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By Lisa Abramowicz and Sarika Gangar

March 12 (Bloomberg) -- Companies in the U.S. facing a $557 billion deficit in their pensions are accelerating bond sales to fill the gap in a wager that returns on the proceeds will outpace their borrowing costs.

Ford Motor Co. leads borrowers issuing at least $2.9 billion of debt to help fund pensions in 2013, the fastest start to a year on record, according to data compiled by Bloomberg.

Akron, Ohio-based Goodyear Tire & Rubber Co., the largest U.S. tire-maker, sold $900 million of 6.5 percent senior-unsecured notes on Feb. 21 for payments to its U.S. plans.

With yields on corporate debt hovering close to a record low 3.5 percent, down from last year's high of 4.8 percent, companies are selling bonds rather than cutting retiree benefits or committing additional cash into pensions that face the biggest funding gaps on record. The plans typically target 7.5 percent returns to meet actuarial obligations, exceeding the 6.5 percent yield on B tier high-yield bonds.

"It could be a problem," said Boris Rjavinski, a strategist in the global rates group at UBS Securities LLC in Stamford, Connecticut. "If we go into some kind of a recessionary and deflationary situation, that's a nightmare for corporate pensions."

'Fighting Fire'

Companies are seeking to benefit from the same low yields that have exacerbated the funding gaps as corporate pensions invest more of their assets in debt, said Mark Oline, global head of corporate ratings at Fitch Ratings.

The funded status of the typical U.S. corporate pension plan slid 0.5 percentage point to 80.7 percent in February, according to a March 5 statement from the BNY Mellon Investment Strategy and Solutions Group.

"One of the reasons why underfunded pensions have swollen to the degree they have is because of low interest rates," said John Lonski, chief economist for Moody's Capital Markets Group in New York. "You're sort of fighting fire with fire."

Elsewhere in credit markets, Barclays Plc quit as co- manager of Honduras's first international bond sale after learning about a pending lawsuit that wasn't initially included in a sales prospectus for the securities, three investors said.

Nissan Motor Co. raised $1 billion through its finance unit after doubling the size of the bond offering. Morgan Stanley said a new rule may change how banks insured by the Federal Deposit Insurance Corp. invest in collateralized loan obligations as they assess the cost of holding assets calculated in their ability to withstand stress.

Rate Swaps

The U.S. two-year interest-rate swap spread, a measure of debt-market stress, decreased 0.49 basis point to 14.16 basis points. The measure narrows when investors favor assets such as corporate bonds and widens when they seek the perceived safety of government securities.

The cost of protecting corporate bonds from default in the U.S. fell to the lowest level in more than two years. The Markit CDX North American Investment Grade Index, which investors use to hedge against losses or to speculate on creditworthiness, decreased 1.1 basis point to a mid-price of 79.5 basis points, according to prices compiled by Bloomberg. That's the lowest level for the index since February 2011.

The Markit iTraxx Europe Index of 125 companies with investment-grade ratings added 1.1 to 105.4 at 11:10 a.m. in London. In the Asia-Pacific region, the Markit iTraxx Asia index of 40 investment-grade borrowers outside Japan was little changed at 101.5.

GE Bonds

The indexes typically fall as investor confidence improves and rise as it deteriorates. A basis point equals $1,000 annually on a contract protecting $10 million of debt.

Bonds of Fairfield, Connecticut-based General Electric Co.
were the most actively traded dollar-denominated corporate securities by dealers yesterday, accounting for 4.6 percent of the volume of dealer trades of $1 million or more, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority.

In emerging markets, relative yields were at 280 basis points, or 2.80 percentage points, according to JPMorgan Chase & Co.'s EMBI Global index. The measure ended last year at 265.8.

Honduras amended the prospectus for the sale to show that the country faces a $205 million lawsuit tied to a government- owned logging company, according to the revised document sent to investors and obtained by Bloomberg News.

Nissan Bonds

Barclays's withdrawal took place after government officials met with potential investors. Deutsche Bank AG is the lead manager of the deal, said a person familiar with the offering who asked not to be identified because terms aren't set.

Brandon Ashcraft, a spokesman for Barclays in New York, declined to comment. Ari Cohen, a spokesman for Deutsche Bank, declined to comment. Officials at Honduras's Finance Ministry didn't immediately return an e-mail and call seeking comment.

The offering from Nissan Motor Acceptance, increased from an initially planned $500 million, consists of $400 million of five-year, 1.8 percent notes that yield 95 basis points more than similar-maturity Treasuries and $600 million of three-year,
1 percent securities at 65 basis points, Bloomberg data show.

