

President's Message



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Pension Reform Is Needed Now

Everyone knows that Social Security is under stress. Less well-known is that some private defined-benefit pension plans are facing even greater problems.

Under a defined-benefit plan, a company promises to pay a set monthly benefit to a retiree. If a company ceases operations and has a fully funded pension plan, retirees will continue to receive their checks and current employees will get their pensions when they retire.

But for an increasing number of workers, the reality is not matching employers' promises. More and more plans are underfunded. The blame lies in two broad areas: The average life span of retirees is being underestimated, and earnings on assets of the plan are falling short. More specifically, some companies are investing too much of their pension funds in risky stocks. Others aren't setting aside enough in the first place for pensions—or, worse, are diverting the money for other uses. And some well-established companies just can't keep up with the burgeoning number of retirees, especially if their newer competitors have almost none. The end result is that some companies' pension programs are in jeopardy.

But isn't there insurance to back up these plans? Yes, 30 years ago, Congress created the Pension Benefit Guaranty

Corp. to at least partly cover the owed payments. The corporation is financed by employer-paid insurance premiums and by returns on its assets. But the PBGC is being overwhelmed with requests to take over pension plans these days. As a result, the PBGC had a record deficit last year—more than \$11 billion. The plans that it insures are underfunded in total by more than \$350 billion. Rumbblings of a taxpayer bailout are being heard—shades of the 1980s' S&L crisis.

But there's still time to fix the PBGC. A simple first step is for the government to forbid underfunded plans from sweetening their promises to employees. Next, premiums should be more closely linked to risk. Those companies with shaky pension programs and speculative investments should pay much more for their insurance than the companies with fully funded plans and conservative investment policies. Of course, some underfunded companies will threaten to dump their pension plans or file bankruptcy if forced to pay more. They'll want more and more extensions to get their house in order. But as we learned from the S&L crisis, such delays usually end up costing the taxpayer more in the end.

Meanwhile, employers must be more careful where they invest their pension funds. Instead of buying

stock, they should act more like life insurance companies—investing in fixed dollar assets that mature when cash outlays are expected. The returns won't be as high when the stock market is booming, but they won't be as low, either, when the market tanks.

The government could take many other steps to shore up the PBGC. To be in a position to encourage such reform, the more than 40 million employees who are still covered by defined-benefit plans should educate themselves about the problems. Unfortunately, many workers have never heard of the PBGC. To get them to start thinking about this issue, the government could require all companies to notify their employees annually how much they'd get if their pension plan were terminated right then. Currently, only underfunded plans must provide this information.

No matter which step we take first, we must move now. If we wait a few more years, a taxpayer bailout could be unavoidable. And this drain on the Treasury could come at a time when Social Security is looking to be rescued, too.

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