Book Review

Pension dumping. The reasons. The wreckage. The stakes for Wall Street

Fran Hawthorne

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In this book, Fran Hawthorne describes in some detail the history of the Pension Benefit Guarantee Corporation (the PBGC) in the United States, and the impact that it has had on the ‘safety’ of retirement benefit schemes. The PBGC was, of course, the model that was used in setting up the Pension Protection Fund in the United Kingdom, and thus the issues described in this book give a familiar flavour of the problems faced by defined benefit occupational pension arrangements.

Hawthorne is a journalist, and has written on a range of financial topics for American publishers. Her journalistic style makes the book readable – although occasionally some of the technical detail tends to get lost in the rather breathless narrative of the events she is trying to explain.

The book is set out in 12 chapters, tracing the development of the PBGC from its inception in 1974 to the introduction of the Pension Protection Act in the United States in 2006. It highlights the problems surrounding the PBGC and the way in which defined benefit provision in the United States was progressively undermined. The fact that the bankruptcy system in the United States relegated retirement benefit schemes to the status of unsecured creditors meant that liabilities were seldom recovered after the sponsoring employers had gone bankrupt.

The introduction of the PBGC in 1974 was meant to ensure that pension liabilities could be safeguarded in the event of potential or actual bankruptcy. However, as Hawthorne describes in

some detail, the way in which US legislation introduced the PBGC did not prevent companies from ‘dumping’ their pension liabilities on the PBGC in the first place. As she points out, between 1975 and 2007 more than 3500 financially troubled or bankrupt companies ‘pension dumped’, with a total deficit of US\$32.6 billion by the early 2000s. Part of this was inevitably caused by the fluctuations of the stock markets, demographic changes and assorted economic reasons. But a flaw in the relevant legislation made matters worse, because it made it easy for companies to offload their pension liabilities in the first place in order to make corporate savings, thereby leaving the PBGC to assume greater liabilities than it initially bargained for.

The relevant legislation did not introduce any management tools to ensure that retirement benefit schemes were run in such a way as to ensure proper funding of pension liabilities and it discouraged the building up of surpluses for fear that companies would use their retirement benefit schemes as tax shelters.

Refinements were introduced to the legislation over time, including introducing a risk-related premium for under-funded companies, amendments to laws making it harder for under-funded schemes to improve their benefit structures, requiring retirement benefit schemes to improve their funding position more quickly and setting tighter time limits on actuarial assumptions and putting restrictions on the

circumstances in which companies could terminate their pension plans.

Although such measures were introduced to avoid wholesale 'pension dumping', it could not avoid pension liabilities being offloaded in cases in which there were major bankruptcies in particular industries, for example, in the US airlines industry and the steel industry. In addition, the impact of the US bankruptcy code meant that there was little incentive for US companies to retain their pension liabilities: dumping seemed to make economic sense.

President George W Bush signed the Pension Protection Act 2006 into law in order to, in the President's words, ensure that '... workers will get what they've been promised when they retire'. The Pension Protection Act has tightened legislation in terms of requiring schemes to be 100 per cent funded within a shorter timescale.

Hawthorne shows that there has been a move in the United States towards focusing on ways to

ensure that defined benefit retirement schemes in the United States can be restored to solvency as opposed to merely trying to improve the safety net for schemes that can no longer be maintained. In other words, the United States is now belatedly trying to deal with the problem of 'pension dumping'. Whether this will have success is something that time will have to tell.

Overall, the book provides an interesting recap on the decline of the defined benefit pension provision in the United States in the past 35 years. But it does no more than that and is sometimes lacking in technical detail. It would have been useful if the book had had some kind of conclusion and had gone into a little more depth on the future of the PBGC. Perhaps these are points that may be covered in any future edition.

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