AMERICA’S BROKEN RETIREMENT PLANS
AND PENSION SYSTEMS –
ANOTHER “GIFT” FROM WALL STREET

WILLIAM S. LERACH
University of California, Berkeley
October 26, 2010
STOCKS COLLAPSE IN 16,410,030-SHARE DAY, BUT RALLY AT CLOSE CHEERS BROKERS; BANKERS OPTIMISTIC, TO CONTINUE AID
FERDINAND PECORA

WALL STREET
UNDER OATH

THE STORY OF OUR MODERN
MONEY-CHANGERS

THE CRESSET PRESS
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LONDON W.1
Leadership is unqualified commitment to the major anxiety of the people. As it was for Roosevelt . . .
President Roosevelt signs the 1933 Securities Act, part of his administration’s “New Deal” -- reform of the financial markets.
Winds Blow For Rollback Of Regulation

By W. Glenn Hubbard, an economist at Columbia University, who is chairman of a panel calling for less regulation of companies.

Bush administration officials are moving with the force of the wind to roll back regulations, and they are meeting with little resistance. The push comes as Wall Street, labor unions and others have made common cause in a battle against the Bush administration.

The winds that are blowing for rollback include:cutting regulations; slowing the pace of new regulations; delaying the implementation of existing regulations; and making it harder to enforce regulations.

The administration's push for rollback comes as Wall Street and labor unions have been joined by others in a fight against the Bush administration. The administration is trying to weaken regulations, and it has been met with little resistance.

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$5 Billion in Political Contributions Bought Wall Street Freedom From Regulation, Report Finds

March 4, 2009

The financial sector invested more than $5 billion in political influence purchasing in Washington over the past decade, with as many as 3,000 lobbyists winning deregulatory decisions that led to the current financial collapse, according to a 231-page report issued today by Essential Information and the Consumer Education Foundation.


Nearly 3,000 officially registered federal lobbyists worked for the industry in 2007 alone. Surveying 20 leading financial firms, "Sold Out" finds 142 of the lobbyists they employed from 1998-2008 were previously high-ranking government officials.

The report documents a dozen distinct deregulatory moves that, together, led to the financial meltdown. These include prohibitions on regulating financial derivatives; the repeal of regulatory barriers between commercial banks and investment banks; a voluntary regulation scheme for big investment banks; and federal refusal to act to stop predatory subprime lending.

"The report details, step-by-step, how Washington systematically sold out to Wall Street," says Harvey Rosenfield, president of the Consumer Education Foundation. "Depression-era programs that would have prevented the financial meltdown that began last year were dismantled, and the warnings of those who foresaw disaster were drowned in an ocean of political money."
In the good old days of the Gilded Age, the Senate knew who was boss.
Making It Harder For Investors to Sue

Some Say Congress Is Going Too Far

By DIANA B. HENRIQUES

Now that Congress is back at work after the summer recess, it faces the task of crafting, out of rival House and Senate proposals, a single bill that would change the rules governing how and when American investors can sue companies for securities fraud.

The competing proposals, sponsored by the Republicans who control Congress, both aim to protect companies from ill-founded investor lawsuits. And, despite differences in the fine print, both would make it significantly harder for plaintiffs to bring cases.

“I’ve been frivolously sued, too,” said Anthony C. Lami, a pizza parlor owner in Sandy, Utah, who joined a class-action suit after he lost more than $400,000 of his investment in Media Vision, whose stock collapsed after the company retracted past financial statements. “I can see that for a company like Apple, say, whose stock has gone from $70 a share to $20 a share several times in its life, it may be cheaper to pay a settlement than to litigate.”

“[B]ills may … leave many wronged investors without hope of justice.”
"This bill repeals parts of the 1933 Glass-Steagall Act ... [and] allows mergers of banks, securities firms and insurers ..."
Where were regulators when banks were failing?

Some were asleep at the switch, while others took an active role helping hide the problem, reports find.
Is the S.E.C. Changing Course?

Critics Say Cox Is Moving Closer to Business, Not to Investors

Christopher Cox says he is responding to court decisions and budget constraints but that he remains committed to protecting investors.

By STEPHEN LABATON

WASHINGTON, Feb. 28 — In his first year as chairman of the Securities and Exchange Commission, Christopher Cox confounded both supporters and detractors by taking a more moderate and impecunious position than they had predicted in a variety of regulatory issues, based on his record as a conservative Republican lawmaker.

In recent weeks, however, Mr. Cox has begun to send signals, both directly and through aides, that he may be swinging the pendulum more toward business and Wall Street interests and against investor groups.

Some investor advocates and securities law experts say that Mr. Cox, by not pushing for tighter regulation of hedge funds and by urging the Supreme Court to adopt a tougher standard for investors in lawsuits, has begun moving closer to the business view that the administration overreacted to the corporate scandals that began with the collapse of Enron in 2001.

They have also criticized his recent decision to appear at the Chamber of Commerce in two weeks just as it is to issue a report criticizing the Bush administration and the S.E.C. for being too hard on companies.

"You look at a parade of items and it begins to look like this commission is starting to take an historic shift away from investor interests," said James D. Cox, a law professor at Duke University.

The S.E.C. chairman strongly disputes that view, noting, for instance, that his appearance before the chamber should not be perceived as a change in the tilt of the agency.

"The United States government has an agency that serves business and it is the Department of Commerce," he said. "Our role is to be the investors' advocate. I want to make sure that every company understands that so long as they treat their investors well, the S.E.C. will be friendly to them.

"And if they attempt to drive a wedge between the

Continued on Page 13
Dream court for American business

US Supreme Court was right to limit investor lawsuits

Corporate America has scored a hat-trick in the US Supreme Court, winning a trio of big cases that could substantially reduce the amount of crpetingly costly investor litigation faced by any company that lists on US soil.

This was exactly what President George W. Bush wanted. Faced with growing concern about how litigation costs are burdening the competitiveness of US markets, he did what only a president can do to stop it: packed the country's top court with business-friendly conservatives such as John Roberts, the new chief justice, a former corporate lawyer; and Samuel Alito, a hardline conservative who replaced the inconsistently pro-corporate Sandra Day O'Connor.

He created what amounts to a dream court for American business. So it is hardly surprising that the top court delivered another big win to business this week, ruling in Stoneridge v Scientific-Atlanta that banks, lawyers and accountants can often escape being sued by investors, even if they play a fairly big part in perpetrating a securities fraud. To be able to sue, investors must prove that they relied on the third parties to make their investment decisions. And that, normally, is very hard to do.

That may sound like the wrong result for investors. Certainly, the facts of the case were unsavoury: Charter Communications, a cable company, persuaded Scientific-Atlanta and another supplier to participate in sham transactions so Charter could deceive its investors. That certainly sounds like behaviour that courts should punish - and indeed, they can: the Securities and Exchange Commission can sue third parties that scheme with companies to perpetrate fraud, and it can distribute the proceeds to wronged investors. The only issue in the Stoneridge case was: should private investors also be allowed to get in on the act, or should the task of suing third parties be left solely to professionals at the SEC?

It is not as though third parties that aid and abet fraud are getting off scot-free: the SEC can, and should, still pursue them. Third parties - including accountants that help cook the books - must not be allowed to escape liability. But nor should profit-driven lawyers be allowed to eat up the recoveries with huge transaction fees.

