EBRI

T-86

Statement

Before the Senate Finance
Subcommittee on Private Retirement Plans and Oversight

on

The Financial Strength of the Pension Benefit Guaranty Corporation

by

Dallas L. Salisbury,
President
Employee Benefit Research Institute

Washington, D.C.

25 September 1992

EMPLOYEE BENEFIT RESEARCH INSTITUTE
2121 K Street, NW / Suite 600 / Washington, DC 20037-2121
Telephone 202-659-0670 FAX 202-775-6312

STATEMENT OF DALLAS SALISBURY
EMPLOYEE BENEFIT RESEARCH INSTITUTE

SUMMARY

The Employee Retirement Income Security Act of 1974 (ERISA) was a landmark piece of legislation. Among its major provisions was the creation of PBGC. ERISA in general, and the provisions related to PBGC in particular, have been amended many times since 1974 in an effort to better achieve the original purposes of the Act. PBGC has consistently undertaken analysis to identify areas where further change would improve the system.

I was at PBGC during 1977 and 1978. I had the privilege of working with Senators Jacob Javits and Harrison Williams on early revisions of the PBGC statute. I had the honor of directing the study effort that led to "reform" of the PBGC Multi-employer program and the present stability of that program. I have participated in ongoing reviews of PBGC, including a PBGC Advisory Committee Privatization Task Force in 1982-83, and presently serve by appointment of President Bush on the PBGC Advisory Committee.

Employer-sponsored pension plans represent an important source of retirement income for Americans. In 1990, private pension retirement benefits of $141 billion accounted for 31 percent of the $457 billion in total retirement benefit payments (U.S. Department of Commerce). Factoring contributions and earnings, along with benefit payments, private sector defined benefit pensions had an estimated tax expenditure (using government methodology) of $8.2 billion in fiscal 1993; total tax expenditures for public and private sector employer-provided pensions was $56.5 billion.

Table 1 presents a time trend of financial information for PBGC and the insured system. It demonstrates the willingness of Congress to adjust premiums to maintain the cash flow solvency of the agency. Table 2 compares PBGC's current reported exposure level with available figures of past exposure (Ippolito, 1989). 1990 exposure ($25.6 billion) is lower than at anytime between 1978 ($116.9 billion) and 1986 ($49.2 billion). In fact, current exposure is approximately 40 percent of the historic average of $59.9 billion. PBGC is a stronger agency today than at any time in its history, both financially and in its legal authority.

Public confidence is something to be guarded. It should only be threatened if there is a real reason to do so. Comparison of PBGC to the "S&L fiasco" serves to imply that a large number of pension plans that no one thinks are in trouble are on the verge of failure, that a taxpayer bailout is imminent, and that PBGC is in historically bad condition. None of these conditions exist. The unfortunate terminations of Eastern and Pan Am, which increased PBGC liabilities in 1991, were anything but unexpected. The prospect of liabilities from LTV were well known nearly a decade ago.

Congress has a long history of careful monitoring of PBGC and legislative action when needed to avoid any type of situation even resembling the "S&L fiasco." ERISA has been extremely successful in strengthening the overall insured defined benefit system. Furthermore, it should be emphasized that the "S&L fiasco" had other features not found in the pension system (see pages 5-6). One important distinction between the two programs is that funds are not generally available to the participant on demand in a defined benefit pension plan prior to termination of employment. At that point approximately 40 percent of plans offer a lump-sum option. Perhaps the most important difference between the two guarantee funds is that the likelihood that a plan insured by PBGC will fail is diversified across several key industries whereas S&L guarantee funds were exposed exclusively to the risks of a single industry that was extremely vulnerable to fraud and events beyond its control.

Review of PBGC history (see pages 6-10), from the perspective of the 1976-1991 PBGC Annual Reports to Congress, suggests that the agency and the Congress have acted on a consistent basis to improve the program and the underlying statute. The reports make clear that the overall status of the system has remained strong, and due to past reforms has gotten stronger over time. The reports also state clearly

that the vast majority of participants in defined benefit pension plans face no risk of accrued benefit loss. Reports from the General Accounting Office, the Congressional Budget Office, and the Joint Committee on Taxation, as well as others, make clear that there is not agreement yet among analysts upon the specific changes that should be made to the PBGC program. The history noted above indicates that the Congress will enact reforms to assure that crisis will not occur, and will enact additional reforms in the future if needed to insure stability of PBGC.

It must be realized that general taxpayer interests lie as well in policymakers giving attention to the long-term tax consequences of public pension and retiree medical benefit promises that have not been advance funded. During fiscal 1991 alone, combined unfunded liabilities of civilian and military pension plans increased by $52 billion. Actuarial deficiencies of federal retirement annuity programs consist of $864 billion in the Civil Service Retirement and Disability Fund and $702 billion in the Military Retirement System that future taxpayers will have to pay.

