Funding Squeeze

U.S. Economic Recovery Threatened by Rising Pension Expenses, New Survey Says

U.S. firms sponsoring defined benefit pension plans expect to see massive increases in expenses as a result of weak equity markets, according to a new survey by Deloitte & Touche LLP. And that could mean a major funding squeeze impacting corporate earnings growth and, ultimately, the likelihood of economic recovery in the U.S. this year.

Deloitte & Touche surveyed 80 mid-sized and large U.S. companies with median revenues of $1 billion and an average of 5,000 employees. A full 40 per cent of respondents say their pension expenses will rise by more than 50 per cent in 2003. Another 20 per cent say their expenses will rise by 26 to 50 per cent, while another 16 per cent of firms see increases of 11 to 25 per cent.

DB changes

Such enormous increases have prompted many companies to make fundamental changes to their defined benefit plans. According to the survey, at least four in ten companies are either making changes to their defined benefit pension plans or considering what those changes will be. Twelve per cent have already decided what to change and another 31 per cent of companies surveyed are looking at alternatives such as cash-balance or profit sharing plans.

Making changes now, however, will not fix the funding problem in the U.S., warns David Hilko, practice leader of the employee benefits group at Deloitte & Touche. "Companies that change their pension plans solely because of stock market volatility and the current higher expenses could be making a mistake," he says. Getting rid of benefits will not help companies attract and retain talent—and that should be the goal of company benefits.

Canadian implications

In 2002, Christine Wiedman from the Richard Ivey School of Business, University of Western Ontario, published a study on the impending crisis in defined benefit plans, "Pension Accounting: Coming to light in a bear market." Talking about pension issues in the U.S., Wiedman points out the announcement is coming at a particularly bad time when both Canada and the U.S. have been innundated with bad news.

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"Unfortunately, this pension issue has this lagged effect, so the bad news is coming out later." However, it's not a new issue and Wiedman doesn't think the situation will be as severe in Canada. Speaking about expected return on asset assumptions, she believes that Canadian firms may be more conservative.

Going forward, Wiedman doesn't believe the market should overreact to this news. "It's just a question of economics," she says. "The deterioration of the plans has happened, and now it's flowing through the financial statements. Hopefully if the markets rebound or come up somewhat, that will help."

Executive benefits

In the U.S., Deloitte & Touche also notes a major trend in the area of executive retirement benefits. One out of three companies surveyed have either moved, or are considering ways to move, a larger percentage of their executive benefits into more secure investment vehicles. In the past, executives have borne greater risk, while employee retirement benefits were secured.

MORE BAD NEWS

U.S. pension woes continue as PBGC reports biggest loss ever.

As if there's not enough bad news for U.S. pension funds, the Pension Benefit Guaranty Corporation (PBGC) released some alarming numbers in its financial results for 2002. The PBGC swung from a $7.73 billion surplus at the end of fiscal 2001 to a deficit of $3.64 billion—a net loss of $11.37 billion in just one year. It's the largest loss in the 28-year history of the PBGC, a federal agency created by the Employee Retirement Income Security Act (ERISA) in 1974 to insure and protect pension benefits in defined benefit plans. The PBGC is looking for ways to strengthen its pension insurance program in the long term to deal with the issue of underfunding in pension plans sponsored by financially troubled employers.

Insured under the PBGC's single-employer program are 30,660 plans covering the pensions of 34.4 million Americans. Eighty per cent, or $9.31 billion, of the total losses for 2002 were from completed and probable pension plan terminations. Declining interest rates were also a problem, and increased the program's liabilities by $1.65 billion.

The PBGC also absorbed a loss of $1.85 billion from the underfunded pension plans of LTV Corp. and another loss of $396 million from pension plans of other steel companies. In total, the steel industry accounted for $7.57 billion of the $9.31 billion in losses from completed and probable pension plan terminations.