EQUITIES

The Stock Price Response to Pension Terminations and the Relation of Terminations With Corporate Takeovers

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This article offers observation on the stock price response to pension terminations and the relation of terminations with corporate takeovers in the U.S. Defined-benefit pension plans account for roughly two-thirds of the private pension coverage of employees in the country.

Participants in defined-benefit plans are promised annuities at retirement that reflect years of service and final wages. Historically, defined benefit-plans were underfunded — that is, the present value of the amount promised to employees was greater than the assets of the plans.

Firms sponsoring defined-benefit pension plans that are overfunded — that is, their assets exceed the benefits promised to employees — are entitled to the excess assets. Under the provisions of the Employee Retirement Income Securities Act of 1974, a sponsoring firm must first terminate the plan before the excess assets revert to the firm.

Analyzing the stock price response to the termination of overfunded pension plans during 1980–1987 finds a positive effect on shareholder wealth around the date the terminations are filed, with firms undergoing reorganization experiencing relatively larger reactions on the file date. No stock price reaction is found on the legal termination date.

However, the reason for positive reaction is a subject of contention in financial research. At issue is whether the positive abnormal returns reflect a transfer of wealth from plan participants to shareholders or instead result from an efficient restructuring of the corporate balance sheet. As a policy issue, pension terminations are considered in some circles to be one of the aspects of corporate takeovers that harms employees.

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