



# Investment Insights

Kevin Kennedy

## When A Promise Isn't A Promise

There's a major storm brewing in the financial world, one that may reshape American society in dramatic and destabilizing ways. This storm may hit everyone, from the schoolteacher in Michigan to the airline pilot in San Francisco to the city employee in San Diego. When the clouds clear, we may be looking at a landscape so different from today's that to many it will be unrecognizable.

I'm talking about the impending pension plan disaster. Doesn't apply to you, you have a guaranteed pension? Hold on, you're in the eye of this storm. Counting on that monthly check in retirement? Think again. Based on recent events, and future projections, those guaranteed benefits might not deliver anything near what millions of Americans are banking on.

To see how this storm formed, we need a quick refresher on fixed-benefit retirement plans, also known as Defined Benefit Plans. Defined benefit plans are designed to do exactly what the name implies: deliver a defined benefit to the participant, often in the form of a fixed monthly payment. Defined benefit plans are primarily funded through employer contributions. The amount of annual funding needed to provide the defined benefit is determined by a number of factors, including expected returns, future earnings levels of the employee, and life expectancy.

Defined benefit plans used to be the standard in the U.S., and the picture of the 30-year IBM employee retiring to a life of leisure and \$4000 per month guaranteed payments was the Rockwellian picture of retirement. Punch the clock for enough time, and your future is secure...or is it?

Here's the catch, the seed for the storm that's now looming over our country: you're counting on someone else to ensure the safety of your future, and they may not be as concerned about your future as you are. And when push comes to shove, as it is in the economy right now, promises made to you over the years may become a trivial inconvenience for these parties.

To make sure they could meet the obligations promised to you, employers set aside a certain amount of money each year to cover this future payment based on the factors described above. However, a "perfect storm" of sorts has formed to jeopardize the ability of these plans to deliver on the promises they have made. First, investment returns have

suffered from the deep bear market in stocks, causing investment losses instead of gains, thus forcing employers to fund even greater amounts to keep balances up to the level needed to provide benefits. Second, people are living longer, meaning the benefits must be paid over a much longer period than anticipated. And thirdly, the amount of money going towards defined benefit funding payments has risen to become a substantial part of many employers' otherwise tight budgets.

No way, you say. They told me I'd get my monthly pension, they can't break a promise. Oh, but they can. And they very well will.

According to the Pension Benefit Guarantee Corporation (PBGC), a governmental agency charged with insuring defined benefit pension plans for over 44 million American workers, such plans in 2003 were under funded to the tune of \$278.6 billion. To put that in layman's terms, that means these 1,050 pension plans needed additional contributions by employers of \$278.6 billion just to be caught up to current requirements. Might they come up with the nearly \$300 billion? Sure, or they might do what two major airlines, US Air and United, did recently and simply declare bankruptcy. In that event, the pension obligations get turned over to the PBGC. Will the PBGC be able to cover this \$278.6 billion? Let's hope so. If recent history is an indication, benefits might be covered partially, with a limit on the maximum benefit one can receive. And, according to many industry experts, the PBGC is not adequately funded to handle the potential pressure of more large plans falling into their laps.

I suggested that we might be in for a major shock to society as this situation unfolds. The shock will be the uncomfortable realization that we really do need to be self sufficient, and in fact others really may not be looking out for our well-being. In many societies, defined benefit plans, whether private or government-sponsored, have provided a safety net for millions of citizens. However, the long-term feasibility of providing such benefits is now being tested severely. Already, in some cases, economic reality has exposed the flaws of these strategies. The debate has even encompassed the largest defined benefit plan in this country, Social Security, where government officials are trying to figure out a way to make the numbers add up right. Creation of new retirement savings vehicles like ROTH IRAs has happened, in part, by the growing need to shift responsibility for our future financial well-being to ourselves.

Regardless of your feelings on how this situation should play out, and what the ultimate solution should be, this is an issue that must be addressed now, before the safety net completely falls apart, and millions of American citizens are left high and dry wondering what happened to something so seemingly secure.

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