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# Low Rates Force Companies to Pour Cash Into Pensions

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By MIKE RAMSEY and VIPAL MONGA

Ford Motor Co. [F +0.23%] expects to spend \$5 billion this year shoring up its pension funds, almost as much as the auto maker spent last year building plants, buying equipment and developing new cars.

The nation's second-largest auto maker is one of a who's who of U.S. companies pouring cash into pension plans now being battered by record low interest rates. Verizon Communications Inc. [VZ -0.25%] contributed \$1.7 billion to its pension plan in the fourth quarter and—highlighting companies' sensitivity to this issue—Boeing Co. [BA -1.12%] now reports "core earnings" to separate out pension expenses.

Some of America's biggest companies are shifting cash that could be used for development or expansion into pension funds as low interest rates designed to spur the economy push up pension liabilities. Mike Ramsey joins Markets Hub. Photo: AP.

"It is one of the top issues that companies are dealing with now," said Michael Moran, pension strategist at investment adviser Goldman Sachs Asset Management.

The drain on corporate cash is a side effect of the U.S. monetary policy aimed at encouraging borrowing to stimulate the economy. Companies are required to calculate the present value of the future pension liabilities by using a so-called discount rate, based on corporate bond yields. As those rates fall, the liabilities rise.



Dow Chemical CEO Andrew Liveris, above last month, called pension discount rates a 'massive' headwind.

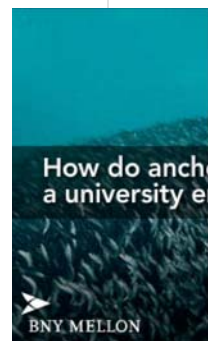
Of course, low interest rates also help companies. Ford, for instance, can borrow money cheaply and use it to offer cut-rate loans or other discounts to help sell its cars. Ford borrowed \$1.2 billion to contribute to its pension.

When interest rates rise again, the pension shortfalls should narrow and could even become surpluses. But when that will happen is difficult to predict. The Federal Reserve has committed to keeping rates low for another two years

at least.

Pension plans became popular in the U.S. in World War II as a means of compensating workers rather than using pay raises.

As the workforce grew, these pension plans grew enormous. They started to fall out of favor because of their large balance sheet liabilities and costs in the 1980s. Companies shifted from defined benefit plans—those that manage the investment



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portfolio and guarantee set payments to retirees—to defined contribution schemes like 401(k) retirement savings plans, where the retirees are responsible for their own investment decisions.

Jeff Chiappetta, 66, a retired plant manager at Chrysler Group LLC, watched a portion of his pension designated for management-level workers disappear in Chrysler's 2009 bankruptcy proceedings. He watches keenly what is happening to pensions.

"Luckily, the majority of [my pension] made it through bankruptcy," he said. "Do I feel lucky to have grown up in an era where I had a pension? Definitely. But can that be sustained? It looks like it can't."

Today, many of the companies contributing to the pensions are struggling with the costs but don't offer defined benefit plans to new workers.

According to the most recent statistics by the U.S. Department of Labor, the number of defined benefit plans fell to 46,543 in 2010 from 103,346 in 1975. Many of the largest companies are still carrying the funds on their books. Consulting firm [Towers Watson](#) [TW -0.18%] tallies 584 of the Fortune 1000 companies had defined benefit plans at the end of 2011, down from 633 in 2004.

[Andrew Liveris](#), chief executive of [Dow Chemical Co.](#), [DOW +0.68%] which posted a loss of \$716 million for the fourth quarter, said the company faces a "massive pension headwind" because of the change in the discount rate that added \$2.2 billion to its pension liability. Pension expense this year is going to rise between \$250 million and \$300 million.

"Other companies have got it, and so we're not alone, but clearly those are big numbers for us," Mr. Liveris said.

Overall, pension plan funding fell by \$79 billion last year at about 400 large companies with defined benefit plans, according to preliminary estimates by Towers Watson. The total estimated deficit at those firms now stands at \$418 billion, 23% more than in 2011, and the highest since the firm began tracking.

Companies, which by law must keep defined benefit pension plans funded within a certain period of time, are taking a variety of paths to address the issue. They are buying out pensioners, unloading pension accounts to third parties and upping their contributions.

Ford's unfunded liability expanded to \$18.7 billion at the end of 2012, despite a series of efforts by the company to get a handle on the problem. "It has got to be a problem for any large company that has a defined benefit plan," said Ford Chief Financial Officer Bob Shanks.

Ford embarked on a pension buyout plan for salaried workers, which knocked out \$1.2 billion in liabilities through year-end, and it will continue trying to buy out workers this year.

Ford also contributed \$3.4 billion into the funds—\$2 billion more than legally required.

In the end, however, falling interest rates in the U.S. and Europe, where Ford has had operations in England for 100 years, erased its gains. Ford's pension plans had strong real-world returns—up more than 14%. But the company had to lower its discount rate to 3.84% from 4.6%, which created a bigger liability on its balance sheet.

Ford, intent on hitting a goal of getting to a fully-funded pension by mid-decade, is committing to spend \$5 billion on its pensions this year. It is using \$1.2 billion in borrowed funds to pay into the accounts, as well as cash on hand.

In the U.S., Ford and its Detroit rivals, [General Motors Co.](#) [GM +0.35%] and Chrysler fought with the United Auto Workers union for years to reduce retiree health-care expenses. All three U.S. companies were able to off-load the expenses to union-run trust funds. But the bulk of union pension plans remained the responsibility of auto makers, even surviving the government-backed bankruptcy proceedings of General Motors and Chrysler. Ford didn't seek bankruptcy-court protection.

GM has off-loaded its entire salaried worker pension fund, which represents about 110,000 retirees, to Prudential Insurance Co. Even so, GM still has a much larger union worker fund that was underwater last year and is expected to be underfunded as of the end of 2012.

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Boeing also is pouring money into its pensions. The Chicago aerospace company plans to spend \$1.5 billion in cash to shore up its fund in 2013 after putting in \$1.6 billion last year. The fund currently stands at 26% below the liability.

The pension's drag on earnings is so great, Boeing started to break out "core earnings" for investors to give a snapshot of the business that excludes its pension expenses.

"The continued decline in the pension discount rates, driven by the unprecedented low interest rate environment, has caused a significant noncash increase in our pension expense," said Greg Smith, Boeing's CFO.

Telecommunications companies [AT&T Inc.](#) (T 0.00%) and Verizon Communications both reported big hits to recently released fourth-quarter results because of the effect of low discount rates on their pension plans.

AT&T posted a loss of \$3.9 billion, but most of the loss came because the company lowered its discount rate, and therefore increased its liability. Last fall, AT&T said it would contribute \$9.5 billion in company stock to its funds in an attempt to shore them up.

Verizon, which took a \$4.4 billion charge for pension valuation changes and other expenses, took a path similar to GM last year. It sent \$7.5 billion in pension funds to Prudential to manage.

While pensions may be an anchor on capital for many companies, for hundreds of thousands of workers, they represent deferred pay and a commitment that kept them working at a particular company when other offers were dangled.

The promise of a pension kept Weldon Gorlich, 80, working for Ford for 30 years as a tool maker at two plants in New Jersey that are no longer open.

He had a chance to move to General Motors, but wanted to get his pension and stayed. "That's very true, that and the medical benefits," said the Florida resident.

"I thank God every morning to wake up with what I have."

—Jon Ostrower contributed to this article.

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