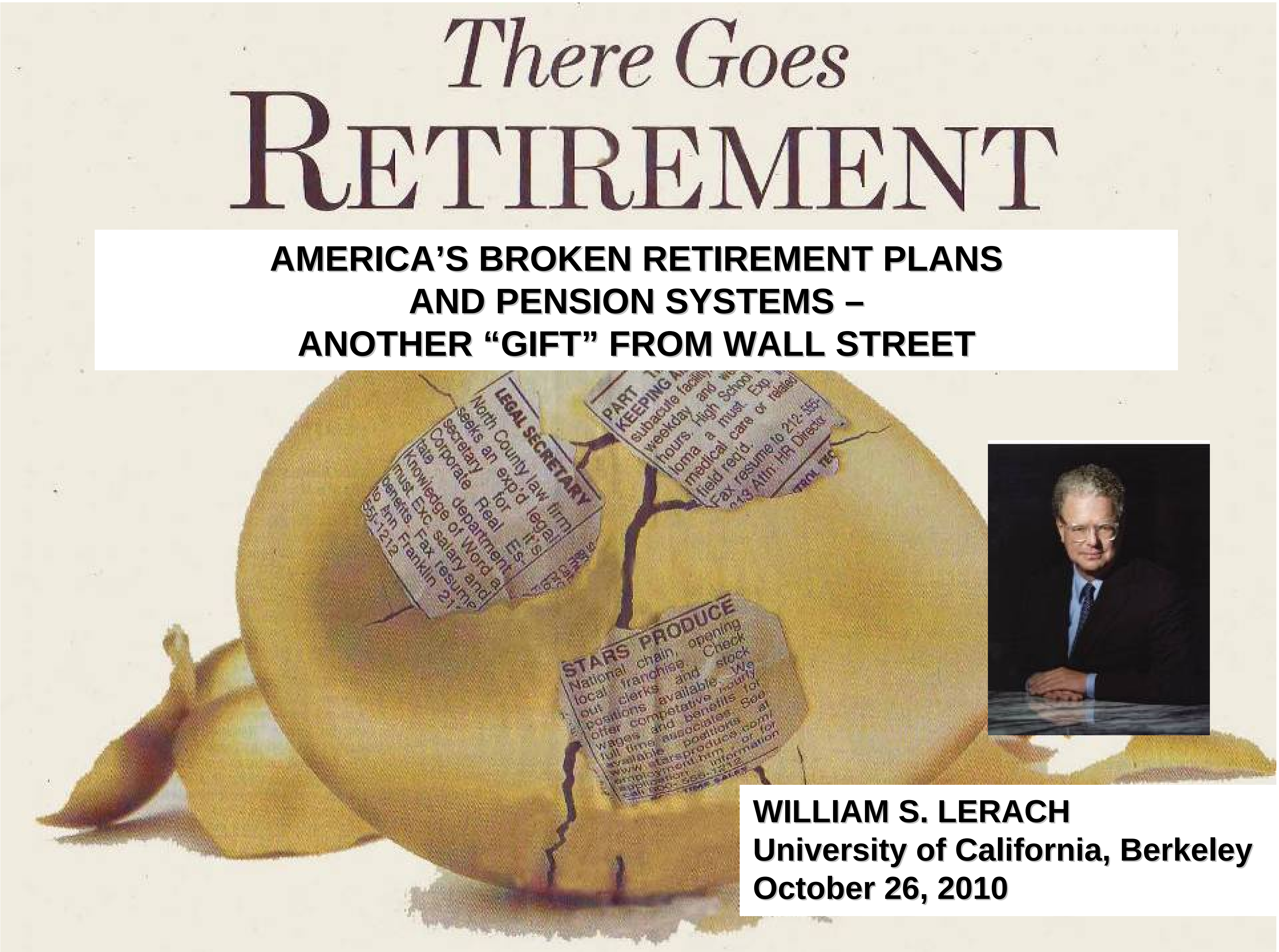


AMERICA'S BROKEN RETIREMENT PLANS AND PENSION SYSTEMS – ANOTHER "GIFT" FROM WALL STREET

WILLIAM S. LERACH
University of California, Berkeley
October 26, 2010

"All the News That's Fit to Print."

The New York Times.

THE WEATHER

NEW YORK, WEDNESDAY, OCTOBER 30, 1929 — TWO CENTS

GRUNDY FOR CURBING BACKWARD STATES ON THE TARIFF BILL

KAHN REFUSES POST IN SENATE CAMPAIGN; CALLS CHOICE UNWISE

STOCKS COLLAPSE IN 16,410,030-SHARE DAY, BUT RALLY AT CLOSE CHEERS BROKERS; BANKERS OPTIMISTIC, TO CONTINUE AID

LEADERS SEE FEAR WANING

Point to 'Lifting Spells' in Trading as Sign of Buying Activity.

GROUP MEETS TWICE IN DAY

240 Issues Lose $15,894,818,894 in Month; Slump in Full Exchange List Vastly Larger

CLOSING RALLY VIGOROUS

Leading Issues Regain From 4 to 14 Points in 15 Minutes.

INVESTMENT TRUSTS BUY

Large Blocks Thrown on Market at Opening Start Third Break of Week.

BIG TRADERS HARDEST HIT

COALITION FIGHTING MOVE TO KILL TARIFF

MISSING AIRLINER BROUGHT IN SAFELY

Navy Paymaster Leads Way to $47,000 Loot, Dug Up by Night in Washington Chicken Yard

STOCKS COLLAPSE IN 16,410,030-SHARE DAY, BUT RALLY AT CLOSE CHEERS BROKERS; BANKERS OPTIMISTIC, TO CONTINUE AID

FERDINAND PECORA

WALL STREET UNDER OATH

THE STORY OF OUR MODERN MONEY-CHANGERS

THE CRESSET PRESS
11 FITZROY SQUARE
LONDON W.1

Leadership is unqualified commitment to the major anxiety of the people. As it was for Roosevelt . . .

President Roosevelt signs the 1933 Securities Act, part of his administration's "New Deal" -- reform of the financial markets.

Winds Blow For Rollback Of Regulation

banks.

HIGH & LOW FINANCE

President Bush came to office with a clear bias against heavy regulation, and Harvey L. Pitt, his first chairman of the Securities and Exchange Commission, made it a priority to improve relations with auditing firms when he took office.

Then came Enron and WorldCom. A nearly unanimous Congress passed, and President Bush signed, the Sarbanes-Oxley Act in 2002, dramatically increasing regulation.

Mr. Bush's Justice Department set up a task force to deal with corporate crime and it brought criminal charges against Arthur Andersen, a major accounting firm that had been

W. Glenn Hubbard, an economist at Columbia University, is co-chairman of a panel calling for less regulation of companies.

Enron's accountant. The firm promptly went out of business.

Auditors, accustomed to very light self-regulation, got a regulator, the Public Company Accounting Oversight Board, that was quite willing to tell them how to conduct audits and to force them to redo audits it found inadequate.

At first glance, now would not seem to be the logical time to push an antiregulatory agenda. By no means are Democrats automatically pro-regulation, but they are less likely than Republicans to be against it, and they will control Congress in the next two years. Mr. Bush appears to be weakened.

But many business leaders are hopeful that at least some of what they see as post-Enron excesses can be rolled back, with a battle cry of making America more competitive. Companies complain that auditors spend too much money and time auditing internal controls. Wall Street argues that it is such rules — and not higher investment banking or listing fees — that keep foreign stocks from

Continued on Page 10

The New York Times

December 1, 2006

PR Newswire
United Business Media

$5 Billion in Political Contributions Bought Wall Street Freedom From Regulation, Report Finds

March 4, 2009

The financial sector invested more than $5 billion in political influence purchasing in Washington over the past decade, with as many as 3,000 lobbyists winning deregulatory decisions that led to the current financial collapse, according to a 231-page report issued today by Essential Information and the Consumer Education Foundation.

The report, "Sold Out: How Wall Street and Washington Betrayed America," shows that, from 1998-2008, the financial sector made $1.7 billion in political contributions and spent another $3.4 billion on lobbyists.

Nearly 3,000 officially registered federal lobbyists worked for the industry in 2007 alone. Surveying 20 leading financial firms, "Sold Out" finds 142 of the lobbyists they employed from 1998-2008 were previously high-ranking government officials.

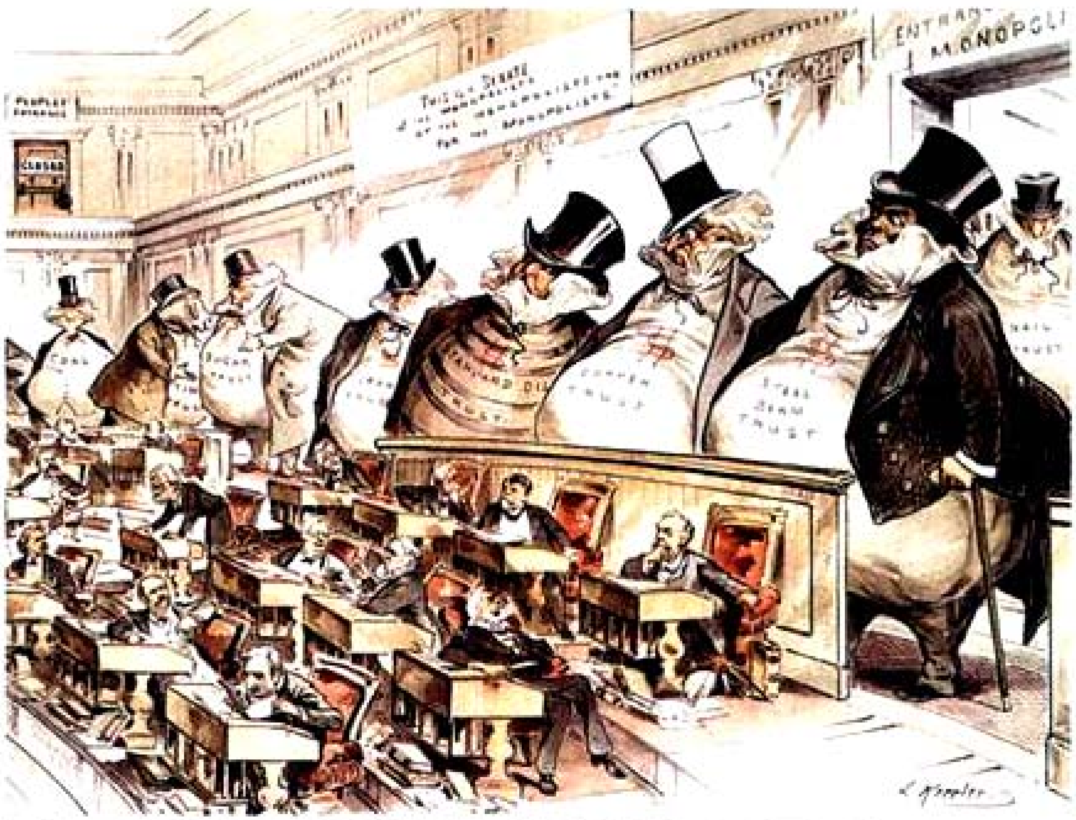
The report documents a dozen distinct deregulatory moves that, together, led to the financial meltdown. These include prohibitions on regulating financial derivatives; the repeal of regulatory barriers between commercial banks and investment banks; a voluntary regulation scheme for big investment banks; and federal refusal to act to stop predatory subprime lending.

"The report details, step-by-step, how Washington systematically sold out to Wall Street," says Harvey Rosenfield, president of the Consumer Education Foundation. "Depression-era programs that would have prevented the financial meltdown that began last year were dismantled, and the warnings of those who foresaw disaster were drowned in an ocean of political money.

Street Life ▪ Andy Serwer

Congress to business: How may I serve you?

pared with the regulatory relief afforded



In the good old days of the Gilded Age, the Senate knew who was boss.

FORTUNE

April 4, 2005

Making It Harder For Investors to Sue

Some Say Congress Is Going Too Far

By DIANA B. HENRIQUES

NOW that Congress is back at work after the summer recess, it faces the task of crafting, out of rival House and Senate proposals, a single bill that would change the rules governing how and when American investors can sue companies for securities fraud.

The competing proposals, sponsored by the Republicans who control Congress, both aim to protect companies from ill-founded investor lawsuits. And, despite differences in the fine print, both would make it signifi-

dominated by caricature. Congressional critics have vilified lawyers who file securities class-action cases as fee-hungry extortionists who do nothing to help investors. Corporate executives dismiss the plaintiffs in those suits as cynical opportunists who buy stock only to gain suing rights. Class-action lawyers condemn their corporate

"I've been frivolously sued, too," said Anthony C. Lami, a pizza parlor owner in Sandy, Utah, who joined a class-action suit after he lost more than $400,000 of his investment in Media Vision, whose stock collapsed after the company retracted past financial statements. "I can see that for a company like Apple, say, whose stock has gone from $70 a share to $20 a share several times in its life, it may be cheaper to pay a settle-

ward looking" earnings statements and encourage judges to force the losing party to pay the winner's legal bills if the judge believes the loser's case was not justified.

Both would also limit a guilty defendant's financial liability to some "proportionate share" of the blame, repealing the current "joint and several liability" doctrine

"[B]ills may … leave many wronged investors without hope of justice."

The New York Times

September 10, 1995

The New York Times

November 13, 1999

Clinton Signs Legislation Overhauling Banking Laws

— President Clinton signed into law today a sweeping overhaul of Depression-era banking laws. The measure lifts barriers in the industry and allows banks, securities firms and insurance companies to merge and to sell each other's products.

"This legislation is truly historic," President Clinton told a packed audience of lawmakers and top financial regulators. "We have done right by the American people."

The bill repeals parts of the 1933 Glass-Steagall Act and the 1956 Bank Holding Company Act to level the domestic playing field for United States financial companies and allow them to compete better in the evolving global financial marketplace.

Analysts and industry leaders say the measure will probably fuel a wave of mergers as companies compete to build financial supermarkets offering all the services customers

statutes, which had increasingly come to be viewed as anachronisms.

"The world changes, and Congress and the laws have to change with it," said Senator Phil Gramm of Texas, chairman of the Banking Committee and one of the bill's prime sponsors.

Supporters of the legislation say it will also benefit consumers, providing them with greater choice and convenience and spurring competition that will lead to lower prices.

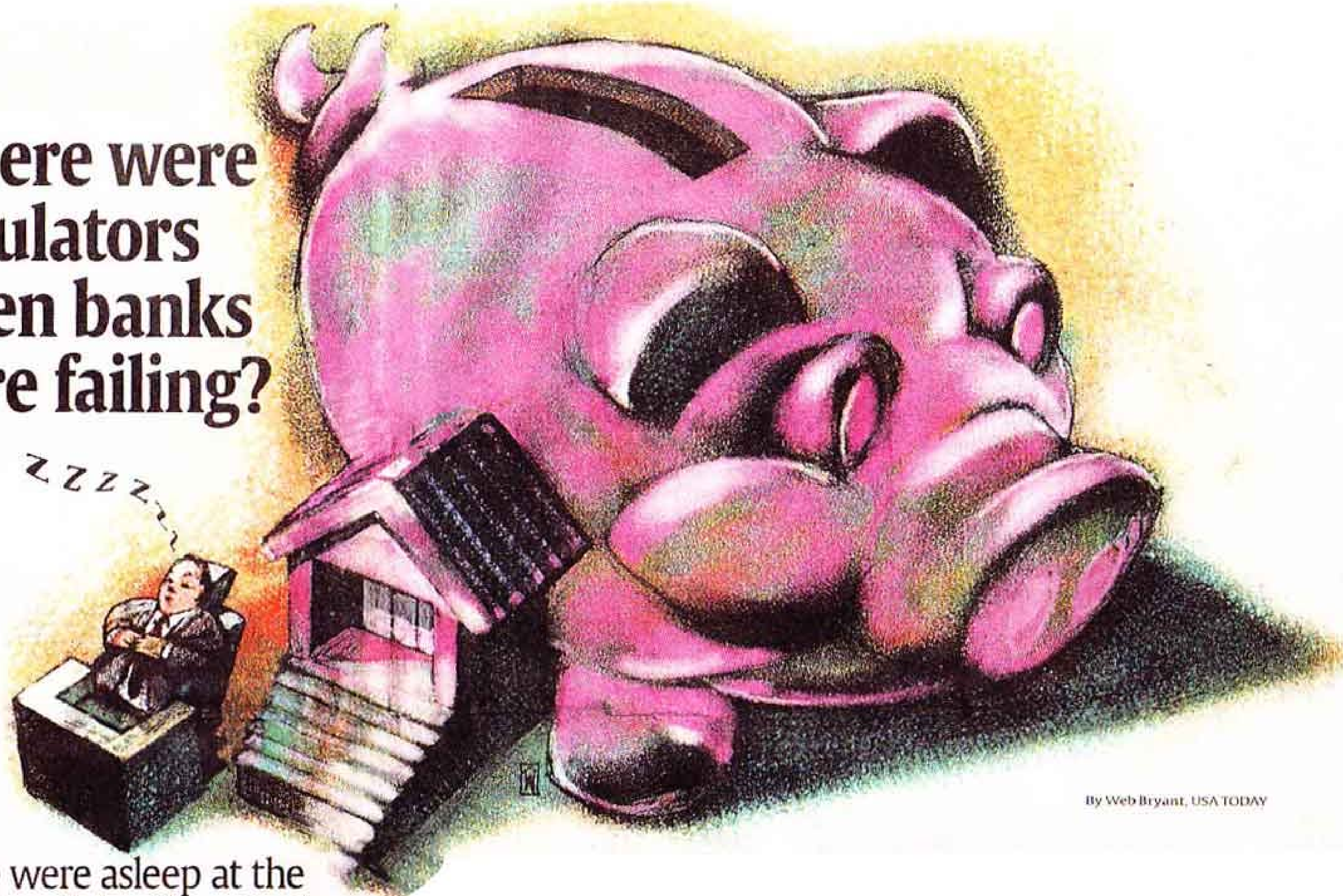
"With this bill," Treasury Secretary Lawrence H. Summers said, "the American financial system takes a major step forward toward the 21st Century — one that will benefit American consumers, business and the national economy." Opponents said it would have the opposite effect, creating behemoths that will raise fees, violate customers' privacy by sharing and selling their personal data, and put the stability of the financial system at risk.

by 90 to 8 on Nov. 4 and the House followed suit by a vote of 362 to 57. Congress had previously made almost a dozen unsuccessful attempts

gether a legislative proposal to take to Congress next year that would extend the privacy provisions of the legislation.

"This bill repeals parts of the 1933 Glass-Steagall Act … [and] allows mergers of banks, securities firms and insurers …"

Where were regulators when banks were failing?



