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Who Killed Private Pensions?

How Companies Helped Hasten the End of Retirement Plans and Benefits

By ELLEN E. SCHULTZ

Gary Skarka had a rewarding middle-management career at <u>AT&T</u>, along with some of the best retirement benefits in the country. But instead of enjoying a comfortable retirement, he is working as a security guard. "I know I will have to work at menial jobs until I die," he says.



Mr. Skarka's financial predicament isn't the result of investment losses or runaway spending. He is among millions of Americans who encountered an unexpected risk to their retirement: their employer.

Over the past two decades, companies have cut pensions, slashed retiree health coverage and killed other benefits. Many have reduced their contributions to 401(k)s as well.

Companies say they are the victims of a "perfect storm" of unforeseen forces: an aging work force, market turmoil, adverse interest rates. Certainly, these all contributed to the retirement crisis. But employers have played a big and hidden role in the death spiral of pensions and retiree benefits as well.

Workers with a significant portion of their net worth tied up in employer-sponsored retirement plans should be aware of the hidden risks they face. Here are some to watch out for:

Tapping Pension Plans

Just over a decade ago, pension plans had a quarter of a trillion dollars in surplus assets. Today, they are collectively underfunded by about 20%. Market losses and historically low interest rates erased a lot of this, but much of the damage was self-inflicted.

Verizon Communications' predecessor Bell Atlantic, in a typical move, used more than \$3 billion of its pension assets to finance retirement incentives for thousands of managers. Similar moves enabled companies to shed hundreds of thousands of older employees without dipping into corporate cash. Employers also began using pension-plan assets to pay health benefits they promised retirees.

These types of moves helped drain Verizon's pension surplus, so when the market cratered in

1 of 3

2008, there was no surplus left to cushion the blow. The plan, whose surplus peaked in the late 1990s, is now \$3.4 billion in the hole. A Verizon spokesman says the amount of pension assets used to make incentive payments is "immaterial."

Another issue: In the swirl of mergers and acquisitions in the 1990s and 2000s, many companies "monetized"—that is, sold—billions of dollars worth of pension assets. A common technique was to sell a unit and transfer workers and retirees to the buyer, along with more pension money than necessary to cover the benefits owed them. The buyer might pay 70 cents on the dollar for the surplus, leaving the seller with a less well-funded plan—but also with a lot of cash they wouldn't otherwise have received.

What to watch for: In annual reports, companies usually disclose their use of pension assets for severance-type pay and the amounts they transfer from pension plans to pay retiree medical benefits. But it can be virtually impossible to determine whether pension money changed hands in M&A deals.

Boosting Income

Cutting benefits provided employers with an additional windfall: income. Because the benefits are recorded as debts on a company's books, reducing the debt generates paper gains, which are added to operating income right along with income from selling hardware or trucks.

Thanks to these accounting rules, which all companies adopted in the late 1980s, retiree plans have become cookie jars of potential earnings enhancements: Essentially every dollar owed to current and future retirees—for pensions, health care, dental, death benefits or disability—is a potential dollar of income to a company.

What to watch for: Employers can raise or lower their retiree obligations by billions simply by changing key assumptions, such as "discount rates" and "estimated returns." If your employer announces it is cutting pension or retiree health benefits because costs are "spiraling," ask whether the company merely changed the assumptions in the plan to justify the cuts.

Cutting Benefits

With so many ways to tap pension surpluses, companies had an incentive to cut pension benefits even when their plans were overfunded.

Many companies, including AT&T, converted their pensions to so-called cash-balance plans, which slowed the growth of benefits for older workers and, in many cases, froze them altogether for a period of years. Mr. Skarka, 64, who left the company in 2003, says his pension would have been \$50,000 a year, but is only \$18,000 because of the pension changes.

His \$1,500 monthly pension was further reduced by \$500 a month to pay for his share of retiree health benefits, leaving the South Thomaston, Maine, resident a monthly pension of just \$1,000.

While unable to comment on an individual case, an AT&T spokesman said, "We continue to provide great benefits—including market-competitive health, pension and savings plans—to our 1.2 million employees, retirees and their dependents."

Lump-sum payouts are another way companies can cut pension costs. Such payments don't only entice older workers to leave but may be worth less than the actual value of the pension benefit. They also shift all the investment, interest rate and longevity risk to the retirees.

2 of 3 11/6/2012 3:45 PM

What to watch for: If you are offered a lump sum, ask the employer to show you how the payout stacks up against a monthly pension in retirement. You might have to hire an actuary to do this.

Financing Executive Pay

Employers' ability to generate profits by cutting retiree benefits coincided with the trend of tying executive pay to performance. Intentionally or not, top officers who greenlighted massive retiree cuts were indirectly boosting their own compensation.

As their pay grew, executives deferred more of it. Supplemental executive pensions, which are based on pay, also ballooned. These executive liabilities account for much of the "spiraling" pension costs many companies complain about.

Many companies—especially large banks in the past few years—have taken out billions of dollars of life insurance on their employees. The policies function as tax-sheltered investment pools that can be used to offset the cost of executive benefits. The companies also collect tax-free death benefits when employees, former employees and retirees die.

What to watch for: Your employer—and former employers—don't have to tell you if they bought a policy on your life before 2006. If your employer has taken out insurance on you in recent years, it must get your consent, but doesn't have to say how much the policy is for. It is up to you whether you want to be a human resource to finance executive pay.

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3 of 3