



# Pension Missiles: Is the Cure Worse than the Disease?

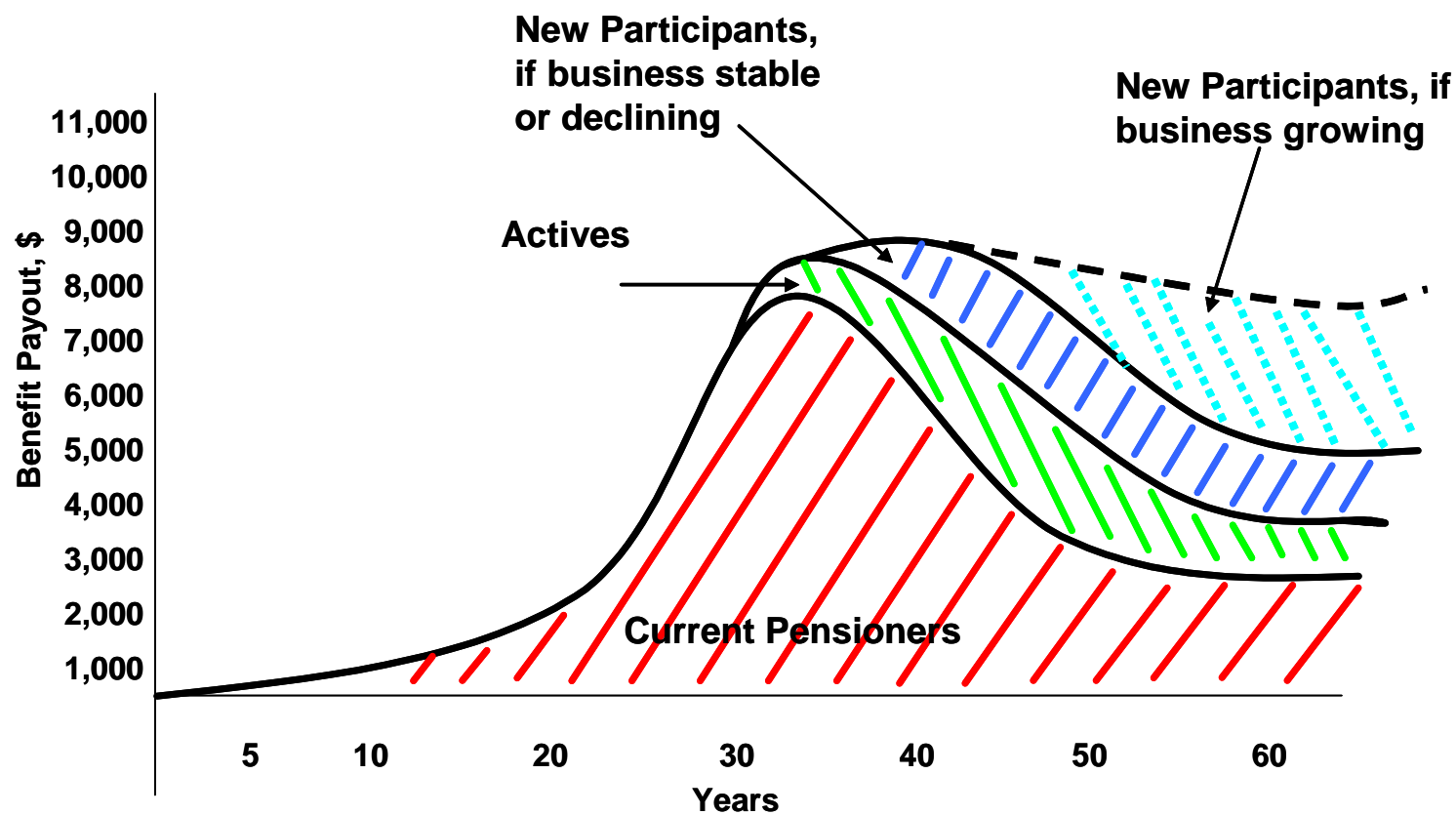
EBRI/ERF Policy Forum #55  
Richard Berner and Trevor Harris  
May 6, 2004

