Statement of
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Before the
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight

Hearing on the Financial Status of the
Pension Benefit Guaranty Corporation's
Single Employer Insurance Program

March 20, 1984

* The views expressed herein are those of the witness and do not represent the views of Trustees, Sponsors or Staff of the Employee Benefit Research Institute. EBRI is a nonprofit, nonpartisan public policy research organization located in Washington, DC.
Introduction

Mr. Chairman, it is a pleasure to appear before you today to discuss the Pension Benefit Guaranty Corporation (PBGC).

I am President of the Employee Benefit Research Institute (EBRI), a nonprofit, nonpartisan public policy research organization founded in 1978. EBRI sponsors research and educational programs to provide a sound basis for legislative and regulatory policy decisions in the field of employee benefits. EBRI does not take pro or con positions on legislative proposals.

Prior to joining EBRI, I had the honor of serving at PBGC as Assistant Executive Director for Policy. During my tenure, I directed the congressionally mandated study of the Multiemployer Plan Termination Program that led to enactment of the Multiemployer Pension Plan Amendments of 1980.

Upon establishing EBRI in 1978, our very first project was to conduct a policy forum titled Pension Plan Termination Insurance: Does the Foreign Experience Have Relevance for the United States? I/ Experts from Germany, Finland, Sweden, Japan, and the United States came together to discuss a number of the issues being reviewed by your Committee today—premium levels and calculation methods (fixed versus variable rate) and basic design questions such as alternative definitions of the "insurable" event.

That policy forum reinforced my conviction that pension policy must be considered in a more comprehensive manner than this nation has generally attempted. Further, it highlighted the fact that every aspect of a benefit guarantee program is interrelated: the premium structure, the program structure, and the nature of the guarantee. And, that other issues such as the reversion of assets are inextricably intertwined as well.

I/ Published in 1979 and still available from EBRI.

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My statement today focuses on these interrelated issues. First, I emphasize my concern that one of the most important purposes of the PBGC established by the 1974 Employee Retirement Income Security Act (ERISA) is not being given the full attention it deserves: continuation of pension plans.

Second, I seek to provide you with a framework for evaluating the PBGC request for a $7.00 per participant premium for the single employer program.

Third, I seek to provide a framework for assessing whether the premium issue can appropriately be severed from the far-reaching issue of basic reform of the guarantee program.

The Purposes of PBGC

The first PBGC annual report was dated June 30, 1975, less than one full year after establishment of the program. The transmittal letter stated:

"Enactment of the plan termination insurance program as part of ERISA ushered in a new era in security for pension plan participants in the private sector. Approximately 29 million Americans covered by defined benefit plans are now assured that once their basic benefits become vested, those benefits are guaranteed."

The report also noted that the purposes of PBGC contained in ERISA are to:

- encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants;
- maintain insurance premiums at the lowest level consistent with carrying out its obligations; and
- provide for the timely and uninterrupted payment of pension benefits under plans covered by PBGC.


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These purposes intertwine to a greater degree than legislative policy debates of the last nine years have implied. The debate over the current request for a premium increase, for example, has failed to consider possible effects on the universe of pension plans. Plan continuation is the basis of funding the PBGC and of providing retirement income to the vast majority of present and future retirees.

The nine years preceding passage of ERISA saw the creation of over 177,000 defined benefit plans--a 321 percent increase (Table 1). The nine years following passage of ERISA saw the creation of just over 95,000 defined benefit plans--a 41 percent increase. Calendar year 1976 actually saw a net decrease in the number of defined benefit pension plans.

These data indicate that the scope and nature of federal regulation clearly affect employer decisions regarding sponsorship and design of defined benefit pension plans.

Has PBGC Achieved Its Purposes?

First, as far as making benefit payments: PBGC has provided for the timely and uninterrupted payment of pension benefits under terminated plans. During FY 1983 32,600 beneficiaries received benefit checks from the two trust funds of the PBGC. The FY 1985 proposed budget estimated 61,800 beneficiaries for FY 1984 and 68,700 in FY 1985. PBGC's most recent statements estimate 75,000 beneficiaries for FY 1984 and 90,000 for FY 1985.

