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The PBGC Premium Rate Question and the Future of U.S. Pension Insurance

By George M. Kraw

The Pension Benefit Guaranty Corporation has protected American workers' pensions for more than three decades, but now it faces a future as difficult as that facing the single-employer and multiemployer defined benefit plans it insures. The Great Recession has worsened PBGC's financial difficulties, and the agency's conflicting goals have made its financial recovery problematic.

Significant reforms are necessary to avoid further harm to the agency's insurance programs. Among the needed changes are improvements in PBGC governance, expanded authority to set insurance premium rates and guaranteed pension benefits, and greater flexibility in selecting investments. Governance reform is a necessary first step, but the other changes must follow quickly.

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Demographics and economic trends are at the root of PBGC's problems.[1] The Government Accountability Office has designated PBGC's single-employer and multiemployer insurance programs as ''high risk.'' According to GAO, the agency had approximately $79.5 billion in assets and $102.5 billion in liabilities on Sept. 30, 2010, reflecting a deficit that is more than double its 2008 deficit.[2] For single-employer plans, the percentage of participants who are active workers declined from 78 percent in 1980 to 41 percent in 2007.[3] In the multiemployer program, PBGC has gone from a surplus in 2000 to a net deficit of $1.4 billion on Sept. 30, 2010. The active participation rate in plans insured under the multiemployer program is now less than 50 percent.[4] In its 2010 annual report, PBGC estimated that its future obligations for multiemployer plans might exceed $20 bil-

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[1] PBGC maintains two insurance programs, one for single-employer plans and another for multiemployer plans. The maximum guaranteed annual pension for a participant in a single-employer plan that is terminated in 2011 is $54,000; for multiemployer plans, it is $12,870 for a participant with 30 years of covered service.

[2] Statement of Barbara D. Bovbjerg before the United States Senate, ''Pension Benefit Guaranty Corporation: Improvements Needed to Strengthen Governance Structure and Strategic Management,'' Government Accountability Office, Dec. 1, 2010, p. 3.

[3] PBGC, Pension Insurance Data Book 2009, No. 14, Summer 2010, Figure 10, p. 27.

[4] Bruce Perlin, Nick Novak, Eric Field ''PBGC Multiemployer Program'' presentation at the 2011 NCCMP Lawyers and Administrators Meeting, May 5, 2011, Washington, D.C.

lion. GAO concluded that PBGC can make scheduled benefit payments for the near future but that the agency is at financial risk for the longer term.[5]

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The Employee Retirement Income Security Act of 1974 (ERISA) created PBGC, the agency tasked with encouraging the creation and maintenance of defined benefit plans, protecting retiree pensions, and keeping premium rates as low as possible in doing so.[6] Those three goals were never easily achievable and are even more difficult to attain today when many PBGC-insured plans are sponsored by industries in transition or decline. In the midst of the 2008-2009 financial and economic crisis here, PBGC took in more than 200,000 participants from failed plans sponsored by Lehman Brothers, Delphi, Nortel, IndyMac, and others. Since then thousands more participants have become wards of PBGC.

A continuing drop in the ratio of active participants to retirees puts additional financial pressure on corporate pension plans and PBGC. The agency is financed with insurance premiums paid by active insured plans, investment gains from the assets of terminated plans, and bankruptcy claims against insolvent employers. Its financing does not come from general tax funds. Plan failures occur in financially weak industries and individual companies, and those failures in turn limit options available to PBGC for protecting plan participants. With any action that addresses PBGC's short-term problems, whether it be to increase pension funding requirements or raise pension insurance premiums, the agency faces the risk of reducing participation in defined benefit plans or encouraging sponsors to terminate their plans. There is growing evidence that increased pension funding required by the Pension Protection Act of 2006 is reducing employment in some industries affected by the requirement. Government mandates that shift the financial burden of past pension funding decisions onto current and future workers raise questions about generational fairness.

