

## Moody's May Look at Multiemployer Pension Plan Under-Funding when Rating Contributing Employers

Earlier this year, Moody's Investors Service issued a Request for Comment (RFC) entitled, "Multiemployer Pension Plans: Moody's Analytical Approach," which describes a proposal to take into account the impact of under-funding in multiemployer plans when Moody's rates the creditworthiness of contributing publicly traded companies. This *Bulletin* summarizes the proposal and the key concerns that The Segal Company has expressed to Moody's about it. (It is important to note that Moody's proposal would *not* affect the many small, closely held companies that contribute to multiemployer pension plans.)

### MOODY'S PROPOSED APPROACH

Moody's has tried to devise a way to take account of future increases in multiemployer-plan contributions in its analysis of a company's financial statements. In effect, they propose to treat the obligation to make *future* contributions to an under-funded multiemployer plan as if it were already a debt of the employer. They would calculate the amount a company might have to pay in the future based on publicly available information about plan funding and the employer's historical contribution levels.

### KEY CONCERNS

The key concerns with Moody's proposal are:

- ***Questionable Relevance of Multiemployer Pension Plan Under-Funding for Ratings of Companies' Creditworthiness*** The core question that Segal and others have raised with Moody's is whether an on-going employer's future multiemployer pension obligations are

enough like a debt of the employer to justify considering them in weighing the company's creditworthiness.

The simple fact is that no employer ever owes more to a multiemployer plan than what its collective bargaining agreement requires—unless and until the employer withdraws, or in the rare event of an ERISA funding deficiency. This is because the responsibility for funding a typical multiemployer plan is shared among all of the contributing employers, with none of them bearing a direct, dollar-for-dollar obligation for the benefit costs of any specific employee group or assigned share of the plan's liabilities. Rather, each employer's contribution obligation typically fluctuates with the levels of work by its covered employees.\*

Of course, when an employer withdraws from a multiemployer pension plan it may have an actual debt, in the form of withdrawal liability. That depends on a variety of circumstances that come into play at the point of withdrawal, including the funded status of the plan at the end of the previous plan year, the operation of the plan's allocation formula, the applicability of the *de minimis* and other limitations on the liability, including the narrow definition of "withdrawal" for construction and entertainment-industry plans. This debt is payable in installments, in amounts roughly comparable to the employer's recent periodic plan contributions, so ordinarily it would not dramatically disrupt the company's cash flow. As to company financial disclosure, if a withdrawal is deemed probable or reasonably possible in the near term, generally accepted accounting principles already require sufficient disclosure with

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\* This is in sharp contrast to single-employer plans, which reflect a direct promise made by a given employer to its employees. It is these plans that have been at the heart of several high-profile bankruptcy petitions filed in recent years just prior to deadline for making a pension contribution.

respect to withdrawal liability. Before that point, it is not relevant for a company's credit rating.

- ***Need to View Contributions to Multiemployer Plans in Context as Part of the Negotiated Compensation Package*** Moody's identifies a "trend" of recent increases in contributions to multiemployer pension plans that exceed the increases in certain benchmarks (*i.e.*, sales, cost of sales and number of employees). However, the most relevant item — total labor costs — is not cited in that comparative list. Because contributions to multiemployer pension plans are just one element in the bargained-for compensation package, they should be viewed the same as the other elements of pay in weighing an employer's financial condition. That is, if the pension contributions increase disproportionately for any reason, some other part of compensation will almost certainly be adjusted in the bargaining process to offset this, and the company's ability to service its debt will be unaffected.
- ***Moody's Reliance on Questionable Assumptions about Plans' Responses to Under-Funding*** The proposed calculations presume that the response to under-funding will be contribution rate increases. In fact, trustees of many plans have decided to reduce future benefit accruals in an attempt to rebalance benefit obligations and resources available to pay for them. In some cases, the collectively bargained, industry-wide character of multiemployer plans allows for a unique solution to funding challenges: mergers between multiemployer plans, which further broaden and diversify the contribution base.
- ***Inadequacy of the Proposed Methodology*** In addition to these basic conceptual questions, there are serious problems with the specifics of the proposed approach. For example, it arbitrarily assumes that the employer will absorb 75 percent of all contribution increases, which will result in lower profits and less cash available to meet other obligations. By contrast, employees would say that they "pay" 100 percent of the contribution because a higher contribution rate will be offset by less of something else, such as wages. As another example, Moody's proposal would group plans by industry and come up with an average funding ratio for all within a specific classification (*e.g.*, construction and transportation), in order to gauge likely future contribution demands. But these averages

would be highly misleading, not to mention irrelevant, for any specific company.

## THE SEGAL COMPANY'S COMMENTS

In comments to Moody's, Segal has shared its opinion that the concept of rating a company's creditworthiness based on formulaic adjustments to financial statements on account of its participation in a multiemployer pension plan is ill advised. Segal's comments to Moody's are available on the following Web page: <http://www.segalco.com/taft/moodys.pdf>

## WHAT'S NEXT?

Underlying the shortcomings in the proposed calculation methodology is the fact that it is designed to use only publicly available data about plans and employers. Segal understands that Moody's may be planning to use the proposed generalizations and averages only as a default, if it cannot obtain more up-to-date and pertinent information from the companies it rates. If Moody's goes forward with this initiative, boards of trustees may decide to make more relevant information readily available to contributing employers that request it in connection with their Moody's ratings.



*Segal will inform clients of significant developments concerning proposed changes in credit-rating methodology for public companies that contribute to multiemployer plans.*



ATLANTA	678.306.3100
BOSTON	617.424.7300
CALGARY	403.692.2264
CHICAGO	312.984.8500
CLEVELAND	216.687.4400
DENVER	303.714.9900
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SAN FRANCISCO	415.263.8200
TORONTO	416.969.3960
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