Second, concerning premium levels: PBGC can be judged in more than one way relative to this purpose. Advocates of a pay-as-you-go system suggest that PBGC premium requests have been too high. Yet, advocates of a fully funded program suggest that PBGC premiums and requests haven't been high enough.
Third, in terms of encouraging defined benefit plans: the current program--and in that sense the PBGC--appear to neither encourage the maintenance nor the creation of defined benefit plans. From the earliest days of the PBGC--including the period during which I ran the policy staff--this has not been an explicit guide used as a touchstone in policy deliberations. Up to and including the debates of 1982 and 1983, preservation and expansion of the premium base--i.e., the universe of defined benefit plans--has not been given much consideration.

Terminations of major pension plans in recent years, and the significant post-ERISA slowdown in the establishment of new defined benefit programs, provide evidence that PBGC and the Congress should become explicitly concerned with this founding purpose. Yet, the March 1982 PBGC study entitled Premium Requirements for the Single Employer Basic Benefit Insurance Program did not even mention this purpose, not even Section VI which assessed the "Impact of the Premium Increase." The General Accounting Office issued a report to the Congress on November 14, 1984 (GAO/HRD-84-5) entitled Legislative Changes Needed to Financially Strengthen Single Employer Pension Plan Insurance Program. The GAO report also totally ignored this founding purpose of the PBGC. Finally, in Senate testimony supporting a proposed premium increase, the PBGC failed to even mention this purpose or assess the potential consequences on defined benefit plans--the premium base--of the proposed 169 percent premium increase.

If Congress hopes to maintain the PBGC as a self-financing agency, Congress must carefully consider the implications of every legislative pension policy decision for the "maintenance and creation of defined benefit pension plans." Not only do they provide the funds for the PBGC, but they
also aid in meeting the economic security needs of millions of Americans at all income levels.

The PBGC Deficit and Premiums

Although PBGC has sufficient financial reserves to cover its known obligations for the next several years, it does not have enough of a financial reserve today to pay all the future benefits it is responsible for as a result of terminations of plans with insufficient assets.

Of the more than 46,000 single employer defined benefit plans that have terminated since the enactment of ERISA, just under 1,000 had insufficient assets (2 percent). By the end of FY 1983 the PBGC estimated its deficit from these terminations at over $400 million. The studies already mentioned argue that the deficit merits an immediate premium increase "to guarantee that our (PBGC) obligations will be met." And, PBGC argues that the premium increase "is essential to our (PBGC) existence as a sound insurance corporation and to guaranteeing payment of future pension benefits to some 40 million Americans."

The continuation of enough defined benefit pension plans to pay PBGC premiums is--in fact--the only way to guarantee PBGC solvency on a self-financing basis.

PBGC projects continuing deficit growth if the premium increase is not granted. This is based on an income estimate of $127,596,000 at the present rate ($2.60) compared to $286,006,000 at the proposed rate ($7.00).

PBGC projects FY 1985 expenses of $237,650,000 as compared to a FY 1984 estimate of $192,327,000. This increase is due to projected growth in benefit payments in FY 1985 to $182 million from $156 million in FY 1984.
This means that, at the present premium rate, income would fall short of expenses by approximately $110 million in FY 1985.

But PBGC estimates total reserves at the end of FY 1983 at $1.1 billion, i.e., enough to cover the current annual revenue shortfall for several years.

While use of reserves for this purpose might not be the ideal policy course, PBGC is clearly not on the brink of insolvency; and, using the reserves may, in fact, be in the interest of program survival.

A review of the FY 1983, FY 1984 and FY 1985 budgets indicates why defined benefit plan sponsors are concerned about (1) the structure of the current program and (2) prospects for future premium rates.

The PBGC, for reasons I shall return to, is not an insurance program in any conventional sense of that term. This is reflected in its annual budgets. The budget shows that PBGC has let each current year serve as its guide to the future. In terms of number of terminations the FY 1984 budget projection of 145, was based upon an actual 1982 experience of 155. The FY 1985 budget assumed trusteeship of 102 insufficient plans in 1984--the number it did acquire in 1983. The FY 1985 budget assumes the 102 plan rate for 1985 as well.