Meeting the Challenges

Many policy solutions proposed for addressing PBGC's challenges have included some combination of the following measures:

- government would directly fund PBGC,
- government would guarantee the agency's debt,
- premium rates would be raised,
- guaranteed pension benefits would be lowered,
- funding rules for insured plans would be further tightened, or
- the agency would be privatized.

Each of those measures has drawbacks, and some measures are less likely than others to be adopted. The government's budget situation and the politics of pensions make government funding of PBGC impossible under current circumstances. Government guarantees of PBGC debt are politically unrealistic. Reducing insured benefit limits would result in reduced pensions for many Americans. Further raising premium rates discourages the creation and continuation of defined benefit plans and is ineffective if active participant levels continue to decline. Declining numbers of unionized workers, the most significant stakeholders and strongest proponents of defined benefit plans in the private sector, make it difficult to expand the active plan population. Stricter funding rules work only if sponsors can afford to fund their plans, and often the funding rules encourage plan terminations. The privatization option is likely to lead to less oversight of plans and to make insurance unavailable to plans that need it most.

In pursuing its conflicting statutory goals— maintaining defined benefit plans, guaranteeing pension benefits, and keeping premiums rates low—future compromises most likely will be required. To address PBGC's challenges in a way that preserves defined benefit plans and provides the greatest benefit for the largest number of plan participants, PBGC needs reforms that will enable it to meet changing circumstances.

Among the necessary reforms are:

- improving PBGC governance by increasing the number of directors, broadening the board's authority, and encouraging regular board and committee meetings consistent with the corporate governance principles followed by most large U.S. American corporations;
- expanding PBGC's authority by transferring from Congress to the PBGC Board of Directors the ability to set premium rates and adjust guaranteed pension benefits; and
- permitting a broader range of investments by lifting a requirement that some PBGC funds purchase only U.S. government securities.

Governance Reform

The PBGC Board of Directors currently consists of the secretaries of Treasury, Labor and Commerce. The president appoints the agency's executive director, who must be confirmed by the Senate. The agency has an advisory committee of seven members who represent the interests of the general public, employers, and employee organizations[7]

PBGC's board met only 23 times between 1980 and 2010.[8] Between February 2008 and February 2010, it had no meetings at all. A basic problem is that cabinet secretaries and senior assistants are too busy with other

[5] Bovbjerg, Ibid.
[6] 29 U.S.C. § 1302.

[7] The question of who is an appropriate representative of employee organizations has been subject to various interpretations by different administrations. At various times the post has been filled by lawyers, consultants, academics, and at one time an officer of a multinational oil company. Unlike European corporate boards, there is no mandatory union presence on the committee.
[8] Bovbjerg, Ibid. page 9.

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matters to devote additional time to the board. Many similar government entities have outside directors. PBGC should also. It would allow for shared workload and create a more effective board.

During the past several years, the Government Accountability Office has recommended a series of governance changes for PBGC. The recommendations generally have followed Conference Board guidelines. In 2009, legislation was introduced in the Senate to improve governance (145 PBD, 7/31/09; 36 BPR 1804, 8/4/09). PBGC at one point hired a consulting firm to suggest options.

Although an extended debate can be held about corporate governance improvements, there are certain obvious changes—many of them were contained in the 2009 Senate legislation—that PBGC needs to make sooner rather than later.

Increase the Size of the Board. The PBGC Board of Directors is the smallest of that of any similar government corporation board. A board of at least 10 directors would allow it to retain current board members and to add directors chosen for skills that specifically match PBGC's needs. Except for Cabinet members, director terms should be for no less than five years and should be staggered. At least one seat on the board should be reserved for a representative of employers and one for a representative of labor. To help insure that appropriate appointments are made, directors should be subject to Senate confirmation.

Hold Regular Meetings. The board should meet at least four times a year and should receive regular reports from the executive director and the advisory committee. It should be entrusted with a robust oversight role and should have ultimate responsibility for the operation and management of PBGC.

Create Board Committees. Board committees should oversee audits, investments, and risk controls. These are standard committee responsibilities for organizations engaged in insurance and similar activities. By expanding its size, the board will have room for individual board members who have experience in those areas.