Investor advocates, and their Democratic backers in Congress, have reacted to the ruling with howls of outrage. If Congress wants private investors (and their entrepreneurial lawyers) to sue third parties, it can pass a law that says so.

In the meantime, that job is better left to the SEC.
TWO MUCH CORPORATE POWER?

Even though Big Business helped create UNPRECEDENTED PROSPERITY, most Americans think corporations have EXCESSIVE INFLUENCE over their lives. Now, it's become a hot POLITICAL ISSUE. What's going on?

September 11, 2000
“If the antifraud provisions of the securities laws are gutted, as [the Reform Act] would do…worry about the public and your markets, and in 10 or 15 years you will be holding another hearing with the debacle in the securities markets that will make you remember the S&L mess with fondness.”

William S. Lerach,
“The bulk of the losses ($100-150 billion) are directly attributable to the failure by management …to follow basic, prudent business practices, including the establishment of effective systems of internal control.”
Regulators and prosecutors target corporate fraud, accounting lies and executive-suite greed

Investors now know that the stock market's long boom in the 1990s was at least partly built on deception. The truth began to come out last October when Enron, then the nation's seventh-largest company, revealed more than $1 billion of accounting errors that sent investors fleeing and launched investigations that are continuing today. Since then, dozens of companies have admitted to, or are being investigated for, accounting frauds or other financial misdeeds. USA TODAY reporter Gary Stoller compiled this summary of many companies tainted by scandal.

Caught in scandal

Companies whose executives are facing or have settled charges in financial scandals in the past year.

Funny numbers

Regulators and prosecutors target corporate fraud, accounting lies and executive-suite greed

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In the 1990s, a new class of investors became a powerful economic and political force. How many feel misled by Wall Street, corporations, accountants, and the government. The strength of the recovery hinges on winning back their confidence. PAGE 104
Record Household Wealth Destruction Forces Families And Firms To Curb Debts

Net Assets Dived 9% In Q4

Retail sales solid in Feb., but housing, stock woes sap consumers’ strength

U.S. household wealth tumbled a record 9% in the final quarter of 2008, as stock prices and home values plummeted, the Federal Reserve said Thursday.

Net worth — defined as assets minus liabilities — fell by $5.1 trillion from the July-September quarter to $51.5 trillion, the lowest in four years, according to the Fed’s flow of funds report. The 9% decline was the biggest since the government began keeping records in 1952. Net worth sank 18% vs. a year earlier.
Behind Soaring Executive Pay, Decades of Failed Restraints

Instead of Damping Rewards, Disclosure, Taxes, Options Helped Push Them Higher
Return of Golden Parachutes

By JoAnn M. Lurie and Scott Thurm

In 1993, activist investor Ralph Whitworth skittered United Shareholders Association, a group that was trying to tackle the contentious issue of executive pay. It looked as if his work was done. Federal securities regulators had just forced companies to reveal details about pay and perks for top officials, in some cases for the first time. The changes would “make touts think twice” before approving compensation plans that couldn’t be justified, Mr. Whitworth recalls thinking.

Around the same time, Congress attacked executive pay for the second time in a decade by removing tax breaks on compensation above one million dollars.

Since then, the average pay for chief executives of large companies has quadrupled, according to Kevin Murphy, a professor at the University of Southern California’s Marshall School of Business. The average last year was $16.5 million, a figure that includes salary, bonus and the value of stock and stock-option grants.

There are many reasons why Mr. Whitworth was mistaken in his prediction, including the bull market of the 1990s, easy corporate boards and CEOs striving to keep pace with highly paid athletes and entertainers. What’s often overlooked is the rejection of all the efforts—by Mr. Whitworth and many others—to limit CEO compensation. For more than two decades, critics tried to slow skyrocketing pay through regulations, legislation and shareholder pressure. Few of their tactics worked. Many backfired.

As it turns out, disclosure requirements can push pay higher by revealing to CEOs what their peers receive. Limiting one type of compensation often encourages new types of pay, such as stock options, which were pitched as an alternative only to become tainted by scandal. Now that shareholders are quicker to push out poorly performing chiefs, CEOs are seeking more financial guarantees. And if companies turn to executives, they often have to pay extra.

Curburing executive compensation is “like moving Jell-O,” says Kayla Gillan, the former general counsel of the Californian
The 1920’s were a period of pro-business, anti federal regulation, pro-stock investing prosperity with an increasing disparity between rich and poor. What followed next?
How's your pension doing?
Worrying ’bout my generation

Workers and companies are both fretting about the ability to meet large commitments imposed by defined benefit schemes.
MORE PENSION PAIN

Last year investors pummeled big-company stocks because of problems with their pension plans. By the end of 2003, huge corporations owed

Would have improved. But a new study by Credit Suisse First Boston (the former home of Frank Quattrone) shows that it is actually getting worse. The reason is persistently low interest rates. Companies use a so-called discount rate, which is tied to interest rates, to calculate the cost of funding retiree pensions. When the discount rate declines, the calculated value of a company’s pension obligations rises to reflect lower interest rates. CSFB accounting analyst David Zion estimates that 92% of all pension plans offered by S&P 500 companies are now underfunded, vs. 24% before the bubble burst. Zion thinks the situation will worsen through 2004. That’s bad news for earnings, especially at old-line manufacturers and union strongholds like Ford, Boeing, and Raytheon. By the end of 2003 Congress is expected to approve a bill that would temporarily reduce the amount companies must pay to their plans; for now, managers hope that higher interest rates and a bull market will come to the rescue.

Stay tuned,—Janice Revell

Pension shortfall for S&P 500 plans

FORTUNE CHART / SOURCE: CSFB

November 10, 2003
"Here are the numbers you wanted cooked, sir."
“Accounting rules … [have] provided an artificial means for companies to pad their reported earnings – the bottom line that determines top executives’ bonuses....”
A Pension Deficit Disorder

Investors already have seen their equity holdings hammered by the economic crisis. But, in some cases, they are discovering that companies are exposed to the down cycle twice over.

- Operating profits are collapsing. But pension deficits also are ballooning because of the stock market dive. Absent a sudden market recovery, those will likely be made up in hard cash, undermining profits for years to come.

S&P 500 companies had a combined pension deficit of $35.6 billion at the end of 2008, according to Bank of America. Many companies with defined-benefit plans had more than half their assets in equities at the end of 2007. If all that was in the U.S., they still lost 40% last year. Falling interest rates, meanwhile, increased the present value of pension obligations for some.

Shares of technology-services company NCR fell 15% Feb. 5 after the company said it would contribute $120 million to its pension in 2009 and another $200 million to $250 million in 2010.

NCR, with a $1.6 billion market capitalization, previously disclosed that 66% of its $3.4 billion in U.S. pension assets were in equities at the end of 2007.

The pension headache is hitting companies already under huge pressure to cut costs. Caterpillar recently announced 20,000 job cuts and warned that it may post its first quarterly loss since 1992.

Caterpillar's U.S. pension had $10.4 billion in assets as of the end of 2007—$11.4 billion less than its obligations. Caterpillar's pension likely shrank by about $2.8 billion last year, bringing the 70% of its invested in debt and, generously, the rest in equities this year, the company says it will contribute close to $1 billion to its pension this year. It says it could still leave a deficit as high as $2.5 billion.

