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Pensions keep crimping the bottom line

By Rachel Beck
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NEW YORK | -- Even if the economy manages to bounce back, don't expect corporate profits to soar, not if under funded pensions keep crimping the bottom line.

When Wall Street was going up and up, companies shifted more of their pension funds into stocks and watched their assets grow. But the plunging stock market has sent their holdings tumbling, and now they will have to contribute big money to cover their costs.

That's sure to knock down earnings for at least the immediate future, in some cases taking millions of dollars out of profits.

"Earnings won't be able to come back so fast, if only for the problem with pensions," said Frederic M. Stiner, chairman of the accounting, taxation and law department at Long Island University in Brooklyn, N.Y.

The pension crunch only affects companies with defined benefit plans or those that promise future pension payments to their employees. About 360 of the 500 companies in the Standard & Poor's 500 stock index offer them.

Unaffected are companies' defined contribution plans, such as 401(k)s. In these plans, employees pitch in part of their salary each month, with the company sometimes making a matching contribution at the same time.

During the stock market boom, soaring share prices resulted in a big boost to pension assets, with growth far outpacing expenses. Accounting rules let companies add that extra income to their earnings, spaced out over a 15-year period. They could then put that surplus to other uses.

The pension surplus in 1999 was $252 billion, the highest level in more than a decade, according to a recent study on pensions from UBS Warburg.

But that drastically changed over the last three years, with UBS Warburg estimating a current pension deficit of $126 billion.

Two factors are to blame for the steep and swift tumble.

Stock markets have seen a sell off since early 2000, with the S&P losing nearly half its value and other market indexes also tumbling. During that period, many companies had estimated that the equity investments of their pension plans would rise by about 11 percent to 12 percent, said David Bianco, who heads UBS Warburg's U.S. Valuation and Accounting Group.

On top of that, declining interest rates have resulted in lower discount rates, which are used to estimate how much money is required today to meet the pension obligations over an employee's lifetime. The lower the discount rate, the greater amount of money the company needs to contribute to its pension fund.

"It's a double whammy with the lower discount rates and the volatile stock market," said Clyde Stickney, a professor of management at the Tuck School of Business at Dartmouth College.

When pension plans are under funded by at least 10 percent of their obligations, companies have to fill the void. And the cash contributions have to come from somewhere, whether they're taken out of money that was supposed to be allocated to stepping up operations, buying back stock or paying down debt.

So even when the economic recovery really kicks in, many companies may still very well be pressed for cash, and that will likely mean lower profits.

A recent study by Credit Suisse First Boston estimates that companies in the S&P 500 with defined benefit plans will have assets to cover only 79 percent of their liabilities by the year's end.

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