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# Key Points

- Is there a role for DB plans?
- Is there still a problem?
  - Demographics
  - Deficits / returns / contributions
  - Promises vs Reality
  - Transparency
- What needs to be done?
  - Enhanced transparency
  - Improved incentives to fund regularly
  - Relate “costs” to risks
- Implications of changes for markets

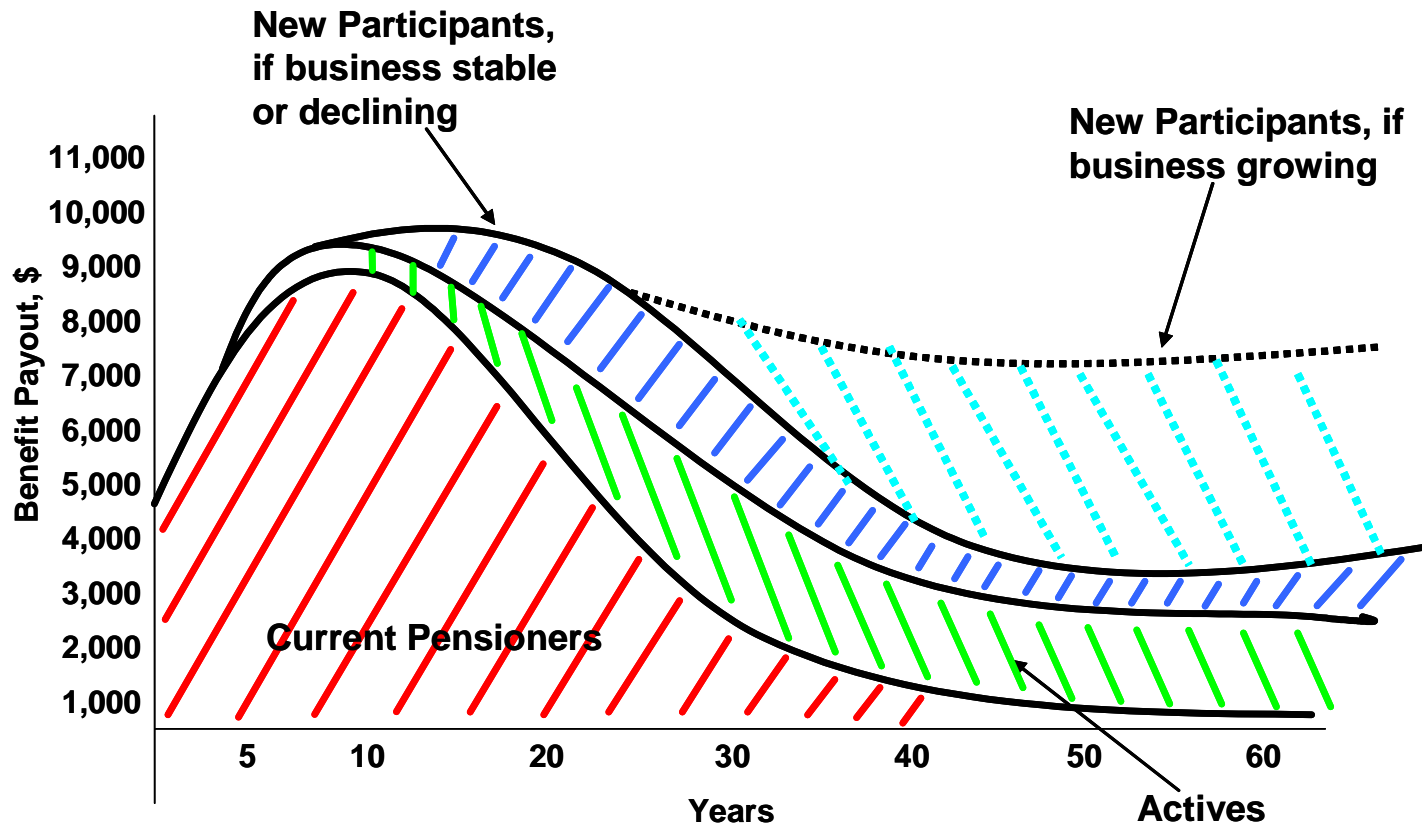
# Pension Fund for a Young Company



Source: Morgan Stanley Research, See "Pension Missiles: Is the Cure Worse than the Disease?" March 25, 2004

