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Statement Submitted

for the record

by

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PRIVATE PENSIONS AND THE PBGC: STRENGTH FOR THE FUTURE

Mr. Chairman, I am pleased to submit this statement for the record on the funding status of private pension plans.

This statement focuses on the growth of pension-plan assets, the funding status and other indicators of pension-plan financial health, and the role of the Pension Benefit Guaranty Corporation (PBGC) in assuring benefit security and plan integrity. Our research suggests that both the PBGC and the private system promise long-term financial stability. As the Congress debates issues concerning the Social Security system and the private pension system, it is important that it do so on the basis of accurate data.

THE GROWTH OF PENSION-PLAN ASSETS

More than 28 million workers participate in defined-benefit plans. The PBGC's role in guaranteeing these workers' benefit security is more important than it has ever been, because defined-benefit plans are more important than ever. Defined-benefit plans represented 71 percent of all plan assets and a similar proportion of all plan participants in 1977. Over 15,000 net new defined-benefit plans have been formed annually since 1971. New defined-contribution plans are being formed more rapidly, and the assets in defined-contribution plans are also growing at a faster rate. The larger size of the average new defined-benefit plan, however, means that defined-benefit plans will maintain at least their current share of the covered population for some time to come.

High rates of new plan formation have led to significant growth in pension-plan asset holdings as well. Between 1976 and 1981, private pension plan assets more than doubled in current dollar terms, reaching over half a trillion dollars in 1981. Private pension growth has been significant even when the effects of inflation are taken into account. Between 1975 and 1980, pension plan assets grew at an average annual rate of 9.2 percent after adjusting for inflation. By comparison, state and local government pension plan assets grew 3.7 percent annually in real terms during this period. Private pension plans now provide nearly 9 percent of total credit available to financial markets and hold nearly a quarter of all corporate bonds and more than 12 percent of corporate equities.

The importance of pension plans in providing credit and investment resources promises to increase even further. Additions to pension reserves appear to have been one of the factors that kept savings rates from declining even more than they have in recent years. Pension plans may thus have helped to offset the detrimental effects of inflation on Americans' choices between spending and saving.

THE FINANCIAL HEALTH AND STABILITY OF PRIVATE PENSION PLANS

This growth in pension plan asset holdings has had a favorable impact on participant benefit security. Recently the Internal Revenue Service has made its pension-plan disclosure data available for public use, thereby providing researchers with data on the broadest and most representative group of pension-plans available anywhere.

Our tabulations of IRS data for the 1977 plan year--the most recent year for which data are available--suggest that the funding status of private pension plans is better than previous small-sample studies had found. Of the defined-benefit plans with 1000 or more participants--which account for more than three-quarters of all participants in defined-benefit plans--more than a fifth of multi-employer plans and nearly half of single-employer plans had assets equal to or greater than the value of their total vested liabilities. Of the plans with fewer than 1000 participants, a third of the multi-employer plans and more than half of the single-employer plans were likewise fully-funded or over-funded. And, with the exception of the larger multi-employer plans, from half to three-quarters of all defined-benefit plans are at least 75 percent funded.

Many large plans also appear to be well-backed by their sponsors' assets. More than 90 percent of the large corporate plans sampled in two recent studies had unfunded vested liabilities less than 20 percent of sponsor's net worth. Since the Pension Benefit Guaranty Corporation can claim up to 30 percent of a sponsor's net worth if a plan is terminated, such firms not only have no incentive to terminate their plans, but were they to do so, only they would bear the cost. Thus, the condition of the less than 2 percent of large plans with shaky sponsor backing isolated by Dr. Munnell is not an accurate picture of the other 98 percent.

What does underfunding mean to pension-plan participants? Does it mean that their benefits are unsafe? More likely, it means one of three things:

- o their plan has been enriched, providing higher benefits;
- o some participants have received retroactive service credits; or
- o actual plan experience has diverged from what the actuary forecast, necessitating adjustments in funding to amortize these differences.

Since the plan must amortize all of these changes over a period of time,funding is not likely to fully reflect them for a number of years. But the price of keeping plans fully-funded at all times could be foregoing benefit increases entirely.

Funding status, of course, is not the only measure of a pension plan's health or financial stability, though under current law it is probably the most important one for measuring society's potential responsibility for a plan. Other measures of plan financial condition include pension costs as a percent of wages and salaries, or the current cost burden of the plan to its sponsor, and plan investment returns. The smaller the plan's burden to the sponsor, the more likely the sponsor is to continue the plan, and the higher the plan's investment return, the lower the burden of the plan to the sponsor.

On both of these measures again, private pension plans display considerable strength. In plans with more than 100 participants, pension contributions average 7 percent of labor costs, rising to 37 percent of labor costs only in plans with 10 or fewer participants. To put these numbers in perspective, state and local governments contributed 17.5 percent of payroll to their pension plans in 1980, and the Federal government contributed over 30 percent of payroll to the Civil Service Retirement System and over 45 percent to the Military Retirement System.

