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While Executives See Their Pensions Grow, Regular Workers See Their Benefits Shrink


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Sonny Arnold and Richard Korpan joined Florida Progress Corp. in 1989. Now, 12 years later, both men have lost their jobs since Carolina Power & Light Co.'s acquisition of the utility last year. For one of the men, it's a case of hard luck. For the other, it's a case of hard cash -- lots of it.

Mr. Arnold, a 62-year-old welder-mechanic, hasn't worked the requisite 15 years to begin drawing his pension of \$681 a month. He must wait three more years for that. The Tampa house he and his wife live in is paid for. The children are grown and on their own. And Mr. Arnold is receiving \$22,968 in severance pay. But he still needs the paycheck.

 ¹Deferred-Compensation Plans Are Similar to a 401(k), but With Much Better Benefits

 ²Regular Employees Face Greater Risks Than Executives During Retirement

 ³Companies Reduce Contributions to Employee 401(k) Savings Plans

"I'm going to try to find some work," Mr. Arnold says. That won't be easy, though, because he has asbestosis and lost much of the use of his left hand in an accident on the job. He isn't eligible for retiree medical coverage, and won't be eligible for Medicare until he turns 65. "I don't know what I'm going to do."

Mr. Korpan, 59, needn't look for work. As the former chief executive of the St. Petersburg company, he enjoys the benefits of a pension agreement custom-tailored just for him. Among other things, it credits him with 35 years of service, which will bring his yearly pension to \$828,845, or \$69,070 a month, according to company filings. He also got \$15.8 million in severance.

A spokesman for the newly merged **Progress Energy Corp.** says the company provided "extremely generous" severance packages to displaced employees, while Mr. Korpan's compensation "was determined by the Florida Progress board and was part of the deal itself."

Beyond the View of Most

It's also part of a little-known sideshow to the spectacle of surging executive compensation in recent years. Word of CEOs rewarded with millions of dollars for enhancing profits through layoffs has often provoked public indignation. But the ever-widening gap in retirement income between regular workers and executives has gone largely unnoticed by regulators, policy makers and investors. That's true even though in the past decade, many big companies have been setting up or improving special retirement packages for their highest-paid employees while freezing or trimming pension, medical and other retirement benefits for millions of lower- and middle-income workers.

These maneuvers are perfectly legal. Agreements like Mr. Korpan's that give executives years of service that they

didn't actually work, among other generous calculations, have become typical at large companies. The result is that while regular pensions are generally structured to replace 20% to 30% of a worker's final pay, many plans for top executives aim to replace 50% to as much as 100% of pay. When Mr. Arnold finally does begin receiving his pension, for instance, he will get about 18% of his final pay. Mr. Korpan's pension replaces about 50% of his.

"Not only is compensation wealth lavished on top executives while they're working," says Judith Fischer, managing director at Executive Compensation Advisory Services in Alexandria, Va. "After they retire, the supplemental pensions provide a continuation of what I call eternal wealth."

No Money Set Aside

These rich retirement packages have remained largely hidden because disclosure requirements are weak and accounting rules let companies bury the costs within the figures for their regular pensions. And because companies usually don't set aside money for special executive pensions (as they do for rank-and-file pension plans), these programs constitute unfunded liabilities of which many companies' shareholders are unaware.

Regulators don't track the phenomenon, and companies usually provide few clues. Even most compensation experts are unaware of the magnitude of the liabilities. However, a Wall Street Journal analysis of government filings, some obtained under the Freedom of Information Act, shows that special executive pensions account for a growing share of many companies' pension liabilities.

A Growing Share

A Wall Street Journal analysis of companies' filings shows that at many the liabilities for the supplemental executive pensions make up a growing portion of total pension liability. Typically, the regular pension plans cover tens of thousands of employees and retirees, while the executive pensions cover fewer than 100.