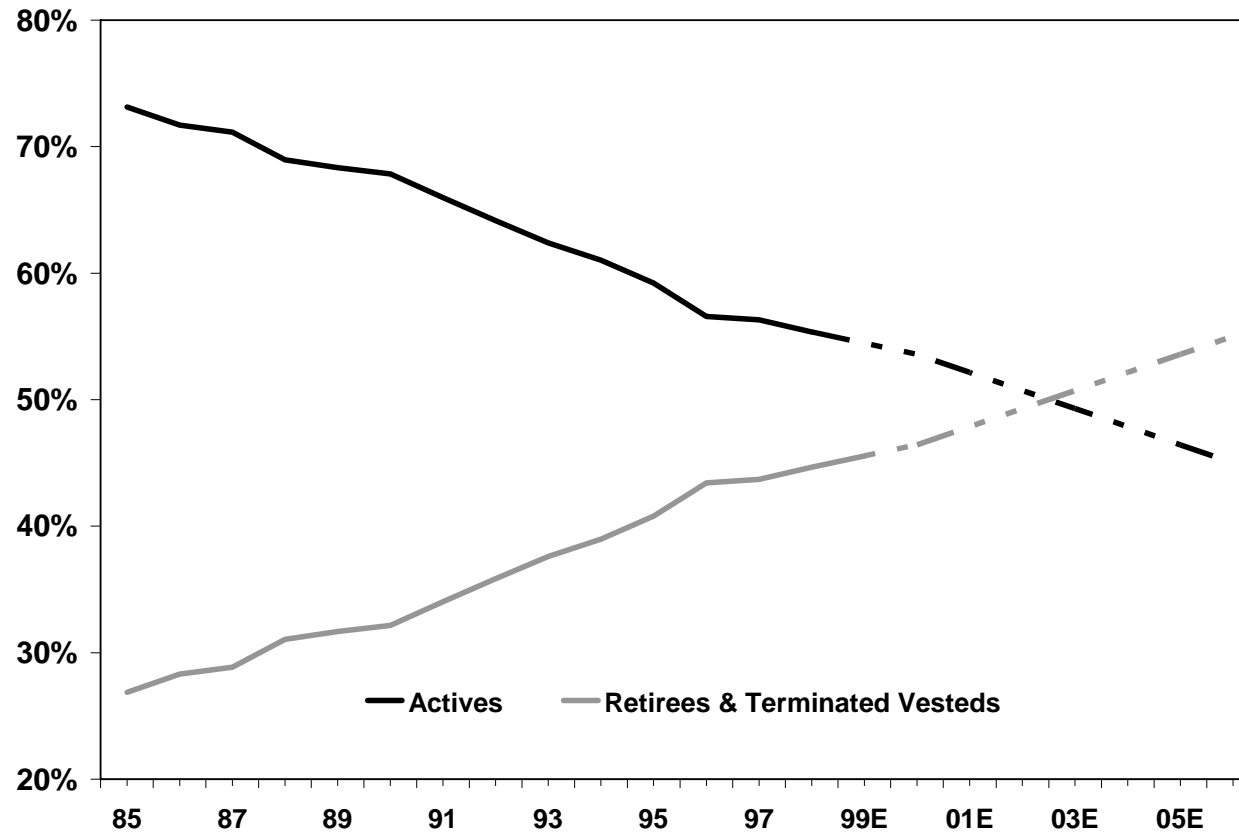
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# Pension Fund for a Mature Company