When considering any retirement income policy proposal, like OBRA '87 or the Revenue Act of 1978, its potential effect on PBGC should be considered. For example, the Senate version of the pending energy bill (H.R. 776) includes a provision that could have the United Mine Workers pension fund reallocate $210 million to pay retiree medical benefits and would create significant new liabilities for employers who had previously employed mine workers. This policy proposal has a direct impact on the affected employers and their ability to fund their own pension plans, and could therefore ultimately harm PBGC. This does not mean that it should not become law, but the decision to affect PBGC should be understood and explicit.

Clearly, if we are concerned about insuring the fiscal viability of PBGC, we should carefully think through the potential implications for PBGC of all policy proposals related to pensions and retiree health benefit plans. We should guard public trust, and we should continue to take actions that assure that promises made are promises kept. We should "tell the people" the truth; we should not "fear-monger."

STATEMENT OF DALLAS SALISBURY
PRESIDENT
EMPLOYEE BENEFIT RESEARCH INSTITUTE
BEFORE THE SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE
COMMITTEE ON FINANCE
U.S. SENATE
SEPTEMBER 25, 1992

I am pleased to appear before you this morning to discuss the financial condition of the Pension Benefit Guaranty Corporation (PBGC). My name is Dallas Salisbury. I am president of the Employee Benefit Research Institute (EBRI), a nonprofit, nonpartisan, public policy research organization based in Washington, DC.

EBRI has been committed, since its founding in 1978, to the accurate statistical analysis of economic security issues. Through our research, we strive to contribute to the formulation of effective and responsible health, welfare, and retirement policies. Consistent with our mission, we do not lobby or advocate specific policy solutions.

Introduction

The Employee Retirement Income Security Act of 1974 (ERISA) was a landmark piece of legislation. Among its major provisions was the creation of PBGC. ERISA in general, and the provisions related to PBGC in particular, have been amended many times since 1974 in an effort to better achieve the original purposes of the Act. PBGC has consistently undertaken analysis to identify areas where further change would improve the system.

Most recently, additional proposals for change were discussed in the 1991 PBGC Annual Report to Congress. Changes to the Bankruptcy Act were proposed in November 1991 in separate pieces of legislation (S. 1985 and H.R. 3837); amended versions of these bills have been passed by their respective chambers. The President's FY 1993 Budget proposed extensive changes for PBGC that were introduced in legislative form by Senator Majority Leader Robert Dole (S. 2485) and House Minority Leader Robert Michel (H.R. 4545) last March. Most recently, Senator James Jeffords and Representative J.J. Pickle introduced legislation proposing further reforms for the PBGC (S. 3162 and H.R. 5800). The House Ways and Means Subcommittee on Oversight held a hearing on these proposals on August 11.

The descriptions of the PBGC situation have revolved around the word "crisis," amid comparison to the "S&L fiasco." (Martin, 7/28/92). Most recently it has been turned into an election issue, with statements being made that can only be said to stretch the facts.

I was at PBGC during 1977 and 1978. I had the privilege of working with Senators Jacob Javits and Harrison Williams on early revisions of the PBGC statute. I had the honor of directing the study effort that led to "reform" of the PBGC Multi-employer program and the present stability of that program. I have participated in ongoing reviews of PBGC, including a PBGC Advisory Committee Privatization Task Force in 1982-83, and presently serve by appointment of President Bush on the PBGC Advisory Committee.

Concerned by developments in 1991, EBRI undertook its own review of PBGC and in May 1992 published *EBRI Issue Brief* No. 126: "PBGC Solvency: Balancing Social and Casualty Insurance Perspectives." I ask that the full text of that review be included in the record of this hearing. The PBGC and its underlying statute still have room to evolve, but both have grown progressively stronger since 1974.

Employer-sponsored pension plans represent an important source of retirement income for Americans. In 1990, private pension retirement benefits of $141 billion accounted for 31 percent of the $457 billion in total retirement benefit payments (U.S. Department of Commerce). By comparison, private pension benefits totaled $7.4 billion in 1970. Factoring contributions and earnings, along with benefit payments, private sector defined benefit pensions had an estimated tax expenditure (using government methodology) of $8.2 billion in fiscal 1993; total tax expenditures for public and private sector employer-provided pensions was $56.5 billion.[1]

PBGC Financial History and Current Financial Status

Concern regarding PBGC's financial viability arises from a current agency deficit of $2.5 billion in the single employer fund and the estimated $31 billion in underfunding within individual single-employer plans, $13 billion of which is considered by PBGC to pose a serious risk because of sponsor's financial trouble. Table 1 presents a time trend of financial information for PBGC and the insured system.

Table 1 demonstrates the willingness of Congress to adjust premiums to maintain the cash flow solvency of the agency. Premium income is currently at an all time high and the cash flow is quite positive. According to PBGC, "Although cash flow could turn negative as early as three years in the pessimistic forecast, the fund has ample assets to pay its liabilities (benefit payments) for a considerable period of time" (Pension Benefit Guaranty Corporation, 1991).