	Pension liability in 2000 (in millions)		Executive pension as % of total liability	
	Total	Executive	1999	2000
May Dept. Stores	\$739	\$147	19.2%	19.9%
Hormel	500	55	10.2	11.0
Motorola	3,444	298	8.2	8.7
Walt Disney	1,825	126	6.2	6.9
Black & Decker	763	54	6.7	7.1
Ceridian	566	25	4.0	4.4
General Electric	28,535	1,132	3.8	4.0
Eastman Kodak	5,717	187	3.2	3.3
International Paper	6,319	212	2.5	3.4
3M	5,905	187	3.1	3.2
BellSouth	12,264	292	2.2	2.4

Source: Wall Street Journal, based on company filings

At **May Department Stores Co.**, where disclosures are more extensive than at most companies, the liability for pensions covering 82,000 employees and retirees stood at \$592 million at the end of 2000. But the St. Louis-based operator of chains such as Filene's and Lord & Taylor also had a \$147 million liability for special plans that cover fewer than 1,000 executives. In other words, almost 20% of the company's pension liability was for executives, up from 19.2% in 1999.

Marguerite Asbury retired five years ago after 24 years in May Department Stores' audit department, earning a pension of \$536 a month. That was enough to replace about 16.5% of her final pay -- hardly generous, even among retailers, which tend to offer small pensions. Executives of the company, meanwhile, have a supplemental pension plan, crafted so that in retirement, they will receive 50% of their final pay from all retirement plans combined.

Mrs. Asbury is relatively lucky. Like many companies, May has taken steps to limit growth in pension costs for regular workers. A change the company made in 1995, just as Mrs. Asbury was retiring, has so far slowed the rate at which employees build up pensions. Under the current arrangement, future pensions will replace only 12% to 15% of the salaries of employees like Mrs. Asbury. May used to increase the pension formula periodically, but hasn't done so since 1995.

A spokeswoman confirms that it hasn't, but says in a statement that "the company updates benefits when appropriate, taking into account many factors, including Social Security benefits and inflation. There has not been an update in recent years primarily due to low inflation." She adds that Mrs. Asbury's retirement benefits are

more generous than what executives receive because, adding Social Security and her retirement savings plan, the total amount replaces 57% of her final pay.

Mrs. Asbury doesn't think that's a fair assessment. "Most of the money in the savings plan I saved out of my own pay," she says. "They need to have a halfway decent pension for the small guy," says the 72-year-old Irvine, Calif., retiree.

A Decade of Change

For years, executives typically relied on the same pension plan as everyone else, so they had an incentive to make it generous. But in the past decade, many executives have been receiving the bulk of their pensions from supplemental executive retirement plans, or SERPs, often called "top hat" plans. The incentive to provide better benefits for regular employees has dwindled. In fact, it is often reversed: Executives' pay increasingly is linked to corporate earnings, which benefit from cuts in the cost of pensions for regular workers and retirees.

Many companies have made such cuts since the mid-1990s. Some have frozen pension benefits or ended cost-of-living rises. Others have converted their regular pension plans to complex new structures with names like pension-equity plans and cash-balance plans. These steps save money by eliminating the sharp buildup of benefits in an employee's last few years. And the plans at many large companies are now overfunded and have no pension expense. In fact, many pension plans shower millions of dollars on the bottom line (thanks to a rule that lets a company count as income the amount by which investment returns on pension assets exceed a pension plan's current costs).

Hershey Foods Corp. switched most workers to a cash-balance plan in the late 1980s, thereby ending the costly system of linking benefits to pay in the final years. But when Hershey's chief executive, Kenneth Wolfe, retires by early next year, his pension will be calculated by the traditional formula that multiplies years of service by final annual average compensation -- \$1.3 million in his case. Hershey and Mr. Wolfe decline to comment. The latest Hershey proxy statement notes: "The purpose of the supplemental pension is to provide to executives and upper level management employees the means to continue their attained standard of living in retirement."

Motorola Inc. last year changed its pension plan for 120,000 workers from a traditional structure to a pension-equity plan, cutting Motorola's liability for them by \$110 million. Meanwhile, Motorola's liability for executives' pensions grew to 8.7% of its total pension liability from 8.2% a year earlier. The executive pension plan covers just 71 people. A Motorola spokesman confirms the figures but declines to comment further.