How did the budget projections prove out? Even though forty-three fewer insufficient plans terminated in 1983 than expected--a 30 percent error--PBGC's liabilities were only $15 million lower than the earlier budget estimate based upon the higher termination rate--a 2 percent dollar reduction. In other words, the total deficit was only 3.6 percent less than projected in spite of this significant 30 percent drop in terminations.

This trend is consistent with PBGC budgets since FY 1976. The PBGC, given the non-insurance design of the program, has been very unsuccessful in
projecting year to year experience. The PBGC liability at the end of FY 1982, for example, was $585 million, or 52 percent higher than projected in the FY 1983 budget.

The sponsors of defined benefit pension plans who support the program financially have argued that a premium increase—or a change in the premium calculation method—should come about only as part of reforms that bring insurance principles to the program.

Congress must consider whether PBGC might get into trouble if there is delay in the premium increase. Worst case studies have been done that can assist in that analysis.

A study published in the spring of 1982 in the *New England Economic Review* presented the "worst case" for PBGC in identifying the eighty-six firms out of 6,000 firms that had unfunded liabilities exceeding 30 percent of net worth. Were all eighty-six to have terminated, they would have represented potential claims totaling $4.3 billion over the remaining lifetimes of the plan participants and beneficiaries. All single employer defined benefit pension plans have current assets of more than $400 billion—a very significant asset coverage ratio for the system which means that at its worst the potential exposure of PBGC is less than 1 percent of total pension asset reserves.

The PBGC and Pension Funding

The early history of pension plans was marked by plan failures because many plans operated on a pay-as-you-go basis. The low contributions necessary in a plan's early years had caused some employers to overpromise. When pension contributions became very high in later years, the plan could not be financially maintained. Without advance funding a pension plan must continue for any benefits to be paid.

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Prior to ERISA, sponsors were legally required to contribute only the "normal cost" plus interest on accrued liabilities. As a result, a major portion of contributions made on behalf of active workers were frequently being used to pay retiree benefits. For the most part, this is the pay-as-you-go funding approach used today for social security, civil service retirement, and military retirement.

ERISA established stricter funding requirements. The minimum ERISA contribution for a single employer defined benefit plan is the normal cost, plus forty-year funding of pre-ERISA past service costs, plus thirty-year funding of post-ERISA past service costs, plus fifteen-year funding of investment experience gains and losses, plus thirty-year funding of gains and losses resulting from changes in actuarial assumptions.

ERISA also established that past service costs could not be funded on a tax deductible basis on less than a ten-year basis. In this sense, ERISA discouraged full funding of plans. Nonetheless, the defined benefit pension plan universe is well funded.

The Funded Status of Plans: Is There a Problem?

Greenwich Research Associates (GRA) began doing an annual survey of large corporate pension plans in 1972 covering the vast majority of plan participants. Those surveys have traced the trend of increasingly better funding of the major pension plans in this country.

The overview essay to the GRA's recently released eleventh survey which covered 1,670 large corporations noted:

3/ For a thorough treatment of this issue see Retirement Income Opportunities in an Aging America: Pensions and the Economy, by Sophie M. Korczyk, Chapter II (Washington, DC: Employee Benefit Research Institute, 1982).

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"...The aggregate unfunded past service obligations for large corporations are now less than 10% of total employee benefit fund assets. Unfunded obligations of large corporations are estimated at $29 billion while employee benefit fund assets are projected to be $325 billion. The vested and unfunded obligations are estimated at only $13 billion--less than 5% of total assets." 4/

A recently released survey of 550 of the nation's largest corporations, conducted by Johnson & Higgins, one of the nation's leading employee benefit consulting firms, found that, in the aggregate, 92.5 percent of total accumulated benefits were fully funded and 95.4 percent of vested benefits were fully funded. 5/ Four-fifths of the surveyed companies were fully funded with respect to vested benefits; two-thirds of the surveyed companies were fully funded with respect to total accumulated benefits.

This means that most pension plans present no risk to the PBGC at this time. Instead, they have accumulated over $400 billion in assets to assure that promised benefits will be paid.