The agency's deficit, while trending upward over time, has exhibited a great deal of volatility, particularly in the mid-to-late 1980s. The 1986 PBGC Annual Report placed the deficit at $4 billion due to LTV. The present deficit of $2.5 billion is higher than at any time other than 1986. While the reported deficit includes the present value of liabilities for future benefit payments, it makes no attempt to include future revenue receipts that will be available to at least partially cover these liabilities. According to PBGC, current premium receipts total $790 million per year, while interest and dividend receipts currently approximate $305 million per year (PBGC, 1991).

Table 2 compares PBGC's current reported exposure level with available figures of past exposure [2](Ippolito, 1989). 1990 exposure ($25.6 billion) is lower than at anytime between 1978 ($116.9 billion) and 1986 ($49.2 billion). In fact, current exposure is approximately 40 percent of the historic average of $59.9 billion. PBGC is a stronger agency today than at any time in its history, both financially and in its legal authority.

[1]The breakdown for the estimated tax expenditure of $56.5 billion for employer-provided pensions is as follows: private defined benefit, $8.2 billion; private defined contribution, $19.3 billion; public defined benefit, $27.9 billion, and public defined contribution, $1.1 billion. Keough plans had a tax expenditure of $2.7 billion and Individual retirement plans, $7.1 billion. (EBRI compilation from Joint Committee on Taxation data and EBRI estimates by plan type.)

[2]All figures are in 1986 dollars.

Status of the Defined Benefit System

The PBGC's ability to meet its future obligations depends also upon the health of the private defined benefit system as a whole. PBGC reports that in the aggregate defined benefit plans have $1.3 trillion in assets to back $900 billion in benefit liabilities. Available evidence suggests that approximately 85 percent of pension plans have assets equal to or exceeding 100 percent of liabilities, up from 45 percent in 1981, and 38 percent of plans have assets in excess of 150 percent of liability for accrued benefits (table 3).[3] The percentage of plans that were fully funded on a termination basis increased every year between 1981 and 1987 and leveled off between 1987 and 1991.

From 1977 to 1987, the funding status of single-employer defined benefit plans has significantly improved, rising from an average of 85 percent funded to 129 percent funded on a termination basis (table 4). Since 1980, defined benefit plans on average have been overfunded. The increase in funding ratios most likely reflects a combination of factors, including higher contribution rates needed to meet minimum funding standards, favorable investment returns on equity, and the use of higher interest rate assumptions to discount future benefits.

Despite the sound aggregate funding status of the defined benefit system, the net deficit of the single-employer insurance system can be significantly increased by single occurrences of distress terminations of large pension plans. PBGC publishes an annual list of the top 50 underfunded pension plans. Underfunding by plans on this list increased from $14.2 billion in 1989 to $21.5 billion in 1990.[4] Three firms, General Motors, Chrysler, and LTV are responsible for 97 percent of the increase in underfunding ($7.1 billion). (PBGC has reached tentative agreements with LTV to limit exposure. General Motors is the agency's largest premium payer.) The same three companies are also responsible for 64 percent of the top 50 companies' unfunded liabilities. Funding ratios of plan sponsors listed ranged from 6 percent for LTV, to 94 percent for National Steel, with an aggregate overall funding ratio of 75.5 percent. The underfunding of plans on the "Top 50" list is defined as unfunded guaranteed benefit liabilities (liabilities for non-guaranteed benefits are not included). Being on the "Top 50" list does not mean the plan is in danger of a distress termination. PBGC estimates that companies experiencing financial troubles accounted for $13 billion of pension plan underfunding in 1991, an increase from $8 billion in 1990.

Seventy-five percent of the listed plans' underfunding is attributable to plan sponsors in the airline, steel, auto, and tire industries, most of which sponsor flat benefit plans. Pension plan underfunding for an individual plan sponsor on the top 50 list ranged from $47 million to $7.1 billion. It should be noted that some plan sponsors

---

[3]Throughout this discussion termination basis refers to basing funding ratios on benefits accrued and assets accumulated at the end of the plan year—the assumptions plans would use to calculate liabilities for standard terminations. Termination basis funding does not refer to PBGC's calculation of liabilities for underfunded terminations, using termination mortality and retirement age assumptions.

[4]PBGC derived its top 50 list using a computerized data base created by Standard & Poor's Compustat Service, Inc., which contains corporate annual reports for fiscal years ending in 1990. PBGC supplemented the database with data from corporate annual reports for fiscal years ending in 1989 and earlier fiscal years, and where available, 1987 and 1988 5500 forms. PBGC also sent letters to plan sponsors containing their plans' funding information for comment prior to publication.

listed have pension plans that are overfunded, but since the PBGC does not have legal recourse to the excess assets of overfunded plans these assets are not included on the list.

