



## Pension Risk: What We Don't Know Can Hurt

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You are about to retire. The last thing on your mind is the possibility of a pension meltdown. Will you need to work again, relinquishing your dreams of experiencing the golden years? You are an institutional shareholder of what you thought were rock-solid companies. More than a few have announced losses related to pension plan redesign or under-funding. Dividends drop. Earning forecasts change. Some of the bonds you own are downgraded. You are a taxpayer. You live in a state that has promised workers more than it can pay. Your employer does not offer a retirement plan and they are cutting jobs in order to remain globally competitive.

Unlikely scenarios? Think again. The \$10 trillion retirement system is arguably reaching crisis proportion and nearly every adult in this country will be affected in one way or another. A lot of the bad news will come as an unpleasant surprise, after the fact and too late to do anything but mourn the outcome. Perhaps more than ever before, access to complete, clear and timely financial information is paramount. Unfortunately, getting the lowdown on pension plans is like finding a needle in a haystack. Information is either unavailable, reported long after the filing date or is too broad to be of practical use.

Things may change soon. According to its release in late March, the Financial Accounting Standards Board plans to unveil new rules for post-retirement benefit reporting in time for year-end implementation. The first phase will require a company to recognize "the overfunded or underfunded status of defined benefit postretirement plans as an asset or a liability in the statement of financial position." A second phase of this multi-year project will impact reported earnings. Current rules permit a company to disclose funding status as a financial statement footnote. Proponents of reform assert that balance sheet and income statement inclusion will promote transparency and close the gap between economic and accounting numbers.

Will more disclosure mean better information for beneficiaries and shareholders? Only

time will tell. On a positive note, it probably can't get any worse than the current situation. The flipside is that companies may respond by freezing or terminating defined benefit plans or accelerate existing plans to otherwise deal with what C-level executives increasingly see as a real drag on growth. (A discussion of the accounting and economic impact of frozen or terminated plans is outside the scope of this article.)

History offers a few lessons. Consider FAS 133, the mammoth rule book for derivative instrument accounting. Not long after it took effect, more than a few companies cut back on the use of derivatives, citing FAS 133 compliance as overly complex and time-consuming. Reducing speculative positions is one thing. Abstaining from the use of derivatives to mitigate interest rate, commodity, currency or equity risk is another thing altogether. Following the promulgation of FRS 17 in the UK several years ago, the National Association of Pension Funds "found that more than three quarters of companies offering final salary pension schemes were less likely to do so because of the new accounting standard."

As with any regulatory initiative, the goal is to achieve benefits that outweigh the costs of compliance in terms of time, money and management attention. A worst case outcome is that companies spend millions of dollars to comply with post-retirement accounting rules and interested persons remain in the dark.

Ignorance is not bliss. Without good information, beneficiaries are at the mercy of plan fiduciaries to make the right decisions on their behalf. They can only hope that corrective action will be taken long before disaster strikes. Even when good people are in place, they are frequently torn between competing job duties and interests. (Read "Do Fiduciaries Need Better Incentives to Make the Retirement System Work?" for an in-depth discussion of this issue.)

Can you identify pension fiduciaries at any particular company? Do you know whether they have the skills and experience to navigate the plan through choppy waters?

According to U.S. Department of Labor Secretary Elaine L. Chao, "many employers have not implemented a systematic process to educate fiduciaries about their responsibilities under ERISA." To be fair, there are countless fiduciaries who are experts in their own right. What about those who are tasked to evaluate complex strategies yet may not have a strong background in finance, law or actuarial science? (Remember that outsourcing plan-related functions to consultants and other professionals does not absolve fiduciaries from their duties.)

Who monitors the fiduciaries? Is there a relationship between fiduciary liability insurance costs and scope of coverage and the quality of fiduciaries in place? Should the job of pension fiduciary be a full-time position? Should C-level executives and board members be made more accountable for pension fiduciary recruiting and decision-making? Is it time for a "fiduciary expert" standard that parallels the notion of a Sarbanes-Oxley "financial expert"?

What is the answer? User-friendly financials must be made available to the public on a timely basis and with sufficient granularity to ensure that they are helpful. Accounting rules that articulate a risk-based assessment of pension assets and liabilities is a good start. Disclosing detailed information about plan fiduciaries is equally compelling. A pension meltdown that could have been prevented with better information is bad enough but the wave of new retirees have to contend with Social Security woes as well. Working at 80 may be a reality. ■

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