What we know about the financing of PBGC and the strength of the pension system appears to justify certain conclusions:

First, PBGC will at some time need more revenue than the current premium of $2.60 per year per participant, if insufficiently funded plan terminations continue;

second, the PBGC's current liability, and the total liability exposure of the PBGC, are small compared to the total assets of single employer defined benefit pension plans; and

third, since liabilities (the deficit) occur, in part, due to the structure of the program, the premium issue should not be explored in isolation.

The PBGC Deficit, the Premium, and Reform

A clear consensus exists that the PBGC program is in need of fundamental design changes. The program violates the basic principles of insurance to such a degree that PBGC cannot hope to be "a sound insurance corporation"--as it claims it would be if a $7.00 premium were granted--without reform.

First, the PBGC maximum liability is not predetermined and is based upon an unrelated condition--the plan sponsor's net worth;

second, the insured can increase the insurance coverage (benefits) without the consent of the insurer (the PBGC); and

third, the premium paid is unrelated to the amount of coverage obtained.

At the 1979 EBRI policy forum it was pointed out that:

"In the absence of an attempt to return to basic insurance principles (i.e., risk borne by related plan sponsors and their employers), the only solution can be excessive premiums (i.e., risk borne by unrelated plan sponsors) or application of general revenues (i.e., risk borne by the general taxpayer)."

A framework for reform was suggested by the participants at the EBRI forum. Reforms suggested at the forum would, first, be based upon movement toward principles of insurance. Second, PBGC would only take on obligations at the point that a plan sponsor terminating a plan experienced business insolvency. Third, a form of reorganization or temporary relief would be offered to plan sponsors who are in financial difficulty but are not insolvent. Fourth, premiums would somehow be tied to the exposure created for the PBGC.

Since 1979, the Administration, members of Congress, and others have suggested similar changes in the single employer program.

The important point is this: the design of the program has, itself, created a portion of the current liabilities. Further, the present design
can actually provide incentives for plan termination and disincentives for funding. For example, an increase in the premium rate at this time would initially reduce the deficit, but could actually cause the financial situation to **worsen** over time, in the absence of program redesign that encourages the maintenance and establishment of defined benefit pension plans.

As I have reported, it does not appear that anyone in the federal government has undertaken this analysis. Yet, millions of middle-income workers could needlessly be put in jeopardy due to this failure to act in a careful and comprehensive way.

**Conclusion**

ERISA served to strengthen many of those pension plans that existed in 1974, and it assures that employers establishing new plans will carefully consider design and funding.

PBGC has already assured that tens of thousands of pension participants and beneficiaries will receive greater benefits than would have occurred had ERISA not been passed.

The PBGC's record of success should be carefully built upon. Adjustments to the PBGC program—including premium changes—should be evaluated against the purposes stated in ERISA. Other ERISA proposals, such as reversion of assets, must also be considered in terms of their PBGC implications. Any changes or "reforms" that might discourage the maintenance and growth of defined benefit pension plans may be inconsistent with the nation's long term economic security goals; and they may harm the PBGC. This long term perspective should—and must—become the basis of premium increase and program reform considerations.

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Mr. Chairman, I would like to ask that the relevant sections of two EBRI publications that I cited in my testimony be made a part of the hearing record.
TABLE 1
CORPORATE DEFINED BENEFIT PENSION PLAN QUALIFICATIONS, TERMINATIONS, AND NET PLANS CREATED 1956-1983