Others might face similar problems. Goodyear Tire & Rubber had U.S. pension assets worth $4.5 billion at the end of 2007, when liabilities totaled $5.1 billion. With 68% of its portfolio in equities and the rest in debt, Goodyear's portfolio may have lost $1.1 billion last year. The company, with a
The underfunding of America’s corporate defined benefit pensions poses a daunting challenge, threatening not only their 40m beneficiaries but the entire US economy.
MANY COMPANIES ENDING PROMISES FOR RETIREMENT

PENSIONS BEING REPLACED

401(k) Plans Shift Risk to Employees, Who Must Make Decisions

Continued on Page A29
HAS THE 401(k) FAILED?

A small but vocal group of advocates think the 401(k) is a relic of a bygone age. What’s wrong with the current system—and how it can be salvaged.
Many retirement experts have come to a similar conclusion: The 401(k) system, which has turned countless amateurs into their own pension-fund managers, has serious shortcomings.
So far, the cumulative wipe-out of household retirement savings totals about $2 trillion. As a result, participants in 401(k)’s are in greater danger than ever of coming up short in retirement.
There’s an old accounting joke: What starts with “f,” ends with “k,” and means “screw your workers”? That’s right—401(k).
Despite Risks, Workers Guzzle Company Stock

Participants in 401(k) Plans See Safety in Employer Shares; No Other Options for a Match

At a time of extreme market uncertainty, many 401(k) participants are making a risky move: loading up on the stock of their employers.

In January, for the first time in more than seven years, a large group of 401(k) participants tracked by consulting firm Hewitt Associates poured more money into company stock than any other type of investment. The workers poured $85 million into employer shares that month—the most recent for which data are available—even as they yanked money out of other stock investments and put smaller amounts into conservative holdings such as bond and stable-value funds.

Employees' enthusiasm for company stock marks a sharp reversal of recent trends. Workers have generally been diversifying out of their employer's shares this decade as Enron, WorldCom and other high-profile corporate blowups exposed the dangers of heavy company-stock holdings. Participants added money to company stock in only eight months during the past six years, according to Hewitt—yet five of those months have come since the middle of last year.

Workers stuffing their retirement accounts with company stock are making a tremendous bet on the health of their employer. If the company stumbles, workers could lose their retirement savings, as well as their jobs. Just in the past year, stock-price meltdowns at Lehman Brothers Holdings Inc., Fannie Mae and other companies have crushed the retirement savings of many employees who were heavily invested in those shares.

"In this economy, you'd expect people to move in the other direction, trying to diversify their risks," says Pamela Hess, director of retirement research at Hewitt.

People may be turning to company stock now because the old familiar employer shares seem to be a haven in the market storm. Academic research has found that most employees holding company stock believe it's safer than a diversified stock fund. "Obviously, they're not understanding what they're buying," says Shlomo Benartzi, a behavioral economics professor at the University of California, Los Angeles.

Playing With Fire

Company stock offered in 401(k) plans poses a number of risks for employees:

- Workers tend to underestimate the risk of their own company's stock.
- If their employer heads south, workers heavily invested in company shares can lose both their jobs and their retirement savings.
- Employees often fail to diversify out of company stock as they age.
Of growing concern, however, are multiemployer retirement plans under-funded by $150 billion in 2004, a 50% jump in the deficit from the year before, the federal insurer reported.
EDITORIAL COMMENTARY

THOMAS G. DONLAN

Sinkhole

The private pension system continues its slow decline and fall

The federal Pension Benefit Guaranty Corp. turned in its annual report card last week, acknowledging that its accrued deficit had doubled in fiscal 2004. It has $39 billion in assets, but its liabilities from terminated single-employer plans have a present value of at least $62 billion. Also the agency’s estimate of the present value of “reasonably possible” future pension defaults has grown by over $1 billion in recent years.

The PBGC has responsibility for the present or future pensions of more than 10 million participants in single-employer plans. It currently pays benefits a present value of $60 billion to those participants. To meet those obligations, the PBGC needs to invest the $60 billion in a way that will generate returns sufficient to cover future liabilities. The pension obligations for any given group of single-employer plans are uncertain, and the PBGC faces the challenge of investing in a way that will cover future liabilities.

The PBGC’s current strategy is to invest in diversified portfolios of stocks and bonds, with the goal of generating returns that will exceed the inflation rate and provide a safety margin. However, the PBGC’s investments have not performed as well as expected, and the agency is now considering alternatives.

An important consideration for the PBGC is the impact of changes in the financial markets, particularly the unprecedented rise in interest rates. Rising interest rates can reduce the value of future liabilities, which in turn reduces the present value of future obligations. However, rising interest rates also reduce the value of existing investments, which can limit the PBGC’s ability to meet its obligations.

Sinkhole

The private pension system continues its slow decline and fall

Crash Landing

One example that came to light recently was the case of US Airways, which has struggled to meet its pension obligations. The company has filed for bankruptcy twice in recent years, and its pension obligations have increased significantly as a result. US Airways has been unable to deliver the returns that were expected, and the company is now facing the possibility of a significant impairment charge.

The PBGC has been working with US Airways to develop a plan that will allow the company to fulfill its obligations, but the process has been complicated by the company’s financial difficulties. The PBGC has also been working with other companies that have struggled with pension obligations, including United Airlines and Delta Air Lines.

In the end, the PBGC’s role is to ensure that pension obligations are met, but the agency faces significant challenges in doing so. The agency must balance the need to generate returns with the need to maintain the integrity of the pension system, and it must work with companies to develop strategies that will allow them to meet their obligations.

Although the PBGC has been successful in meeting its obligations in many cases, the agency faces significant challenges in doing so. The agency must continue to work with companies to develop strategies that will allow them to meet their obligations, and it must continue to find ways to generate returns that will cover future liabilities. The agency’s success in doing so will be critical to the health of the pension system as a whole.
The Public Pension Bomb

For years, states all across the country have been starving their retirement plans.
Public Pension Plans Lose Billions in Ailing Stock Market

By Christian Davenport and Matthew Mosk
Washington Post Staff Writers
Public Pension Plans Face Billions in Shortages

By MARY WILLIAMS WALSH
In 2003, a whistle-blower forced San Diego to reveal that it had been shortchanging its city workers' pension fund for years, setting off a wave of lawsuits, investigations and eventually criminal indictments.

The mayor ended up resigning under a cloud. With the city's books a shambles, San Diego remains barred from raising money by selling bonds. Cut off from a vital source of cash, it has fallen behind on its maintenance of streets, storm drains and public buildings. Potholes are proliferating and beaches are closed because of sewage spills.

Retirees are still being paid, but a portion of their benefits is in doubt.

COSTLY PROMISES
Taxpayers at Risk

because of continuing legal challenges. And the city, which is scheduled to receive a report today on the causes of its current predicament, still has to figure out how to close the $1.4 billion shortfall in its pension fund.

Maybe someone should be paying closer attention in New Jersey. And in Illinois. Not to mention Colorado and several other states and local governments.

Across the nation, a number of states, counties and municipalities have engaged in many of the same maneuvers with their pension funds that San Diego did, but without the crippling scandal — at least not yet.