By Web Bryant, USA TODAY

Some were asleep at the switch, while others took an active role helping hide the problem, reports find

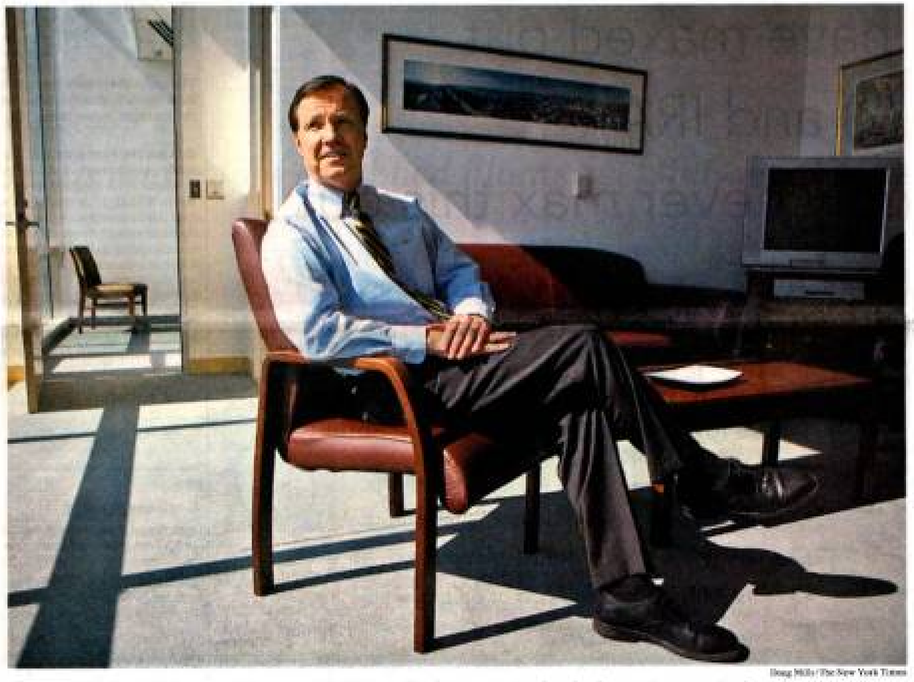
The New York Times

March 1, 2007

NewYorkTimes 3.1.07

Is the S.E.C. Changing Course?

Critics Say Cox Is Moving Closer to Business, Not to Investors



Doug Mills / The New York Times

Christopher Cox says he is responding to court decisions and budget constraints but that he remains committed to protecting investors.

By STEPHEN LABATON

WASHINGTON, Feb. 28 — In his first year as chairman of the Securities and Exchange Commission, Christopher Cox confounded both supporters and detractors by taking a more moderate and nuanced position than they had predicted on a variety of regulatory issues, based on his record as a conservative Republican lawmaker.

In recent weeks, however, Mr. Cox has begun to send signals, both directly and through aides, that he may be swinging the pendulum more toward business and Wall Street interests and against investor groups.

Some investor advocates and securities law experts say that Mr. Cox, by not pushing for tighter regulation of hedge funds and by urging the Supreme Court to adopt a tougher standard for investors in lawsuits, has begun moving closer to the business view that the administration overreacted to the corporate scandals that began with the collapse of Enron in 2001.

They have also criticized his recent decision to appear at the Chamber of Commerce in two weeks just as it is to issue a report criticizing the Bush administration and the S.E.C. for being too hard on companies.

"You look at a parade of items and it begins to look to me like this commission is starting to take an historic shift away from investor interests," said James D. Cox, a law professor at Duke University.

The S.E.C. chairman strongly disputes that view, noting, for instance, that his appearance before the chamber should not be perceived as a change in the tilt of the agency.

"The United States government has an agency that services business and it is the Department of Commerce," he said. "Our role is to be the investors' advocate. I want to make sure that every company understands that so long as they treat their investors well, the S.E.C. will be friendly to them.

"And if they attempt to drive a wedge between the

Continued on Page 13

Dream court for American business

US Supreme Court was right to limit investor lawsuits

Corporate America has scored a hat-trick in the US Supreme Court, winning a trio of big cases that could substantially reduce the amount of cripplingly costly investor litigation faced by any company that lists on US soil.

This was exactly what President George W. Bush wanted. Faced with growing concern about how litigation costs are burdening the competitiveness of US markets, he did what only a president can do to stop it: packed the country's top court with business-friendly conservatives such as John Roberts, the new chief justice, a former corporate lawyer, and Samuel Alito, a hard-line conservative who replaced the inconsistently pro-corporate Sandra Day O'Connor.

He created what amounts to a dream court for American business. So it is hardly surprising that the top court delivered another big win to business this week, ruling in *Stoneridge v Scientific-Atlanta* that banks, lawyers and accountants can often escape being sued by investors, even if they play a fairly big part in perpetrating a securities fraud. To be able to sue, investors must prove that they relied on the third parties to make their investment decisions. And that, normally, is very hard to do.

That may sound like the wrong result for investors. Certainly, the facts of the case were unsavoury: Charter Communications, a cable company, persuaded Scientific-Atlanta and another supplier to participate in sham transactions so Charter could deceive its investors.

That certainly sounds like behaviour that courts should punish – and indeed, they can: the Securities and Exchange Commission can sue third parties that scheme with companies to perpetrate fraud, and it can distribute the proceeds to wronged investors. The only issue in the Stoneridge case was: should private investors also be allowed to get in on the act, or should the task of suing third parties be left solely to professionals at the SEC?

It is not as though third parties that aid and abet fraud are getting off scot-free: the SEC can, and should, still pursue them. Third parties – including accountants that help cook the books – must not be allowed to escape liability. But nor should profit-driven lawyers be allowed to eat up the recoveries with huge transaction fees.

Investor advocates, and their Democratic backers in Congress, have reacted to the ruling with howls of outrage. If Congress wants private investors (and their entrepreneurial lawyers) to sue third parties, it can pass a law that says so. In the meantime, that job is better left to the SEC.

FINANCIAL TIMES

January 17, 2008

September 11, 2000

“If the antifraud provisions of the securities laws are gutted, as [the Reform Act] would do…worry about the public and your markets, and in 10 or 15 years you will be holding another hearing with the debacle in the securities markets that will make you remember the S&L mess with fondness.”

William S. Lerach,

Congressional testimony, 1995.

White-Collar Crime to Blame for S&L Crisis, GAO Tells House Panel

Wednesday.

The General Accounting Office told the House Judiciary Committee's criminal justice subcommittee that it had examined 26 insolvent thrift institutions in eight states and found evidence of fraud or abusive insider dealing in each.

While the survey was skewed to

"Ten billion dollars would go a long way to housing the homeless, feeding the poor, educating the public, caring for the sick," Schumer said. "Instead, it has been wasted on lavish parties, jets, real estate, travel and meals at the expense of taxpayers."

Atty. Gen. Dick Thornburgh last month blamed fraud and insider

"The bulk of the losses (\$100-150 billion) are directly attributable to the failure by management …to follow basic, prudent business practices, including the establishment off effective systems of internal control."

mittee.

"The bulk of the losses are directly attributable to the failure by management of a minority of the industry to follow basic, prudent business practices, including the establishment of effective systems of internal control," Wolf said.

Asked if that is a crime, Wolf said violation of fiduciary responsibilities to operate in a sound manner is clearly a criminal issue.

Few Convictions

The GAO said it found inadequate records and controls at all 26 of the failed thrifts it examined in detail, excessive loans to one borrower at 23, conflicts of interest among officers or directors at 20 and excessive salaries and benefits at 17.

The subcommittee's chairman, Rep. Charles E. Schumer (D-N.Y.), complained that of the 11,000 S&L cases the Federal

at least 11 after pleading guilty—and 19 more were under indictment. Two people were acquitted in trials.

Of those convicted, 15 were sentenced to prison, but the sentences "generally were suspended with probation," Wolfe said.

The GAO did not name the 26 S&Ls it examined, saying some are still open, or the individuals whose names had been referred to the Justice Department for criminal investigation.

"We are prohibited by law from disclosing the names of open banks we review and, as a matter of longstanding policy, we treat thrifts in the same manner," Wolf said.

He said the GAO also is "sensitive to the effect such disclosures could have on the government's effort to seek recoveries in civil suits or to prosecute alleged criminal acts."

Los Angeles Times

October 21, 2002

Regulators and prosecutors target corporate fraud, accounting lies and executive-suite greed

Investors now know that the stock market's long boom in the 1990s was at least partly built on deception. The truth began to come out last October when Enron, then the nation's seventh-largest company, revealed more than $1 billion of accounting errors that sent investors fleeing and launched investigations that are continuing today. Since then, dozens of companies have admitted to, or are being investigated for, accounting frauds or other financial misdeeds. USA TODAY reporter **Gary Stoller** compiled this summary of many companies tainted by scandal.

Caught in scandal

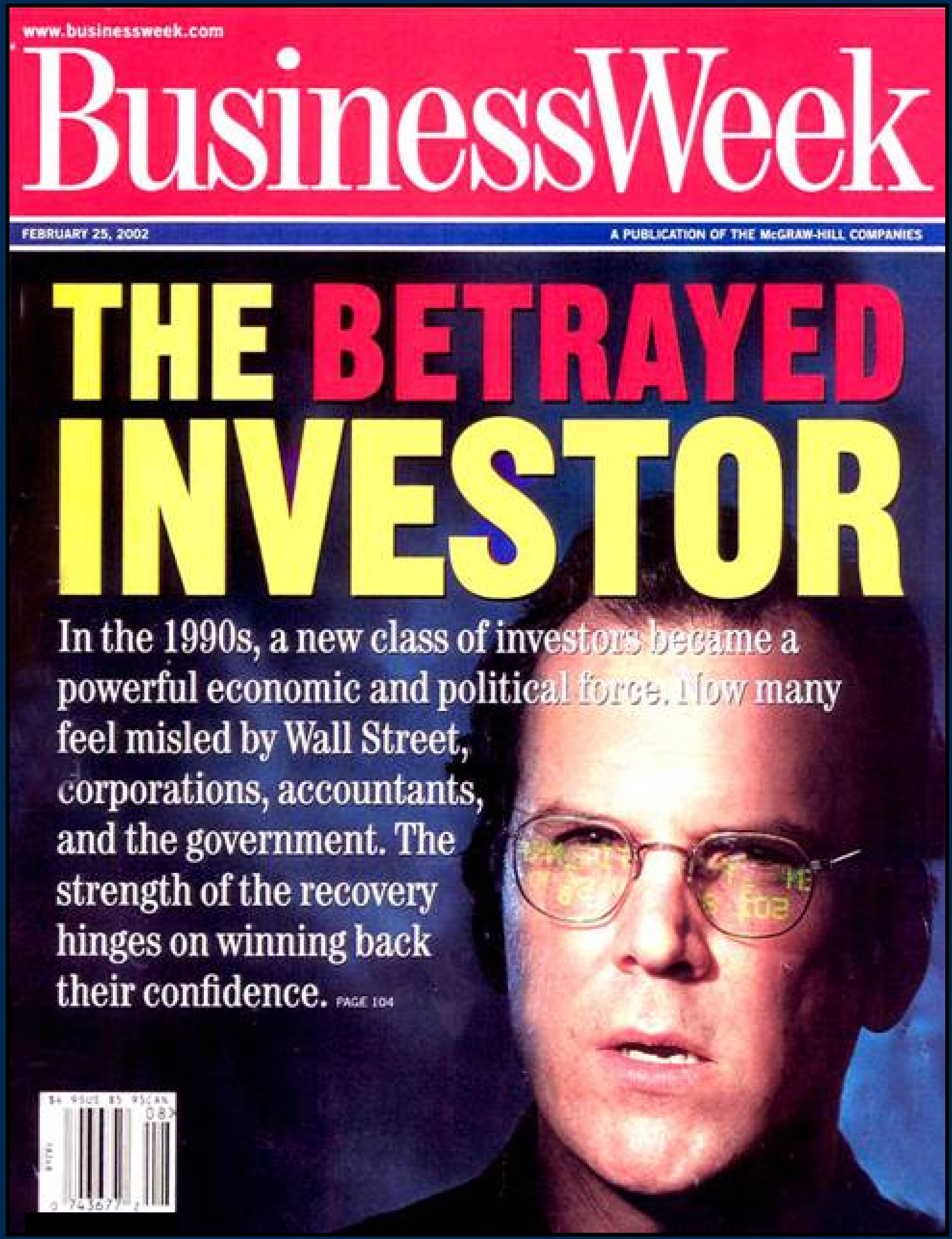
Companies whose executives are facing or have settled charges in financial scandals in the past year.

Funny numbers

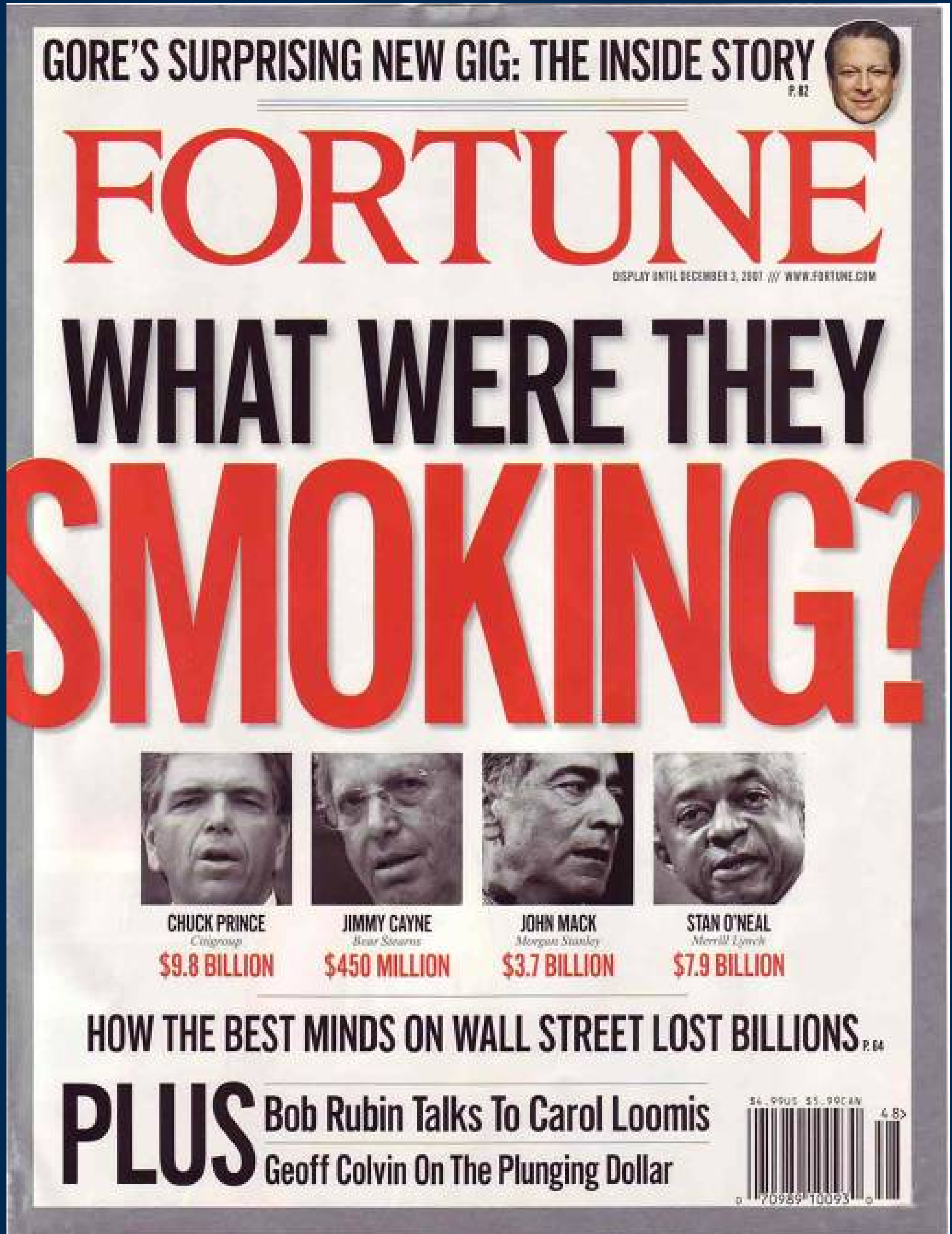
Allegations, admissions & investigations

Regulators and prosecutors target corporate fraud, accounting lies and executive-suite greed

Caught in scandal



February 25, 2002



November 26, 2007

Investor's Business Daily

March 12, 2009

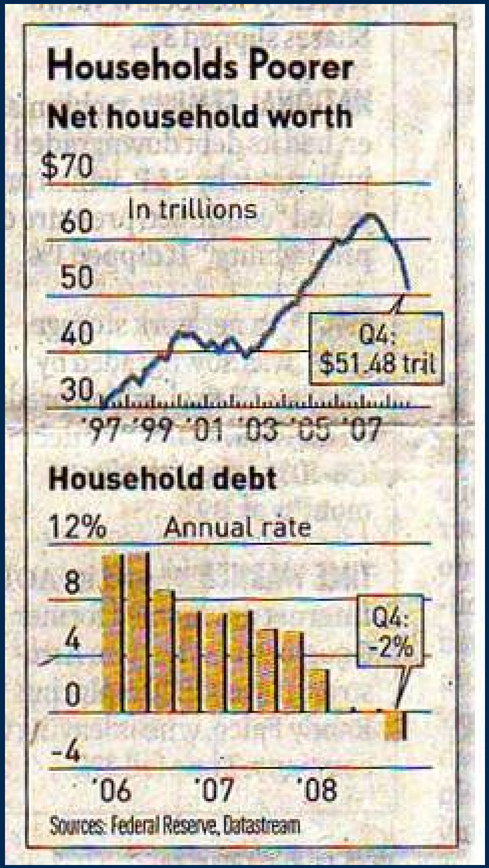
Record Household Wealth Destruction Forces Families And Firms To Curb Debts

Net Assets Dived 9% In Q4

Retail sales solid in Feb., but housing, stock woes sap consumers' strength

U.S. household wealth tumbled a record 9% in the final quarter of 2008, as stock prices and home values plummeted, the Federal Reserve said Thursday.

Net worth — defined as assets minus liabilities — fell by $5.1 trillion from the July-September quarter to $51.5 trillion, the lowest in four years, according to the Fed's flow of funds report. The 9% decline was the biggest since the government began keeping records in 1952. Net worth sank 18% vs. a year earlier.



Behind Soaring Executive Pay, Decades of Failed Restraints

THE WALL STREET JOURNAL.

October 12, 2006

Instead of Damping Rewards, Disclosure, Taxes, Options Helped Push Them Higher

Return of Golden Parachutes

By Joann S. Lublin
And Scott Thurm

In 1993, activist investor Ralph Whitworth shuttered United Shareholders Association, a group that was trying to tackle the contentious issue of executive pay. It looked as if his work was done.

Federal securities regulators had just forced companies to reveal details about pay and perks for top officials, in some cases for the first time. The changes would "make boards think twice" before approving compensation plans that couldn't be justified, Mr. Whitworth recalls thinking. Around the same time, Congress attacked executive pay for the second time in a decade by removing tax breaks on compensation above one million dollars.