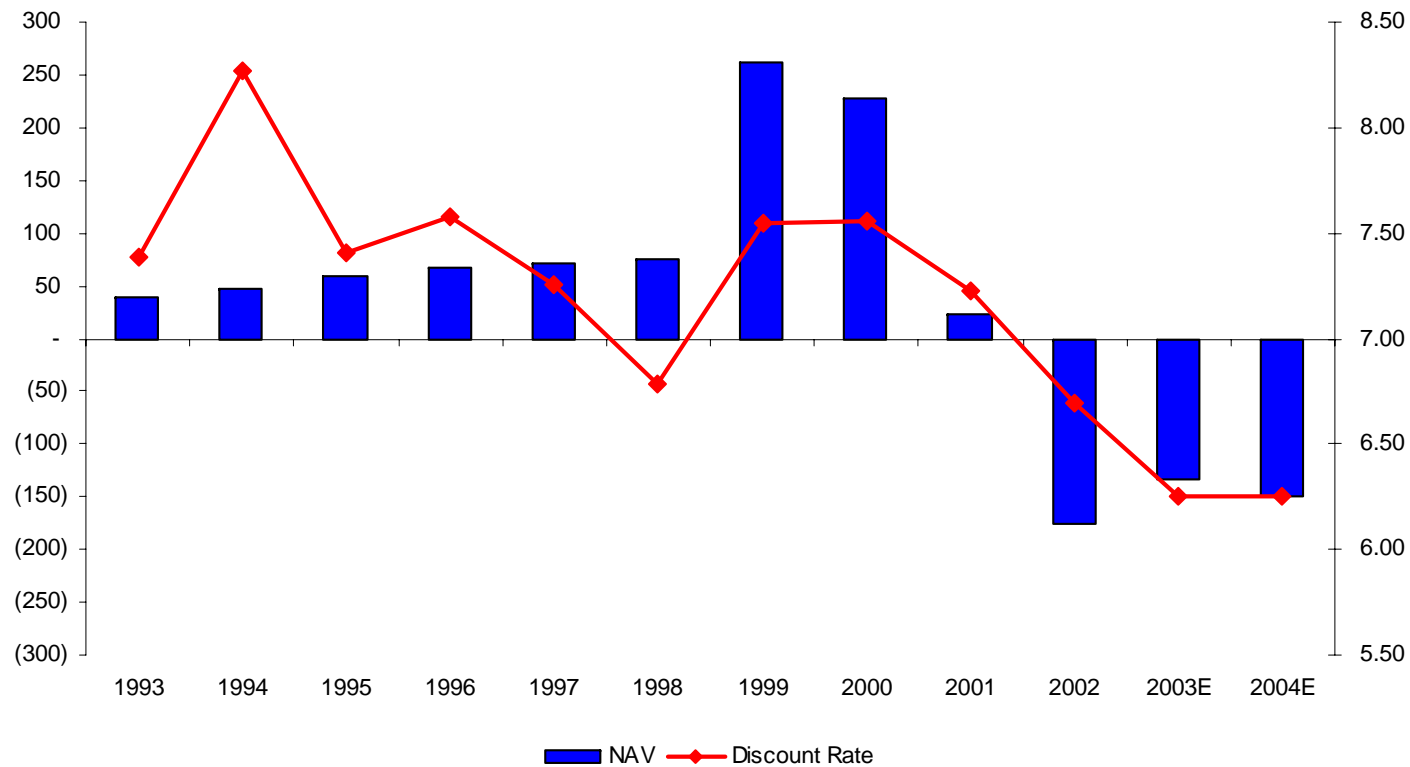
Source: Morgan Stanley Research, See "Pension Missiles: Is the Cute Worse than the Disease?" March 25, 2004

# Retirees Now Outnumber Active Participants The Trend Is Unfavorable



Source: US Department of Labor, including estimates, See "Pension Missiles: Is the Cure Worse than the Disease?" March 25, 2004