It is hard to know the extent of the problems, because there is no central regulator to gather data on public plans. Nor is the accounting for government pension plans uniform, so comparing one with another can be unreliable.

But by one estimate, state and local governments owe their current and future retirees roughly $375 billion more than they have committed to their pension funds.

And that may well understate the gap: Barclays Global Investments has calculated that if America's state pension plans were required to use the same methods as corporations, the total value of the benefits they have promised would grow 22 percent, to $2.5 trillion. Only $1.7 trillion has been set aside to pay those benefits.

Not all of that shortfall, of course,
PUBLIC RETIREMENT FUNDS ACROSS THE U.S. ARE IGNORING A LOOMING CRISIS, ONE FED BY UNDERFUNDING AND POOR INVESTMENTS—AND PAPERED OVER BY ACCOUNTING GIMMICKS. FUTURE GENERATIONS OF TAXPAYERS WILL FOOT THE BILL.
The $2 Trillion Hole
Promised pensions benefits for public-sector employees represent a massive overhang that threatens the financial future of many cities and states.

March 15, 2010
LIKE A CALIFORNIA WILDFIRE, populist rage burns over bloated executive compensation and unrepentant avarice on Wall Street.

Deserving as these targets may or may not be, most Americans have ignored at their own peril a far bigger pocket of privilege -- the lush pensions that the 23 million active and retired state and local public employees, from cops and garbage collectors to city managers and teachers, have wrangled from taxpayers.

Some 80% of these public employees are beneficiaries of defined-benefit plans under which monthly pension payments are guaranteed, no matter how stocks and other volatile assets backing the retirement plans perform. In contrast, most of the taxpayers footing the bill for these public-employee benefits (participants' contributions to these plans are typically modest) have been pushed by their employers into far less munificent defined-contribution plans and suffered the additional indignity of seeing their 401(k) accounts shrivel in the recent bear market in stocks.

And defined-contribution plans, unlike public pensions, have no protection against inflation. It's just too bad: Maybe some seniors will have to switch from filet mignon to dog food.
Sinkhole

How public pension promises are draining state and city budgets

June 13, 2005
The public servants have been guaranteed retirement benefits that are far richer than private pensions, yet elected officials have failed to set aside enough money to cover the promised benefits.
Is Wall Street good for anything?

Not lately. But it could be if it lost the cartel mentality, learned some ethics, and remembered the little guy. *BY SHAWN TULLY*

WHEN THE FEDERAL GOVERNMENT DEREGULATED commissions on stock trades in 1975, the purpose was to bust up Wall Street's cartel. What the '70s boom demonstrated is that the cartel is still in place and still needs busting—more than ever. Despite sporadic reforms, almost everything Wall Street does is inefficient and benefits select insiders at the expense of regular investors. Many of its services aren't just useless, but damaging—constituting a sort of aristocratic tax on America's economic activity. Today's scandals could breed no reform more important than to kill the Wall Street levy. The abuses center on three areas: equity research, mergers and acquisitions, and IPO offerings.

**Research.** Mutual funds and other professional investors have long considered Wall Street's research tainted and worthless. But analysts were valuable because they shielded inside information from companies, via winks and nods, to fund managers in exchange for inflated commissions.

No what can be done now? The SEC's Regulation FD makes the excuse leaks illegal but doesn't erase that basic conflict. The best weapon is investor education. Shareholders betrayed by Wall Street are already flocking to independent research houses like Sanford C. Bernstein.

**M&A.** Corporate America is still acting from Wall Street's horrendous M&A advice in the late '80s. The investment banks championed horrid deals, from Conoco/Freeport McMoRan to WorldCom/MCI to AOL/Time Warner (parent of FORTUNE's publisher). In each case the buyer paid such huge premiums that the deal was dead on arrival, causing enormous losses in shareholder value. Wall Street firms not only collected big fees for selling overpriced deals but also justified the overpayments by writing "fairness opinions" for their clients—for an additional $1 million or so per opinion. (In those remarkable documents they dredged up every conceivable bogey rationale to show that their clients were paying a reasonable price. It was the fairness opinions that shackled management from shareholder suits.

**IPOs.** The most egregious example of the continuing cartel—and its effect on the rest of us—is the IPO allocation system. As a middleman, Wall Street deserves to pocket fees for raising money. But if these fees are far higher than a client would pay in an efficient, competitive market, the industry is simply screwing clients and investors.

Merrill Lynch, Goldman Sachs, and everyone else charge a 7% fee even though the cost of arranging a $200 million IPO is about the same as a $50 million offering. That's a sure sign of a cartel—as are the firms' refusals to negotiate on price. Worse, Wall Street uses IPOs to create what is essentially a loan fund of "free money" by systematically undersubscribing shares—in effect, taking money from the pocket of the issuers—so that the stock will jump when it starts trading. They then hand the cheap-shares to their insured clients, chiefly hedge and mutual funds. During the bubble, underwriters demanded that the funds kick back a big share of the windfall profits. That slash fund has also played another nicer role. The SEC is investigating Solomon Smith Barney for in effect hiring executives at WorldCom, Qwest, and other telecom giants by granting them cheap IPO shares in exchange for lucrative investment-banking business.

The NASD is proposing complex rules to restrict what Wall Street can do with this free money. Instead it should recognize that free money is the problem and eliminate it altogether.

The market already has an elegant solution for the IPO problem: auctions. San Francisco investment bank W.R. Hambrecht opens its IPO sales to all bidders. Whoever pays the most, be it Fidelity or small investors, gets the shares. No underpricing, no free money, no kickbacks. Congress should demand open access to IPOs: Wall Street should lose its right to lock out bona fide bidders. That simple change would break the cartel's grip on IPOs. Auctions would take over. Fees would drop. Wall Street firms would become what they should be—efficient, low-cost middlemen. The aristocrats would become our servants.

**TELECOMMUNICATIONS**

Wireless Carriers Aren't All Talk

*BY STEPHANIE N. MEHTA* On the surface the wireless-phone industry is more beaten down than the 9,999 American Idol rejects combined. Unnoticed by the prospect of slowing growth and reduced returns on a constellation of industry's high-stakes push into mobile data, investors have pummeled shares of the companies. Nextel is down 30% this year. AT&T Wireless stock has slid roughly 50%, and Sprint's PCS tracking stock has tumbled more than 40%. 

PHOTOGRAPH BY DAVID BASLAW
Pension ‘Crisis’: Did Prop 21 pave the way?

June 1, 2010

A little-known ballot measure a quarter century ago, Proposition 21 in 1984, opened the door for much of the current controversy over California's public employee pensions.

Pension funds had been required to put most of their money into bonds. The measure lifted the lid and pension funds, seeking higher yields, began shifting most of their money to stocks and other riskier investments.
FINANCIAL TIMES

December 31, 2002

Pension funds seek way out of equity trap

The stock market slide has left companies with a £85bn funding black hole.

Norma Cohen asks what they can do.

A gaping £85bn ($133bn) hole in the pension accounts of the UK’s 100 largest companies cannot be easily dismissed.

Yet, a new report from analysts at Morgan Stanley shows that the latest slide in the stock markets and falling interest rates on bonds have combined to produce a shortfall of that amount in the space of a year.

Morgan Stanley highlights a handful of companies — British Energy, BAE Systems, Rolls-Royce and Royal & Sun Alliance — as being most at risk of having to increase cash funding for their pension schemes.

