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### Congress Finally Acts on Pension Problems

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The Congress finally took some action to clean up our pension system last week. The bill is now before President Bush and he is expected to sign it into law soon.

The legislation tackles the whole spectrum of pension issues and the most important is the growing deficits of defined benefit pension plans. A “defined benefit” plan is what we think of when we hear about pensions and it promises its members certain payments during their retirement. This differs from “defined contribution” plans, like 401(k)s, which are more common today and promise nothing longer term.

Over 44 million Americans, about 40% of workers, are enrolled in defined benefit plans, although fewer and fewer companies offer them due to their costs. Every participant, especially those already retired, has an enormous stake in making sure the promised “benefits” actually are paid, as they have planned their lives around these benefits.

Unfortunately for the rest of us, big business and big labor have conspired over the years to make their “private” negotiations the responsibility of all Americans. Back in 1974, a law was enacted that put the taxpayer on the hook for these benefits if companies fail to meet their obligations. It drives me nuts that steel companies and airlines, along with their labor unions, were free to irresponsibly negotiate big contracts with huge benefits and then push the cost onto you and me when they realized the promises were too costly.

While I realize retirees often get smaller benefits when the government takes over a plan, why should the average American worker, who has no pension plan, be forced to pay any benefits to a United pilot, flight attendant or mechanic?

Let us hope the new legislation fixes the problem and fully funds the government Pension Benefit Guaranty Corp. (PBGC) which is the agency responsible for paying unfunded benefits. Right now it is being overwhelmed and has \$23 billion of debt.

But it is going to be a long and hard road with private pension plans currently under-funded by \$450 billion. In fact, the situation might get worse before it gets better. The new bill gives companies leeway to pay less for the next few years, in order to reduce the incentive of companies to just throw in the towel and walk away. Eventually the law becomes more stringent and projects the system will be solvent by 2015.

For taxpayers this is only part of our problem, as public pension plans, run by our cities and states are in an even a bigger pickle. They are under-funded to the tune of around \$800 billion.

While some forward-looking private companies, like IBM, have cut or eliminated pension benefits, it's going to be harder for elected officials to take on the unions to cut future pension benefits. Most elected officials that try to cut benefits lose their jobs. For this reason most officials merrily go along promising benefits, because the no one has to pay the piper until they themselves are long gone. Great system!

Looking at the bright side, the pension bill included a number of incentives for individuals to save more. One of the most significant changes allows companies to get more involved with their employees 401(k) plans. Up until now, companies were hesitant to get mixed up with their employees' 401(k)s due to potential liability issues. The new law gives companies the green light to be more aggressive in helping and coaxing employees to make better use of these programs.

One of the principal changes allows companies to automatically enroll new employees in a 401(k) plan and deduct funds from their paychecks. On top of this employers can decide to automatically invest the money in stock and bonds, rather than in ultra-safe, but low-returning money market funds. Employees will still have the final say, but only if they speak up and actively choose to opt out of these programs. Supporters expect these changes to significantly increase participation in, and contributions to 401(k) programs.

A particularly controversial provision allows employers to hire financial firms to provide financial planning advice to employees. Everyone agrees employees need more assistance, but many observers do not trust Wall Street firms to provide it. This is a hard one, as Wall Street certainly makes a pretty penny on the back of retail investors, but most investors are in need of more help and who else can provide it?

College savings plans, known as 529s, got a boost from the law and hopefully this will reinvigorate interest in these plans. 529s allow investors to grow after-tax dollars tax-free as long as the money is used for higher-education purposes. Under current law this tax-free provision was due to expire in 2010, but the new legislation makes it permanent - or at least as permanent as any tax provision!

In summary, this is the first major overhaul of our pension system in over 30 years. And while it easy to find a few faults in a 900 page bill, let's hope it works at shoring up the old regime and giving workers the right incentives to be successful going forward.

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