# DB Pension Plan Net Asset Value and Discount Rates: S&P 500 1993–2004E

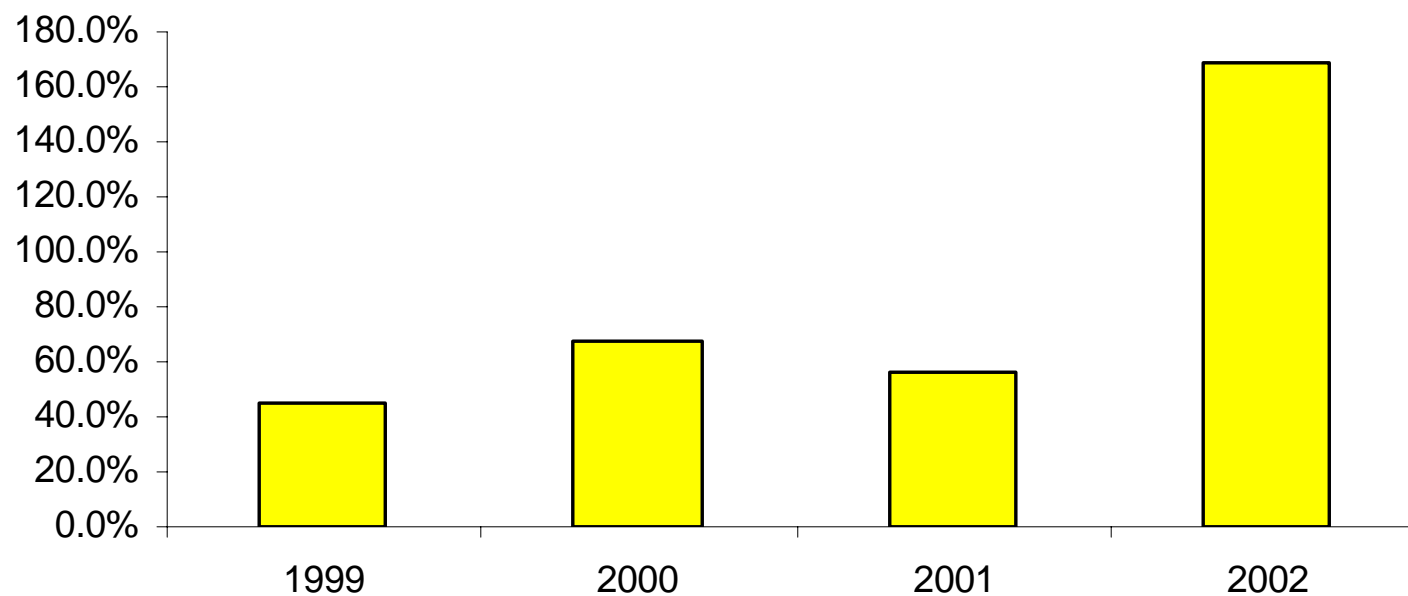


Sources: Company