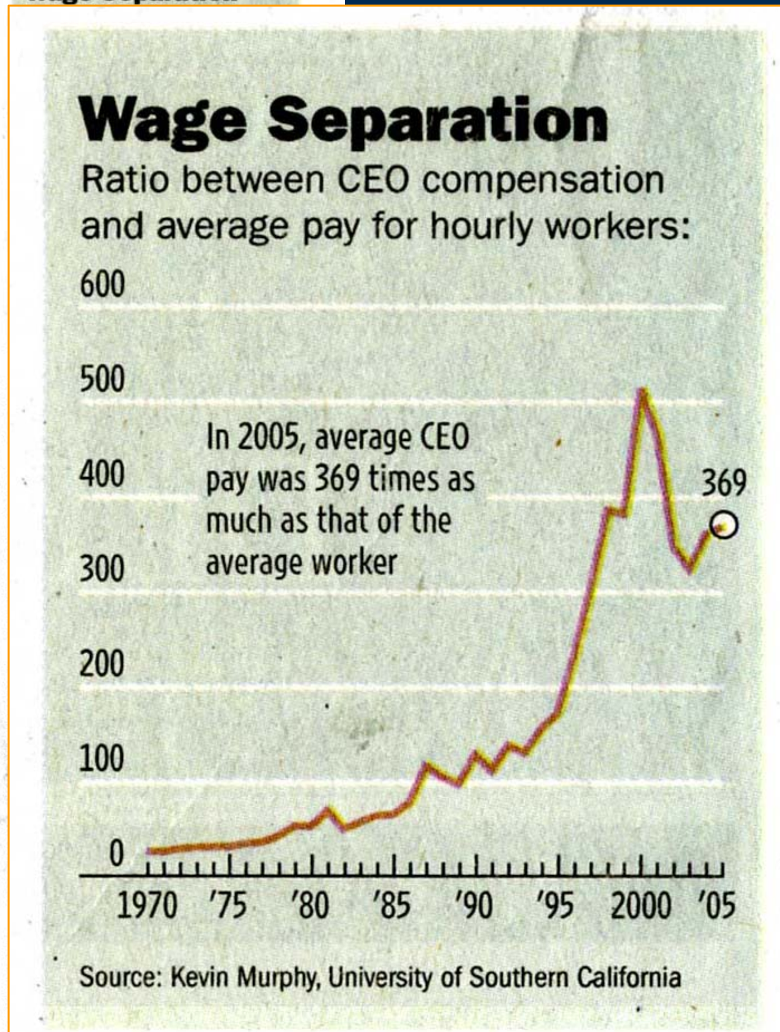
Since then, the average pay for chief executives of large companies has quadrupled, according to Kevin Murphy, a professor at the University of Southern California's Marshall School of Business. The average last year was $10.5 million, a figure that includes salary, bonus and the value of stock and stock-option grants.

There are many reasons why Mr. Whitworth was mistaken in his prediction, including the bull market of the 1990s, cozy corporate boards and CEOs striving to keep pace with highly paid athletes and entertainers. What's often overlooked is the role of all the efforts—by Mr. Whitworth and many others—to limit CEO compensation. For more than two decades, critics tried to slow skyrocketing pay through regulations, legislation and shareholder pressure. Few of their tactics worked. Many backfired.

As it turns out, disclosure requirements can push pay higher by revealing to CEOs what their peers receive. Limiting one type of compensation often encourages new types of pay, such as stock options, which were pushed as a solution only to become tainted by scandal. Now that shareholders are quicker to push out poorly performing chiefs, CEOs are seeking more financial guarantees. And if companies turn to outsiders, they often have to pay extra.

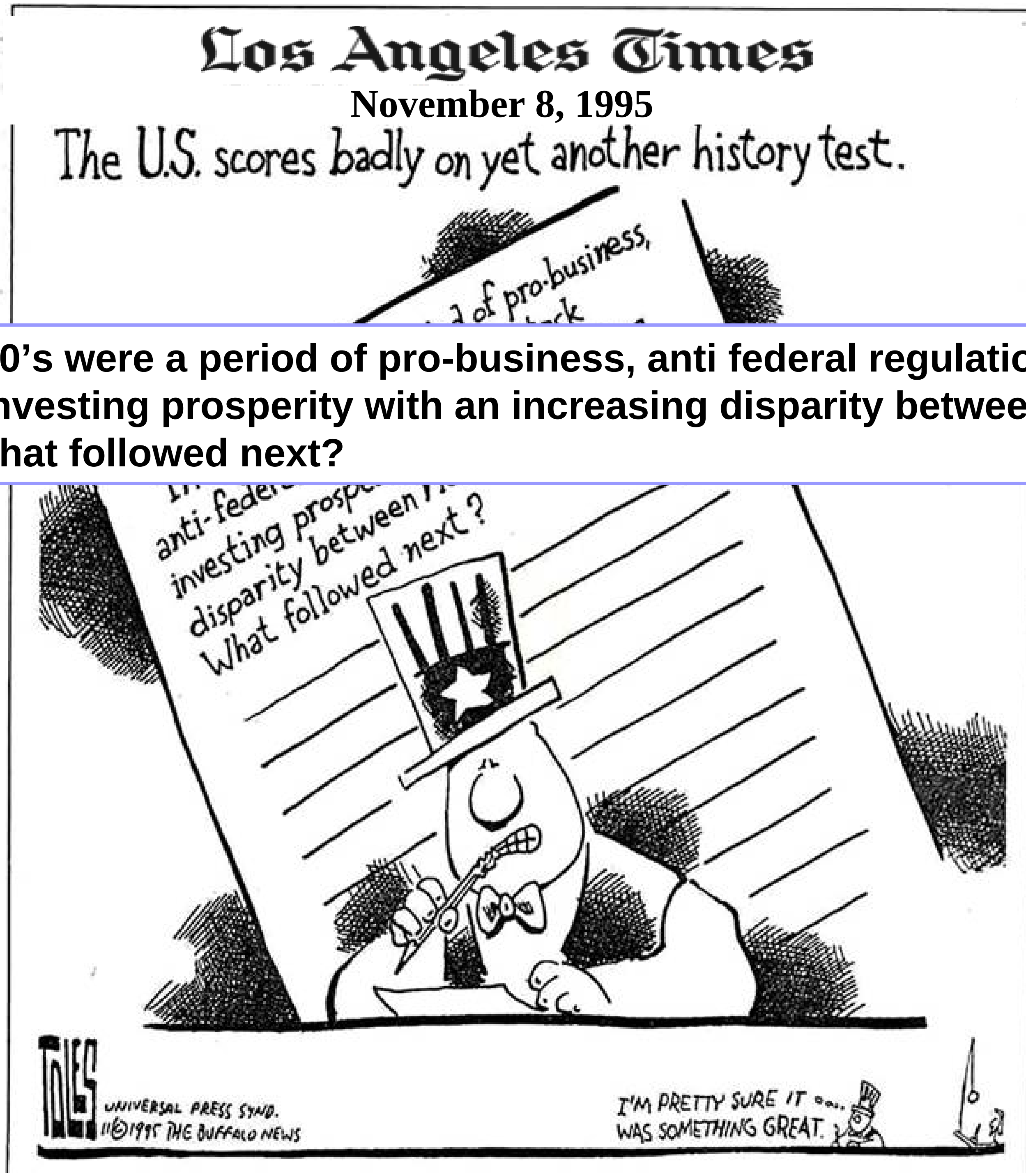
Curbing executive compensation is "like moving Jell-O," says Kayla Gillan, the former general counsel of the Califor-

Wage Separation

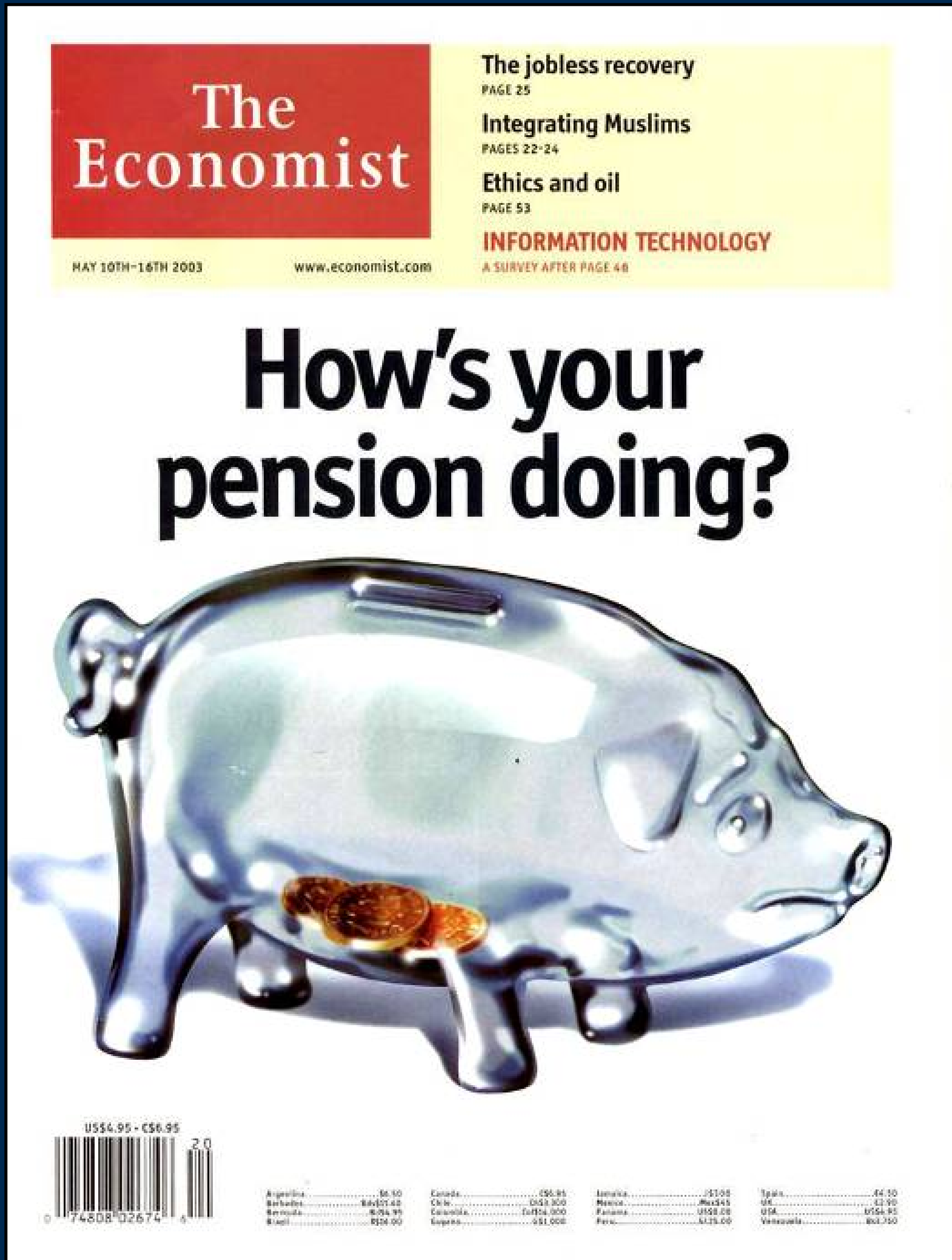


ble on the country-club porch" about the resulting political turmoil over the pay question. They're "mad at corporate Amer-

Please Turn to Page A16, Column 1



The 1920's were a period of pro-business, anti federal regulation, pro - stock investing prosperity with an increasing disparity between rich and poor. What followed next?


The Economist
The jobless recovery
PAGE 25
Integrating Muslims
PAGES 22-24
Ethics and oil
PAGE 53
INFORMATION TECHNOLOGY
A SURVEY AFTER PAGE 48
MAY 10TH-16TH 2003
www.economist.com
How's your pension doing?
US$4.95 - C$6.95

May 10, 2003

US EDITION
FINANCIAL TIMES
Friday May 23 2003
USA $1.00 Canada C$2.00

SPECIAL REPORT FT 500 7

PENSIONS by Barry Riley

Worrying 'bout my generation

Workers and companies are both fretting about the ability to meet large commitments imposed by defined benefit schemes

Legacies used to be regarded as valuable windfalls, but today's "legacy companies" are dogged expensively by their pasts. In particular, they have heavy pension commitments, and the biggest burdens are imposed by defined benefit schemes, especially those of which the main beneficiaries are long-serving male employees.

The sheer size of these obligations is now being viewed with trepidation by stock market analysts and credit rating agencies. In the US, in the cases of the big steel and motor companies for example, these pension liabilities are often heavily topped up by healthcare promises.

The impact is highly variable, and the problem is scarcely significant for newer giants such as Microsoft or Vodafone, which have relatively small workforces and unambitious pension schemes.

Shrinking companies are often among the worst hit, because their past liabilities (including those to retired employees) are out of proportion to their current profits and assets.

Growing companies, in contrast, probably have relatively few workers with long employment histories, and anyway the recent trend has been away from the defined benefit model, with its uncertain liabilities and typically mismatched funding.

Pensions problems are weighing down market capitalisations and credit ratings of many of yesterday's giants

HOW TO INVEST
for Growing Income and Family Security

An investment guide inserted in the Reader's Digest as a special advertisement by

THE NEW YORK STOCK EXCHANGE

MORE PENSION PAIN

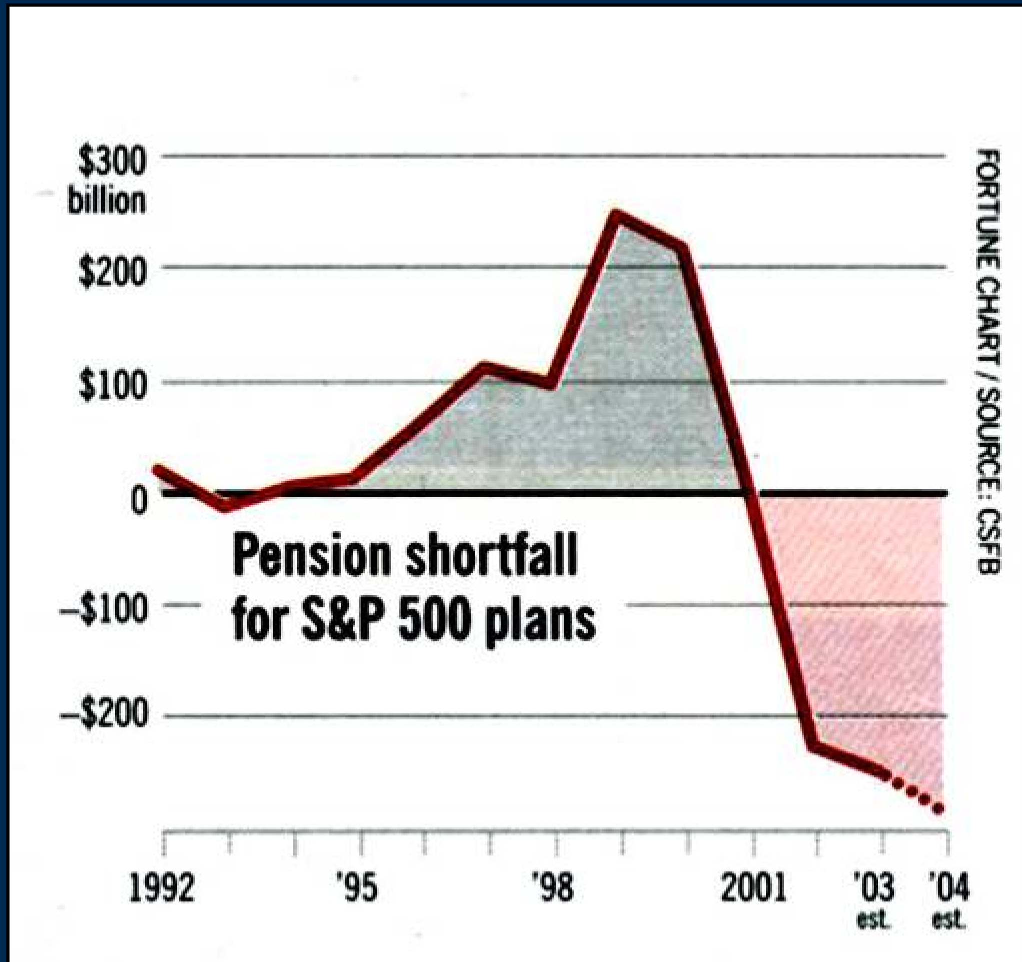
MORE PENSION PAIN

FORTUNE

November 10, 2003

Last year investors pummeled big-company stocks because of problems with their pension plans. By the end of 2002 large corporations owed …

… would have improved. But a new study by Credit Suisse First Boston (the former home of Frank Quattrone) shows that it is actually getting worse. The reason is persistently low interest rates. Companies use a so-called discount rate, which is tied to interest rates, to calculate the cost of funding retiree pensions. When the discount rate declines, the calculated value of a company's pension obligations rises to reflect lower interest rates. CSFB accounting analyst David Zion estimates that 92% of all pension plans offered by S&P 500 companies are now underfunded, vs. 24% before the bubble burst. Zion thinks the situation will worsen through 2004. That's bad news for earnings, especially at old-line manufacturers and union strongholds like Ford, Boeing, and Raytheon. By the end of 2003 Congress is expected to approve a bill that would temporarily reduce the amount companies must pay to their plans; for now, managers hope that higher interest rates and a bull market will come to the rescue. Stay tuned. —*Janice Revell*



“Here are the numbers you wanted cooked, sir.”

The New York Times

October 20, 2002

Pension Accounting Whoppers

For all of this year's accounting scandals, one of the most perilous financial minefields may still lie ahead — corporate America's management of traditional pension plans covering some 45 million

"Accounting rules … [have] provided an artificial means for companies to pad their reported earnings – the bottom line that determines top executives' bonuses…."

determines top executives' bonuses. Many blue-chip companies' financial statements continue to assume 9 or 10 percent returns, even now in the middle of the most severe bear market in decades.

Over all, it is estimated that 50 of America's largest companies counted $54.4 billion of pension fund gains as profits last year, when they in fact lost $35.8 billion. The accounting rules made it very easy for corporate managers to legally distort their numbers, to their benefit and to the detriment of shareholders.

Phantom earnings. Sound familiar? In a year when Americans have learned just how corrosive other accounting fictions can be to the financial markets' integrity — ostensibly independent offshore partnerships come to mind — such wishful bookkeeping can no longer be tolerated.

The Financial Accounting Standards Board, the body that sets accounting rules, should heed the call of investment advocates like Warren Buffett and California's controller, Kathleen Connell, who have been clamoring to put an end to this practice. If necessary, Congress should intervene. The overhaul of accounting standards must be aimed at revealing

boom years of the late 1990's, companies didn't need to deposit any new cash in these funds to keep them fully funded. But now they find themselves with glaring pension fund deficits, as they did in previous down markets.

Wall Street analysts and debt-rating agencies are concerned that more and more companies across a broad range of industries will have to invest in their underfunded pension funds when they can least afford it. General Motors and Lucent are two major companies that recently took big hits to address shortfalls.

The broader concern for the economy, particularly if the stock market and interest rates remain depressed, is that this trend could help feed a potentially vicious circle. Companies facing pension liabilities could refrain from new capital investments, thereby depressing the stock market further. But nothing is gained by having fictitious accounting sugarcoat this looming threat.

Associated Press

February 12,2009

A Pension Deficit Disorder

Investors already have seen their equity holdings hammered by the economic crisis. But, in some cases, they are discovering that companies are exposed to the down cycle twice over.

Operating profits are collapsing. But pension deficits also are ballooning because of the stock-market dive. Absent a sudden market recovery, those will likely be made up in hard cash, undermining profits for years to come.

S&P 500 companies had a combined pension deficit of $376 billion at the end of 2008, according to Bank of America. Many companies with defined-benefit plans had more than half their assets in equities at the end of 2007. If all that was in the U.S., they still lost 40% last year. Falling interest rates, meanwhile, increased the present value of pension obligations for some.

Shares of technology-services company **NCR** fell 15% Feb. 5 after the company said it would contribute $120 million to its pension in 2009 and another $200 million to $250 million in 2010. NCR, with a $1.6 billion market capitalization, previously disclosed that 66% of its $3.4 billion in U.S. pension assets were in equities at the end of 2007.

