

# Pensions&Investments

## Multiemployer plan sponsors may face peril, Moody's says

By Christine Williamson

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If Moody's Investors Service, New York, has its way, the precariously weak funding levels of many multiemployer pension plans finally will become more critical to the way analysts evaluate the creditworthiness of U.S. corporations.

Moody's estimated that U.S. multiemployer plans were collectively underfunded by at least \$165 billion, putting their funded status around 56% at the end of 2008.

That's a precipitous fall from 2007 when multiemployer plans were already in "weak shape," with an aggregate funding status of 77% resulting from total underfunding of \$87 billion, wrote Wesley Smyth, vice president and senior accounting analyst, in a Sept. 10 report, "Growing Multiemployer Pension Funding Shortfall is an Increasing Credit Concern."

By contrast, Mr. Smyth noted that single-employer pension plans started 2008 with a collective funding status of 101% and ended the year at 75%.

Multiemployer pension plans were defined by the Taft-Hartley Act of 1947. The plans provide pension benefits to workers in a particular industry — such as trucking, construction, food service/grocery, hotels/casinos or printing — and are funded by employer contributions that are determined through collective bargaining with labor unions.

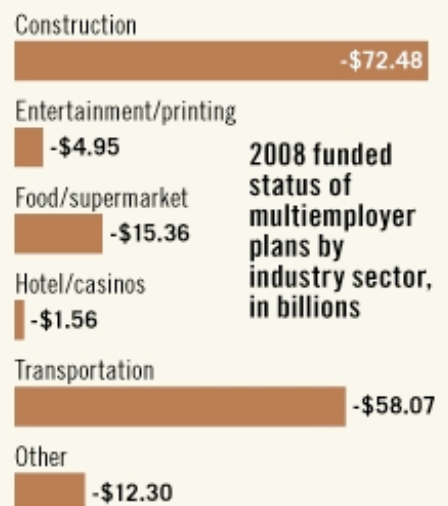
While Moody's has "long treated single-employer pension liabilities as debt because it can materially affect the company," it wasn't until 2006 that Moody's researchers "woke up to the multiemployer issue," said Mark LaMonte, senior vice president and Mr. Smyth's boss.

The wake-up call came when a Moody's credit analyst flagged a financial footnote in The Kroger Co.'s annual Securities and Exchange Commission 10-K filing that year that said the Cincinnati grocery retailer's contribution obligation to multiemployer pension plans was \$1.2 billion.

Mr. LaMonte said "that was eerily similar to defined benefit plan obligations that we use when we calculate leverage and other metrics in determining a company's credit rating."

Corporations are not required to recognize their contribution requirement to multiemployer plans as a pension obligation on their balance sheets; they only have to record the expense annually in the 10-K filing, Mr. LaMonte said.

**In the hole** Multiemployer pension plans had an aggregate funded status of -\$64 billion in 2008.



Source: Moody's

But Moody's analysts recognized a risk unique to multiemployer pension plans that could result in significant risks for corporations whose workers remain in the plan when other corporate contributors drop out.

### **Acute problem**

Mr. Smyth and his colleagues noted in the report that during an economic downturn, "a situation can arise where many contributors or possibly a particularly large but vulnerable employer may exit the plan as the result of bankruptcy. This problem would be particularly acute if it occurs at a time when a plan's status becomes critically underfunded, requiring increased contributions from a shrinking sponsor pool. As a result, an otherwise healthy sponsor could face daunting levels of additional contributions to MEPPs in which it participates. The remaining companies are effectively paying for the retirement benefits of employees that never worked for them - commonly referred to as 'orphans.'"

Because of that "imputed liability," Mr. LaMonte said that in 2006, Moody's analysts started estimating a corporation's obligation to multiemployer pension plans and adding it into the debt metrics used to rate the creditworthiness of the company.

It was also in 2006 when credit analysts at Standard & Poor's Ratings Service, New York, had a similar revelation about the impact of multiemployer plans on corporations, said Jonathan Nus, director of financial reporting analysis.

"We noted that companies are accounting for their MEPP as they do for 401(k) plans and there are all of these off-balance sheet considerations that are not being addressed," Mr. Nus said.

Standard & Poor's also started to include multiemployer plan implied obligations in corporate credit ratings. Mr. Nus said that "after steep declines in assets as a result of poor market returns in 2008, companies fall under a much more stringent amortization schedule under the Pension Protection Act of 2006 and that has put a strain on companies which have to increase their contributions. That caused a liquidity shock for many companies. This is something we are evaluating very seriously this year." Mr. Smyth and his colleagues at Moody's present a bleak future for corporations that contribute to multiemployer plans, given that the sharply lower funded status of the plans carries an implied liability for each company.

"With the underfunded status of so many plans growing to critical levels, combined with considerable stress experienced in the mostly cyclical industries involved ... the condition of the multiemployer plans will likely (a) negatively impact the cash flow generating capability of a contributing company and/or (b) meaningfully increase debt," Mr. Smyth wrote in the report.

He also noted that "the severity of the shortfall suggests that ... these funding levels will no doubt result in remediation plans which will cut benefits and/or increase contributions."

While most companies participating in such plans won't see their ratings downgraded by Moody's based on their implied liabilities, Mr. Smyth said the potential for increased contributions "could have a material impact" on smaller companies or "speculative grade" companies without ready sources of cash.

Moody's researchers based their analysis on data from the 5500 forms filed with the Department of Labor by 126 companies that contribute to multiemployer plans.

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