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Consultants and Actuaries

Multiemployer Review

Update on Issues Affecting Taft-Hartley Plans

FEBRUARY 2006

• Annual Notice of Funding Status

Moody's Proposes to Consider Multiemployer Participation to Set Companies' Credit Ratings

Moody's, a leading credit-rating service, has proposed*

determining companies' credit ratings by considering their participation in a multiemployer pension plan. Underlying Moody's proposal is its belief that the credit ratings of companies that make significant contributions to underfunded multiemployer plans could be adversely affected if their portion of the underfunding is material in relation to their total debt. Moody's views an employer's share of the underfunding as a "long-term debt-like liability" and thus intends to ask companies for more information about their level of participation in multiemployer plans. Moody's estimates that the amount of a company's "debt" ranges between 3.4 and 6.9 times its annual contribution to the plan.

Moody's analysis was based on the 2003 Forms 5500 for 132 multiemployer pension plans. It estimated the average of the underfunding by examining the average of two different liability numbers reported on the plans' Form 5500. On this basis, Moody's determined that the average funding ratio was 77%, with a total underfunding for the 132 plans of \$68 billion. Although the study found only 63 companies whose credit Moody's rates, the proposed process of measuring multiemployer underfunding could cause lenders to look at the multiemployer obligations of other employers.

Mechanics of the Process

Moody's will view a company's portion of multiemployer underfunding as an additional "debt" and will impute future interest expense to this "debt." The actual methodology proposed does not examine each plan individually but estimates the average "underfunding multiple" for multiemployer plans in one of six industry groups: construction; entertainment/printing; food/supermarket; hotels/casinos; transportation; and other. The underfunding multiple for a plan is the total unfunded liability divided by the total contributions made

to the plan. The weighted average multiple (e.g., 5.5 for the construction industry) is then multiplied by a company's annual contributions to arrive at that company's estimated "debt." Moody's may increase or decrease the multiple, depending on various factors, such as the company's geographic location.

There are several questionable aspects about Moody's proposed methodology:

- First, use of industry group averages could be highly misleading, given that the funded ratio within an industry varies greatly from plan to plan.
- Second, Moody's fails to recognize that an employer's contributions to a plan are based on covered hours, and thus, the employer's share of any underfunding will vary depending on its level of participation in the plan. In the construction industry, not only can the hours vary greatly, but also an employer ceasing to work in the area would incur no withdrawal liability and essentially be free of any continuing obligation to the plan.
- Third, Moody's recognizes that the employer contributions are part of the wage package in negotiations, but proposes to treat contributions as giving rise to a long-term debt, whereas it does not treat wages the same way.
- Fourth, the information on which the estimated "debt" is based is several years old by the time the estimate is made. As Moody's recognizes, the underfunding could be significantly reduced or eliminated entirely in the interim period. The funding of multiemployer plans deteriorated very quickly during the market downturn of the early 2000s and it could improve quickly as well.

* *Request for Comment, Multiemployer Pension Plans: Moody's Analytical Approach*, January 2006 (© 2005, Moody's Investors Service, Inc.). The document is available through www.moody.com after registering.

Moody's estimates that employers will finance 75% of the underfunding, with the remaining 25% absorbed by reductions in accruals or other benefit adjustments. This allocation is flawed for plans with processes that automatically adjust benefits when underfunding develops; the plans shift the entire burden to employees.

For the reasons above and others, Milliman believes the basis for estimating the multiemployer underfunding attributable to a particular company is fundamentally flawed and will lead to unrepresentative measures of an employer's liability. Milliman is submitting formal comments on the proposal to Moody's.

Annual Notice of Funding Status

The Department of Labor's final regulations on the annual notice a multiemployer plan must provide about its funding status include a model notice that will satisfy the notice requirement. The model notice contains language explaining the requirements for insolvent plans and an explanation of benefits guaranteed by the Pension Benefit Guaranty Corporation (PBGC).

The important points regarding the notice are:

- The plan administrator must furnish the notice within nine months following the last day of the plan year to which the notice relates (unless the plan is granted an extension for filing its Form 5500).
- The notice must be given to: all participants; beneficiaries receiving benefits; contributing employers; employers that could be subject to withdrawal liability in the future (including employers in the construction industry that have ceased operations but that would be subject to withdrawal liability were they to recommence operations in the plan's jurisdiction on a noncovered basis); each union representing employees covered by the plan; and the PBGC.
- The acceptable means of distributing the notice are the same as for the plan's annual statement, which include distribution in electronic form, subject to certain conditions.
- The notice must state whether the plan's funding ratio exceeds 100%, and if not, it must specify the ratio. The liabilities are not based on the plan's actuarial assumptions, but rather on the

assumptions published by the IRS for determining a plan's current liability. In recent years these assumptions have resulted in plan liabilities being greater under the notice requirements than those shown for funding purposes. The assets are based on the value of actuarial assets used by the plan, but the notice must disclose the actual market value of plan assets as of the last day of the plan year.

The notice may be found at <http://www.dol.gov/ebsa/regs/fedreg/final/2006000194.htm>.

The plan may include such other explanatory information the Trustees believe is necessary to help recipients understand the information in the notice, but the information must be relevant to the notice's mandatory information. For instance, comparative information on a plan's funded status under alternative measures would appear to be prohibited.

The notice is based on statutorily prescribed interest rates that can vary greatly from year to year. Thus, the plan might appear very well funded one year and underfunded the next, even if there are no investment losses. Accordingly, the Trustees might want to consider including an explanation of the basis for the IRS interest rate used for the required measure of funded status, together with a history of those rates and a history of the funded percentage using those rates. Although the final regulations do not specifically prohibit this, Trustees wishing to insert such explanatory information in the notice should check with fund counsel.

Multiemployer Review: Update on Issues Affecting Taft-Hartley Plans is intended to provide information and analysis of a general nature. Application to specific circumstances should rely on separate professional guidance.

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