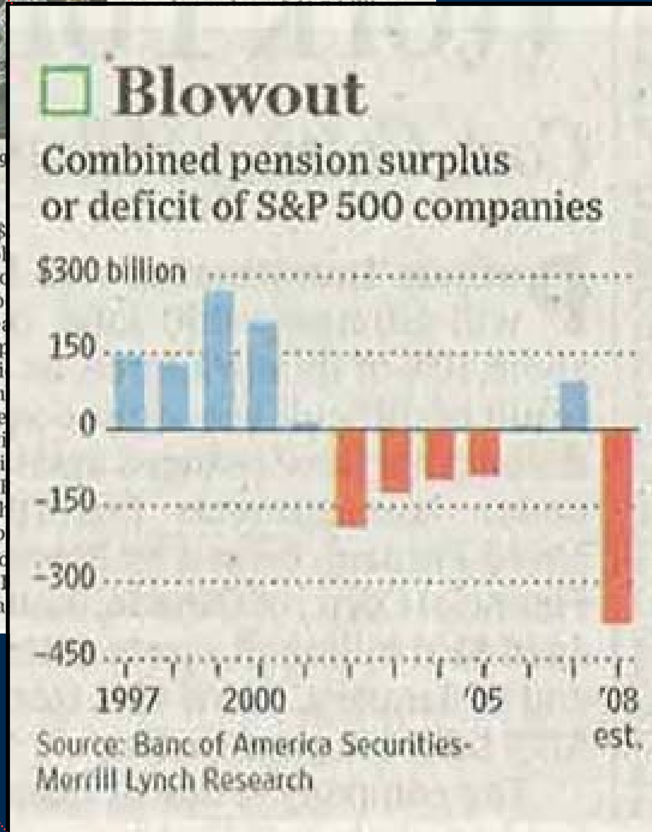

Associated Press

Goodyear faces larg deficits

The pension headache is hitting companies already under huge pressure to cut costs. **Caterpillar** recently announced 20,000 job cuts and warned that it may post its first quarterly loss since 1992.

Caterpillar's U.S. pension had $10.4 billion in assets at the end of 2007—$ lion less than its o Caterpillar's pensi likely shrank by ab $2.8 billion last ye ing the 70% of its p dedicated to equiti and, generously, th vested in debt rose company says it wi ute close to $1 billi pension this year. I could still leave a h much as $2.5 billio

Others might f **Goodyear Tire & I** had U.S. pension a worth $4.5 billion at the end of 2007, when liabilities totaled $5.1 billion. With 68% of its portfolio in equities and the rest in debt, Goodyear's portfolio may have lost $1.1 billion last year. The company, with a



April 17, 2009

Vampire pensions could be a corporate nightmare

While economists worry about "zombie" banks holding back lending vampire pension plans may soon be stalking a company near you. The underfunding of America's corporate defined benefit pensions poses a daunting challenge, threatening not only their 40m beneficiaries but the entire US economy.

Recently enacted fund

such funding commitments would drive them to file for bankruptcy.

The new law was drafted to help protect pension recipients from discovering too late that their bankrupt ex-employers had seriously underfunded pension plans. When this happened at Bethlehem Steel the Pension Benefit Guaranty Corporation (PBGC), the federal corporation that insures pensions, saw its funding deficit soar by nearly $4bn, while workers missed out on $600m in pension promises. Among the problems

The underfunding of America's corporate defined benefit pensions poses a daunting challenge, threatening not only their 40m beneficiaries but the entire US economy.

The New York Times

January 9, 2006

MANY COMPANIES ENDING PROMISES FOR RETIREMENT

PENSIONS BEING REPLACED

401(k) Plans Shift Risk to Employees, Who Must Make Decisions

garies of the financial markets.

"I.B.M. has, over the last couple of generations, defined an employer's responsibility to its employees," said Peter Capelli, a professor of management at the Wharton School of Business at the University of Pennsylvania. "It paved the way for this kind of swap of loyalty for security."

Mr. Capelli called the switch from a pension plan to a 401(k) program "the most visible manifestation of the shifting of risk onto employees." He added: "People just have to deal with a lot more risk in their lives, because all these things that used to be more or less assured — a job, health care, a pension — are now variable."

I.B.M. said it is discontinuing its

Continued on Page A20

FORTUNE

June 16, 2009

HAS THE 401(k) FAILED?

A small but vocal group of advocates think the 401(k) is a relic of a bygone age. What's wrong with the current system—and how it can be salvaged.

THE WALL STREET JOURNAL.

Big Slide In 401(k)s Spurs Calls For Change

The stock-market rout has ignited a crisis of confidence for millions of Americans who manage their own retirement savings through 401(k) plans.

Many retirement experts have come to a similar conclusion: The 401(k) system, which has turned countless amateurs into their own pension-fund managers, has serious shortcomings.

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have come to a similar conclusion: The 401(k) system, which has turned countless amateurs like Ms. Gardner into their own pension-fund managers, has seri-

The New York Times
Expect the World®

From Here to Retirement

So far, the cumulative wipe-out of household retirement savings totals about $2 trillion. As a result, participants in 401(k)'s are in greater danger than ever of coming up short in retirement.

Mother Jones

May + June 2009

There's an old accounting joke:
What starts with "f," ends with "k,"
and means "screw your workers"?
That's right—401(k).

Despite Risks, Workers Guzzle Company Stock

Participants in 401(k) Plans See Safety in Employer Shares; No Other Options for a Match

THE WALL STREET JOURNAL.

At a time of extreme market uncertainty, many 401(k) participants are making a risky move: loading up on the stock of their employers.

In January, for the first time in more than seven years, a large group of 401(k) participants tracked by consulting firm Hewitt Associates plowed more money into company stock than any other type of investment. The workers poured $65 million into employer shares that month—the most recent for which data are available—even as they yanked money out of other stock investments and put smaller amounts into conservative holdings such as bond and stable-value funds.

Employees' enthusiasm for company stock marks a sharp reversal of recent trends. Workers have generally been diversifying out of their employer's shares this decade as Enron, WorldCom and other high-profile corporate blowups exposed the dangers of hefty company-stock holdings. Participants added money to company stock in only eight months during the past six years, according to Hewitt—yet five of those months have come since the middle of last year.

Playing With Fire

Company stock offered in 401(k) plans poses a number of risks for employees:

- Workers tend to underestimate the risk of their own company's stock.
- If their employer heads south, workers heavily invested in company shares can lose both their jobs and their retirement savings.
- Employees often fail to diversify out of company stock as they age.

Workers stuffing their retirement accounts with company stock are making a tremendous bet on the health of their employer. If the company stumbles, workers could lose their retirement savings, as well as their jobs. Just in the past year, stock-price meltdowns at **Lehman Brothers Holdings** Inc., **Fannie Mae** and other companies have crushed the retirement savings of many employees who were heavily invested in those shares.

"In this economy, you'd expect people to move in the other direction, trying to diversify their risks," says Pamela Hess, director of retirement research at Hewitt.

People may be turning to company stock now because the old familiar employer shares seem to be a haven in the market storm. Academic research has found that most employees holding company stock believe it's safer than a diversified stock fund. "Obviously, they're not understanding what they're buying," says Shlomo Benartzi, a behavioral economics professor at the University of

THE WALL STREET JOURNAL.

May 26, 2005

Pension Agency Faces a New Front

Multiemployer Plans Saw Deficits Jump 50% in '04; Industry, Unions Are Split

By MICHAEL SCHROEDER

WASHINGTON—As the government wrestles with strategies to deal with failed pension plans sponsored by troubled companies such as UAL Corp.'s United Airlines, big problems in many multiemployer plans have been largely overlooked.

Lawmakers say they recognized only recently that Congress also must address financial turmoil in this separate segment of government-backed pension plans, which covers about 10 million workers in several industries.

Meanwhile, industry and union coalitions pushing Congress to take action are fighting among themselves over how far lawmakers should go to shore up the plans, with United Parcel Service Inc. on one side

parts companies that have dumped billions of dollars of pension liabilities on the PBGC, which estimates that the whole universe of single-employer plans have liabilities that exceed assets by $450 billion.

Of growing concern, however, are multiemployer retirement plans underfunded by $150 billion in 2004, a 50% jump in the deficit from the year before, the federal insurer reported.

Multiemployer plans were set up so that workers who tend to move from employer to employer within various unionized industries could maintain retirement-benefit plans negotiated under a common union contract. A total of 1,600 multiemployer plans are paid for by 65,000 mostly small companies with 10 million unionized workers in such industries as trucking, construction and grocery-store chains.

As old-line industries like trucking companies consolidated, many multiemployer plans have gone into the red. The reason: fewer surviving employers with a declining number of active workers are responsible for the plans' growing rolls of retirees.

Rep. John Boehner (R., Ohio), chairman of the Education and the Workforce Committee, says the seriousness of problems in the multiemployer plans require fixes to be included in his pension-overhaul bill, which is expected to be introduced in early next month.

Industry and union representatives have been meeting with lawmakers promoting plans to bolster funding and to strengthen weak disclosure require-

for years for ways to lower its pension costs. For instance, it is a member of the Central States Pension Fund, which alone had liabilities of $30 billion and assets of $15 billion at the end of 2003, according to an Internal Revenue Service report.

The situation has brought together once-fierce adversaries to find a legislative solution. During a strike against UPS in 1997, the International Brotherhood of Teamsters turned back the delivery service's attempt to withdraw from multiemployer plans in order to form its own single-employer pension fund. The plans would have been unable to survive without a big prosperous contributing member such as UPS.

UPS has shifted away from the strategy of getting out of multiemployer plans and has pushed for reform as a member of a large coalition that includes the Teamsters and the National Coordinating Committee for Multiemployer Pension Plans, primarily a union trade group.

The coalition is pushing proposals on Capitol Hill aimed at requiring multiemployer plans that are funded at 65% or less to increase employer contributions and to develop a broad reorganization plan to raise funding above 80% within 10 years.

According to a copy of the coalition's blueprint, employers through collective bargaining would have broader discretion to cut nonbasic retirement benefits, such as early-retirement benefits and life insurance. It also would allow UPS to protect its employees from cutbacks if the company would make higher-than-required payments into affected pension plans.

Meanwhile, the Food Marketing Insti-

lines that were $6.6 billion underfunded.

While the PBGC is on the hook to pay about $45,000 to retirees from single-employer plans it takes over, the agency is obligated to contribute about $12,000 per worker for multiemployer plans that fail.

If a multiemployer plan becomes insolvent both the surviving companies and PBGC share in the financial burden of paying benefits that in many cases would be cut by 66%. "Everyone gets hurt," says Michael Mathis, Teamsters' director of government affairs in Washington.

Of growing concern, however, are multiemployer retirement plans under-funded by $150 billion in 2004, a 50% jump in the deficit from the year before, the federal insurer reported.

EDITORIAL COMMENTARY

THOMAS G. DONLAN

Sinkhole

The private pension system continues its slow decline and fall

The federal Pension Benefit Guaranty Corp. turned in its annual report card last week, acknowledging that its actuarial deficit had doubled in fiscal 2004. It has $39 billion in assets, but its liabilities from terminated single-employer plans have a present value of at least $62 billion. Also, the agency's estimate of the present

BARRON'S

November 22, 2004

Sinkhole

The private pension system continues its slow decline and fall

The Public Pension Bomb

For years, states all across the country have been starving their retirement plans.

The Washington Post

October 31, 2001

Public Pension Plans Lose Billions in Ailing Stock Market

By CHRISTIAN DAVENPORT *and* MATTHEW MOSK
Washington Post Staff Writers

The New York Times
August 8, 2006

Public Pension Plans Face Billions in Shortages

COSTLY PROMISES
Taxpayers at Risk

By MARY WILLIAMS WALSH

In 2003, a whistle-blower forced San Diego to reveal that it had been shortchanging its city workers' pension fund for years, setting off a wave of lawsuits, investigations and eventually criminal indictments.

The mayor ended up resigning under a cloud. With the city's books a shambles, San Diego remains barred from raising money by selling bonds. Cut off from a vital source of cash, it has fallen behind on its maintenance of streets, storm drains and public buildings. Potholes are proliferating and beaches are closed because of sewage spills.

Retirees are still being paid, but a portion of their benefits is in doubt because of continuing legal challenges. And the city, which is scheduled to receive a report today on the causes of its current predicament, still has to figure out how to close the $1.4 billion shortfall in its pension fund.

Maybe someone should be paying closer attention in New Jersey. And in Illinois. Not to mention Colorado and several other states and local governments.

Across the nation, a number of states, counties and municipalities have engaged in many of the same maneuvers with their pension funds that San Diego did, but without the crippling scandal — at least not yet.

It is hard to know the extent of the problems, because there is no central regulator to gather data on public plans. Nor is the accounting for government pension plans uniform, so comparing one with another can be unreliable.

But by one estimate, state and local governments owe their current and future retirees roughly $375 billion more than they have committed to their pension funds.

And that may well understate the gap: Barclays Global Investments has calculated that if America's state pension plans were required to use the same methods as corporations, the total value of the benefits they have promised would grow 22 percent, to $2.5 trillion. Only $1.7 trillion has been set aside to pay those benefits.

Not all of that shortfall, of course,

Continued on Page C10

PUBLIC RETIREMENT FUNDS ACROSS THE U.S. ARE IGNORING A LOOMING CRISIS, ONE FED BY UNDERFUNDING AND POOR INVESTMENTS—AND PAPERED OVER BY ACCOUNTING GIMMICKS. FUTURE GENERATIONS OF TAXPAYERS WILL FOOT THE BILL.

APRIL 2009 **BLOOMBERG MARKETS**

BARRON'S

The $2 Trillion Hole

Promised pensions benefits for public-sector employees represent a massive overhang that threatens the financial future of many cities and states.

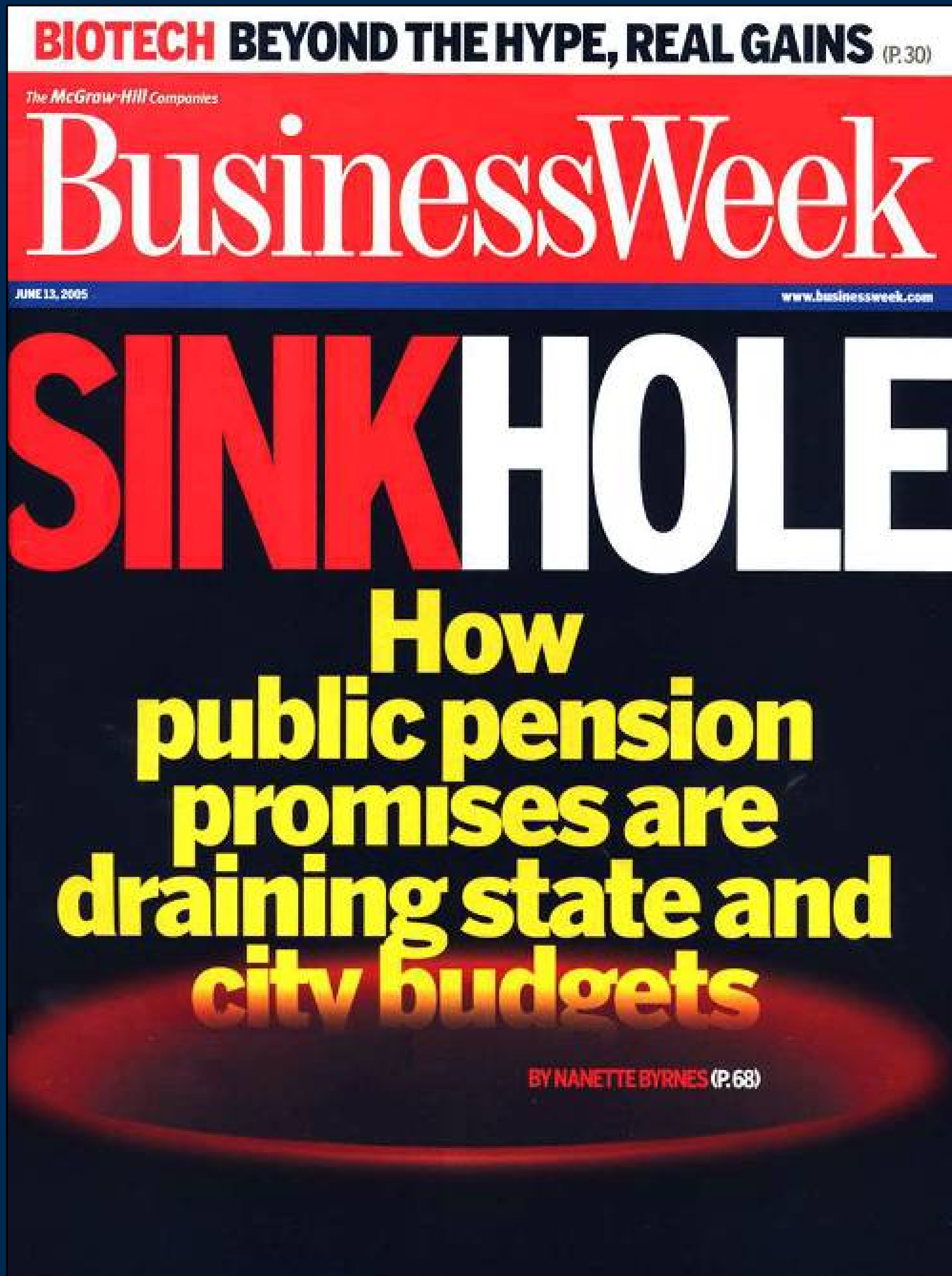
March 15, 2010

LIKE A CALIFORNIA WILDFIRE, populist rage burns over bloated executive compensation and unrepentant avarice on Wall Street.

Deserving as these targets may or may not be, most Americans have ignored at their own peril a far bigger pocket of privilege -- the lush pensions that the 23 million active and retired state and local public employees, from cops and garbage collectors to city managers and teachers, have wangled from taxpayers.

Some 80% of these public employees are beneficiaries of defined-benefit plans under which monthly pension payments are guaranteed, no matter how stocks and other volatile assets backing the retirement plans perform. In contrast, most of the taxpayers footing the bill for these public-employee benefits (participants' contributions to these plans are typically modest) have been pushed by their employers into far less munificent defined-contribution plans and suffered the additional indignity of seeing their 401(k) accounts shrivel in the recent bear market in stocks.

And defined-contribution plans, unlike public pensions, have no protection against inflation. It's just too bad: Maybe some seniors will have to switch from filet mignon to dog food.


BIOTECH BEYOND THE HYPE, REAL GAINS (P.30)
The McGraw-Hill Companies
BusinessWeek
JUNE 13, 2005
www.businessweek.com
SINKHOLE
How public pension promises are draining state and city budgets
BY NANETTE BYRNES (P.68)

June 13, 2005

USA TODAY

January 17, 2005

Nation

Pension funds fall short of guarantees

Some say public sector's benefits are too generous

By Dennis Cauchon
USA TODAY

Giving back: Former teachers George Haven and his wife, Mary Jo, take meatballs and hot dogs to their grandson's first-grade class at Owen Marsh Elementary School in Springfield, Ill. From left are students Julia Gorden, 7, Jacob Huntham, 6, Jessica Hermann, 6, and Noah Thoma, 7.

Comparing paychecks

The public servants have been guaranteed retirement benefits that are far richer than private pensions, yet elected officials have failed to set aside enough money to cover the promised benefits.

FORTUNE

September 16, 2002

First

Feedback? first@fortunemail.com

Is Wall Street good for anything?

Not lately. But it could be if it lost the cartel mentality, learned some ethics, and remembered the little guy. BY SHAWN TULLY

WHEN THE FEDERAL GOVERNMENT DEREGULATED commissions on stock trades in 1975, the purpose was to bust up Wall Street's cartel. What the '90s boom demonstrated is that the cartel is still in place and still needs busting up—more than ever.