PBGC and the "S&L Fiasco"

Public confidence is something to be guarded. It should only be threatened if there is a real reason to do so. Comparison of PBGC to the "S&L fiasco" serves to imply that a large number of pension plans that no one thinks are in trouble are on the verge of failure, that a taxpayer bailout is imminent, and that PBGC is in historically bad condition. None of these conditions exist. The unfortunate terminations of Eastern and Pan Am, which increased PBGC liabilities in 1991, were anything but unexpected. The prospect of liabilities from LTV were well known nearly a decade ago. In 1986 the PBGC deficit was reported at $4.0 billion (compared to $2.5 billion in 1991) due to the short term holding of the LTV plans by PBGC.

Congress has a long history of careful monitoring of PBGC and legislative action when needed to avoid any type of situation even resembling the "S&L fiasco." And, ERISA has been extremely successful in strengthening the overall insured defined benefit system.

Furthermore, it should be emphasized that the "S&L fiasco" had other features not found in the pension system. These features are:

- As of year-end 1988, FSLIC-insured savings institutions were much more concentrated in securities sensitive to downturns in the real estate market than defined benefit pension plans are today (charts 1 and 2). Defined benefit pension plan assets are highly diversified.
- S&Ls were given new investment powers in 1980 and many marginally capitalized institutions believed they could grow their way out of their problems. The rapid growth of agency-guaranteed liabilities does not appear to be the case with PBGC.
- Best judgments are that fraud and mismanagement existed in about 60 percent of the S&L failures and that it contributed to the failure or the insolvency in perhaps about 25 percent of the cases. Evidence of such activity among single-employer pension plans is almost non-existent.
- As S&Ls found themselves constrained by limits on the amount they could lend to a single borrower they began to sell off pieces of the loan to other institutions (loan participation). Many of these secondary lenders relied on the underwriting capacities of the originating S&L. Although a large proportion of defined benefit plan assets are placed in bank pooled funds and similar investments where there is a sharing of investment results, it is fundamentally different than loan participations that have been characterized as "a transfer of risk from a party who lacks courage to one who lacks knowledge."[5]
- From 1981 to 1987, S&Ls insured by FSLIC were permitted to use accounting options that were not in agreement with Generally Accepted Accounting Principles (GAAP) and have been described as "self-deceptive accounting procedures" by the Executive Director of PBGC. In contrast, pension plans must

[5]Koeppel, Jeffrey. "The Insolvency Looking Glass." *Best's Review* (September 1991): 37ff

adhere to very conservative accounting measures under FAS 35 while the vast majority of the large defined benefit plan sponsors follow GAAP procedures, at least for those events defining their solvency and net worth determinations.

Perhaps the most important distinctions between the two programs is that funds are not generally available to the participant on demand in a defined benefit pension plan prior to termination of employment. At that point approximately 40 percent of plans offer a lump-sum option. Although there is some potential for lump-sum distributions to negatively impact the cash flow of a pension plan, this could be controlled (at least theoretically) by ERISA Section 4045, which allows PBGC to recapture part of any distributions that start within the three-year period immediately preceding the failure of the plan. Certainly, there is only limited evidence of catastrophic "runs on the bank" from the standpoint of defined benefit plan sponsors or PBGC.

Moreover, after a termination the cash flow position is also markedly different between the two programs. Depositors in S&Ls were typically paid immediately, while PBGC can spread payments over a long period of time.

Although most of the discussion here has dealt with the similarities (or lack thereof) between the exposures of S&Ls and PBGC, the most important difference between the two guarantee funds is that the likelihood that a plan insured by PBGC will fail is diversified across several key industries whereas S&L guarantee funds were exposed exclusively to the risks of a single industry that was extremely vulnerable to fraud and events beyond its control.

The Long History of PBGC Reform

A review of PBGC Annual Reports to Congress finds that recognition of the "imperfection" of the original statute came early. The 1976 report raised the potential need for higher premiums, which were in turn increased in 1977 from $1 to $2.60. The 1978 report stated: "PBGC studies and research reflect both a growing awareness of fundamental defects in that program and possible solutions that will add to the long-term strength of the private pension system." That year PBGC told Congress that the Contingent Employer Liability Program called for by ERISA was "unworkable and undesirable."

The 1979 report outlined planned legislative proposals for the single employer program and reviewed proposed changes in the Multiemployer program, while the 1980 report contained further discussion of desired change and reported that the Multiemployer changes had been enacted (MEPPA).

The 1981 report outlined single employer program changes that were introduced in Congress. The 1982 report highlighted a request for higher premiums and more legislative proposals. The 1983 report revised the premium request and the proposals. The 1984 report found a positive income year and a positive claims year with a higher premium request but a spreading of the deficit being funded from 10 years to 15 years.