At British Airways, a company Morgan Stanley estimates now has a pension scheme deficit equal to 37 per cent of its market capitalisation, the need to increase contributions is acknowledged.

BA says it has given “a clear commitment to fund the scheme”, and the restructuring plan that will reduce headcount is expected to ensure that enough funds are available.

John Birch, the secretary to BA’s scheme, says a valuation of scheme assets is set for March 2003; and the contribution rate of 16 per cent of payroll — which includes 2 percentage points to clear a deficit identified in a valuation three years ago — may have to be increased.

Just a few years after the UK passed sweeping legislation on pensions, how could workers’ retirement benefits fore are best matched with bonds.

Charles Cowling, worldwide partner at Mercer, the pension consultant, says that many schemes, if viewed on their own without a guarantee from an employer — cannot meet liabilities.

“Current solvency is too scary to even think about,” he says.

For years, pension schemes have been failing to match their liabilities with assets that mimic the required payment stream.
Stocks Tarnished By ‘Lost Decade’

U.S. Shares in Longest Funk Since 1970s; Credit Crunch Could Prolong Weakness

Going Nowhere
By one broad measure, the stock market has made no progress over the past nine years.

Total return on a $10,000 investment in the S&P 500, adjusted for inflation

Note: Monthly data
Source: Morningstar Inc.
STOCKS VS. BONDS, CUMMULATIVE RELATIVE PERFORMANCE 1801-2009

Source: Research Affiliates, cumulative relative performance 1801-2009
PARSKY’S PARTY
The UC Regent [Gerald Parsky] whose pension fund may have cost the university billions is now in a position to play with even more of the public’s money.

PARSKY'S PARTY
The UC regent whose pension fund overhaul may have cost the university billions is now in a position to play with even more of the public's money.

May 9, 2007
Last December, Governor Arnold Schwarzenegger created a new panel to figure out how to solve what may be California's worst-ever budget crisis.

ments. In the 1990s, he gradually rose through the ranks of the California Republican Party until he became one of the state's most important power brokers. He raised millions to organize the 1996 Republican National Convention in San Diego, and chaired the state presidential campaigns of George W. Bush in both 2000 and 2004. Today, he reviews candidates for California US Attorney positions on behalf of the Bush Justice Department. He has been appointed senior economic adviser to presidential candidate John McCain; if McCain is elected president, Parsky could well become the next secretary of the Treasury.

But it was in his capacity as a regent of the University of California that Parsky made his greatest impact. In the ten years before he took over as chair of the Regents’ Investment Committee, the university’s pension plan, which provides retirement benefits for more than 190,000 employees, made a small fortune playing the stock market and investing in long-term bonds.
Contentious plan for sagging UC pension fund
UNIVERSITY OF CALIFORNIA

A tidal wave of unfunded retirement obligations that could top $40 billion in four years is washing over the University of California, forcing employees to pay far more for those benefits and threatening students with the possibility of more tuition hikes and years of austerity.

They also point to a particular recommendation that would improve the pension benefits of the 250 top-paid employees…. "While claiming that cost-cutting is needed, UC unbelievably increases retirement benefits for highly compensated executives, while cutting low-wage retirement benefits in half," said Julian Posadas, vice president of the American Federation of State, County and Municipal Employees, which represents 21,000 UC workers who typically earn around $40,000 a year.

Pitts also said that in exchange for retaining benefits, highly paid employees would eventually contribute more to the pension fund - up to 7.7 percent of their paycheck - than low-wage workers. This would happen after 2013, if the regents approve the recommendations. Most employees pay 2 percent of their salary toward retirement. The UC regents are expected to approve an interim increase for all employees at their meeting in San Francisco next week. It would raise the employee contribution to 3.5 percent beginning in July 2011, and to 5 percent in July 2012.
Contributions to start; benefit cuts possible

Contributions to start; benefit cuts possible

SAP FRAN...

years, the University of California pension system seemed to be a Wall Street wonder, building assets and paying billions in benefits without any contributions from the university or its employees.

Those days will soon be over, and there will be a price to pay for the remarkable contribution holiday.

UC regents voted yesterday to start regular payments and, along with UC President Mark Yudof, served notice of a possible reduction in benefits for thousands of retirees.

“I see no way around restructuring the benefits,” Yudof said at the end of a budget meeting with regents. “I don’t know what we’re legally allowed to do, but we’ll find out,” Yudof continued.

There are levers, like the vesting period, and employee contributions, and how you treat new employees.

“I have no set views on that, other than I feel the board and I have a fiduciary responsibility to put this on a path to fixing it.”

Admissions changes pass: UC regents hope new rules widen applicant pool. A4

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“I have no set views on that, other than I feel the board and I have a fiduciary responsibility to put this on a path to fixing it.”

SEE Pensionfund, A10

OVERVIEW

Background: The University of California pension system was so healthy that for two decades it grew through investments from the employees.

What’s changing: Like other pension systems, the UC’s is in a dive. University regents have acted to restart employee and university contributions.

The future: Regents say that even if their contribution schedule is fully adopted, it won’t be enough to cover the shortfall. They warn of benefit reductions.
SPECIAL REPORT pensions

TO JUICE UP THEIR SAGGING PORTFOLIOS, PENSION FUND MANAGERS ARE SEEKING ALTERNATIVE INVESTMENTS.
BY RANDY MYERS

Casting For Returns

LAST YEAR, BILL EINHORN FINALLY HAD ENOUGH. WITH 2002 drawing to a close, the $1.1 billion pension fund that Einhorn administers for the Teamsters union in Philadelphia was set to post its third straight year of lackluster investment returns—up around 2 percent in 2000, flat in 2001, and down 5.89 percent in 2002. During that time, it had slid from being more than 90 percent funded to only about three-quarters funded. Now, all the analysis Einhorn could put his hands on was telling him that returns on fixed-income investments—the only portion of his portfolio that had been making money in the past couple of years—were heading toward single-digit levels.

His decision: dip a toe in alternative investments. With the agreement of the board of trustees, Einhorn took 4 percent of the fund’s portfolio out of fixed income and put it into private real estate investments managed by New York-based General Motors Asset Management (GMAM), the $300 billion-plus (in assets) pension arm of General Motors Corp.

“What we were looking for was a higher return with some additional risk, but not too much risk, to help us meet our 7.5 percent earnings assumption,” says Einhorn, who until this year had his fund’s assets split 40-60 between publicly traded stocks and bonds. (The Teamsters checks its earnings assumption every five years; the current assumption was...
CalPERS loses $854 million on collateral reinvestment

August 11, 2009

CalPERS recorded an unrealized loss of $854.3 million on collateral that was reinvested from its internally managed securities-lending program.

The loss is a result of market turmoil that affected pricing for even top-quality collateral, staff of the $188.5 billion Sacramento-based California Public Employees' Retirement System wrote in a memo to the CalPERS' investment committee.

For the year ended March 31, CalPERS' securities-lending program posted a loss of $634.1 million, including the unrealized loss on the internal collateral reinvestment. Excluding the loss, the program generated $220 million in income for the year.

CalPERS' investment committee will review the program at its Aug. 17 meeting.

Separately, the staff is recommending issuing an RFP for a preapproved list of real estate consultants. The new five-year contracts would begin July 1, 2010.

