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PENSION REFORM: EVOLUTION OR REVOLUTION?

“Congress, regulators, lobbyists, and the news media are all scrambling to find out what has gone wrong with the pension system...”

NY Times
July 31, 2005

A Pension ‘Tipping Point’ Indeed

One year ago, in the August 2004 *Letter*, we noted that the *United Airlines* pensions case had “all the makings of a ‘tipping point’: that marginal element in a heretofore apparently steady-state system that tips the balance toward disequilibrium and material change”. Last year’s observation seems even more on the mark today. For example, yet another *UAL* pensions article appeared on July 31 in the *New York Times* titled “How Wall Street Wrecked United’s Pension”.

Strangely, the article misdirects its aim by blaming *UAL*’s money managers and other financial advisors for the airline’s pension troubles. In contrast, we have been arguing for years that at the heart of *UAL*’s (and many other employers’) pension troubles lie only partially-defined, complex risk-sharing ‘deals’. Under financial stress, such ‘deals’ invite game theory-driven bargaining between such strange adversaries or bedfellows as retirees, older workers, younger workers, corporate boards, corporate managements, bond holders, shareholders, and the *Pension Benefit Guaranty Corporation (PBGC)*. Pension regulators, securities regulators, actuaries, accountants, and the courts all play supporting roles in the scripts of

these bargaining dramas. Given these realities, it seems disingenuous for the *Times* to blame Wall Street for legally generating fees out of such potentially chaotic situations.

Where the *Times* is right, is in its observation that finding out, and fixing, what is wrong with the workplace-based pension system is now on everybody’s radar screen. There are already reform proposals in circulation from governments and various professional bodies. Rather than recite in detail what these proposals have to say, the goal of this *Letter* is to develop a broader perspective on pension reform, now that the winds of change are in the air. What, in an ideal world, should happen? Will the measures actually being proposed narrow the gap between where we are, and where we ideally should be? These are the questions to be addressed below.