The 1985 report pushed for legislative change that was enacted and reported upon in the 1986 report (SEPPAA) along with a premium increase to $8.50. This legislation fundamentally restricted the circumstances under which employers could terminate an underfunded plan and "dump" liabilities on PBGC. The 1985 report also stated, however: "Unfortunately, the legislation is not sufficient to secure the program's future. The PBGC now faces a financial crisis that poses a serious threat to the future of its single-employer insurance program. Payments to current retirees are not at risk in the immediate future, and there is sufficient time to make the necessary changes. But the need for changes must not be ignored." The report highlighted the fact that the "underfunding of a small percentage of private pension plans threatens the PBGC's future."

The 1987 report highlighted an extraordinarily successful legislative effort by the agency: significant change in the single-employer program and movement to a variable rate premium structure. The changes in the Pension Protection Act of 1987 again tightened the minimum funding standards, with new minimum contributions, quarterly contributions, a lien for missed contributions, and new restrictions on funding waivers. Also, PBGC's position in bankruptcy was improved and even tighter requirements for allowing a plan termination were enacted. PBGC handed the plans terminated by LTV back to the company. The number of plan terminations increased to 10,865, but terminations with asset reversions declined. The theme of the report was "Keeping Promises", and it again highlighted the strength of the overall system.

The 1988 report stated: "Serious problems do remain, in part due to the uncertain status of the contested LTV plans. Unpredictable catastrophic claims and economic downturns could still threaten the agency's financial stability. But with the FY 1988 pension reforms, the pension insurance system now is considerably more stable and equitable. The reforms have provided greater security for the system and the benefits it protects. The program is better funded and many of the opportunities for abuse have either been eliminated or reduced. As a result, employers, workers, and retirees can all look to a brighter future, confident that defined benefit pension plans will continue to pay benefits as promised -- and that the PBGC will continue to protect them."

The 1989 annual report (the first to be signed by PBGC Executive Director James Lockhart) noted that "defined benefit plans are healthier than ever before. PBGC, however, remains exposed to the risk of some large underfunded pension plans...and is determined to encourage better funding of pension plans and to make it more difficult for employers to terminate these underfunded plans....As we continue to protect the pensions of workers and retirees, we look to the future with great confidence. This confidence is based on the soundness of the defined benefit pension plans, the recent legislative changes that reinforced the program, and the quality and dedication of the PBGC staff."

The 1990 report highlighted that the variable rate premium was increased to $19 per $1000 of unfunded vested benefits with a maximum per participant charge of $72 from $16 per $1000 of unfunded vested benefits with a maximum of $50 per participant for the new fiscal year. The year brought a significant increase in the PBGC deficit to $1.8 billion, with total liabilities of $5.1 billion and assets of $3.3 billion. The report pointed out for the first time that PBGC is exposed to about $20 billion to $30 billion in unfunded pensions. The annual report letter noted: "Our long-term goal is to operate as a service-oriented, financially solvent and professionally managed insurance company that serves as a safety net for a healthy, growing defined benefit pension system."

PBGC adopted a revised investment policy in 1990 that immediately reduced equity exposure from 50 percent to 33 percent, with subsequent decreases to 25 percent in 1991, and increased bond exposure from 43 percent to 59 percent, with further increases to 70 percent in 1991. This represented a significant shift from the investment policy urged upon the agency in the 1970's by ERISA author Senator Jacob Javits, who argued that an equity oriented emphasis would allow lower premiums over the long term. The new policy has the virtue of limiting swings in the PBGC deficit when interest rates change, but the negative of lowering the long term rate of return that might be achieved by a higher exposure to equities.

By the end of fiscal year 1990, the agency had not proposed any specific legislative language. The annual report noted: "PBGC could encourage better funding and reduce its exposure by seeking tougher funding rules, better pricing the cost of insuring underfunded plans, reducing insurance coverage by limiting guarantees, or increasing coinsurance by sharing losses....the keystone to a sound insurance program is legislative changes to strengthen the insurance fund."

The 1991 annual report carried the cover theme: "Strengthening the Pension Safety Net" The report stated: "It is becoming clear that we cannot achieve the goal of financially sound pension insurance without legislative changes." The year brought adverse court decisions and major terminations. The report states: "without further changes in the program the deficit could approach $18 billion by the end of the decade."

The 1991 report notes that insured single-employer plans have $1.3 trillion in assets and $900 billion in liabilities. It states that troubled plans, concentrated in steel, auto, tire and airline industries, are underfunded by $40 billion, with $13 billion in financially troubled companies. The report notes a $31 billion single employer plan liability with the following breakdown: "probable, $776 million; reasonably possible , $13 billion; remote, $18 billion."

The report states: "PBGC represents a major portion of the government's hidden liabilities. The defined benefit pension plans insured by the PBGC comprise more than 20 percent of the nearly $4.5 trillion in federal insurance. Fortunately, the assets of the pension plans exceed liabilities by several hundred billion dollars. The worth of the sponsoring companies provides further security. Nevertheless, within a generally healthy defined benefit system, pockets of underfunded pensions can be found, primarily in unionized manufacturing and transportation sectors of the economy."