The Standard & Poor's/LSTA U.S. Leveraged Loan 100 Index rose 0.14 cent to 98.02 cents on the dollar, the highest level since July 2007. The measure, which tracks the 100 largest dollar-denominated first-lien leveraged loans, has returned 1.7 percent this year.

Rethink Participation

Leveraged loans and high-yield, high-risk, or junk, bonds are rated below Baa3 by Moody's Investors Service and lower than
BBB- at S&P.

The FDIC regulation requires CLOs, which buy and package speculative-grade credit into securities of varying risk and return, to be treated as "higher-risk" assets, Morgan Stanley said yesterday in a report.

The designation may also include the least-risky portion of CLOs, rated AAA, under the rule set to take effect April 1 for U.S. banks with $10 billion of assets or more, the New York- based lender said. The rule may limit the narrowing of spreads in the top-rated portion of CLOs as banks consider investing in lower-rated slices of the loan funds, according to the note.

"There is a potential for some banks to rethink the extent of their continued participation in the CLO market," Vishwanath Tirupattur and Mia Qian, analysts with Morgan Stanley, wrote in the report. "It is conceivable that some bank investors consider investing in AA tranches to offset the higher FDIC assessments."

'Won't Reveal'

Offerings identified for pension financing have almost quadrupled from $750 million in the same period of 2012, Bloomberg data show. The actual figures may be much higher, with some proceeds sometimes coded to general corporate purposes rather than retirement plans, said Lonski of Moody's.

"They just won't reveal it," he said.

Goodyear, which has contributed $1.4 billion to its U.S. plans over the past five years, still faced a $2.7 billion funding gap as of Dec. 31, up $200 million from a year earlier, according to Fitch.

The bond sale by the largest U.S. tire-maker was part of a strategy to pre-fund and hedge the risk in its pension plans, which provide benefits for people who are living longer, as it closes them to new entrants, Chief Financial Officer Darren Wells said on a Feb. 12 conference call to discuss fourth-quarter earnings.

Merck Bonds

Ford, whose $18.7 billion pension deficit is the second- largest outstanding, according to UBS research, sold $2 billion of 4.75 percent, 30-year debt on Jan. 3 with some of the proceeds going toward accelerating contributions to its pension plans, according to Bloomberg data and a filing at the time from the Dearborn, Michigan-based automaker.

Merck & Co. issued $2.5 billion of bonds in three parts with coupons ranging from 1.1 percent to 3.6 percent on Sept. 10 to help fund its pension obligations and repay debt, among other general corporate purposes, according to Bloomberg data and a company filing at the time.

The U.S. economy is forecasted to grow 1.8 percent this year, following 2.2 percent in 2012, according to the average estimate of 77 economists surveyed by Bloomberg.

S&P expects the trailing 12-month default rate on speculative-grade corporate debt in the U.S. to start rising next month after falling to 2.3 percent in February from 2.5 percent in January and the 2012 peak of 2.96 percent in September, the New York-based ratings company said March 1.

Market Expands

Raising debt to cover funding deficits is "good because you don't have an open-ended, gaping liability," Margie Patel, a money manager at Wells Fargo & Co. in Boston who oversees about $1 billion, said in a telephone interview. "It makes sense to fund that and cap the amount of potential liability, especially if you can borrow at a time when rates are as low as they've ever been."

The amount of dollar-denominated corporate bonds outstanding has expanded by $1.9 trillion since 2008, when the worst financial crisis since the Great Depression spurred the Federal Reserve to start buying bonds and holding benchmark borrowing rates between zero and 0.25 percent. Companies are locking in rates that are partially tax-deductible to plug funding holes in their pensions.

Companies are tapping the bond market as yields rise to

3.63 percent as of March 8 from a record low 3.52 percent on Jan. 23, according to the Bank of America Merrill Lynch U.S.
Corporate & High Yield index. Borrowing costs compare with an average 5.9 percent over the past 10 years.

Falling yields on investment-grade bonds are a primary cause of pension deficits climbing by $73 billion last year, according to a study that tracked S&P 1500 index companies from Mercer, which provides human resources consulting.

While companies sought to combat the pension gap by making an estimated $60 billion of payments to the funds last year, many are “merely treading water,” Jonathan Barry, a partner at Mercer, said in a Jan. 3 release. The deficit will drag on earnings this year, he said.

“The longer lower interest rates persist, the more the fixed-income portfolios get rolled into low coupon securities,”
Oline said. “It gets them farther away from their assumed return.”

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