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New Pension Accounting Rule May Radically Affect Corporations' Balance Sheets; Could Require Amendments to Corporate Loans, says Chapman and Cutler Benefits Attorney Thomas White

FASB 158, effective on December 15, requires public companies to recognize funded status of defined benefit and health plans in their financial statements; New rule will alter method of balance sheet disclosures and may trigger default provisions in loan and bond covenants – “negative shareholder equity”

Chicago, Ill (December 12, 2006) – While corporate America is increasingly facing challenges from underfunded employee pension plans, a pending new rule by the Financial Accounting Standards Board, requiring companies to more visibly disclose the funding terms of their plans, may cause an increase in liabilities reflected in balance sheets, triggering a surprising effect: corporations will have to revise many loan documents to ensure they aren't in default, according to **Thomas White**, an ERISA and benefits attorney at financial services law firm **Chapman and Cutler LLP**.

Mr. White explained that FASB Statement 158, taking effect December 15, obliges public company employers to recognize in their financial statements the funded status of their defined benefit pension plans and post-retirement health plans. Employers without publicly traded securities have until June 15 to recognize this change. Currently, the plan's status is buried in the footnotes of financial statements filed with the SEC and pored over by investors.

Additionally, the new standard requires that companies recognize that future salary increases will have an impact on their projected benefit obligations. This is sharp break from present rules, which allow plans to just list accumulated benefit obligations.

The impact of the new FASB rule will be felt by many employers in the first quarter of 2007, as companies are required to recognize future pension obligations as liabilities. Given the huge underfunding in many pension plans – and the growing number of retirees in the U.S. – that could leave many companies in a state of “negative shareholder equity,” making it harder for large corporations to seek financing.

“There is no question that the new rules will radically alter the financial statements of many public companies,” said Mr. White, who regularly advises companies on benefits planning and ERISA compliance.

“Corporations can no longer bury the true cost of their employees in the footnotes. Now they must give investors a serious look at what their benefit plans will cost in the future. We can expect a serious revision downward of the cash flow and balance sheets of many companies.”

Mr. White noted that the new rules, in combination with requirements in the Pension Protection Act, could theoretically force companies into default on loans and bonds.

“Many loan agreements contain covenants or default events that are triggered by adverse changes in their balance sheet,” he explained. “The new rules, especially when compounded by requirements in the Pension Protection Act, may force companies over the default line on their loans and bonds.”

Although sophisticated investors and institutional lenders have always been on the lookout for signs of financial distress, including pressures created by underfunded pension plans, “The new FASB accounting rule will make pension liabilities all the more glaring in financial statements and could indeed effect the ability of some companies to obtain fresh investment capital or secure commercial loans,” Mr. White said.

He urged companies to immediately begin reviewing all loan documents, as well as amending disclosures to reflect the new requirements. “In fact, the new FASB requirements are just another sign of the larger crisis emerging among American corporations over the problems caused by pension plan underfunding,” Mr. White said. “The next chapter of this story will call for a rewriting of employer-mandated benefits for U.S. workers.”

For public companies the new rules are effective for fiscal years ending after December 15, 2006 and employers without publicly traded securities are required to recognize these liabilities for periods ending after June 15, 2007. Businesses that maintain only profit sharing or 401(k) plans are unaffected by the new rules.

Please contact us if you would like to speak with Mr. White about pension issues.

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