The report noted the bankruptcy reform legislation set forth in November 1991, and promised funding and guarantee reform proposals as well (included in the 1992 budget and introduced in legislative language in mid-1992). The annual report letter from PBGC Executive Director James Lockhart concludes: "Bankruptcy, funding, and guarantee reforms will ensure that PBGC can continue to support the defined benefit pension system."

This review of PBGC history, from the perspective of the 1976-1991 PBGC Annual Reports to Congress, suggests that the agency and the Congress have acted on a consistent basis to improve the program and the underlying statute. The reports make clear that the overall status of the system has remained strong, and due to past reforms has gotten stronger over time. The reports also state clearly that the vast majority of participants in defined benefit pension plans face no risk of accrued benefit loss. Reports from the General Accounting Office, the Congressional Budget Office, and the

Joint Committee on Taxation, as well as others, make clear that there is not agreement yet among analysts upon the specific changes that should be made to the PBGC program. The history noted above indicates that the Congress will enact reforms to assure that crisis will not occur, and will enact additional reforms in the future if needed to insure stability of PBGC.

PBGC Premiums in Perspective

Some argue that significant increases in the minimum per participant premium that all plans must pay could lead well-funded plans to terminate their plans in exchange for a defined contribution plan or other possible employee benefits. There is no data to prove or disprove the hypothesis that the PBGC premium is close to the level where it would cause plans to terminate. However, examining the fees pension funds pay investment managers provides a reference point for the magnitude of the amount pension plans are willing to pay for outside services.

A recent survey shows the average annual fee paid by corporate plans to investment managers, relative to assets managed, was 44.0 basis points, or 0.44 percent (a basis point is equal to 0.01 percent) in 1990 (Greenwich Associates, 1991). According to EBRI tabulations, pension plans paying the minimum premium to PBGC pay a premium rate in the range of 1 basis point to 9 basis points for benefits at the annual guaranty maximum of $28,227 per participant (table 5). Underfunded pension plans paying the maximum premium pay from 3 basis points to 34 basis points for the same level of guarantee. Pension plans currently pay significantly less for their benefit guarantee than they pay to outside managers for pension fund investment services (from 40 basis points to 53 basis points). Only underfunded pension plans pay premiums close to average investment management fees for participants retiring at age 65, 40 years after plan termination.

Conclusion

Does a general taxpayer bailout reminiscent of the "S&L fiasco" loom on PBGC's horizon? There are currently sufficient liquid assets within the aggregate defined benefit system itself to cover the existing pockets of underfunding within individual plans. As shown in table 2, PBGC's current exposure represents a significant improvement for the agency; it currently stands at 40 percent of the average over 1978-1986. Therefore, unless legislative changes are made that cause employers to terminate well-funded defined benefit plans en-masse, thus denying PBGC a base of premium payers, a general taxpayer bailout would not be necessary.

This does not mean that the PBGC program does not have problems or that changes are not needed. Changes may be needed in order to reduce "abuse" and maintain participants' retirement security. As currently structured, the pension insurance system creates a financial incentive for employers to underfund their defined benefit plans. The vast majority of sponsors maintain well-funded plans despite this incentive, but some do not. Without changes, underfunding within the defined benefit system is likely to slowly improve if historical trends continue. Were more firms to begin taking advantage of the system, the financial picture could deteriorate.

It must be realized that general taxpayer interests lie as well in policymakers giving attention to the long-term tax consequences of public pension and retiree medical benefit promises that have not been advance funded. Private defined benefit plans are approximately $400 billion overfunded in the aggregate. PBGC has been the focus of attention during the past two years because of a present deficit of $2.5 billion and a potential shortfall of $30 billion–$40 billion in today's dollars over the next 30 years. This situation has been compared to the savings and loan crisis by some, yet during fiscal 1991 alone, combined unfunded liabilities of civilian and military pension plans increased by $52 billion. Actuarial deficiencies of federal retirement annuity programs consist of $864 billion in the Civil Service Retirement and Disability Fund and $702 billion in the Military Retirement System that future taxpayers will have to pay.

When considering any retirement income policy proposal, its potential effect on PBGC should be considered. For example, legislation, like OBRA '87, which limited the ability of well-funded plans to receive further deductible contributions, served to reduce the "PBGC safety net." In addition, the Revenue Act of 1978, which created 401(k) plans and allowed tax deductible employee contributions to profit-sharing and stock-bonus defined contribution plans but not to defined benefit plans, may well have indirectly harmed PBGC. Finally, the Senate version of the pending energy bill (H.R. 776) includes a provision that could have the United Mine Workers pension fund reallocate $210 million to pay retiree medical benefits and would create significant new liabilities for employers who had previously employed mine workers. This policy proposal has a direct impact on the affected employers and their ability to fund their own pension plans, and could therefore ultimately harm PBGC. This does not mean that it should not become law, but the decision to affect PBGC should be understood and explicit.