Despite sporadic reforms, almost everything Wall Street does is inefficient and benefits select insiders at the expense of regular investors. Many of its services aren't just useless, but damaging—constituting a sort of aristocratic tax on America's economic activity. Today's scandals could breed no reform more important than to kill the Wall Street levy. The abuses center on three areas: equity research, mergers and acquisitions, and IPO offerings.

▸ **Research.** Mutual funds and other professional investors have long considered Wall Street's research tainted and worthless. But analysts were valuable because they shoveled inside information from companies, via winks and nods, to fund managers in exchange for inflated commissions.

So what can be done now? The SEC's Regulation FD makes the exclusive leaks illegal but doesn't erase that basic conflict. The best weapon is investor revulsion. Shareholders betrayed by Wall Street are already flocking to independent research houses like Sanford C. Bernstein.

▸ **M&A.** Corporate America is still aching from Wall Street's horrendous M&A advice in the late '90s. The investment banks championed hordes of misguided deals, from Conseco/Green Tree to WorldCom/MCI to AOL/Time Warner (parent of FORTUNE's publisher). In each case the buyer paid such huge premiums that the deal was dead on arrival, causing enormous losses in shareholder value. Wall Street firms not only collected big fees for selling overpriced deals but also justified the overpayments by writing "fairness opinions" for their clients—for an additional $1 million or so per opinion. In those remarkable documents they dredged up every conceivable bogus rationale to show that their clients were paying a reasonable price. It was the fairness opinions that shielded management from shareholder suits. ... deal a winner for the purchaser's shareholders as well as the probability of achieving the touted synergies.

REPORTER ASSOCIATE Melanie Shanley

> Most of the services Wall Street provides aren't just useless, but damaging.

▸ **IPOs.** The most egregious example of the continuing cartel—and its effect on the rest of us—is the IPO allocation system. As a middleman, Wall Street deserves to pocket fees for raising money. But if those fees are far higher than a client would pay in an efficient, competitive market, the industry is simply screwing clients and investors.

Merrill Lynch, Goldman Sachs, and everyone else charge a 7% fee even though the cost of arranging a $200 million IPO is about the same as a $50 million offering. That's a sure sign of a cartel—as are the firms' refusals to negotiate on price. Worse, Wall Street uses IPOs to create what is essentially a slush fund of "free money" by systematically underpricing shares—in effect, taking money from the pocket of the issuers—so that the stock will jump when it starts trading. They then hand the cheap shares to their favored clients, chiefly hedge and mutual funds. During the bubble, underwriters demanded that the funds kick back a big share of the windfall profits. That slush fund also played another rogue role. The SEC is investigating Salomon Smith Barney for in effect bribing executives at WorldCom, Qwest, and other telecom giants by granting them cheap IPO shares in exchange for lucrative investment-banking business.

The NASD is proposing complex rules to restrict what Wall Street can do with this free money. Instead it should recognize that free money is the problem and eliminate it altogether.

The market already has an elegant solution for the IPO problem: auctions. San Francisco investment bank W.R. Hambrecht opens its IPO sales to all bidders. Whoever pays the most, be it Fidelity or small investors, gets the shares. No underpricing, no free money, no kickbacks. Congress should demand open access to IPOs: Wall Street should lose its right to lock out bona fide bidders. That simple change would break the cartel's grip on IPOs. Auctions would take over. Fees would drop. Wall Street firms would become what they should be—efficient, low-cost middlemen. The aristocrats would become our servants.

PHOTOGRAPH BY DAVID BASHAW

TELECOMMUNICATIONS

Wireless Carriers Aren't All Talk

BY STEPHANIE N. MEHTA ■ On the surface the wireless-phone industry is more beaten down than the 9,999 *American Idol* rejectees combined. Unnerved by the prospect of slowing growth and costs associated with the industry's high-stakes push into mobile data, investors have pummeled shares of the companies: Nextel is down 30% this year, AT&T Wireless stock has slid roughly 50%, and Sprint's PCS tracking stock has tumbled more than 80%.

Septembe

Calpensions

Pension 'Crisis': Did Prop 21 pave the way?

June 1, 2010

A little-known ballot measure a quarter century ago, Proposition 21 in 1984, opened the door for much of the current controversy over California's public employee pensions.

Pension funds had been required to put most of their money into bonds. The measure lifted the lid and pension funds, seeking higher yields, began shifting most of their money to stocks and other riskier investments.

FINANCIAL TIMES

December 31, 2002

Pension funds seek way out of equity trap

The stock market slide has left companies with a £85bn funding black hole.
Norma Cohen asks what they can do

A gaping £85bn ($133bn) hole in the pension accounts of the UK's 100 largest companies cannot be easily dismissed.

Yet, a new report from analysts at Morgan Stanley shows that the latest slide in the stock markets and falling interest rates on bonds have combined to produce a shortfall of that amount in the space of a year.

Morgan Stanley highlights a handful of companies – British Energy, BAE Systems, Rolls-Royce and Royal & Sun Alliance – as being most at risk of having to increase cash funding for their pension schemes.

At British Airways, a company Morgan Stanley estimates now has a pension scheme deficit equal to 77 per cent of its market capitalisation, the need to increase contributions is acknowledged.

BA says it has given "a clear commitment to fund the scheme", and the restructuring plan that will reduce headcount is expected to ensure that enough funds are available.

John Birch, the secretary to BA's scheme, says a valuation of scheme assets is set for March 2003, and the contribution rate of 16 per cent of payroll – which includes 3 percentage points to clear a deficit identified in a valuation three years ago – may have to be increased.

Just a few years after the UK passed sweeping legislation on pensions, how could workers' retirement benefits

Second, the bull market in equities for the past 20 years persuaded many companies that they could effectively provide pensions for nothing, with outsized stock market returns used to pay employers' contribution expenses.

The urge to invest in equities remained, even as the balance of membership in many older schemes shifted.

Current and deferred pensioners produce liabilities that are known, and there-

'Current solvency is too scary even to think about'

fore are best matched with bonds.

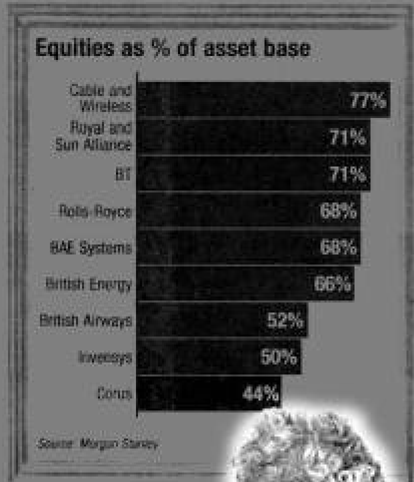
Charles Cowling, worldwide partner at Mercer, the pension consultant, says that many schemes – if viewed on their own without a guarantee from an employer – cannot meet liabilities.

"Current solvency is too scary to even think about," he says.

For years, pension schemes have been failing to match their liabilities with assets that mimic the required payment stream.

Liabilities for pensioners-

Mind the gap



Estimated pension deficit* as % of market value

British Energy	1,580.6
Rolls-Royce	88.9
British Airways	76.9
BAE Systems	73.8
Royal and Sun Alliance	60.9
BT	52.3
Cable and Wireless	42.2
Invensys	22.7
J Sainsbury	21.9

Source: Morgan Stanley

* as at Dec 31 2002

Stocks Tarnished By 'Lost Decade'

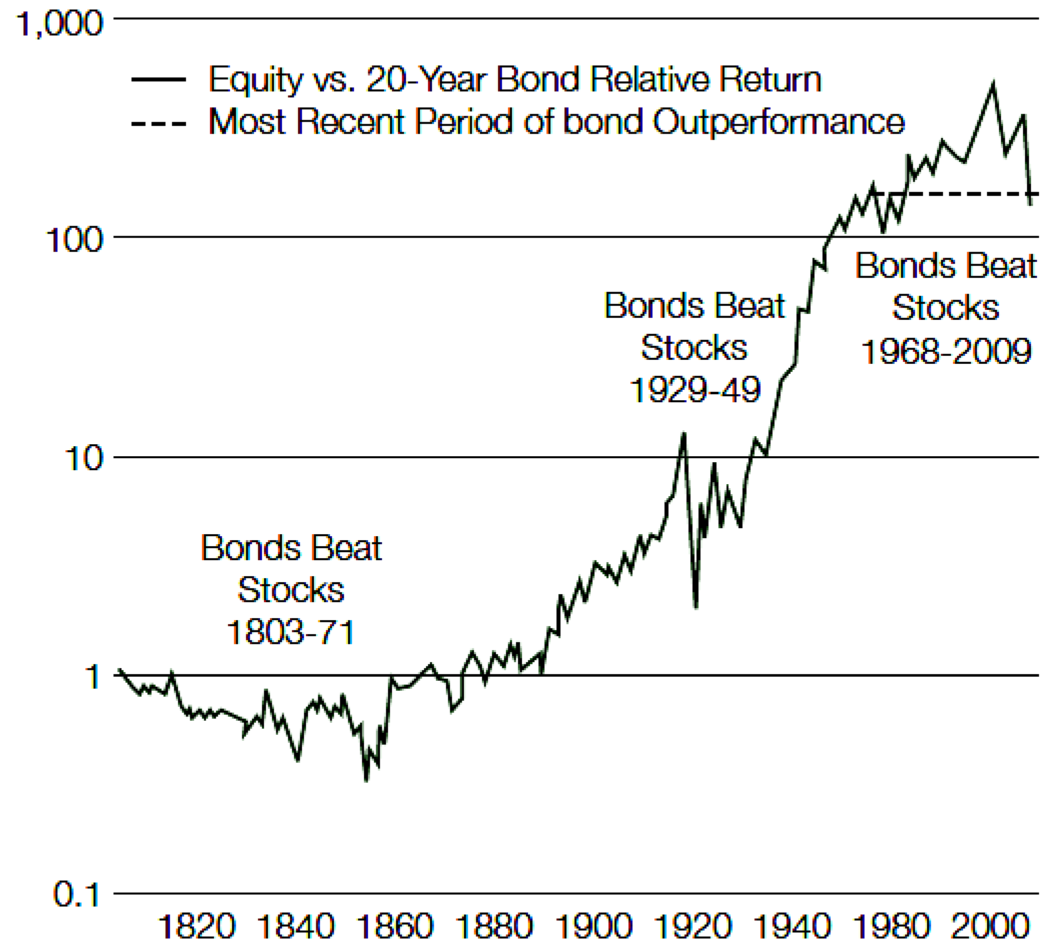
U.S. Shares in Longest Funk Since 1970s; Credit Crunch Could Prolong Weakness

WALL STREET JOURNAL

March 26, 2008

STOCKS VS. BONDS, CUMMULATIVE RELATIVE PERFORMANCE 1801-2009

BARRON'S



Source: Research Affiliates, cumulative relative performance 1801-2009

EAST BAY EXPRESS

Parsky's Party

The UC regent whose pension fund overhaul may have cost the university billions is now in a position to play with even more of the public's money.

May 9, 2007

Last December, Governor Arnold Schwarzenegger created a new panel to figure out how to solve what may be California's worst-ever budget crisis.

PARSKY'S PARTY

The UC Regent [Gerald Parsky] whose pension fund may have cost the university billions is now in a position to play with even more of the public's money.

ments. In the 1990s, he gradually rose through the ranks of the California Republican Party until he became one of the state's most important power brokers. He raised millions to organize the 1996 Republican National Convention in San Diego, and chaired the state presidential campaigns of George W. Bush in both 2000 and 2004. Today, he reviews candidates for California US Attorney positions on behalf of the Bush Justice Department. He has been appointed senior economic adviser to presidential candidate John McCain; if McCain is elected president, Parsky could well become the next secretary of the Treasury.

But it was in his capacity as a regent of the University of California that Parsky made his greatest impact. In the ten years before he took over as chair of the Regents' Investment Committee, the university's pension plan, which provides retirement benefits for more than 190,000 employees, made a small fortune playing the stock market and investing in long-term bonds.

SFGate.com

September 10, 2010

Contentious plan for sagging UC pension fund

UNIVERSITY OF CALIFORNIA

A tidal wave of unfunded retirement obligations that could top $40 billion in four years is washing over the University of California, forcing employees to pay far more for those benefits and threatening students with the possibility of more tuition hikes and years of austerity.

A tidal wave of unfunded retirement obligations that could top $40 billion in four years is washing over the University of California, forcing employees to pay far more for those benefits and threatening students with the possibility of more tuition hikes and years of austerity.

They also point to a particular recommendation that would improve the pension benefits of the 250 top-paid employees….

"While claiming that cost-cutting is needed, UC unbelievably increases retirement benefits for highly compensated executives, while cutting low-wage retirement benefits in half," said Julian Posadas, vice president of the American Federation of State, County and Municipal Employees, which represents 21,000 UC workers who typically earn around $40,000 a year.

Pitts also said that in exchange for retaining benefits, highly paid employees would eventually contribute more to the pension fund - up to 7.7 percent of their paycheck - than low-wage workers. This would happen after 2013, if the regents approve the recommendations. Most employees pay 2 percent of their salary toward retirement. The UC regents are expected to approve an interim increase for all employees at their meeting in San Francisco next week. It would raise the employee contribution to 3.5 percent beginning in July 2011, and to 5 percent in July 2012.

The San Diego Union-Tribune.

February 6, 2009

UC pension system faces economic reality

Contributions to start; benefit cuts possible

SAN FRAN
years, the University of California pension system seemed to be a Wall Street wonder, building assets and paying billions in benefits without any contributions from the university or its employees.

Those days will soon be over, and there will be a price to pay for the remarkable contribution holiday.

UC regents voted yesterday to start regular payments and, along with UC President Mark Yudof, served notice of a possible reduction in benefits for thousands of retirees.

"I see no way around restructuring the benefits," Yudof said at the end of

pension "train wreck."

"I don't know what we're legally allowed to do, but we'll find out," Yudof continued. "There are levers, like the vesting period, and employee contributions, and how you treat new employees.

"I have no set views on that, other than I feel the board and I have a fiduciary responsibility to put this on a path to fixing it."

Admissions changes pass: UC regents hope new rules widen applicant pool. **A4**

Yudof said he would move ahead

gation that is growing by more than $1 billion a year.

The abrupt turnabout in the pension fund's health could help build support for a union-sponsored initiative that would reconfigure the UC pension board to give employees representation.

"We all want a healthy fund, but we

SEE **Pensionfund, A10**

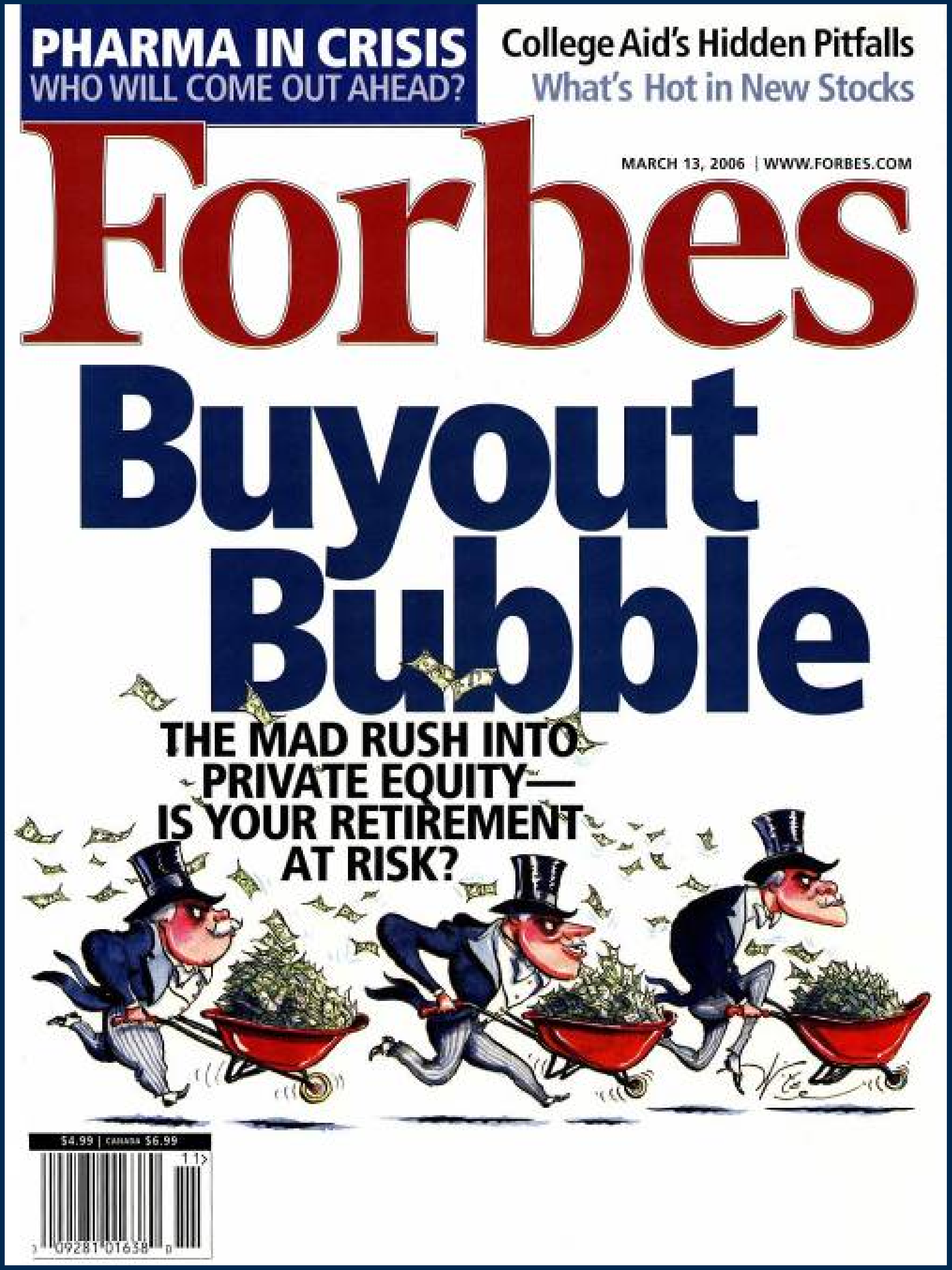
OVERVIEW

Background: The University of California pension system was so healthy that for two decades it grew through investments ibutions from the loyees.

What's changing: Like other pension systems, the UC's is in a dive. University regents have acted to restart employee and university contributions.

The future: Regents say that even if their contribution schedule is fully adopted, it won't be enough to cover the shortfall. They warn of benefit reductions.

Contributions to start; benefit cuts possible



March 13, 2006

SPECIAL REPORT pensions

TO JUICE UP THEIR SAGGING PORTFOLIOS, PENSION FUND MANAGERS ARE SEEKING ALTERNATIVE INVESTMENTS.

BY RANDY MYERS

Casting For Returns

LAST YEAR, BILL EINHORN FINALLY HAD ENOUGH. WITH 2002 drawing to a close, the $1.1 billion pension fund that Einhorn administers for the Teamsters union in Philadelphia was set to post its third straight year of lackluster investment returns—up a measly 2 percent in 2000, flat in 2001, and down 5.98 percent in 2002. During that time, it had slid from being more than 90 percent funded to only about three-quarters funded. Now, all the analysis Einhorn could put his hands on was telling him that returns on fixed-income investments—the only portion of his portfolio that had been making money in the past couple of years—were heading toward single-digit levels.