reports, Morgan Stanley Research

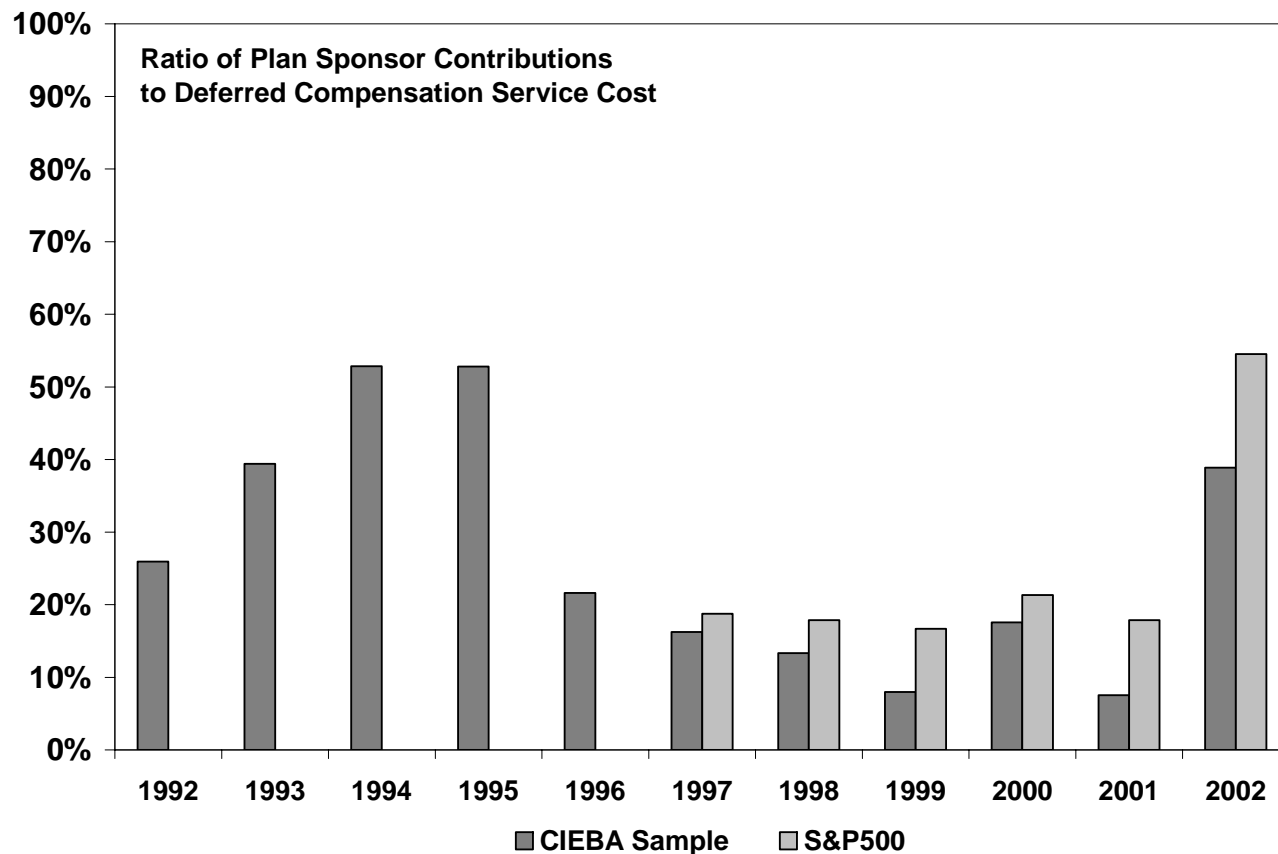
Note: 2004E assumes an 8% actual return on plan assets and no funding.