Clearly, if we are concerned about insuring the fiscal viability of PBGC, we should carefully think through the potential implications for PBGC of all policy proposals related to pensions and retiree health benefit plans. We should guard public trust, and we should continue to take actions that assure that promises made are promises kept. We should "tell the people" the truth; we should not "fear-monger."

Table 1
PBGC Financial Figures

($ in millions)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Premium Income	$19	$30	$25	$47	$70	$71	$75	$80	$81	$81	$82	$216	$284	$482	$624	$681	$764
Benefit Payments	2	10	13	28	32	37	57	94	137	169	170	261	303	325	356	372	516
Cash Flow (Premiums less Benefits)	17	20	12	19	38	34	18	-14	-56	-88	-88	-45	-19	157	268	309	248
Accumulated Deficit	n/a	n/a	95	138	146	95	188	333	523	462	1,299	4,000	1,480	1,451	1,000	1,913	2,510
Single-Employer Defined Benefit Assets[a]	164	190	205	240	280	354	389	484	566	609	716	772	751	772	n/a	n/a	n/a

Source: Pension Benefit Guaranty Corporation, *Pension Benefit Guaranty Corporation Annual Report*, 1975–1991 (Washington, DC: Pension Benefit Guaranty Corporation, 1976-1992), and Department of Labor, Pension and Welfare Benefits Administration, *Trends in Pensions 1992*, John A. Turner and Daniel J. Beller, eds. (Washington, DC: U.S. Department of Labor, 1992).

[a]Includes single employer plans, plans of controlled groups of corporations and multiple-employer noncollectively bargained plans.

Table 2
Exposure Levels Facing PBGC
(billions)

	Expsoure ($ 1986)
1978	116.7
1979	126.0
1980	73.0
1981	42.1
1982	39.5
1983	35.8
1984	25.9
1985	31.8
1986	49.2
Average	59.9
1990	25.6[a]

Source: Ippolito, Richard A. *The Economics of Pension Insurance*, Pension Research Council, Wharton School, University of Pennsylvania, 1989.

[a]In its 1991 Annual Report, PBGC reports exposure in the single employer system of $31 billion. This figure is discounted to 1986 price levels using the Consumer Price Index for All Urban Consurmers (CPI-U).

Table 3
Surveyed Firms' Funded Ratios, by Percentage of All Surveyed Pension Plans

Ratio of Accrued Benefits over Assets	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
0.00–0.49	17%	8%	6%	4%	3%	2%	3%	2%	3%	2%	1%
0.50–0.74	17	13	13	8	6	5	3	4	4	2	4
0.75–0.99	21	24	17	15	13	14	10	11	11	11	10
1.00–1.24	23	26	25	20	21	17	16	16	18	20	25
1.25–1.49	11	12	18	21	19	21	20	20	19	20	22
1.50 or more	11	17	21	32	38	41	48	47	45	45	38
Number of Plans	575	813	700	919	846	799	720	786	787	781	801

Source: The Wyatt Company, *1991, 1990 and 1989 Survey of Actuarial Assumptions and Funding: Detailed Survey Results Pension Plans with 1,000 or More Active Participants* (Washington, DC: The Wyatt Company, 1989, 1990, and 1991).

Note: Data from The Wyatt Company are based on a survey of pension plans covering 1,000 or more active employees. The 1990 survey contained single employer plans (90 percent) and multiemployer plans (10 percent).

Table 4
Funding Ratios of Single Employer Defined Benefit Plans, 1977-1987

	Funding Ratio
1977	85.0%
1978	84.2
1979	91.0
1980	107.0
1981	106.9
1982	115.4
1983	124.7
1984	128.8
1985	136.3
1986	132.4
1987	128.6

Source: U.S. Department of Labor, Pension and Welfare Benefits Administration, *Trends in Pensions*, John A. Turner and Daniel J. Beller, eds. (Washington, DC: U.S. Department of Labor, 1989).