Executive pensions often provide annual cost-of-living increases, a feature many companies are removing from regular workers' pension plans. When **Huntington Bancshares** Inc. Chairman Frank Wobst retires, his estimated annual pension of \$995,000 may be adjusted annually to reflect the U.S. Bureau of Labor Statistics Consumer Price Index for Urban Wage Earners and Clerical Workers. Other employees of the company, including the clerical workers, haven't had a cost-of-living adjustment since the early 1990s. A spokeswoman says that the benefits are in line with peer companies and that the Columbus, Ohio, company could provide an adjustment in the future.

Ironically, the expansion of executive retirement plans and the difficulty of spotting the related liabilities are largely the unintended outcomes of efforts to improve corporate disclosure, rein in growth of executive pay, and ensure that retirement plans don't favor the highly paid.

In the late 1980s, Financial Accounting Standards Board, the accounting industry's rule-making body,

implemented Financial Accounting Standard 87 with the goal of forcing companies to reveal their exposure to pension liabilities of any kind -- those for union and salaried workers, as well as for supplemental plans for executives. FAS 87 doesn't require companies to break out the liabilities of different pension plans. At the time, separate executive plans were less common, and many regular plans were underfunded.

Meanwhile, changes to tax law spurred the growth of special executive pensions. Congress in the 1980s set limits on how much annual pay could be taken into account when calculating benefits in regular pension plans. It's currently \$170,000. The aim was to ensure that pensions, in order to enjoy tax-favored status, were open to employees at all income levels. The result: Many companies began setting up "excess" or "make-up" plans that let executives accumulate more than they would under regular retirement plans.

Then, in 1994, another tax-law change barred employers from deducting anyone's salary and bonus in excess of \$1 million. That further fueled growth in supplemental pensions. It also prompted companies to embrace incentive pay tied to company performance, which preserves the deductibility of the compensation, and plans that, like a giant 401(k), let executives defer huge chunks of their compensation.

These changes meant that by the mid-1990s, big companies had incentives to funnel large amounts of executive compensation toward retirement plans. And they had the means to keep those moves largely hidden, since they didn't have to make a separate disclosure of the new executive plans. To this day, they are required only to file a letter to the Labor Department indicating the number of executive pension plans and the number of participants. Many companies don't even bother to do that.

The increasing use of incentive pay gave top managers impetus to trim the costs of regular pension plans to enhance profits. And that's not all: For pensions that are based on compensation during the last years on the job, anything that boosts an executive's final compensation -- including reductions in benefits for the rank and file -- locks in fatter retirement benefits.

Securities and Exchange Commission filings show that many companies adopted special executive pensions at close to the time that they were curbing pensions for others.

Drug wholesaler **McKesson HBOC** Inc. set up a supplemental pension plan for executives in 1995 and froze pensions for the rank and file the next year. Despite the freeze, the company had an \$8 million pension expense in 2000. It was solely for boosting the pensions of departing executives.

A Bottom-Line Boost

McKesson's frozen plan for regular employees went from underfunded to overfunded. Now, besides no longer requiring company contributions, the plan contributes income to McKesson's bottom line -- income that at many companies helps boost executives' incentive pay. A company spokesman confirms the numbers but points out that when the company froze the pension, it enhanced the 401(k) plan.

Drugstore chain **Rite Aid** Corp. adopted a supplemental pension for 26 executives in 1996. The following year, it converted one of its plans for regular workers to a cash-balance design, reducing the rate at which people build up benefits. Rite Aid's liability for the regular pension plans -- with more than 18,000 participants -- stood at \$65 million on March 3, the end of its latest fiscal year. Its liability for executive pensions, covering just a few dozen people, was \$32 million.

Such moves slipped below the radar of the usual corporate watchdogs because the accounting rules let

companies lump all their pension liabilities together. That meant that the rising cost of executive pensions could be masked in a company's overall pension obligation, especially as liabilities for regular pensions fell.