Nine firms were selected for the pool in 2005. Contracts expired in June 2008 with extension options that will expire in June 2010.

CalPERS spokesman Clark McKinley could not specify how many firms will be selected for the new contracts.
“In effect, they’re going to Las Vegas,” said Frederick E. Rowe, a Dallas investor and the former chairman of the Texas Pension Review Board, which oversees public plans in that state. “Double up to catch up.”
Mr. Dear wants to embrace some potentially high-risk investments in hopes of higher returns. ... he wants to load up on many of the very assets that have been responsible for the fund’s recent plunge.
PENSIONS WADE INTO TOXIC ASSETS

CalPERS and other public funds, eager to boost returns, may invest billions. But at what risk to investors?
A survey of practices across the country portrays a far-reaching web of friends and favored associates: political contributors, campaign strategists, lobbyists, relatives, brokers and others, capitalizing on relationships and paying favors. These influential figures can determine how pension funds are invested....

“What has developed is a corrupt system, where Wall Street, various fiduciaries, politicians and corporate managers are draining America’s savings,” said Frederick S. Rowe, a hedge fund manager who serves on the Texas Pension Review Board, an oversight body.
“The S.E.C.’s findings come at a time of uncomfortable scrutiny for the industry. Pension funds lost billions of dollars during that last bear market, and they have not yet recovered.

The S.E.C. report suggests that at least some of the underfunding is a result of pension assets being invested in ways that reward the consultants.”
Calpers Rocked
By ‘Pay-to-Play’

America's largest public-pension fund, Calpers, revealed that a former board member had reaped more than $50 million in fees for arranging investments that could saddle state taxpayers with hundreds of millions of dollars in losses.

The disclosure deepens concerns that alleged conflicts of interest are undermining state retirement funds.

The California Public Employees' Retirement System said it is launching a "special review" into payments by money managers—including billionaire Leon Black's Apollo Management LP—to firms including Arcco Financial Ventures LLC. Arcco is headed by Al Villalobos, who served on Calpers's board from 1993 to 1995.

Calpers made no accusation of wrongdoing. "We are gathering facts to confirm that the $50 million in fees paid to Arcco did not come at our expense," said spokeswoman Pat Macht.

Mr. Villalobos said in a statement Wednesday that he would cooperate with Calpers's review, which he said would find that staff, advisers and board members at Calpers "have acted properly."

The disclosure stands to embarrass Calpers, a longtime champion of good corporate governance. It also promises to cast the fund even deeper into conflict in California, because the burden of Calpers's soured investments stands to fall flatly on taxpayers who are already reeling from a huge state budget deficit and steep unemployment.

Calpers funds the guaranteed pensions of retired state employees from returns on its investments and contributions from local governments. With its investments tanking, Calpers has requested more money from municipalities. To pay up, many of these governments will have to cut services or raise taxes.

"Whenever any public fund does anything to detract from their investment performance, the victims are local governments and state governments," David Crane, an economics adviser to Gov. Arnold Schwarzenegger, said Wednesday.

Calpers's disclosure also renews questions over the role of the middlemen who collect fees from private-equity firms, hedge funds and other investors.
As New York’s Pension Funds Lagged, Managers Picked Up

By MICHAEL BARBARO
and RUSS BUETTNER

The New York city comptroller, William C. Thompson Jr., is staking his mayoral campaign on his skills as a financial manager, which he says are exemplified by his supervision of the nation’s largest municipal pension system.

But a review of how the $80 billion system has performed since he took office shows it has consistently lagged behind many of its public pension peers... as the city tripled the number of money managers it uses and the fees that it pays those firms.

...the $80 billion system has consistently lagged behind many of its public pension peers... as the city tripled the number of money managers it uses and the fees that it pays those firms.

The City Controller has benefited... collecting more than $500,000 in campaign contributions from its growing roster of money managers.

The New York Times
Expect the World®
August 18, 2009
Chief of New Mexico Pension Resigns

Bruce Malott, the chairman of New Mexico's educational pension fund, resigned after a disclosure that he borrowed $350,000 from the father of a man who shared in as much as $22 million in finder's fees from state investments.

(September 3, 2010) -- Bruce Malott, the chairman of New Mexico's $8.55 billion educational pension fund, resigned following a questionable $350,000 loan.

Malott's resignation from the New Mexico Educational Retirement Board came after he revealed to board officials that in August 2006, he borrowed money from Anthony Correra, whose son, Marc Correra, was a political donor to Governor Bill Richardson. The Albuquerque Journal reported that Malott, a former campaign treasurer for Richardson, used the money to pay $290,000 in federal taxes and $50,000 in state taxes that he owed after the US Internal Revenue Service determined that a limited-liability company set up by him and others was used to avoid taxes. Malott reportedly denied allegations of using a placement agent, telling The Journal that when he obtained the loan, he was unaware that Correra's son, Marc, was getting paid by money managers to help them win business with the teachers' pension...
A senior CalPERS investment officer resigned today after being linked to the pension fund's bribery scandal.....

Shahinian’s name surfaced in Attorney General Jerry Brown's lawsuit against former CalPERS board member Alfred Villalobos and former Chief Executive Fred Buenrostro. The lawsuit said Villalobos bribed Shahinian with an all-expenses-paid junket to New York in 2007.

Weeks later, without disclosing the trip, Shahinian persuaded CalPERS to invest $600 million with one of Villalobos' clients, Apollo Global Management. The deal generated a $13 million commission for Villalobos.
Former New York Comptroller Alan Hevesi, getting an earful from his attorney in Manhattan State Supreme Court on Thursday, is now cooperating with authorities in the ‘pay to play’ probe.

‘Pay to Play’ Scandal Gets a Key Guilty Plea

Focus Turns to Financier Steven Rattner, Among Others

Former New York State Comptroller Alan Hevesi admitted Thursday that he traded access to one of the nation’s largest public pension systems for personal benefits and political favors, agreeing to cooperate with the continuing investigation of the fund he once ran.

At one time among the highest-ranking politicians in New York, Mr. Hevesi was barely audible as he stood up in court and pleaded guilty to a felony corruption charge. He acknowledged accepting nearly $1 million in overseas travel, campaign contributions and other benefits for himself and others from a Cal-

administration “car czar,” and Henry “Hank” Morris, Mr. Hevesi’s former chief political adviser.

“I deeply regret my conduct and sincerely and deeply apologize to the people of the state of New York, to the court and to my family,” Mr. Hevesi, 70 years old, told State Supreme Court Justice Lewis Starr Stone in New York City as his two sons and his daughter sat watching.

Afterward, Mr. Hevesi hurried out with his lawyers trailed by reporters, declining to comment and escaping into an elevator. When he is sentenced, Mr. Hevesi could face 16 months to four years in prison on the felony charge, but

Daniel Hevesi, said the agreement “speaks for itself.” Andrew Hevesi could not be reached.

Mr. Hevesi’s agreement to cooperate could put pressure on others to plead guilty as Mr. Cuomo tries to tie up his investigation before leaving office at the end of the year.

Mr. Morris denies allegations by Mr. Cuomo that he doled out investments by New York’s $125 billion fund in exchange for kickbacks as a placement agent and as rewards for political allies. Mr. Morris is scheduled for trial next year.

