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WINTER WARNING

The Penchant for Pensions

In our newsletter of November 18th. I stated my personal philosophy that *'life is unfair, fragile and there are no guarantees'*. Excepting the spectre of the demon unemployment rearing its ugly head, nowhere in the business world today is this philosophy more meaningful than in the world of corporate defined-benefit pension plans. Indeed, millions of Canadian and American workers make regular contributions to their company pension plans over many decades, augmented by contributions to the plan by their employer. Most corporate employees expect that at the time of their retirement, monies from their company pension plan will be available to provide them with a steady, reliable income in their golden years. Amid the current North American economic recession, employees should not assume that all of their pension expectations are guaranteed.

In a recent report by the Organization for Economic Co-operation and Development (OECD), compared to 27 of the world's most affluent countries, Canadian private pension funds ranked 23rd. in terms of performance, between January and October of this year. Indeed, these Canadian pension funds experienced a 23% decline in nominal terms because equities represented more than 1/3 of the total assets invested. The OECD report stated that exposure to "*toxic*" assets and asset-backed securities were as high as 3% of the assets under management for the Canadian pension funds. Also, according to the OECD report, both defined-benefit and defined-contribution pension plans have been severely impacted by the global financial and credit crises; and if the rate of corporate bankruptcies increase, pension benefits may be cut.

Under Canadian pension laws, every three years pension plans must undergo a solvency test by regulators, to ensure their present and long term viability. Naturally, through the current period of economic recession, not only will a plan's investment portfolio have likely incurred losses, but also, the company's own profitability has probably suffered, resulting in some pension liability exposure. For example, just a handful of representative Canadian companies which have significant, defined-benefit pension plan liabilities include the following well known names: BCE Inc. $2.5 billion; Bombardier Inc. $2.5 billion; General Motors Canada $4.5 billion; Imperial Oil $1 billion and Nortel Networks $1.9 billion. In July, 2009, when scores of Canadian pension funds begin filing their valuation reports, regulators could be faced with a myriad of plan restructurings.

So, what happens to a corporate pension plan if the company declares bankruptcy? Indeed, this very prospect is now facing Nortel Networks, who has recently sought legal counsel to explore bankruptcy protection from creditors, in the event that its restructuring plan fails. Upon bankruptcy, while extant funds in its pension plan would be protected, lawyers say that any deficiency in company contributions would represent an unsecured claim. Accordingly, pension plan members could be forced to launch a class action lawsuit against the company's directors, for the company's contribution shortfall. Moreover, the federal Wage Earner Protection Program allows employees a maximum payment of $2,000 per month for unpaid pensions.

By similar token in America, an enormous transfer of private defined-benefit pension plans from the corporate sector to the Pension Benefit Guaranty Corp. could be looming on the horizon. As an independent federal government agency, PBGC was established by the Employee Retirement Income Security Act of 1974, '*to encourage the continuation and maintenance of private sector defined-benefit pension plans*'. At its 2007 fiscal year end, PBGC insured the pensions of approximately, 44 million Americans and was responsible for the pensions of more than 1.3 million people whose pension plans had been terminated. While PBGC receives a company's assets when it takes over a failed pension plan, oft-times, a significant challenge arises when insufficient assets are transferred to support the deficient plan. PBGC already has a $10.7 billion long-term deficit and if corporate bankruptcies persist, it could eventually be forced to seek an injection of taxpayer funds itself.

During 2008, the global economic recession has caused the funding level of defined-benefit retirement plans of companies in the S&P 500, to drop by an incredible $265 billion (U.S.). Approximately, 70% of the S&P 500 companies are presently, experiencing pension plan contribution shortfalls and 227of them, have pension plans that are more than 20% under funded. The companies that are leading the U.S. corporate parade of under funded pension plans are Ford Motor $12.6 billion; General Motors $4 billion and Goodyear Tire and Rubber $2.2 billion, according to a November /08 report by Credit Suisse.

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So, if General Motors were to declare a Chapter 11 bankruptcy, what would be the likely course of events for its pension plan? Firstly, with assistance from outside consultants and GM creditors, a Government oversight panel could select a new management team. Then GM could transfer its pension obligations to PBGC, which would pay GM employees only a small portion of their expected benefits. Moreover, according to bankruptcy experts, if the new management and the United Auto Workers (UAW) were in disagreement, a court could impose lower wages and a streamlining of workplace rules on the union. However, I believe that the U.S. Government will access funds from the Troubled Asset Relief Plan (TARP) to provide a bridge loan to General Motors this coming week, because it is politically unacceptable to the incoming Obama administration to do otherwise.

Written By: Christopher Funston

Ian A. Gordon, Bolder Investment Partners, Ltd. (604) 742-3200, igordon@bolder.net