His decision: dip a toe in alternative investments. With the agreement of the board of trustees, Einhorn took 5 percent of the fund's portfolio out of fixed income and put it into private real estate investments managed by New York-based General Motors Asset Management (GMAM), the $100 billion-plus (in assets) pension arm of General Motors Corp.

"What we were looking for was a higher return with some additional risk, but not too much risk, to help us meet our 7.5 percent earnings assumption," says Einhorn, who until this year had his fund's assets split 60-40 between publicly traded stocks and bonds. (The Teamsters checks its earnings assumption every five years; the current assumption was

ILLUSTRATION BY DONNA NACER

CFO

THE BUSINESS END OF BUSINESS

August, 2003

Pensions&Investments

CalPERS loses $854 million on collateral reinvestment

August 11, 2009

CalPERS recorded an unrealized loss of $854.3 million on collateral that was reinvested from its internally managed securities-lending program.

The loss is a result of market turmoil that affected pricing for even top-quality collateral, staff of the $188.5 billion Sacramento-based California Public Employees' Retirement System wrote in a memo to the CalPERS' investment committee.

For the year ended March 31, CalPERS' securities-lending program posted a loss of $634.1 million, including the unrealized loss on the internal collateral reinvestment. Excluding the loss, the program generated $220 million in income for the year.

CalPERS' investment committee will review the program at its Aug. 17 meeting.

Separately, the staff is recommending issuing an RFP for a preapproved list of real estate consultants. The new five-year contracts would begin July 1, 2010.

Nine firms were selected for the pool in 2005. Contracts expired in June 2008 with extension options that will expire in June 2010.

CalPERS spokesman Clark McKinley could not specify how many firms will be selected for the new contracts.

PUBLIC PENSIONS ARE ADDING RISK TO RAISE RETURNS

BIDDING FOR THE FUTURE

Companies Shed Stocks as States Try to Make Up Lost Ground

By MARY WILLIAMS WALSH

States and companies have started investing very differently when it comes to the billions of dollars they are safeguarding for workers' retirement.

Companies are quietly and gradually moving their pension funds out of stocks. They want to reduce their investment risk and are buying more long-term bonds.

But states and other bodies of government are seeking higher returns for their pension funds, to make up for ground lost in the last couple of years and to pay all the benefits promised to present and future retirees. Higher returns come with more risk.

"In effect, they're going to Las Vegas," said Frederick E. Rowe, a Dallas investor and the former chairman of the Texas Pension Review Board, which oversees public plans in that state. "Double up to catch up."

The New York Times
Expect the World®

March 9, 2010

"In effect, they're going to Las Vegas," said Frederick E. Rowe, a Dallas investor and the former chairman of the Texas Pension Review Board, which oversees public plans in that state. "Double up to catch up."

The New York Times
Expect the World®

July 25, 2009

California Pension Fund Hopes Riskier Bets Will Restore Its Health

Josep

By LESLIE WAYNE

SACRAMENTO — Big as California's budget woes are today, so are the problems lurking in its biggest pension fund.

The fund, known as Calpers, lost nearly $60 billion in the financial markets last year. Though it has more than enough money to make its payments to retirees for many years, it has a serious long-term shortfall. Meanwhile, local governments in the state are pleading poverty and saying they cannot make the contributions that would be needed to shore it up.

Those problems now rest largely on the slim shoulders of Joseph A. Dear, the fund's new head of investments. He is not an investment seer by training, but he thinks he has the cure for what ails Cal-

higher returns. He aims to pour billions more into beaten-down private equity and hedge funds. Junk bonds and California real estate also ride high on his list. And then there are timber, commodities and infrastructure.

That's right, he wants to load up on many of the very assets that have been responsible for the fund's recent plunge. Calpers's real estate portfolio has tumbled 35 percent, and its private equity holdings are down 31 percent. What is more, under Mr. Dear's predecessor, Calpers had to sell stocks in a falling market last year to fulfill calls for cash from its private equity and real estate partnerships. That led to bigger losses in its stock portfolio.

Mr. Dear wants to embrace some potentially high-risk investments in hopes of higher returns. …. he wants to load up on many of the very assets that have been responsible for the fund's recent plunge.

BusinessWeek

April 23, 2009

PENSIONS WADE INTO TOXIC ASSETS

CalPERS and other public funds, eager to boost returns, may invest billions. But at what risk to investors?

Pension Advice for Hire

More States Start Inquiries
Into Conflicts of Interests

The New York Times
Expect the World®

May 7, 2009

A survey of practices across the country portrays a far-reaching web of friends and favored associates: political contributors, campaign strategists, lobbyists, relatives, brokers and others, capitalizing on relationships and paying favors. These influential figures can determine how pension funds are invested….

“What has developed is a corrupt system, where Wall Street, various fiduciaries, politicians and corporate managers are draining America’s savings,” said Frederick S. Rowe, a hedge fund manager who serves on the Texas Pension Review Board, an oversight body.

friends and favored associates: political contributors, campaign strategists, lobbyists, relatives, brokers and others, capitalizing on relationships and paying favors. These influential figures can determine how pension funds are invested,

"What has developed is a corrupt system, where Wall Street, various fiduciaries, politicians and corporate managers are draining America's savings," said Frederick S. Rowe, a hedge fund manager who serves on the Texas Pension

loss, an urgent issue given the market losses of the last year. In 2007 the Government Accountability Office studied a group of pension funds known to be ad-

Continued on Page 5

The New York Times

May 17, 2005

S.E.C. Looking at Pension Consultants

Concern That Advice May Be Tainted by Conflicts of Interest

By MARY WILLIAMS WALSH

The Securities and Exchange Commission is investigating about a dozen pension consulting firms over suspected failures to disclose conflicts of interest.

The commission, after completing an 18-month review, said yesterday that most consultants that help pension funds invest their assets had business relationships that could be tainting their advice.

One particular problem is in the area of directed brokerage, which can happen when the pension consultant is part of a larger company that has its own broker-dealer unit.

The S.E.C. found e-mail messages between the executives of one such financial services company that detailed how they planned a strategy of finding "commission friendly" money managers — or money managers who would be willing to use the

provided only limited disclosure of such potentially conflicted activities, and a few provided no such disclosure at all. It noted that pension consultants did not have to be divisions of larger financial services companies to be involved in such conflicts, because independent consultants could form their own business relationships with broker-dealers.

In its report, the S.E.C. staff noted that as investment advisers, pension

“The S.E.C.’s findings come at a time of uncomfortable scrutiny for the industry. Pension funds lost billions of dollars during that last bear market, and they have not yet recovered.

The S.E.C. report suggests that at least some of the underfunding is a result of pension assets being invested in ways that reward the consultants.”

was trying to learn whether money managers, in their eagerness to drum up business, were inappropriately paying the pension consultants to steer it to them.

The S.E.C.'s findings come at a time of uncomfortable scrutiny for the industry. Pension funds lost billions of dollars during the last bear market, and they have not yet recovered. The millions of baby boomers, meanwhile, are approaching retirement and preparing to draw their pensions. The painful mismatch between the amount of money needed and the amount available has raised questions about why the money was invested the way it was.

The S.E.C. report suggests that at least some of the underfunding is a result of pension assets being invested in ways that reward the consultants.

ents.

The commission also found evidence that financial services executives were pressuring money managers to engage in more trades, thereby generating more commissions.

Having to pay such commissions would needlessly drain money out of the pension fund.

The S.E.C. staff said it appeared that some money managers became so eager "to curry favor with the pension consultant" that they were willing to direct all their clients' trading to the consultant's preferred broker. The money manager would do so in hopes of getting to handle still more pension money, at the expense of his other clients, who would be told nothing about the arrangements.

The S.E.C. staff also found that the vast majority of pension consultants

The pension consulting field includes giants that do business worldwide and have widely recognized names, like Mercer Investment Consulting, a unit of Marsh & McLennan; Watson Wyatt; and Wilshire Associates. But others are tiny, with just one or two people, and there is a wide range in between. After the S.E.C. began its inquiry, some consultants halted activities that were most in question. And some consulting firms have begun to promote themselves as conflict-free.

The S.E.C. counted 1,742 registered investment advisers who reported doing some amount of work for pension funds. It examined only 24 of them but said that about half of the sample was made up of the world's largest pension consulting firms. The report did not name any of the consulting firms examined.

Calpers Rocked By 'Pay-to-Play'

America's largest public-pension fund, Calpers, revealed that a former board member had reaped more than $50 million in fees for arranging investments that could saddle state taxpayers with hundreds of millions of dollars in losses.

The disclosure deepens concerns that alleged conflicts of interest are undermining state retirement funds.

The California Public Employees' Retirement System said it is launching a "special review" into payments by money managers—including billionaire Leon Black's Apollo Management LP—to firms including Arvco Financial Ventures LLC. Arvco is headed by Al Villalobos, who served on Calpers's board from 1993 to 1995.

Calpers made no accusation of wrongdoing. "We are gathering facts to confirm that the $50 million in fees paid to Arvco did not come at our expense," said spokeswoman Pat Macht.

Mr. Villalobos said in a statement Wednesday that he would cooperate with Calpers's review, which he said would find that staff, advisers and board members at Calpers "have acted properly."

The disclosure stands to embarrass Calpers, a longtime champion of good corporate governance. It also promises to cast the fund even deeper into conflict in California, because the burden of Calpers's soured investments stands to fall flatly on taxpayers who are already reeling from a huge state budget deficit and steep unemployment.

Calpers funds the guaranteed pensions of retired state employees from returns on its investments and contributions from local governments. With its investments tanking, Calpers has requested more money from municipalities. To pay up, many of these governments will have to cut services or raise taxes.

"Whenever any public fund does anything to detract from their investment performance, the victims are local governments and state governments," David Crane, an economics adviser to Gov. Arnold Schwarzenegger, said Wednesday.

Calpers's disclosure also renews questions over the role of the middlemen who collect fees from private-equity firms, hedge funds and other invest-

Please turn to page A4

WALL STREET JOURNAL

October 15, 2009

The New York Times
Expect the World®

August 18, 2009

As New York's Pension Funds Lagged, Ma

By MICHAEL BARBARO and RUSS BUETTNER

The New York city comptroller, William C. Thompson Jr., is staking his mayoral campaign on his skills as a financial manager, which he says are exemplified by his supervision of the nation's largest municipal pension system.

But a review of how the $80 billion system has performed since he took office shows it has consis-

"It's consistently below average, and that's not where you want to be," said Edward A. H. Siedle, president of Benchmark Financial Services, a Florida firm that audits pension plans.

But Mr. Thompson has benefited from his association with the pension system, collecting more than $500,000 in campaign contributions from its growing roster of money managers since he first entered the 2001 race for comptroller. In some cases, the

candidate and a financial expert of equal stature to Mayor Michael R. Bloomberg, a billionaire media mogul and Wall Street veteran.

But beyond politics, his decisions have far-reaching consequences for an army of government retirees, who have entrusted their retirement funds to his office, and for city taxpayers, who must pick up the tab if the pension funds fall short of their

…the $80 billion system has consistently lagged behind many of its public pension peers... as the city tripled the number of money managers it uses and the fees that it pays those firms.

Annualized return on investment, July 2002 to June 2009

2% 4

NATIONAL MEDIAN

market index of the largest American companies. Since he took office, the domestic equity portfolios of the city's largest pension funds have roughly

their peers. For the seven-year period that ended in June 2001, the year Mr. Hevesi left office, the median annual return for large public pension funds was

The City Controller has benefited… collecting more than $500,000 in campaign contributions from its growing roster of money managers.

25 50 75 100

EMPLOYEES FUND

TEACHERS FUND

Source: Wilshire Trust Universe Comparison Service

THE NEW YORK TIMES

said. "The truth is, I don't think that any one person here, whether it's the chief investment officer, myself or someone else, can manipulate the process."

As the city confronts the economic crisis, Mr. Thompson's oversight of pension investments is a key component of his effort to sell himself as a viable mayoral

pointed by city officials, includin the comptroller, and the maj municipal unions.

But the trustees, who are pa time and meet about twice month, rely heavily on the com troller's staff, which oversees t vetting of prospective investme managers and makes recomme dations to the trustees of ea asset international

September 3, 2010

Chief of New Mexico Pension Resigns

Bruce Malott, the chairman of New Mexico's educational pension fund, resigned after a disclosure that he borrowed $350,000 from the father of a man who shared in as much as $22 million in finder's fees from state investments.

(September 3, 2010) -- Bruce Malott, the chairman of New Mexico's $8.55 billion educational pension fund, resigned following a questionable $350,000 loan.

Malott's resignation from the New Mexico Educational Retirement Board came after he revealed to board officials that in August 2006, he borrowed money from Anthony Correra, whose son, Marc Correra, was a political donor to Governor Bill Richardson. *The Albuquerque Journal* reported that Malott, a former campaign treasurer for Richardson, used the money to pay $290,000 in federal taxes and $50,000 in state taxes that he owed after the US Internal Revenue Service determined that a limited-liability company set up by him and others was used to avoid taxes. Malott reportedly denied allegations of using a placement agent, telling *The Journal* that when he obtained the loan, he was unaware that Correra's son, Marc, was getting paid by money managers to help them win business with the teachers' pension

CalPERS investment officer linked to bribery scandal resigns

THE SACRAMENTO BEE

August 26, 2010

A senior CalPERs investment officer resigned today after being linked to the pension fund's bribery scandal…..

Shahinian's name surfaced in Attorney General Jerry Brown's lawsuit against former CalPERs board member Alfred Villalobos and former Chief Executive Fred Buenrostro. The lawsuit said Villalobos bribed Shahinian with an all-expenses-paid junket to New York in 2007.

Weeks later, without disclosing the trip, Shahinian persuaded CalPERs to invest $600 million with one of Villalobos' clients, Apollo Global Management. The deal generated a $13 million commission for Villalobos.

Shahinian with an all-expenses-paid junket to New York in 2007.

Weeks later, without disclosing the trip, Shahinian persuaded CalPERS to invest $600 million with one of Villalobos' clients, Apollo Global Management. The deal generated a $13 million commission for Villalobos.

WALL STREET JOURNAL

October 8, 2010

Associated Press

Former New York Comptroller Alan Hevesi, getting an earful from his attorney in Manhattan State Supreme Court on Thursday, is now cooperating with authorities in the 'pay to play' probe.

'Pay to Play' Scandal Gets a Key Guilty Plea

Focus Turns to Financier Steven Rattner, Among Others

FORMER NEW YORK State Comptroller Alan Hevesi admitted Thursday that he traded access to one of the nation's largest public pension systems for personal benefits and political favors, agreeing to cooperate with the continuing investigation of the fund he once ran.

At one time among the highest-ranking politicians in New York, Mr. Hevesi was barely audible as he stood up in court and pleaded guilty to a felony corruption charge. He acknowledged accepting nearly $1 million in overseas travel, campaign contributions and other benefits for himself and others from a Cali-

administration "car czar," and Henry "Hank" Morris, Mr. Hevesi's former chief political adviser.

"I deeply regret my conduct and sincerely and deeply apologize to the people of the state of New York, to the court and to my family," Mr. Hevesi, 70 years old, told State Supreme Court Justice Lewis Bart Stone in New York City as his two sons and his daughter sat watching.

Afterward, Mr. Hevesi hurried out with his lawyers trailed by reporters, declining to comment and escaping into an elevator.

When he is sentenced, Mr. Hevesi could face 16 months to four years in prison on the felony charge, but

Daniel Hevesi, said the agreement "speaks for itself." Andrew Hevesi could not be reached.

Mr. Hevesi's agreement to cooperate could put pressure on others to plead guilty as Mr. Cuomo tries to tie up his investigation before leaving office at the end of the year.

Mr. Morris denies allegations by Mr. Cuomo that he doled out

investments by New York's $125 billion fund in exchange for kickbacks as a placement agent and as rewards for political allies. Mr. Morris is scheduled for trial next year.

On Thursday, Mr. Hevesi said Mr. Morris "steered Common Retirement Fund invest-

SEC Bans 'Pay to Play' For Advisers

WASHINGTON—The Securities and Exchange Commission took a step toward cracking down on "pay to play" schemes, barring investment advisers who want to manage public pension funds from donating to politicians who oversee the funds.

The 5-0 decision by the SEC's commissioners followed scandals in New York state and elsewhere in which investment advisers were accused of making political payments to help themselves get government business.

The agency backed off a related proposal that would have banned investment advisers from hiring so-called placement agents to help them secure pension-fund business. Under the regulations passed on Wednesday, investment advisers can use placement agents as long as they are registered with the SEC or the regulatory organization known as the Financial Industry Regulatory Authority. Companies with large placement-agent businesses, including **Blackstone Group** and **Credit Suisse Group**, had lobbied against the outright ban.

SEC Chairman Mary Schapiro said the cost of pay-to-play is

She alluded to an April settlement in which private-equity firm **Quadrangle Group** LLC agreed to pay a $12 million fine to resolve civil charges by the SEC and New York Attorney General Andrew Cuomo's office. Authorities alleged Quadrangle secured a $100 million investment by the New York State Common Retirement Fund only after a former executive arranged to distribute the DVD of a low-budget film produced by a state official and his brothers and paid more than $1 million in sham "finder" fees to the top adviser of the state comptroller.

"Our recent cases may represent just the tip of the iceberg," Ms. Schapiro said. "I fear that many other efforts to influence the selection of advisers to manage government plans pass unnoticed or, though highly suspect, cannot be proven to have crossed the line."

The SEC rule prohibits advisers from offering services to pension plans for two years if they contribute to an elected official or a candidate who could be in a position to hire money managers. Certain executives and employees of the money

WALL STREET JOURNAL

June 30, 2010

S&P Sheds Light On Accounting For Pension Costs

By Cassell Bryan-Low

IF BROWN IS THE new black of fashion, pension funds have eclipsed stock-option expensing as the new hot-button issue of accounting.

While momentum has grown in support of expensing stock options since the beginning of the year, pension-related matters have come on strong of late as a subject to be dealt with. Just how big an issue is something that numbers to be publicly released today by Standard & Poor's shed light on.

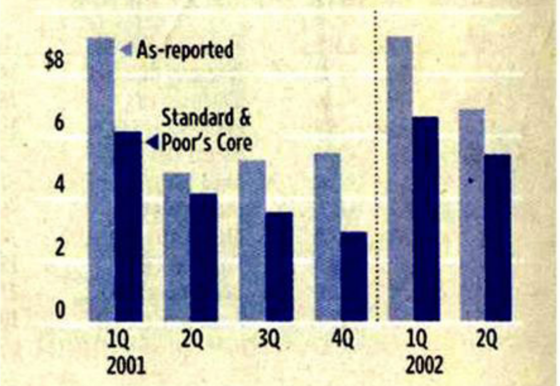
On a net-income basis, the big-company S&P 500-stock index earned $26.74 a share for the 12 months ended June 30. But, after adjusting to account for items including both the actual rate of return on pension funds as well as the expensing of stock options, the figure drops to $18.48 a share, which S&P calls "core earnings." Of the

HEARD ON THE STREET

would have reported $1.84 a share for the 12 months ended June 30. S&P notes that on a net-income basis

Less Than Advertised

Quarterly earnings per share for the companies of the S&P 500, as reported, and as adjusted by Standard & Poor's to include items such as employee stock-option grants, pension interest expenses and adjustments and goodwill.



it reported $2.05 a share. Of the difference between the two numbers, eight cents comes from the expensing of stock options, while nearly double that—14 cents—is attributable to pension-fund costs. A spokesman for Anheuser wasn't immediately able to comment, noting that the company was

GAAP, the expected rate of return on the plans

Please Turn to Page C3, Column 1

THE WALL STREET JOURNAL.