A rule adopted in 1998 called FAS 132 was meant to clarify things. It required separate reporting to the SEC of any pension plans that are underfunded or that, like most SERPs, are unfunded. However, FAS 132 doesn't require that those two types be distinguished. SEC reports by **Sears Roebuck & Co.** and **Unisys Corp.** mix the liability for underfunded regular pension plans with the liability for special executive plans.

Campbell Soup Co. doesn't report its liability for special executive pensions at all. A Campbell spokesman says this is because the sum is "not material." FAS 132 doesn't specify what is material. **Dow Jones & Co.**, publisher of The Wall Street Journal and The Wall Street Journal Online, doesn't disclose the liability for its supplemental executive retirement plan.

A **General Electric Co.** report to the SEC labels an entry for \$1.13 billion as "pension liability." This large sum isn't further identified. GE confirms it is an unfunded obligation for pensions for GE executives.

The companies all say they are following accepted accounting practices. A GE spokesman, for instance, says, "GE's pension disclosures are in full compliance with SEC requirements and provide a clear picture of the status of GE's pension plans."

International Business Machines Corp. discloses that it has an executive pension plan and reports the plan's liability separately -- but not the liability for a second, less-elite IBM executive pension plan. A spokeswoman confirms this.

In January 1995, IBM moved the bulk of its work force into a "pension-equity" plan, saving the company hundreds of millions of dollars by reducing benefits, even as it set up its special pension plan for executives. A spokeswoman says IBM found that its plan for the regular work force was "overly generous" compared to other companies' plans. She says IBM also sweetened contributions to its 401(k) plan after deciding that that program was less competitive.

IBM's pension plan for regular employees now has a \$7 billion surplus, and it contributed \$1.17 billion to income last year, equal to 10.1% of IBM's pretax income.

Companies that do disclose the supplemental plans' liabilities often use opaque language that doesn't call them executive pensions. A Hershey SEC filing, for instance, alludes to special executive pensions this way: "As of December 31, 2000, for pension plans with accumulated benefit obligations in excess of plan assets, the related projected benefit obligation and accumulated benefit obligation were \$36.5 million and \$34.9 million, respectively, with no plan assets." Translation: The company's executive pension liability was \$36.5 million last year. Hershey declines to comment.

Tinkering With the Formulas

Not only do executive pensions use the generous traditional formula -- years of service, multiplied by final pay -- but when it's time to figure the pension, they often twiddle with traditional formulas, by, for example, adding extra years of service, as was the case with Mr. Korpan at Florida Progress. Leo Mullin, chief executive of **Delta Air Lines Inc.**, was awarded 22 years of service in 1998, when he had been at the company only 10 months.

Most executive plans come with change-in-control agreements that guarantee benefits. And while regular

pensions generally don't vest for five years, some executive pensions vest immediately.

When Gary Wendt was hired as chief executive of **Conseco** Inc. last year, he was promised a supplemental pension that will pay him \$1.5 million a year for life, and that upon death will pay his spouse the same amount until her death. This pension became immediately vested, so it would be paid to Mr. Wendt at age 65 even if he had left the company after a few months on the job. Mr. Wendt also received \$45 million as a signing bonus, and departing Chief Executive Stephen Hilbert was paid \$72.5 million in severance. Meanwhile, Conseco last year froze one of its pension plans for regular employees.

Many executives have accumulated more retirement benefits than they will ever need. This has led to the latest twist in executive pensions: programs set up by employers that enable executives to trade their retirement benefits for life-insurance trusts that will pass the benefits to heirs free of estate and income tax.

And it's all as well-hidden as the rest: When executives swap their pension benefits, the liability can disappear, so the only reference to the benefit that has been swapped may be a mention of a life-insurance premium being paid on behalf of an executive. GE's proxy noted that it paid \$1.3 million in premiums last year for a new life-insurance policy for Chairman and CEO John F. Welch Jr.

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