



Credit Risks of Underfunding Pensions

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Reporting of Pension Benefits

- > Improves reporting of financial liabilities;
- > Promotes better financial planning; but
- > Differences in funding efforts can distort a government's true financial position – a significant implication to credit ratings.



Pension Challenge: Managing the Balance Sheet

- > Advance funding requires actuarial estimates of future costs:
 - Number of Retirees;
 - Benefit Levels;
 - Length of Payouts.

- > Prudent Investment Management:
 - Balanced Asset Allocation;
 - Appropriate Risk-Taking; and
 - Reputable Investment Managers.

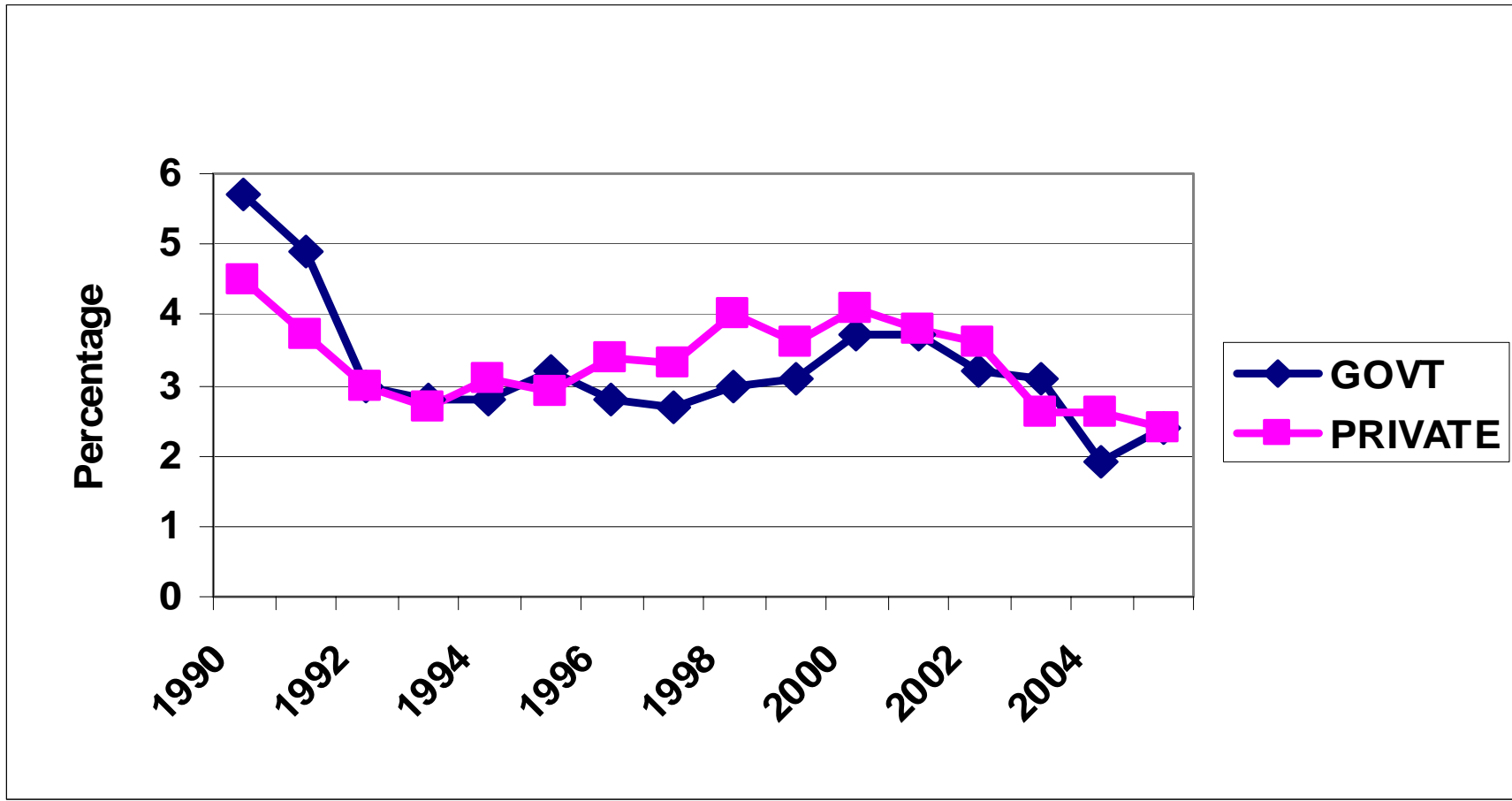


Other Considerations

- > Changing Benefit Levels: of growing importance in labor bargaining;
- > Continued Shift from Defined Benefits to Defined Contributions;
- > Less-generous Benefits for new employees;
- > Periodic Actuarial Studies may suggest contribution rates which lag high-growth benefit costs.