October 24, 2002

"..many companies assume… that their pension plans will return 9% or 10%, while in reality the stock market has resulted in widespread negative investment returns."

WALL STREET JOURNAL

September 18, 2010

Pension Gaps Loom Larger

Funds Stick to 'Unrealistic' Return Assumptions

BY DAVID REILLY

Many of America's largest pension funds are sticking to expectations of fat returns on their investments even after a decade of paltry gains, which could leave U.S. retirement plans facing an even deeper funding hole and taxpayers on the hook for huge additional contributions.

The median expected investment return for more than 100 U.S. public pension plans surveyed by the National Association of State Retirement Administrators remains 8%, the same level as in 2001, the association says.

The country's 15 biggest public pension systems have an average expected return of 7.8%, and only a handful recently have changed or are reconsidering those return assumptions, according to a survey of those funds by The Wall Street Journal.

Corporate pension plans in many cases have been cutting expectations more quickly than public plans, but often they were starting from more-optimistic assumptions. Pension plans at companies in the Standard & Poor's 500 stock index have trimmed expected returns by one-half of a percentage point

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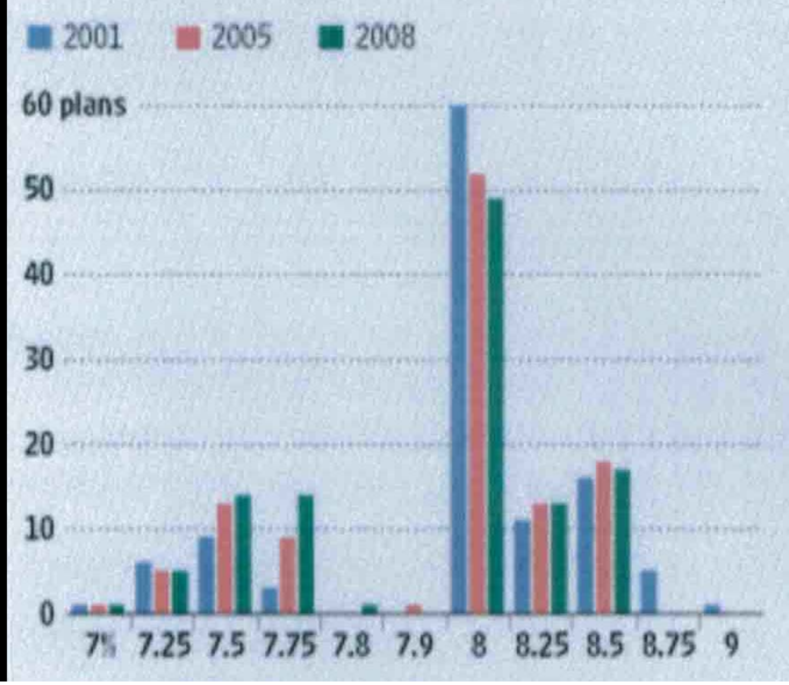
Expected investment return rates for public pension plans, by number of plans reporting particular levels



Public Pensions Cook the Books

Here's a dilemma: You manage a public employee pension plan and your actuary tells you it is significantly underfunded. You don't want to raise contributions. Cutting benefits is out of the question. To be honest, you'd really rather not even admit there's a problem, lest taxpayers get upset.

What to do? For the administrators of two Montana pension plans, the answer is obvious: Get a new actuary. Or at least that's the essence of the managers' recent solicitations for actuarial services, which warn that actuaries who favor reporting the full market value of pension liabilities probably shouldn't bother applying.

Public employee pension plans are plagued by overgenerous benefits, chronic underfunding, and now trillion dollar stock-market losses. Based on their preferred accounting methods—which discount future liabilities based on high but uncertain returns projected for investments—these plans are underfunded nationally by around $310 billion.

The numbers are worse using market valuation methods (the methods private-sector plans must use), which discount benefit liabilities at lower interest rates to reflect the chance that the expected returns won't be realized. Using that method, University of Chicago economists Robert Novy-Marx and Joshua Rauh calculate that, even prior to the market collapse, public pensions were actually short by nearly $2 trillion. That's nearly $87,000 per plan participant. With employee benefits guaranteed by law and sometimes even by state constitutions, it's likely these gargantuan shortfalls will have to be borne by unsuspecting taxpayers.

Some public pension administrators have a strategy, though: Keep taxpayers unsuspecting. The Montana Public Employees' Retirement Board and the Montana Teachers' Retirement System declare in a recent solicitation for actuarial services that "If the Primary Actuary or the Actuarial Firm supports [market valuation] for public pension plans, their proposal may be disqualified from further consideration."

Scott Miller, legal counsel of the Montana Public Employees Board, was more straightforward: "The point is we aren't interested in bringing in an actuary to pressure the board to adopt market value of liabilities theory."

While corporate pension funds are required by law to use low, risk-adjusted discount rates to calculate the market value of their liabilities, public

> Some plans want to hide the truth from taxpayers.

employee pensions are not. However, financial economists are united in believing that market-based techniques for valuing private sector investments should also be applied to public pensions.

Because the power of compound interest is so strong, discounting future benefit costs using a pension plan's high expected return rather than a low riskless return can significantly reduce the plan's measured funding shortfall. But it does so only by ignoring risk. The expected return implies only the "expectation"—meaning, at least a 50% chance, not a guarantee—that the plan's assets will be sufficient to meet its liabilities. But when future benefits are considered to be riskless by plan participants and have been ruled to be so by state courts, a 51% chance that the returns will actually be there when they are needed hardly constitutes full funding.

Public pension administrators argue that government plans fundamentally differ from private sector pensions, since the government cannot go out of business. Even so, the only true advantage public pensions have over private plans is the ability to raise taxes. But as the Congressional Budget Office has pointed out in 2004, "The government does not have a capacity to bear risk on its own"—rather, government merely redistributes risk between taxpayers and beneficiaries, present and future.

Market valuation makes the costs of these potential tax increases explicit, while the public pension administrators' approach, which obscures

Some plans want to hide the truth from taxpayers.

plans to take the same low road that the two Montana plans want to take. It argues against reporting the market valuation of pension shortfalls. But the association's objections seem less against market valuation itself than against the fact that higher reported underfunding "could encourage public sector plan sponsors to abandon their traditional pension plans in lieu of defined contribution plans."

The Government Accounting Standards Board, which sets guidelines for public pension reporting, does not currently call for reporting the market value of public pension liabilities. The board announced last year a review of its position regarding market valuation but says the review may not be completed until 2013.

This is too long for state taxpayers to wait to find out how many trillions they owe.

Mr. Biggs is a resident scholar at the American Enterprise Institute.

THE WALL STREET JOURNAL.

July 6, 2009

Pension Bomb Ticks Louder

The time-bomb that is public-pension obligations keeps ticking louder and louder. Eventually someone will have to notice.

This month, Stanford's Institute for Economic Policy Research released a study suggesting a more than $500 billion unfunded liability for Calif
three biggest pensio
and the University o
System. The shortfa
size of this year's Cal
seven times more tha
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The pension funds
bombs denounced t
Jack Ehnes declared
"most people would
grade of 'F' for qualit
brand of Stanford, it
quite a bit." He called its assumptions "faulty," its research "shoddy" and its conclusions "political." Calpers chief Joseph Dear wrote in the San Francisco Chronicle that the study is "fundamentally flawed" because it "uses a controversial method that is out of step with governmental accounting standards."

Those standards h

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"risk-free" 4.14% disc
to 10-year Treasury b
Accounting Standard
rate pensions to use a
lows *public* pension fu
liabilities at their ex
which the pension fu
assumes a rate of ret
and the UC fund 7.5%. But the CEO of the global investment management firm BlackRock Inc., Laurence Fink, says Calpers would be lucky to earn 6% on its portfolio. A 5% return is more realistic.

Last year the accounting board proposed that the public pensions play by the same rules as corporate pensions. But unions for the public employees balked because the changed standard would likely require employees and employers to contribute more to the pensions, especially in times when interest rates are low. For now, it appears the public employee unions will prevail with the status quo accounting method.

Using these higher return rates for their pension portfolios, the pension giants calculate a much smaller, but still significant, $55 billion shortfall. Discounting liabilities at these higher rates, however, ignores the probability that actual returns will fall below expected levels and allows

> California's public funds are assuming unlikely rates of return.

right. What this means is that taxpayers are on the hook if the economy falters or the pension portfolios don't perform as well as expected.

As David Crane, California Governor Arnold Schwarzenegger's adviser notes, this year's unfunded pension liability is next year's

change the funds when markets are booming. It also recommends shifting investments to more fixed-income assets to reduce risks.

But what the public-pension giants find "political" and "controversial" is the study's recommendation to move away from a defined benefits system to a 401(k)-style system for new hires. Public employee unions oppose this because defined benefits plans are usually more lavish, and someone else is on the hook to make up shortfalls. Calpers and Calstrs are decrying the Stanford study because it has revealed exactly who is on the hook for all of this unfunded obligation—California's taxpayers.

$500 billion unfunded liability for California's three biggest pension funds—Calpers, Calstrs and the University of California Retirement System.

Calstrs assumes a rate of return of 8%, Calpers 7.75% and the UC fund 7.5%. A 5% return is more realistic.

THE WALL STREET JOURNAL.

April 26, 2010

WALL STREET JOURNAL

August 19, 2010

SEC Sues New Jersey As States' Finances Stir Fears

By Kara Scannell
And Jeannette Neumann

The Securities and Exchange Commission, in its first securities-fraud case against a state, accused New Jersey of misleading investors about the health of its two largest state pensions while selling billions of dollars in bonds.

The Securities and Exchange Commission, in its first securities-fraud case against a state, accused New Jersey of misleading investors about the health of its two largest state pensions while selling billions of dollars in bonds.

The New York Times
Expect the World®

September 18, 2010

The Illusion of Savings

Several States Join Illinois In Risky Pension Accounting

By MARY WILLIAMS WALSH

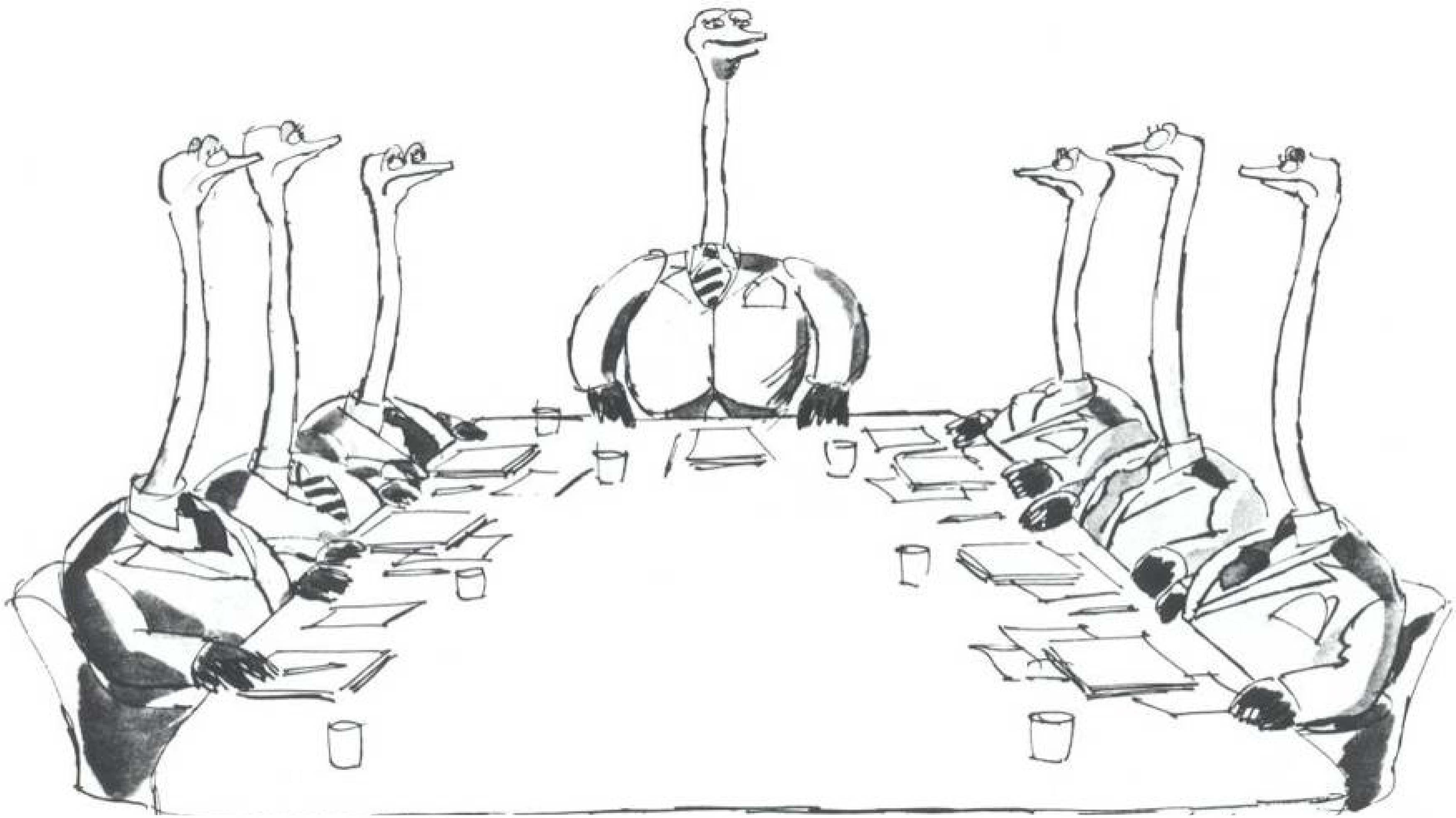
Earlier this year, Illinois said it had found a way to save billions of dollars. It would slash the pensions of workers it had not yet hired. The real-world savings would not materialize for decades, of course, but thanks to an actuarial trick, the state could start counting the savings this year and use it to help balance its budget.

...

fects, are already in use in Rhode Island, Texas, Ohio, Arkansas and a number of other places, allowing those states to harvest savings today by imposing cuts on workers in the future.

Texas saved millions of dollars this year after raising its retirement age for future hires and barring them from counting unused sick leave in their pensions. More savings will appear in coming years. Rhode Island also raised its retirement age for future retir-

Several States Join Illinois in a Risky Illusion of Pension Accounting



“The motion has been made and seconded that we stick our heads in the sand.”

Bloomberg

October, 2010

CLEANING UP CALPERS

After the largest U.S. pension fund lost $70 billion and got embroiled in an influence-peddling scandal, new investment chief Joe Dear says the only way out of this mess is to take more risk.

theguardian

July 24, 2009

Global greying will test rich and poor nations

1.3 billion pensioners expected by 2040

Structure of the family will be transformed

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shows that within 10 years older people will outnumber children for the first time. It forecasts that over the next 30 years the number of over-65s is expected to almost double, from 506 million in 2008 to 1.3 billion – a leap from 7% of the world's population to 14%. Already, the number of people in the world 65 and over is increasing at an average of 870,000 each month.

The rate of growth will shoot up in the next couple of years, with both overall numbers and proportions of older people rising rapidly.

The shift is due to a combination of the time-delayed impact of high fertility levels after the second world war and more recent improvements in health that are bringing down death rates at older ages. Separate UN forecasts predict that the global population will top 9 billion by 2050.

FORTUNE
January 23, 2006

Value Driven ▪ Geoffrey Colvin

Tick, Tick . . . Boom!

Terror alert: America's pension time bomb is **ready to explode.**

SOME OF THE NASTIEST CONFLICTS IN AMERICA'S FUTURE have recently begun to reveal themselves. Let's call them, broadly, the pension wars. They will be fought on a wide range of battlefields, involving not just workers and their employers but also governments at all levels, regulators, accountants, and taxpayers. And these wars will be bitter—because the combatants will be desperate.

A hint of what's to come could be seen in the New York City transit strike. Most of America didn't notice exactly what sparked the first such strike in 25 years, costing businesses, individuals, and the city hundreds of millions of dollars. The answer is pensions. The transit authority and the workers were agreed on virtually everything except how much new employees would contribute toward their pensions—6% of wages vs. 2%—and neither side felt it could give an inch on that.

The reasons illustrate the larger problem. The transit authority, like many private and public employers, is watching its pension costs rocket as longer-living retirees increase in number. That burden will become unbearable. On the other side, union members are watching employers nationwide dumping or cutting their pensions just as Social Security starts to look shaky. They figure retirement security is the one thing they cannot sacrifice. Result: war.

New York's transit strike also illustrates an important reason that the pension wars weren't headed off long ago. The truth about pensions has been systematically hidden, with all parties collaborating in the deceit. Public-employee pensions have never been accounted for like those run by private employers. No government is required to tell you its pension liability the way, say, General Motors is, on the theory that governments can always just extract more money from the taxpayers to pay retirees. But this year the Governmental Accounting Standards Board, which sets the rules for the public sector, is changing its regulations. State and local governments will now have to reveal their pension liabilities, which may be underfunded by $1 trillion or more.

Private employers, while required to account for their pensions, have played sophisticated games with the numbers—all within the rules. For example, they can assume the pension fund increased in value when it actually declined. They can assume it will continue increasing in value at a rate that is almost certainly way too high. They can even jack up their reported profits based on that assumed, though nonexistent, increase in pension-fund value.

But eventually actual dollars must be paid out, a prospect that has seriously spooked private employers. Just this month IBM announced that it would join the long list of companies (Verizon, Hewlett-Packard, Motorola) that have frozen their pension plans, instead increasing 401(k) contributions for employees. And the 18-month negotiation between UPS and its pilots has come down to just two points: whether outsourced pilots overseas must be union members, and (you guessed it) pensions.

The pension wars will inevitably include Congress, which is working out a way to increase funding for the federal Pension Benefit Guaranty Corp., now deeply in the red as huge companies like UAL, parent of United Air Lines, dump their pension plans on it. Since the PBGC is an insurer, the logical move is to raise the premiums companies pay, especially for the riskiest plans. But if Congress mandates a premium hike, as it probably will, then more companies will just dump their plans on the PBGC, redoubling the need for more funds, leading to more premium hikes, and so on. If you can see any way taxpayers will not get billed for a giant bailout, please e-mail Congress immediately.

And then there's the greatest pension crisis of all: Social Security. We've stayed in denial thanks to the so-called trust fund, that magical place where the plan's annual surpluses are sent to be invested until we need them. But since those surpluses must by law be invested in government bonds, they have simply been handed over to the U.S. Treasury and spent by Congress. The trust fund is in fact meaningless, a bit of marketing hooey cooked up in the '30s. When Social Security's annual surpluses end in just six or seven years, the battle over whose ox to gore in order to cover the plan's obligations will be truly epic.