Private plans appear to have outperformed most market indices in their capacity as investors of plan assets. The A.S. Hansen, Inc. Investment Perfomance Survey is the single largest survey of pension-plan investment performance, providing information on plans accounting for eight percent of all private plan assets in 1980. The newest Hansen survey shows that in the last ten years,-- which were devastating times for most financial asset holders -- fixed-income funds matched or exceeded most indices of market performance. Equity funds failed to achieve this record, however, but did achieve returns at the upper end of the range of market indices. Pension fund managers could have bettered their investment performance throughout the last ten years by plunging their entire asset holdings into 90-day U.S. Treasury bills, but, even with perfect foresight, such a course would hardly have satisfied ERISA's prudence requirements.

THE ROLE OF FEDERAL BENEFIT GUARANTEES IN MAINTAINING BENEFIT SECURITY

The Congress is currently re-evaluating the Pension Benefit Guaranty Corporation's role in the pension system. The PBGC was founded to guarantee benefits in defined benefit-plans and is doing its job very well. The corporation currently holds adequate assets to pay benefits in the plans it administers for many years into the future; total assets in the single-employer program at the end of fiscal year 1981 were more than ten times current annual benefit payments. The PBGC is trustee for 659 terminated plans, or less than one-tenth of one percent of all plans currently estimated in existence, and less than 2 percent of all the defined-benefit plans that have been terminated since 1974. Annual net claims against the Corporation have, however, been increasing, and at the end of fiscal year 1981 the Corporation reported an actuarial deficit of $188.8 million.

On the basis of its current deficit, the Corporation is asking the Congress to approve a 131 percent premium increase per participant per year, from the current $2.60 to $6.00. The Corporation argues that this premium increase would allow it to amortize its current actuarial deficit over five years as well as allowing it to accumulate reserves against projected increases in claims resulting from future plan failures. These future failures were forecasted by assuming the Corporation's net claims will continue growing at the same average annual rate experienced since the inception of the single-employer program.

Because of the size of the projected increase, and because it is paid entirely by pension-plan sponsors, this rationale should be examined carefully. The projected premium increase would result in holding the PBGC to much higher funding standards for the liabilities in the plans it adminsters than any private plan would be allowed to meet under the Employee Retirement Income Security Act (ERISA) and applicable tax code provisions. No private plan facing a funding deficit would be allowed to amortize it over a period of less than ten years it it wished to claim tax deductions for the contributions. Likewise, no private pension plan would be allowed to fund its plan to provide benefits for employees not yet on the payroll, which is the equivalent of what the Corporation is asking the Congress to let it do.

Not only are there questions involved in asking plan sponsors to pay for events that have not yet occurred; there are also serious problems involved in forecasting these events. Nearly half the claims outstanding against the Corporation today arose from the termination of 8 large plans. Because there are relatively few large plans, and each of them faces a unique set of circumstances, their terminations are not as predictable as, say, the incidence of automobile accidents among groups of drivers.

Given the uncertainty surrounding plan termination forecasts, therefore, it is useful to explore the impact of alternative projections of future net claims on the private pension system. A recent PBGC staff research paper reviewed alternative measures of the Corporation's risk exposure and found that, depending on how risky plans are identified, the Corporation's exposure could range from over $600 million to $6 billion. Let us assume for a moment that the entire amount of claims forecast in the worst-case scenario were to occur at once, and that existing plans were to be assessed at once--not over a period of even five years -- to make up this funding insufficiency. This assessment would amount to just over 1 percent of private-plan assets outstanding at the end of 1981. If, instead, this funding deficiency were to be amortized over 10 years, and, even if private-plan assets were not to grow at all over the next ten years, the assessment needed to fund this deficiency would be one-tenth of one percent of the assets of private plans each year.

We do not submit these arguments, Mr. Chairman, to dissuade the Congress from considering changes in the Corporation's premium structure, because such changes may well be warranted. We do conclude from our analysis, however, that the Corporation is far from insolvent, and that a compelling case has not been made for funding its liabilities this much in excess of private-sector funding standards.

CONCLUSIONS

The private pension system is strong and growing. Annual rates of net new plan formation have not only regained their pre-ERISA levels--they have surpassed them. In fact, the over 68,000 net new plans formed in 1981 exceeded the highest pre-ERISA annual total by more than 20 percent. While most of the new plans have been defined-contribution plans, defined-benefit plan growth has also been enjoying a resurgence. Current rates of inflation and the resulting increasing real burden of taxation will probably foster this growth as both employers and employees at all income levels seek to shelter income from taxation and maintain the real value of their retirement savings.

The ERISA legislation is only eight years old. Experience and the passage of time have pointed out some flaws in ERISA that should be corrected. As the Congress debates changes in the Social Security program and in legislation governing private pension operations it must, as you fully appreciate, do so on the basis of all the facts. Social Security, private pensions, and other sources of income, are all needed if we hope to meet our common goal of providing adequate retirement income. Those who attempt to undermine confidence in private pensions by inaccurately portraying the financial status of the PBGC or of the private pension system do not serve the nation well.

Today, we must join together to build confidence in Social Security, private pensions, and the nation's commitment to retirement income adequacy.