Premium Pricing and Coverage Reforms

Putting in place a diversified board with clear authority and ready access to necessary information is a critical first step in improving PBGC's governance and operations. Once those changes are in place, Congress should proceed to expand the authority of the board to set premium rates and maximum insured pension benefits. That authority currently is a legislative prerogative. The Obama administration has proposed giving PBGC authority to increase premiums for single-employer plans and to set premium rates to reflect individual company risks.[9] (31 PBD, 2/15/11; 38 BPR 354, 2/22/11). The proposal has met with opposition from employer groups, including the U.S. Chamber of Commerce, Business Roundtable, and National Association of Manufacturers, among others. Those groups are especially concerned about Congress relinquishing its power to set premium rates. But leaving that authority with Congress makes change awkward and raises the risk of future operational deadlock. An expanded board composed of members whose skills match the needs of PBGC and the plans it insures would best be able to oversee the setting of premium rates.

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Similarly, the board should be empowered to set maximum guaranteed benefits for PBGC's two insurance programs. Currently, significant differences exist between single-employer and multiemployer coverage levels and coverage levels within the single-employer program. In the single-employer program, the maximum benefit is indexed to inflation and based on the participant's age at retirement. Multiemployer plan benefits are insured to a maximum of slightly less than $13,000, while the maximum coverage for single-employer plans is $54,000. A worker in a multiemployer plan may have an insured benefit that is only a fraction of that of an otherwise similar counterpart in a single-employer plan.

The PBGC Board of Directors should have the authority to review premium rates and guaranteed annual pension benefits to determine how each should be adjusted to meet changed circumstances. The potentially grave financial challenge facing PBGC might make it impossible for the agency to meet its obligations simply by increasing premium rates. Assuming no financial assistance from the federal government, it could be facing insolvency. PBGC's board should be given the tools now to adjust maximum insured benefits to match the agency's financial resources. If members of Congress are uncomfortable delegating such broad powers to PBGC's board, Congress could retain authority to veto increases in premium rates or decreases in guaranteed pension benefits, and it could empower an independent commission to review them.

Investment Reforms

PBGC assets are held in two separate groups of funds. The revolving funds, valued at approximately $17 billion, receive all premium payments. The trust funds take in assets from terminated pension plans. By law, PBGC is required to invest certain revolving funds in obligations issued or guaranteed by the federal government.[10] The remaining revolving funds can be invested in other fixed-debt obligations. Trust fund as-

[9] See "In the News: About Fair Premiums" http://www.pbgc.gov/news/press/releases/fair-premiums.html.

[10] 29 U.S.C. § 1305

sets can be invested in fixed-income, equity, and private-equity investments. PBGC generated at 12.1 percent overall return on invested assets in fiscal year 2010.[11]

PBGC's investment policy is set by its board. Over the years, the policy has been a source of controversy, raising questions about whether the agency should adopt a conservative liability-to-asset-matching strategy or a strategy based on a higher allocation to non-matching assets such as equities. The Advisory Committee, which has responsibility to advise on policies and procedures related to PBGC's investments, should meet directly with board members on this matter.

Moreover, the board should not be bound by statutory requirements that it keep substantial portions of its assets in U.S. government obligations. Allocations to U.S. government debt should be made solely on the basis of what is in the best investment interests of the agency, as determined by the board at the time the investment is made.

Challenges Ahead

Ultimately, the most significant aspect of PBGC's mission, established under ERISA, is to ''continue and maintain'' private-sector defined benefit plans. It will not succeed in this task by continuing policies that further reduce plan participation and encourage plan sponsors to terminate their plans. If PBGC and the defined benefit community remain under financial pressure, PBGC must be governed by policies that spread the financial burden fairly among all stakeholders. Past practices or prior history must not be allowed to dictate future policies and practices. Strengthening the PBGC Board of Directors and expanding its authority will not guarantee a solution to all the challenges facing PBGC, but it is an important and necessary first step in addressing them.

[11] Investment Program Fact Sheet http://www.pbgc.gov/res/factsheets/page/investments.html.

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