On Thursday, Mr. Hevesi said Mr. Morris “steered Common Retirement Fund invest-
SEC Bans ‘Pay to Play’ For Advisers

WASHINGTON—The Securities and Exchange Commission took a step toward cracking down on “pay to play” schemes, barring investment advisers who want to manage public pension funds from donating to politicians who oversee the funds.

The 5-0 decision by the SEC’s commissioners followed scandals in New York state and elsewhere in which investment advisers were accused of making political payments to help themselves get government business.

The agency backed off a related proposal that would have banned investment advisers from hiring so-called placement agents to help them secure pension-fund business. Under the regulations passed on Wednesday, investment advisers can use placement agents as long as they are registered with the SEC or the regulatory organization known as the Financial Industry Regulatory Authority. Companies with large placement-agent businesses, including Blackstone Group and Credit Suisse Group, had lobbied against the outright ban.

SEC Chairman Mary Schapiro said the cost of pay to play is

She alluded to an April settlement in which private-equity firm Quadrangle Group LLC agreed to pay a $12 million fine to resolve civil charges by the SEC and New York Attorney General Andrew Cuomo’s office. Authorities alleged Quadrangle secured a $100 million investment by the New York State Common Retirement Fund only after a former executive arranged to distribute the DVD of a low-budget film produced by a state official and his brothers and paid more than $1 million in sham “finder” fees to the top adviser of the state comptroller.

“Our recent cases may represent just the tip of the iceberg,” Ms. Schapiro said. “I fear that many other efforts to influence the selection of advisers to manage government pension plans pass unnoticed or, though highly suspect, cannot be proven to have crossed the line.”

The SEC rule prohibits advisers from offering services to pension plans for two years if they contribute to an elected official or a candidate who could be in a position to hire money managers. Certain executives and employees of the money
"..many companies assume... that their pension plans will return 9% or 10%, while in reality the stock market has resulted in widespread negative investment returns."
Pension Gaps Loom Larger

Funds Stick to ‘Unrealistic’ Return Assumptions

BY DAVID REILLY

Many of America’s largest pension funds are sticking to expectations of fat returns on their investments even after a decade of paltry gains, which could leave U.S. retirement plans facing an even deeper funding hole and taxpayers on the hook for huge additional contributions.

The median expected investment return for more than 100 U.S. public pension plans surveyed by the National Association of State Retirement Administrators remains 8%, the same level as in 2001, the association says.

The country’s 15 biggest public pension systems have an average expected return of 7.8%, and only a handful recently have changed or are reconsidering those return assumptions, according to a survey of those funds by The Wall Street Journal.

Corporate pension plans in many cases have been cutting expectations more quickly than public plans, but often they were starting from more-optimistic assumptions. Pension plans at companies in the Standard & Poor’s 500 stock index have trimmed expected returns by one-half of a percentage point over the past three years:

- 2001: 10%
- 2005: 8.75%
- 2008: 8.25%

The rosier expectations, despite the Jones Industr

The rosier expectations, despite the Jones Industr
Some plans want to hide the truth from taxpayers.
$500 billion unfunded liability for California’s three biggest pension funds—Calpers, Calstrs and the University of California Retirement System.

Calstrs assumes a rate of return of 8%, Calpers 7.75% and the UC fund 7.5%. A 5% return is more realistic.
SEC Sues New Jersey As States’ Finances Stir Fears

BY KARA SCANNELL AND JEANNETTE NEUMANN

The Securities and Exchange Commission, in its first securities-fraud case against a state, accused New Jersey of misleading investors about the health of its two largest state pensions while selling billions of dollars in bonds.
The Illusion of Savings

By MARY WILLIAMS WALSH

Earlier this year, Illinois said it had found a way to save billions of dollars. It would slash the pensions of workers it had not yet hired. The real-world savings would not materialize for decades, of course, but thanks to an actuarial trick, the state could start counting the savings this year and use it to help balance its budget.

Such strategies, adopted by more than a dozen states and some local governments, are already in use in Rhode Island, Texas, Ohio, Arkansas and a number of other places, allowing those states to harvest savings today by imposing cuts on workers in the future.

Texas saved millions of dollars this year after raising its retirement age for future hires and banning them from counting unused sick leave in their pensions. More savings will appear in coming years. Rhode Island also raised its retirement age for future retirees. 
“The motion has been made and seconded that we stick our heads in the sand.”
After the largest U.S. pension fund lost $70 billion and got embroiled in an influence-peddling scandal, new investment chief Joe Dear says the only way out of this mess is to take more risk.
Global greying will test rich and poor nations
Tick, Tick... Boom!

Terror alert: America’s pension time bomb is ready to explode.

Some of the nastiest conflicts in America’s future have recently begun to reveal themselves. Let’s call them, broadly, the pension wars. They will be fought on a wide range of battlefields, involving not just workers and their employers but also governments at all levels, regulators, accountants, and taxpayers. And there will be winners—because the combatants will be desperate.

A hint of what’s to come could be seen in the New York City transit strike. Most of America didn’t notice exactly what sparked the first such strike in 25 years, costing businesses, individuals, and the city hundreds of millions of dollars. The answer is pensions. The transit authority and the workers were agreed on virtually everything except how much new employers would contribute toward their pensions—4% of wages is 2%—and neither side felt it could give an inch on that.

The reasons illustrate the larger problem. The transit authority, like many private and public employers, is watching its pension costs rocket as longer-acting retirees increase in number. That burden will become unbearable. On the other side, union members are watching employers nationwide dumping or cutting their pensions just as Social Security starts to look shaky. They figure retirement security is the one thing they haven’t sacrificed. Result: war.

New York’s transit strike also illustrates an important reason that the pension wars weren’t headed off long ago. The truth about pensions has been systematically hidden, with all parties collaborating in the deceit. Public-employee pensions have never been accounted for like those run by private employers. No government is required to tell you in pension liability the way, say, General Motors is, on the theory that government can always extract more money from the taxpayers to pay retirees. But this year the Governmental Accounting Standards Board, which sets the rules for the public sector, is changing its regulations. State and local governments will now have to reveal their pension liabilities, which may be underestimated by $1 trillion or more.

Private employers, while required to account for their pensions, have played sophisticated games with the numbers—all within the rules. For example, they can assume the pension fund increased in value when it actually declined. They can assume it will continue increasing in value at a rate that is almost certainly too high. They can even jink up their reported profits based on that assumption, though nonexistent, increase in pension fund value.

But eventually actual figures must be made public. A prospect that has seriously spooked private employers. Just this month IBM announced but it would join the long list of companies (Verizon, Hewlett-Packard, Motorola) that have frozen their pension plans, instead increasing 401(k) contributions for employees. And the 18-month negotiation between UPS and its pilots has come down to just two points: whether outsourced pilots overseas must be union members, and (you guessed it) pensions. The pension wars will inevitably include Congress, which is working out a way to increase funding for the Federal Pension Benefit Guaranty Corp. to remove the red ink at huge companies like UAL, parent of United Air Lines, dump their pension plans on it. Since the PBGC is in the black, the logical move is to raise the premiums companies pay, especially for the riskiest plans. But if Congress mandates a premium hike, as it probably will, then companies will just dump their plans on the PBGC, redoubled for more funding, leading to more premium hikes, and so on. If you can see any way taxpayers will not get hiked for a giant bailout, please e-mail Congress immediately.

