

# Commentary

BUFFIN PARTNERS INC.

INVESTMENT AND ACTUARIAL RESEARCH

## Developments at the SEC and PBGC

In the June 2002 edition of *Commentary*, we quoted Philip Angelides, California State Treasurer and Amy Domini, author of *Socially Responsible Investing*. They emphasized the importance of proxy voting as a means of affirming management's activities and providing input on important social issues. *Commentary* noted that in the institutional sphere, only trustees of private pension plans are legally required to vote proxies, maintain records and monitor compliance as part of their fiduciary responsibilities, whereas mutual funds and public pension funds are not required to do so. We stated "Most mutual fund shareholders and pension plan participants, if able to vote directly, would probably not vote for non-diverse, self-perpetuating boards, excessive executive compensation or substandard environmental, labor or human rights practices, although this is often precisely what happens by default when mutual fund managers and pension fund trustees simply vote all shares in accordance with the recommendations of corporate management. Mutual fund shareholders and pension plan participants have a right to know how their fund managers and trustees are voting their proxies. We support the view that proxy voting is an important right and should be exercised in a manner consistent with shareholders' interests. Mutual fund managers and pension fund trustees should be required to disclose their proxy voting records and make the information available with respect to each company stock held in the investment portfolio. This would represent a significant step in the right direction to reflect shareholders' interests, improve corporate governance, enhance corporate responsibility and restore confidence in corporate ethics." Now that the Securities and Exchange Commission (SEC) has issued new rules requiring mutual funds to disclose how they vote investors' shares on corporate

issues, shareholder advocates can claim a moral victory on the issue. It is encouraging to note that the SEC Commissioners voted 4 to 1 in favor of the new rules, supporting the view that disclosure would help prevent future conflicts of interest that were previously hidden from view, as mutual funds voted in favor of company management proposals, including excessive executive compensation and stock option awards that were contrary to shareholders' interests. The dissenting vote came from Commissioner Paul Atkins who said that shareholders are not interested in such details and that compliance costs would exceed the benefit to investors. This is akin to saying that homeowners are not interested in protecting their possessions and that the cost of burglar alarms outweighs their potential benefit.

News of the Pension Benefit Guaranty Corporation's (PBGC) surplus of \$8 billion that "disappeared" was widely reported in the media with little sense of objectivity and factual perspective. Missing from the reports was a detailed discussion identifying the sources of the change in the amount of surplus or an explanation of the relative magnitudes of the PBGC's assets and liabilities. Serious questions concerning the financial viability of the PBGC need to be debated, including the assessment of future premiums and the measurement of unfunded pension liabilities.

Almost thirty years have passed since the pension reforms of the Employee Retirement Income Security Act (ERISA). While ERISA addressed the perceived problems of the 1970's, the legislation is widely regarded as harmful to traditional defined benefit pension plans. The number of defined benefit plans has declined dramatically over the last three decades and employer-sponsors have actively shifted the financial risks of providing adequate retirement income over to individual employees through the adoption of

defined contribution arrangements. Pension funding and pension expense accounting are in disarray as financial accounting standards and tax regulations have distorted the orderly funding of pension obligations. Is it too much of an oversimplification to expect that pension funding and pension expense accounting ought to be orderly, consistent from year-to-year, long-term oriented, and recognize that good economic times and periods of strong stock markets are when corporations are best able to make pension funding contributions and that difficult economic times and periods of weak stock markets are when corporations are far less able to maintain pension-funding levels? It is difficult to imagine a more convoluted system of pension funding and pension expense accounting than the current predicament that has evolved to the detriment of all interested parties.

Perhaps it is now time to step back and take a fresh look at the whole question of financial provision for retirement. We would favor a Commission for National Pension Policy with a mandate to examine every aspect of provision for retirement, including Social Security, employer-sponsored plans and personal savings and investment vehicles. The existing system is burdened with too many conflicts and problems. It is time to re-think and correct these problems. The best and brightest minds from the nation's think-tanks and academic institutions, free from the constraints of political agendas, would, in our opinion, be best suited to the task.

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