Table 5
Comparison of PBGC Premium and Investment Management Fee Basis Points

	Premium paid for PBGC Guarantee (expressed in basis points)[a]	
	Participant Retires in 1992 at age 65	Participant Retires in 2032 at age 65[b]
Maximum premium	2.73	33.85
Minimum premium	0.72	8.93

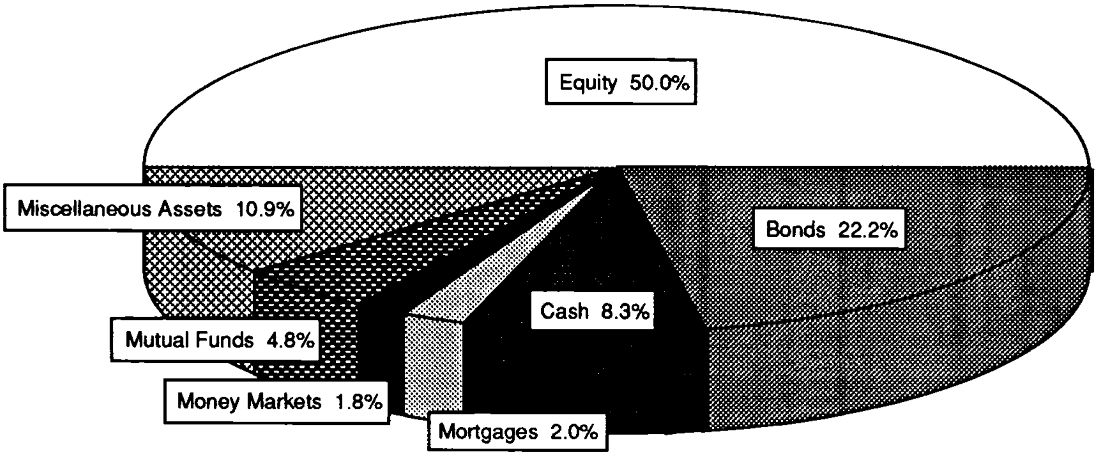
	Average Annual Fees Paid to Outside Managers (expressed in basis points)
	1990
All Corporate Funds	44.0
Over $1 billion	40.7
$501-1,000 million	40.6
$251-500 million	52.5
$101-250 million	43.2
$50-100 million	44.9
Under $50 million	43.7

Source: Employee Benefit Research Institute tabulations; and Greenwich Associates, *Going Global, Good Going, Investment Management, 1991* (Greenwich, CT: Greenwich Associates, 1991).

[a]Based on the annuity purchase price of $9.36 per dollar of annual income starting at age 65, and the 1992 maximum monthly per participant benefit of $2352.27.

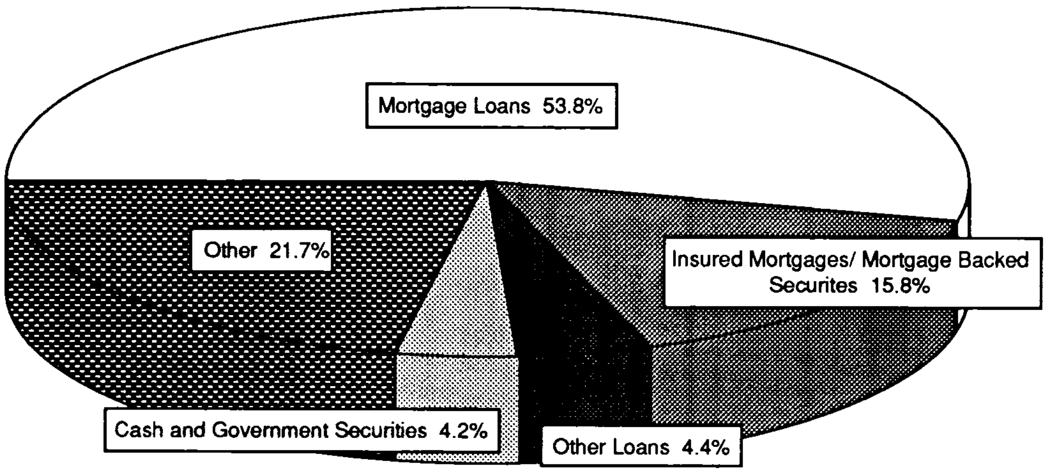
[b]Annuity prices for participants retiring at age 65 in 2032 are discounted at 6.50 percent, the immediate annuity interest rate for January, 1992. Annuity price is expressed in 1992 dollars.

Chart 1
Asset Distribution in Private Trusteed Pension Plans, 1991



Source: EBRI compilation from Board of Governors of the Federal Reserve System, *Flow of Funds Accounts, Financial Assets and Liabilities, Fourth Quarter 1991* (Washington, DC: Board of Governors of the Federal Reserve System, 1992).
Note: The Department of Labor published asset allocation of single-employer defined benefit plans with 100 or more participants based on 1987 5500 forms. Asset allocation in 1987 was equity, 22.9 percent; bonds, 16.7 percent; cash, 11.3 percent, real estate, 0.8 percent; unallocated insurance contracts, 22.4 percent; pooled funds, 20.4 percent; and other, 5.5 percent (John A. Turner and Daniel J. Beller, eds., *Trends in Pensions*, Washington, DC: U.S. Department of Labor, 1992).

Chart 2
Asset Distribution of FSLIC Insured Savings Institutions (as of December 31, 1988)



Source: EBRI compilation from United States League of Savings Institutions, *Savings Institutions Sourcebook* (Washington, DC: United States League of Savings Institutions, 1989).