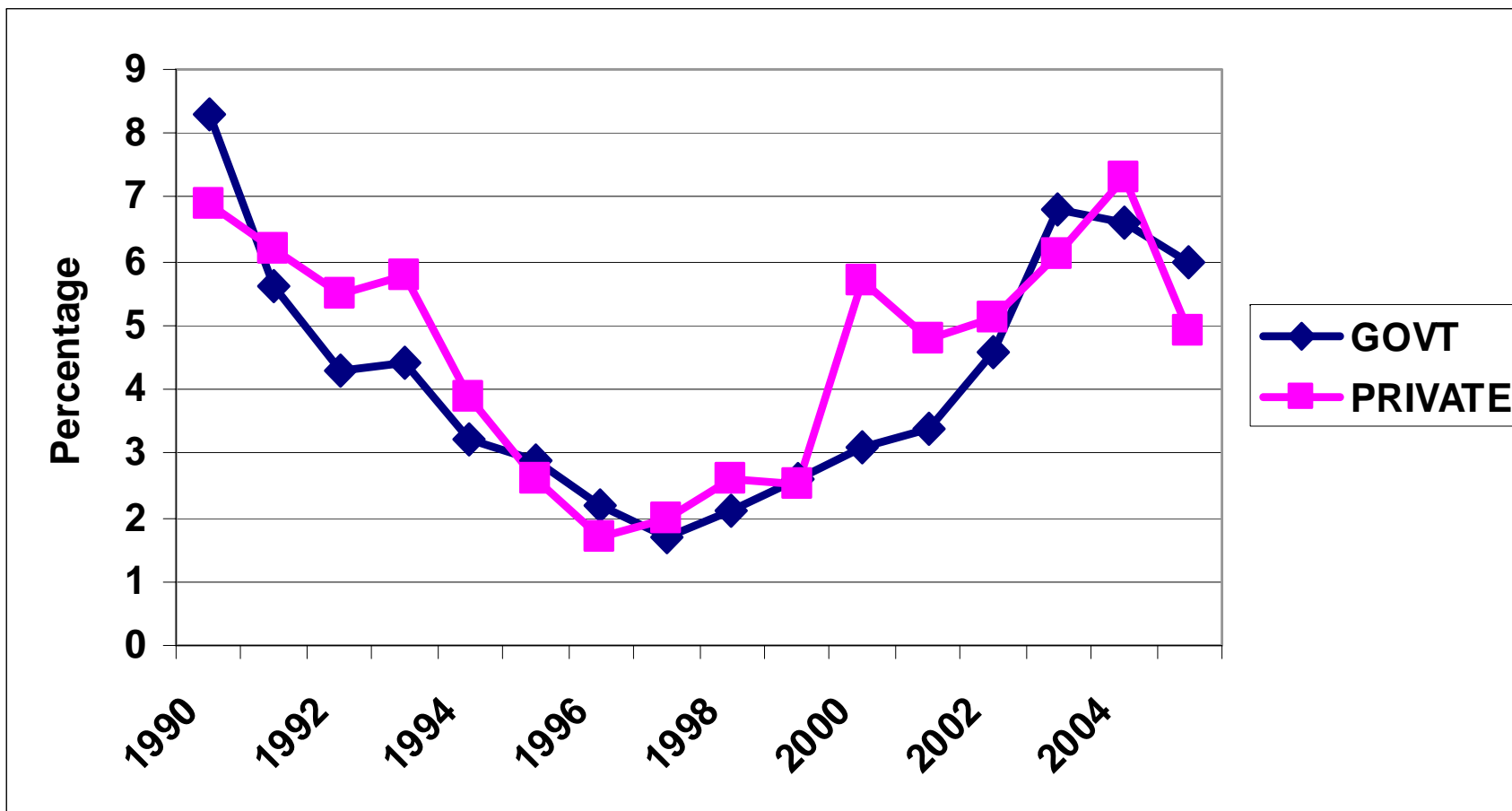


Wage and Salary Growth

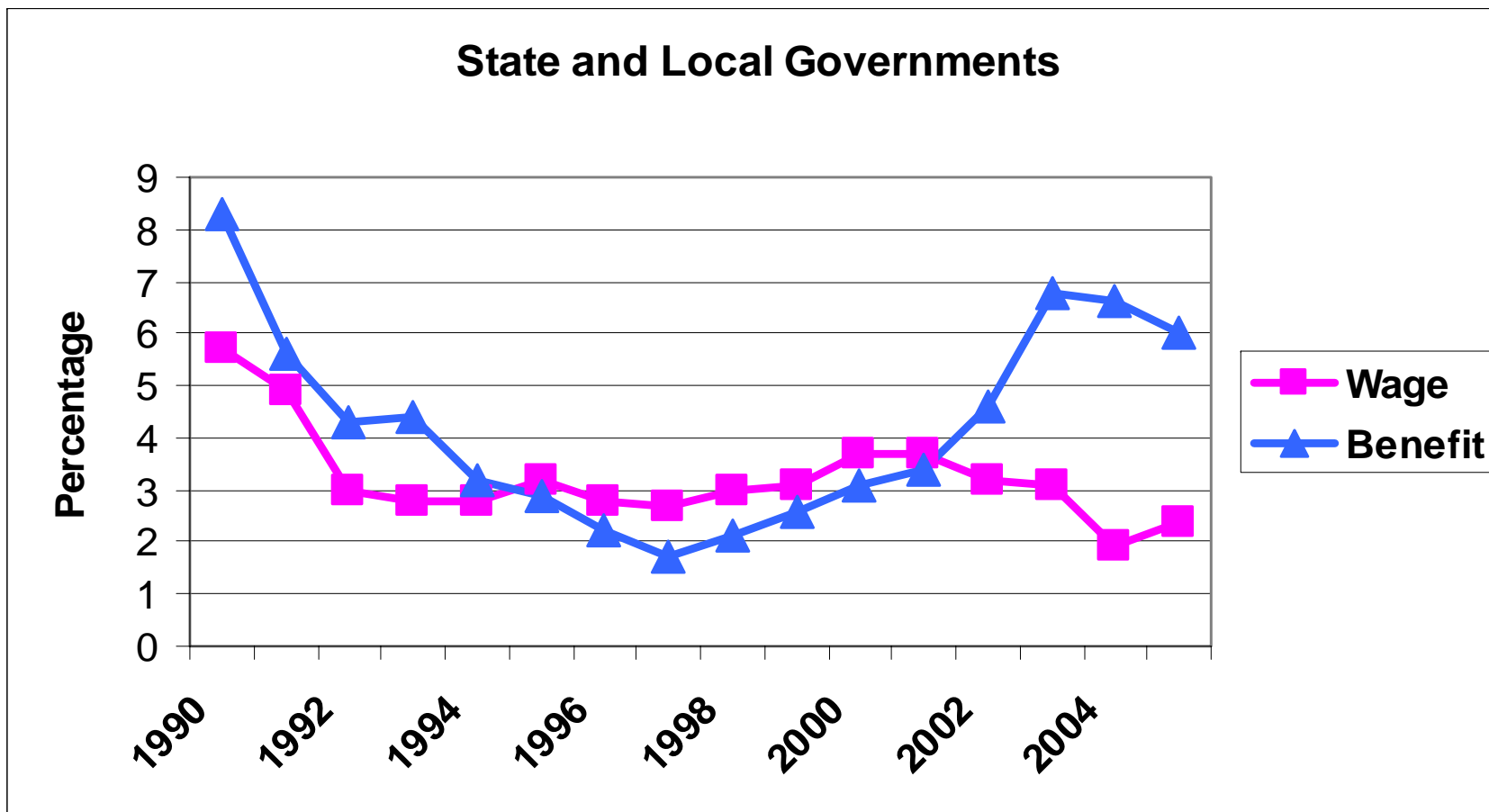




Benefit Growth: Public & Private Sectors

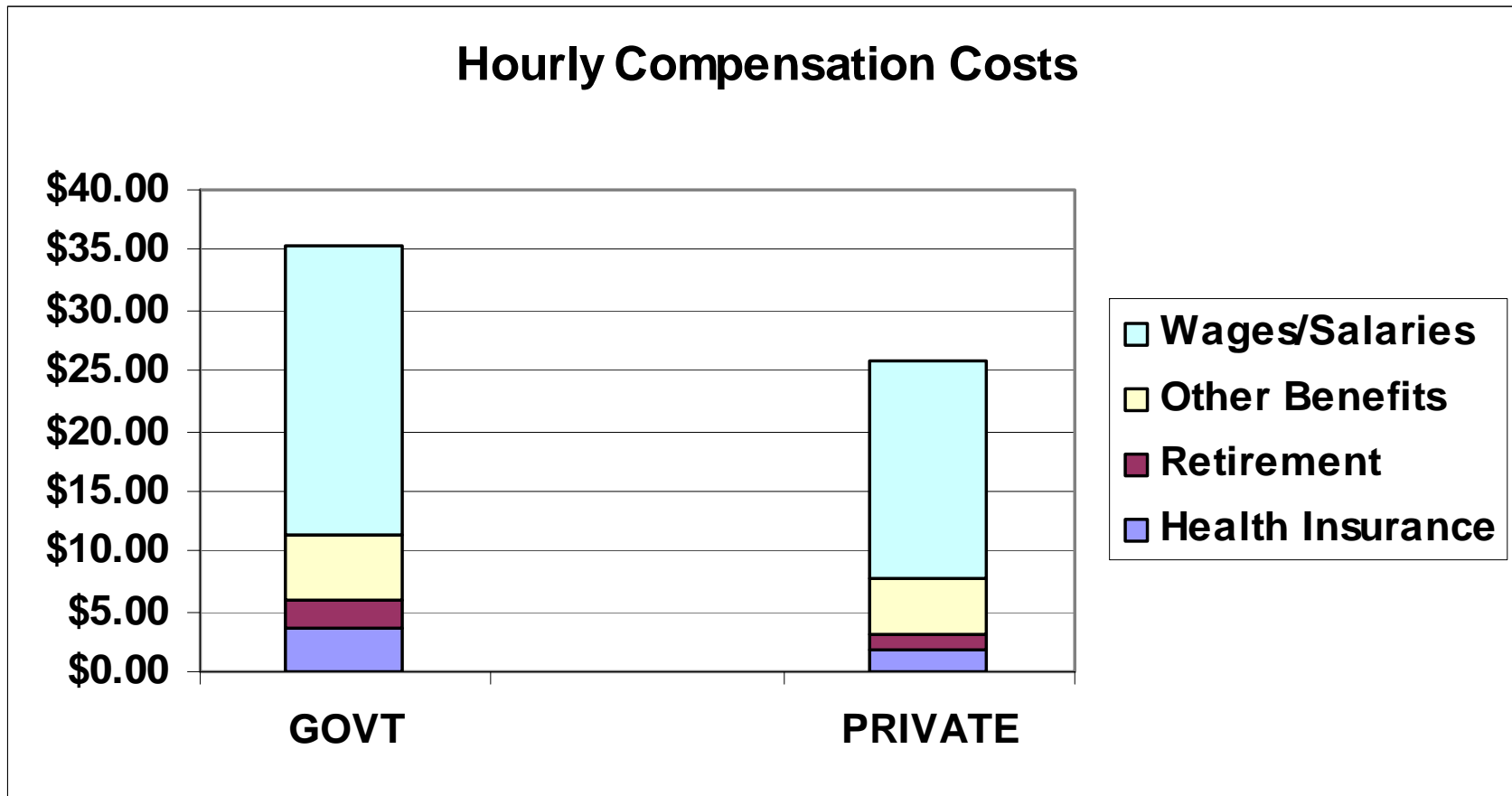


Divergence of Wage and Benefit Growth



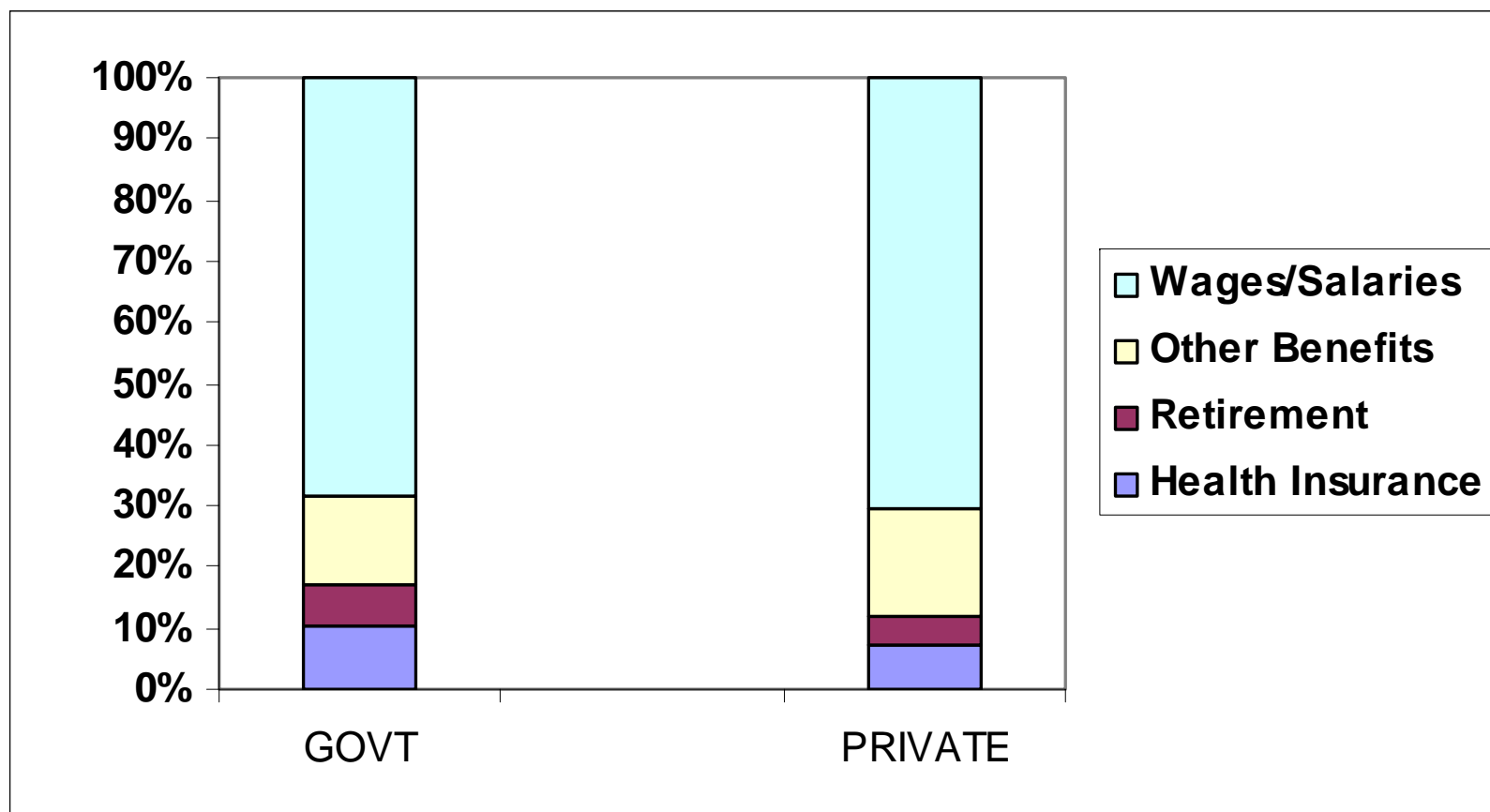


Structure of Compensation





Relative Structure of Compensation





External Financing of Pension Liabilities

- > Fixes the terms of a Liability which carries significant uncertainty;
- > Requires government to assume Investment Management Risks;