The hard reality is that for decades we haven't told ourselves the truth about pensions. Now, as the first baby-boomers turn 60, we must finally confront reality—and absolutely no one will like it. In New York last month, transit workers and management compromised; employees will make small contributions toward health insurance premiums but will keep one of the richest retirement deals around. Soon those compromises simply won't be affordable. And that's when the pension wars will explode. ■

FEEDBACK gcolvin@fortunemail.com

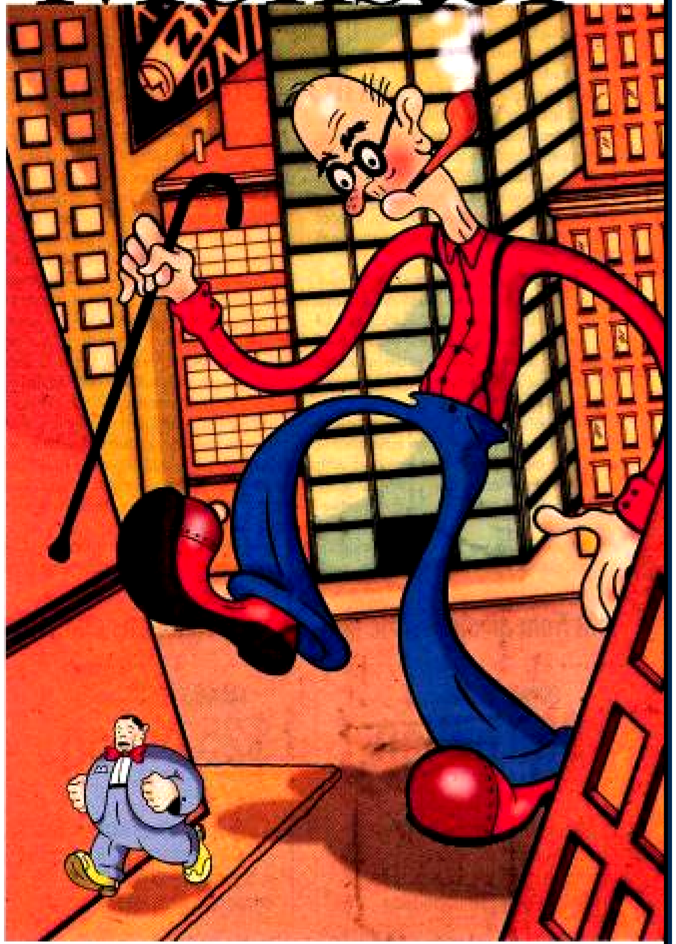
FORTUNE

December 9, 2002

Beware the Pension Monster

It lurks behind funny accounting, ready to pounce on unsuspecting investors.

by Janice Revell



"I think we're faced with the worst financial situation," says one asset manager, "since the Depression."

spective, that's more than half of what they're expected to earn this year.

It's the day of reckoning in corporate America. You've probably read that companies are restating their pension assumptions and will take a hit to earnings as a result. You've no doubt seen how the stocks of some huge, widely held companies like

ILLUSTRATION BY CHRISTIAN NORTHEAST

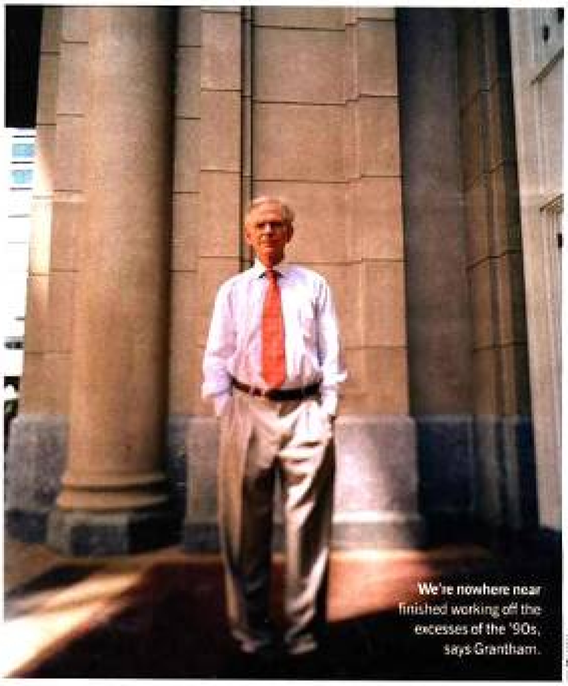
FORTUNE
November 15, 2004

investing

Feedback? investing@fortunemail.com

Here comes the crash

Boston sage Jeremy Grantham thinks investors are facing two tough years ahead. About $70 billion of smart money says the guy is no Chicken Little.
By David Stires



We're nowhere near finished working off the excesses of the '90s, says Grantham.

Talk to Jeremy Grantham about the stock market, and you get the impression the sky is about to fall. For years the chairman and chief strategist of money-management firm Grantham Mayo Van Otterloo has been gleefully rattling listeners' nerves with his claim that the excesses of the dot-com bubble still haven't been unwound and that the market is headed for another precipitous drop. About a year ago his prediction became alarmingly specific. Shortly after this year's election, he says, the market will sink into a "black hole," losing about a third of its value over the next two to three years. He sounded this warning most publicly at the annual Morningstar investment conference in July. In late October, speaking from his elegant Boston townhouse, he told FORTUNE, "We're still in the unraveling of the greatest bull market in American history."

Grantham, 66, clearly relishes his role as stock market Cassandra. But it's not as though he's some madman who just broke out of the asylum. A Britisher who graduated from Harvard Business School in 1966, Grantham co-founded Batterymarch Financial Management before launching GMO with Dick Mayo and Eyk Van Otterloo in 1978. Using GMO's computer models, he has made several well-timed calls. In 1982, with stocks selling at fire-sale prices and the economy recovering, he predicted the market was ripe for a "major rally." That year the U.S. market kicked off its longest bull run ever. He also called the top of the Japanese bubble in 1989, the resurgence of U.S. large caps in 1991, and the rallies in U.S. small-cap and value stocks in 2000. Some veteran market watchers consider him one of the top strategists in the game. "Jeremy has great ideas," says longtime client Jack Meyer, who oversees the $23 billion endowment of Harvard University. "And he's usually right, which is a true rarity in the investment business."

It's hard to argue with Grantham's results. Since inception, GMO's two dozen funds have beaten their respective benchmarks by an average of three percentage points a year after fees. In recent

BARRON'S

June 28, 2004

Anyone who looks ahead can see that when boomers' retirement plans need cash to pay retirement incomes, they will have to sell stocks,… A prolonged bear market is likely… that will destroy the retirement plans…

The Wealth Trap

Loading up on stocks for retirement requires unloading them later

BY THORNTON PARKER • Who sells the stocks that retirement plans buy? If stocks are as good as baby boomers are told they are, why does anyone sell them? Boomers have been … and use the money to buy stocks. Doing that, they are … es need to grow, so their stocks will grow and eventually

… out of stocks.

In spite of the retirements, the total market value of stocks increased from $1.38 trillion to $11.74 trillion. Market action produced this gain—a compound annual-growth rate of 9.7% over the 21 years.

While net issues and retirements largely offset each other, there was a clear pattern of changing ownership, with one group of stockholders being net buyers and another group being net sellers. The net buyers were mutual funds, life insurance companies, foreign investors, state and local pension plans, and others, in that order. The buyers were largely retirement-related. They started out with $249 billion worth of stocks, bought $3.51 trillion worth, and ended up with $5.82 trillion worth. Their growth due to market action was just under 6% per year.

The net sellers were households, com- … pension plans, and bank trusts and …es. They started out with $1.13 trillion … worth of stock, sold $3.… trillion … ended up with $5.92 trillion worth. … growth due to market action was … per year. Households, the largest … group, started out with $780 billion … worth of stock, sold $2.98 trillion, … ended up with $4.19 trillion worth. … growth was 15.1% per year.

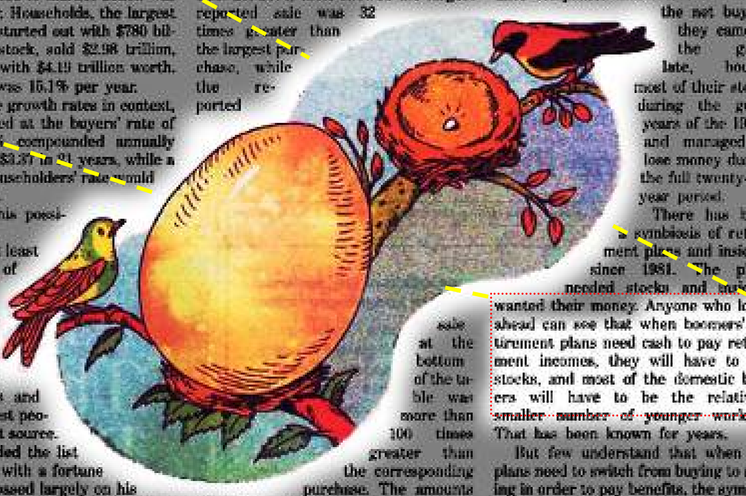
… put those growth rates in context, … invested at the buyers' rate of … under 6% compounded annually … grow to $3.27 in 21 years, while a … at the householders' rate would … to $19.27.

… w was this possi-…

… ere are at least … sources of … and … point to … rate in… The … s articles on the world's and America's richest people are the first source. Bill Gates headed the list in March 2003 with a fortune of $46 billion, based largely on his Microsoft stock. He is reported to have sold about 2 billion shares (adjusted for splits) and still owns 1.2 billion. When Microsoft had its initial public offering, he retained 45% of the shares, and he still has enough to continue selling 20 million shares a quarter for 15 years. His cost was probably less than a million bucks, $0.001 per share, so virtually all of his receipts and the value of the shares he still owns are profit.

Gates is the extreme example, but he and the other 243 Americans identified in Forbes had total fortunes, based largely on stocks, of $700 billion, or a sixth of all the stocks held by American households at the end of 2002. In addition, there are the corporate insiders, including employees who received stock directly from companies as grants or through options. There were an estimated 10,000 "Microsoft millionaires" before the bull market collapsed.

The second source is the weekly table of Insider Transactions published in each issue of *Barron's*. The tables show the huge amount of money that insiders take out of stocks in relation to the amount they put in. For example, the Feb. 23, 2004, table showed the largest reported sale was 32 times greater than the largest purchase, while the reported sale at the bottom of the table was more than 100 times greater than the corresponding purchase. The amounts vary, but the basic pattern has been consistent for years.



Taken together, the Fed data, the Forbes lists and *Barron's* tables show that the households of corporate insiders must have been the primary sellers of the stocks that were bought by mutual funds and other retirement-related portfolios. The extreme gains that households received as a group may well have been driven by the insiders' low acquisition costs.

The hard conclusion must be that retirement-related portfolios absorb the large blocks of stocks that corporate insiders acquire directly from companies at low cost. The portfolios buy many of the shares the insiders sell and help price the stock they retain. Many insiders probably understand this, but most retirement savers are outsiders who do not. The role of insiders has not yet become a national issue, but is important for several reasons.

Insiders who have the lowest costs get the largest profits. When later buyers acquire insiders' stocks on secondary markets, most of the profits the stocks will ever produce have already been made. As a group, retirement savers who buy on secondary markets will always earn less than the insiders.

It is getting harder to make money by buying stocks on secondary markets with the passage of time. Insurance companies illustrate this. Among the net buyers, they came to the game late, bought most of their stocks during the go-go years of the 1990s, and managed to lose money during the full twenty-one year period.

There has been a symbiosis of retirement plans and insiders since 1981. The plans needed stocks and insiders wanted their money. Anyone who looks ahead can see that when boomers' retirement plans need cash to pay retirement incomes, they will have to sell stocks, and most of the domestic buyers will have to be the relatively smaller number of younger workers. That has been known for years.

But few understand that when the plans need to switch from buying to selling in order to pay benefits, the symbiosis will end. The plans will switch from supporting insiders to competing with them for the purchasing power of younger workers. A prolonged bear market is likely, and many of the insiders will be able to make money at prices that will destroy the retirement plans.

The wealth gap between America's middle class and its richest people is growing, and has become a political issue. So far, the way that retirement plans literally transfer money from middle-class workers to corporate insiders and inflate the value of the insider's portfolios has not been recognized. But unless this analysis is wrong, it is only a matter of time until that happens. ■

THORNTON PARKER is the author of *What If Boomers Can't Retire? How to Build Real Security, Not Phantom Wealth*, published in 2001 by Berrett-Koehler and also available in paperback. His e-mail address is Tipparker@aol.com.

Barron's welcomes submissions to "Other Voices". Essays should be about 1,200 words in length, and sent by e-mail to the Editorial Page editor at tg.donlan@barrons.com.

The $44 Trillion ABYSS

The baby-boomers are about to retire, and it's going to cost us—*big.* Here's what the government doesn't want you to know.

BY ANNA BERNASEK

Last fall Paul O'Neill, then Secretary of the Treasury, wanted a simple answer to a thorny question: How prepared was the nation today to pay all its future bills? Two government experts worked for months to calculate the answer. Their findings, which shocked even them, were never published—the Bush administration made sure of that. The reason for the silence was that by the time the two researchers had completed their study, O'Neill had been thrown out of the Treasury and replaced by the more politically astute John Snow. No savvy administration power player would dare point out, right in the middle of tax-cut season, that there was a huge hole in the country's finances—a *$44 trillion* hole.

MAN WITH A MISSION Boston University's Kotlikoff is a one-man fiscal warning system.

PHOTOGRAPH BY REUBEN COX

FORTUNE

November 24, 2003

"… we're heading for a crisis with no escape …one day financial markets will wake up to the size of the problem and send interest rates through the roof … the government will be forced to … raises taxes and cut benefits."

September 10, 2010

Public Sector Workers Are the New Privileged Elite Class

Outrageous public pay, pensions, and inherent corruption are enraging private sector America

By MORTIMER B. ZUCKERMAN
Posted: September 10, 2010

We really are two Americas, but not those captured in the stereotypical populist class warfare speeches that dramatize the gulf between the rich and the poor. Instead there is a new division in America that affronts a sense of fairness. That division is between the workers in the private sector and the workers in the public sectors. No guesses which is the more protected. A new study by the Mayo Research Institute, based in Louisiana, demonstrates that there is a striking differential in the impact of the recession. In 2009, the study found, "private-sector workers were nearly three times more likely to be jobless than public-sector workers."

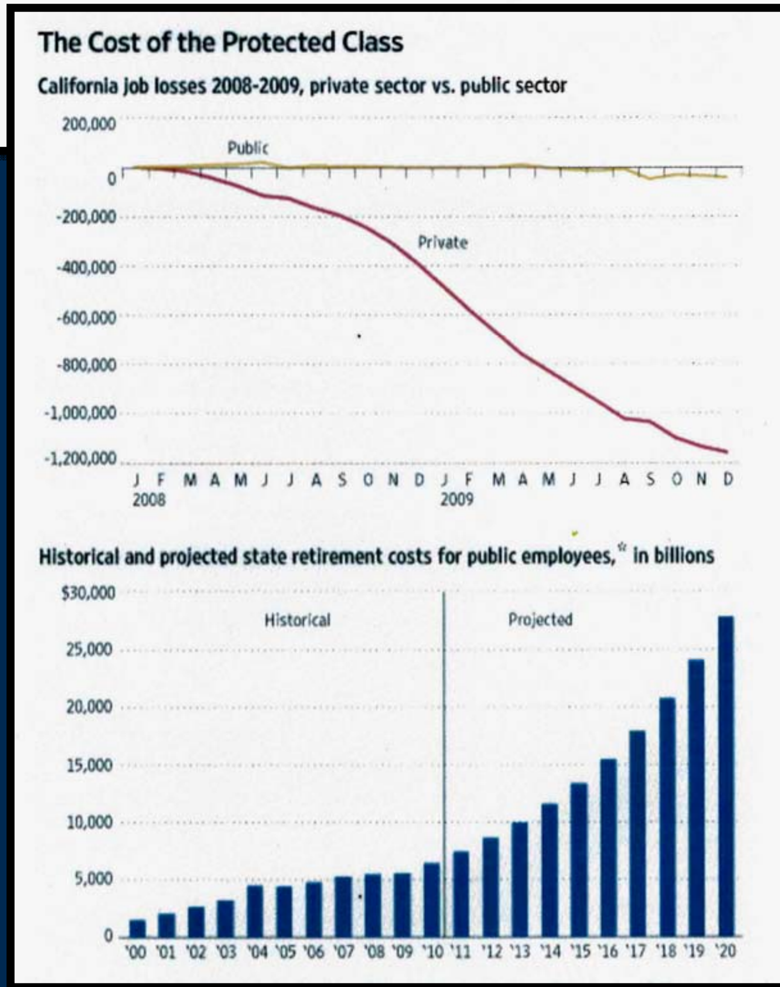
WALL STREET JOURNAL

August 27, 2010

Public Pensions and Our Fiscal Future

Few Californians in the private sector have $1 million in savings, but that's effectively the retirement account they guarantee to many government employees.

By ARNOLD SCHWARZENEGGER



"If we take a late retirement and an early death we'll just squeak by."

The New York Times

Sunday, June 13, 2004

SundayBusiness

Section 3

Healthier and Wiser? Sure, but Not Wealthier

As Pensions Slip Away, Retirees May Take a Fall

By MARY WILLIAMS WALSH

BY many measures, today's older workers appear better equipped for retirement than any previous generation. Their homes are worth more than their parents' homes were. Their bank accounts are fatter. And study after study suggests that typical late-middle-age employees have accumulated more wealth than their counterparts did a quarter-century ago.

But virtually all of these studies have a flaw, a crucial asset that is left out of the equation. Add it back in, and the rosy picture suddenly darkens.

That asset is the traditional pension, an employee benefit that was widely available until the early 1980's but has been vanishing from the American workplace ever since. More than two-thirds of older households — those headed by people 47 to 64 — had someone earning a pension in 1983. By 2001, fewer than half did. The demise of the old-fashioned pension has been much discussed, but the effect on family finances has not. That is because the impact has been hard to measure.

New evidence suggests, though, that the waning of the pension has, imperceptibly but surely, stripped older workers of an immense store of wealth — much more than they probably guessed, if they thought about it at all. Retirement benefits today, particularly the 401(k) account, simply are not worth as much as the older kind of benefits. Some studies suggest otherwise, but they tend to rely on average balances of retirement accounts, and the averages have been skewed upward by the extraordinary gains of a few wealthy households.

When the holdings of more typical households are tracked instead, today's near-retirees turn out to be a little poorer, in constant dollars, than the previous generation was when it approached retirement in 1983. The sweeping change in employee compensation appears to be the reason, according to new research by Edward N. Wolff, an economist at New York University who analyzed 18 years of household financial data collected by the Federal Reserve.

Mr. Wolff found that the average net worth of an older household grew 44 percent, adjusted for inflation, from 1983 to 2001, to $673,000. But much of that growth was in the accounts of the richest households, which pushed the averages up. When Mr. Wolff looked at the net worth of the median older household — the one at the midpoint of the economic ladder, a better indicator of what is typical — the picture changed. That figure declined by 2.2 percent, or $4,000, during the period, to $189,900.

For a generation to emerge from two bullish decades with less wealth than its parents had "is remarkable," Mr. Wolff said. Based on economic growth and market returns over those 18 years, he said, their wealth "should be up around 30 or 40 percent."

The Fed's household-finance data also show that when pensions were more common, they served as a social leveler. Companies that offered them had to use the same pension formula, involving years of service and salary, for all workers in a plan; otherwise, the companies risked losing their tax break. The rich in those days bought big houses and invested in stocks and other assets that were out of reach for the middle class. But pensions would offset, to some degree, the difference between how these groups lived in old age. Traditional pension plans were part of a system that reduced the poverty rate among the elderly to just 1 in 10 in 2002, the lowest in half a century.

The advent of self-directed retirement plans, by contrast, is giving rise to an elite minority who are well prepared for retirement, and a majority

Continued on Page 9

Illustration by The New York Times