And then there’s the greatest pension crisis of all: Social Security. We’ve stayed in denial thanks to the so-called trust fund, that magical place where the plan’s annual surpluses are sent to be invested until we need them. But since those surpluses must by law be invested in government bonds, they have simply been handed over to the U.S. Treasury and spent by Congress. The trust fund is in fact meaningless, a bit of marketing hocus pocus cooked up in the ’70s. When Social Security’s annual surplus ends in just six or seven years, the battle over whose on to 2050 in order to cover the plan’s obligations will be truly epic.

The hard reality is that for decades we haven’t told ourselves the truth about pensions. Now, as the baby-boomers turn 60, we must finally confront reality—and absolutely no one will like it. In New York last month, transit workers and management compromised; employers will make small contributions toward future retirement pensions but will keep one of the nicest retirement deals around. Soon those compromises simply won’t be affordable. And that’s when the pension wars will explode.
Beware the Pension Monster

It lurks behind funny accounting, ready to pounce on unsuspecting investors.
by Janice Revell

I think we’re faced with the worst financial situation,” says one asset manager, “since the Depression.

ILLUSTRATION BY CHRISTIAN NORTHEAST
Here comes the crash

Boston sage Jeremy Grantham thinks investors are facing two tough years ahead. About $70 billion of smart money says the guy is no Chicken Little.

By David Stires

Talk to Jeremy Grantham about the stock market, and you get the impression the sky is about to fall. For years the chairman and chief strategist of money-management firm Grantham Mayo Van Otterloo has been gleefully rattling investors’ nerves with his claim that the excesses of the dot-com bubble still haven’t been unwound and that the market is headed for another precipitous drop. About a year ago his prediction became alarmingly specific. Shortly after this year’s election, he says, the market will sink into a “black hole,” losing about a third of its value over the next two to three years. He sounded this warning most publicly at the annual Morningstar investment conference in July. In late October, speaking from his elegant Boston townhouse, he told FORTUNE, “We’re still in the unwinding of the greatest bull market in American history.”

Grantham, 66, clearly relishes his role as stock market Cassandra. But it’s not as though he’s some madman who just broke out of the asylum. A Briton who graduated from Harvard Business School in 1966, Grantham co-founded Battery March Financial Management before launching GMO with Dick Mayo and Eyk van Otterloo in 1978. Using GMO’s computer models, he has made several well-timed calls. In 1982, with stocks selling at fire-sale prices and the economy recovering, he predicted the market was ripe for a “major rally.” That year the U.S. market kicked off its longest bull run ever. He also called the top of the Japanese bubble in 1989, the resurgence of U.S. large caps in 1991, and the rallies in U.S. small-cap and value stocks in 2000. Some veteran market watchers consider him one of the top strategists in the game. “Jeremy has great ideas,” says longtime client Jack Meyer, who oversees the $23 billion endowment of Harvard University. “And he’s usually right, which is a rare rarity in the investment business.”

It’s hard to argue with Grantham’s results. Since inception, GMO’s 22 dozen funds have beaten their respective benchmarks by an average of three percentage points a year after fees. In recent...
Anyone who looks ahead can see that when boomers' retirement plans need cash to pay retirement incomes, they will have to sell stocks,... A prolonged bear market is likely... that will destroy the retirement plans...
“… we’re heading for a crisis with no escape … one day financial markets will wake up to the size of the problem and send interest rates through the roof … the government will be forced to … raises taxes and cut benefits.”
Public Sector Workers Are the New Privileged Elite Class

Outrageous public pay, pensions, and inherent corruption are enraging private sector America

By MORTIMER B. ZUCKERMAN
Posted: September 10, 2010

We really are two Americas, but not those captured in the stereotypical populist class warfare speeches that dramatize the gulf between the rich and the poor. Instead there is a new division in America that affronts a sense of fairness. That division is between the workers in the private sector and the workers in the public sectors. No guesses which is the more protected. A new study by the Mayo Research Institute, based in Louisiana, demonstrates that there is a striking differential in the impact of the recession. In 2009, the study found, "private-sector workers were nearly three times more likely to be jobless than public-sector workers."
Public Pensions and Our Fiscal Future

Few Californians in the private sector have $1 million in savings, but that’s effectively the retirement account they guarantee to many government employees.

By ARNOLD SCHWARZENEGGER
“If we take a late retirement and an early death we’ll just squeak by.”
Healthier and Wiser? Sure, but Not Wealthier

As Pensions Slip Away, Retirees May Take a Fall

By MARY WILLIAMS WALSH

By many measures, today's older workers appear better equipped for retirement than any previous generation. Their homes are worth more than their parents' homes were. Their bank accounts are fatter. And study after study suggests that typical middle-age retirees have accumulated more wealth than their counterparts did a quarter century ago.

But virtually all of these studies have a flaw, a crucial aspect that is left out of the equation. Add it back in, and the picture suddenly darkens.

That asset is the traditional pension, an employee benefit that was widely available until the early 1980's but has been vanishing from the American workplace ever since. More than onethird of older households — those headed by people 65 to 69 — had someone earning a pension in 1980. By 2001, fewer than half did. The demise of the old-fashioned pension has been much discussed, but the effect on family finances has not.

That is because the impact has been hard to measure.

New evidence suggests, though, that the waning of the pension has imperceptibly but surely, stripped older workers of an important measure of wealth — much more than they previously guessed, if they thought about it at all. Retirement benefits today, particularly the 401(k) account, simply are not worth as much as the older kind of benefits. Some studies suggest otherwise, but they tend to rely on average balances of retirement accounts, and the averages have been skewed upward by the extraordinary gains of a few wealthy households.

When the holdings of more typical households are tracked instead, today's near-retirees turn out to be a little poorer, in constant dollars, than the previous generation was when it approached retirement in 1983. The swelling change in employee compensation appears to be the reason, according to a new research by Edward N. Wolff, an economist at New York University who analyzed 18 years of household financial data collected by the Federal Reserve.

Mr. Wolff found that the average net worth of an older household grew 44 percent, adjusted for inflation, from 1983 to 2001, to $375,900. But much of the growth was in the accounts of the richest households, which pushed the averages up. When Mr. Wolff looked at the net worth of the median older household — those at the midpoint of the economic ladder, a better indicator of what is typical — the picture changed. That figure declined by 12 percent, or $1,900, during the period, to $13,900.

For a generation to emerge from two bullish decades with less wealth than its parents had "is remarkable," Mr. Wolff said. Based on economic growth and market returns over those 18 years, he said, their wealth "would be up around 35 or 40 percent."

The Fed's household financial data also show that when pensions were more common, they served as a social safety net. Companies that offered them had to use the same pension formula, involving years of service and salary, for all workers in a plan. Otherwise, the companies risked losing their tax break. The risk is those days bought big houses and invested in stocks and other assets that were out of reach for the middle class. But pensions would offset, to some degree, the difference between how those groups lived in old age. Traditional pension plans were part of a system that reduced the poverty rate among the elderly to just 1 in 5 in 1990, the lowest in half a century.

The advent of self-directed retirement plans, by contrast, is giving rise to an elite minority who are well prepared for retirement, and a majority

Continued on Page 9