91 to 20 percent in 2008 and this trend is likely to continue. In "*Pension Dumping: The Reasons, the Wreckage, the Stakes for Wall Street*," Fran Hawthorne discusses why so many companies are opting to drop their pension obligations. She also explains how the companies unload their plans, who this affects, and what this means for the future of pension plans.

Pension plans essentially became a tool to jettison aging workers in favor of younger, cheaper, more productive workers when they first came to prominence in the late nineteenth century. Pension plan enrollment peaked again after World War II, but this time as a tool to attract workers. The Federal Stabilization Act of 1942 placed a cap on wages, but exempted pension benefits, so companies began offering defined benefit pensions as an inducement to workers, touting them as "a tool to effectively shelter a portion of their (workers) compensation from taxes." As a result, the number of workers covered by a pension plan increased from 19 percent to 41 percent of the workforce between 1945 and 1960.

So, why are traditional pension plans disappearing? The author posits several reasons. First, the kinds of companies that traditionally provided defined benefit plans (e.g., the steel, textile, and auto and airline industries), are now in financial trouble, at least partly because foreign competitors do not typically bear the burden of large "legacy costs" (providing pension payments for retired workers). Other tough, unexpected challenges have emerged as well. The September 11th terrorist attacks heavily affected the airline industry, and corporate scandals helped to bring down companies such as Enron and WorldCom. Systemic issues exacerbated already weak balance sheets of companies or even entire industries. Surviving companies had to do whatever was needed to stay afloat, including "cut costs by unloading their retirement plans." The move to defined contribution retirement plans also benefited companies by transferring the responsibility (and risk) of financial planning for retirement to the employee. Hawthorne notes the dramatic change that has occurred within a mere two decades since just defined contribution plans have been offered to new employees. In the late 1970s only 7 percent of the private workforce in America had a defined contributions plan, while 28 percent had a traditional plan; by the late 1990s these percentages had essentially reversed, with 27 percent of the private workforce in defined contribution plans and only 7 percent in traditional pension plans.

According to Hawthorne, a majority of companies filing for bankruptcy are now underfunded, meaning that the company has greater obligations to pay in retirement benefits than they have funds to cover them. This is true for a couple of reasons: 1) companies are not generating enough income, and therefore cannot contribute the required amount and 2) the pension plan's assets are losing money. The standard allocation of investments for a pension plan had been 60 percent in blue-chip stocks and 40 percent in bonds, yielding a relatively stable rate of return. The 60–40 rule was replaced by the "prudent person" rule, permitting retirement fund managers to invest in riskier instruments. This has resulted in major losses since the 2008 economic recession began.

Hawthorne opines that changes in bankruptcy laws also assisted companies shed their pension liabilities into the Pension Benefit Guarantee Corporation, or PBGC. The PBGC, created in 1974, is charged with verifying that all retirement plans have enough assets to meet their obligations, and it guarantees that workers who were in failed plans receive up to 90 percent of the retirement benefit which was promised, or $54,000 per year, whichever is less. Hawthorne argues that many times courts will allow failing companies to simply unload their pension obligations onto the PBGC because the objective of courts is to help companies emerge from bankruptcy rather than protect pensions.

So, who is hurt when pension plans are unloaded? Certainly current and retired workers, whose promised benefits are suddenly in jeopardy. But, interestingly, Hawthorne looks at the players who benefit from pension dumping as well. "Vulture investors," as they are sometimes cuttingly referred to, realize there is still enormous value in distressed properties if their pension obligations can transferred to the PBGC. They justify their behavior by claiming that, without the equity injection they provide, the business would go under. Further, they claim the workers benefits as well, by getting up to 90 percent of the benefits promised them. Others, quite naturally, view this claim negatively. They see the vulture investors as recklessly wiping out the workers' pension plans, all the while knowing that the PBGC will bail them out and raise premiums on companies playing by the rules to make up the difference.

Another institution adversely affected by the pension decline has been labor unions. Failing industries reduce the union's power to negotiate, forcing them to make tough decisions; for example, whether to give up benefits for retired workers or lay off active workers. Decreasing rates of union membership is also a factor. In the 1950s, the private sector union membership rate was 35 percent; however, by 2006, the rate had fallen to less than 8 percent. Hawthorne does not distinguish whether this is a cause or an effect of the weakening power of the unions.

Lastly, Hawthorne projects the future of traditional pension plans if no changes are made. As of 2007, there were 29,000 private sector retirement plans still active. By 2012, the author predicts that close to 20 percent of them will be terminated. Hawthorne predicts that the next big sector to fail or dump its pension plans is the auto industry; as of mid 2009, Chrysler and General Motors, two of the big three auto companies, have filed for bankruptcy, although their retirement plans have not yet been terminated.

Hawthorne puts tremendous effort into each chapter, reviewing specific case studies of companies that sank into bankruptcy then restructured and unloaded their pension plans onto the PBGC. She also examines the laws that have allowed pension dumping to occur on the scale we see today. Readers will not be disappointed at the depth of the interviews with subject matter experts, government officials, union leaders, and even vulture investors. Her explanation of the history of the pension system is clear and educational, accentuating and exposing the problems that are plaguing the pension world. The factual accounts flow smoothly, reading as though from a novel. The issues raised in the book are relevant and timely, especially with respect to the auto industry's decline.

One weakness is that the author offers few suggestions for improvement. Hawthorne argues, albeit briefly, that public policy must help remedy this situation; however, nothing concrete is suggested. Any way one dices the situation, one thing is inherently obvious–with the cost cutting mentality of the corporate world and the increased popularity of the defined contribution plans, the glory days of the traditional defined benefit plans may be a thing of the past. □

—Song Yi
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