See "Pension Missiles: Is the Cute Worse than the Disease?" March 25, 2004

## Contributions as % of Total Service Costs: S&P 500



# Ratio of Pension Contribution to Benefits Paid for S&P 500 and CIEBA Sample

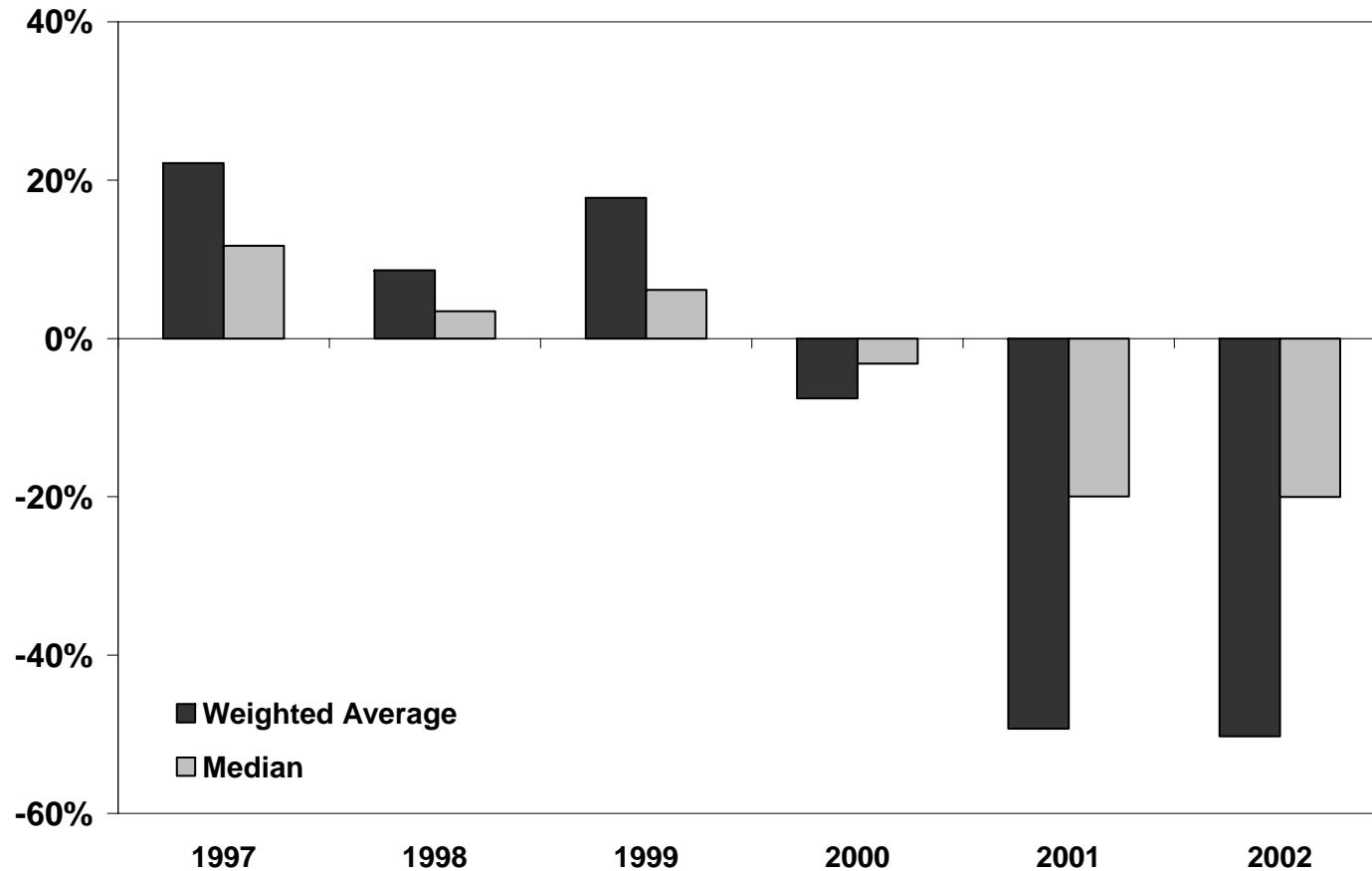


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Source: CIEBA Pension Survey, Morgan Stanley Research, Company Reports, See "Pension Missiles: Is the Cute Worse than the Disease?" March 25, 2004



# S&P 500: Estimated Impact on Net Income of Mark-to-Market Returns on Pension Plan Assets, 1997–2002



Source: Morgan Stanley Research Estimates, Company reports, See "Pension Missiles: Is the Cute Worse than the Disease?" March 25, 2004

# Missiles' Impact: Plan Sponsor Changes to Equity Allocation

	Percentage point change in equity allocation
1 FASB elimination of smoothing	-9.0%
2 Treasury requires the use of an unsmoothed corporate yield curve	-8.1%
3 PBGC alters premium system so that premiums are based on equity allocation	-7.0%
4 Discount-rate process altered to allow use of a single long-term growth rate	-0.8%
5 Rating agencies treat the PBO as "debt"	-7.0%
6 Broad adoption of S&P's definition of core earnings	-5.5%
7 FASB requirement to disclose expected returns	-0.3%
Collective impact	-12.7%

*Note: Includes US and international equity.*

*Source: CIEBA Pension Survey, Morgan Stanley Research*

*See "Pension Missiles: Is the Cute Worse than the Disease?" March 25, 2004*

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Equal-weight	785	44%	280	44%	36%
Underweight	375	21%	101	16%	27%
Total	1,779		643		

Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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