- > Success of Bond Financing could depend on Market Timing;
- > Governments must decide on the appropriate need for external financing.



Credit Issues

- > Debt Issuance may grow.
- > Actuarial Methods for calculating Benefit Costs and Funding Levels could vary – Limiting Comparability of Funding Levels;
- > Investment Practices and Policies may need upgrading;
- > Collective Bargaining discussions will intensify;
- > Limited Taxing Flexibility and Strong Service Needs, may require personnel or service cuts to meet pension funding requirements.



Effect on Debt Ratings

- > Pension funding, Off-Balance Sheet Liabilities and Other Financial Exposures (e.g., Derivatives) have always been part of the Issuer's Debt Profile;
- > Challenge is making financial results comparable to other governments:
 - Should an issuer of Pension Bonds be penalized because of its larger debt burden than another government with underfunded pensions?
- > Asset/Liability Management will be a greater consideration.



Long-Term Considerations

- > Can governments meet pension funding needs within existing tax revenue and service delivery constraints?
- > Will governments reduce their benefit offerings to new employees?
- > Can technology and management skill achieve greater operating efficiency?



Our Approach

- > Assess Management Strategy and Risk Preferences;
- > Review Financial Exposures and Debt Profile; and
- > Draw Conclusions about Financial Flexibility.



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