<table>
<thead>
<tr>
<th>Year</th>
<th>Plans Qualified</th>
<th>Plans Terminated</th>
<th>Net Plans Created</th>
<th>Cumulative Number Created</th>
<th>Percent Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1956</td>
<td>3,175</td>
<td>192</td>
<td>2,983</td>
<td>19,209</td>
<td>18.4%</td>
</tr>
<tr>
<td>1957</td>
<td>3,527</td>
<td>180</td>
<td>3,347</td>
<td>22,556</td>
<td>17.4%</td>
</tr>
<tr>
<td>1958</td>
<td>3,883</td>
<td>224</td>
<td>3,659</td>
<td>26,215</td>
<td>16.2%</td>
</tr>
<tr>
<td>1959</td>
<td>3,824</td>
<td>270</td>
<td>3,554</td>
<td>29,769</td>
<td>13.6%</td>
</tr>
<tr>
<td>1960</td>
<td>5,011</td>
<td>300</td>
<td>4,711</td>
<td>34,480</td>
<td>15.8%</td>
</tr>
<tr>
<td>1961</td>
<td>4,919</td>
<td>374</td>
<td>4,545</td>
<td>39,025</td>
<td>13.2%</td>
</tr>
<tr>
<td>1962</td>
<td>5,188</td>
<td>476</td>
<td>4,712</td>
<td>43,737</td>
<td>12.1%</td>
</tr>
<tr>
<td>1963</td>
<td>5,840</td>
<td>441</td>
<td>5,399</td>
<td>49,136</td>
<td>12.3%</td>
</tr>
<tr>
<td>1964</td>
<td>6,581</td>
<td>509</td>
<td>6,072</td>
<td>55,208</td>
<td>12.4%</td>
</tr>
<tr>
<td>1965</td>
<td>7,495</td>
<td>512</td>
<td>6,983</td>
<td>62,191</td>
<td>12.6%</td>
</tr>
<tr>
<td>1966</td>
<td>10,124</td>
<td>603</td>
<td>9,521</td>
<td>71,712</td>
<td>15.3%</td>
</tr>
<tr>
<td>1967</td>
<td>11,292</td>
<td>602</td>
<td>10,690</td>
<td>82,402</td>
<td>14.9%</td>
</tr>
<tr>
<td>1968</td>
<td>12,896</td>
<td>672</td>
<td>12,224</td>
<td>94,626</td>
<td>18.8%</td>
</tr>
<tr>
<td>1969</td>
<td>14,692</td>
<td>868</td>
<td>13,824</td>
<td>108,450</td>
<td>14.6%</td>
</tr>
<tr>
<td>1970</td>
<td>16,512</td>
<td>1,442</td>
<td>15,370</td>
<td>123,820</td>
<td>14.2%</td>
</tr>
<tr>
<td>1971</td>
<td>22,493</td>
<td>1,605</td>
<td>20,888</td>
<td>144,708</td>
<td>16.9%</td>
</tr>
<tr>
<td>1972</td>
<td>28,265</td>
<td>1,745</td>
<td>26,520</td>
<td>171,228</td>
<td>18.3%</td>
</tr>
<tr>
<td>1973</td>
<td>33,830</td>
<td>2,222</td>
<td>31,608</td>
<td>202,836</td>
<td>18.5%</td>
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<tr>
<td>1974</td>
<td>32,579</td>
<td>2,577</td>
<td>30,002</td>
<td>232,838</td>
<td>14.8%</td>
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<tr>
<td>1975</td>
<td>15,519</td>
<td>4,550</td>
<td>10,769</td>
<td>243,607</td>
<td>4.6</td>
</tr>
<tr>
<td>1976</td>
<td>4,790</td>
<td>8,970</td>
<td>-4,180</td>
<td>239,427</td>
<td>1.7</td>
</tr>
<tr>
<td>1977</td>
<td>6,953</td>
<td>5,337</td>
<td>1,616</td>
<td>241,043</td>
<td>0.7</td>
</tr>
<tr>
<td>1978</td>
<td>9,728</td>
<td>4,625</td>
<td>5,103</td>
<td>246,146</td>
<td>2.1</td>
</tr>
<tr>
<td>1979</td>
<td>15,755</td>
<td>3,267</td>
<td>12,488</td>
<td>258,634</td>
<td>5.1</td>
</tr>
<tr>
<td>1980</td>
<td>18,849</td>
<td>4,297</td>
<td>14,552</td>
<td>273,186</td>
<td>5.6</td>
</tr>
<tr>
<td>1981</td>
<td>23,789</td>
<td>4,536</td>
<td>19,253</td>
<td>292,439</td>
<td>7.0</td>
</tr>
<tr>
<td>1982</td>
<td>28,189</td>
<td>5,043</td>
<td>23,146</td>
<td>315,585</td>
<td>7.9</td>
</tr>
<tr>
<td>1983 a/</td>
<td>18,393</td>
<td>5,481</td>
<td>12,912</td>
<td>328,497</td>
<td>4.1</td>
</tr>
</tbody>
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Total: 141,765 95,629 328,497 328,497

SOURCE: IRS Disclosure Data; EBRI tabulations.