RIGHTSIZING PENSION PREMIUMS TO PROTECT PARTICIPANTS, PLANS, AND THE PBGC

Summary. According to the Pension Benefit Guaranty Corporation’s (“PBGC”) own financial reports and projections, PBGC’s single employer plan system is financially strong and is receiving more premiums than are needed to provide security to that system. In that context, the extremely high level of PBGC premiums is unnecessarily causing significant harm to plans, employees, employers, and the PBGC itself. Accordingly, it is time to update the premium rules for single employer plans as follows to take into account the changes in PBGC’s financial strength:

- Small businesses with 500 or fewer employees would have their premiums calculated without the increases enacted in 2006, 2012, 2013, and 2015. This would return these plans to the premium levels in effect before concerns about PBGC solvency triggered the massive premium increases over the last 11 years. The same treatment would apply to “CSEC plans,” which are generally multiple employer plans comprised of charities or cooperatives.
- All other businesses would have their premiums adjusted to take into account the actual financial strength of the PBGC, determined in the same manner that the funding status of private plans is measured, pursuant to Congressionally set standards.
- Since PBGC premiums cannot be used for any other governmental purposes, premium increases or decreases would not be taken into account in determining the budget effects of legislation.

Background. In the past, there has been uncertainty about the solvency of the PBGC’s single employer plan insurance program. That uncertainty has led to very large increases in PBGC’s single employer plan premiums. Generally, prior to the enactment of the Pension Protection Act of 2006 (“PPA”), single employer plans were obligated to pay annual flat rate premiums to the PBGC equal to $19 per participant. That $19 rate is scheduled to increase to $80 in 2019, more than four times the level 11 years ago. Prior to the PPA, plans were also subject to a variable rate premium equal to .9% of plan underfunding. That .9% rate is scheduled to be at least 4.2% in 2019, again more than four times the level 11 years ago. These increases are the result of legislation in 2006, 2012, 2013, and 2015.

These enormous premium increases need to be revisited in light of new information. This year, the PBGC has confirmed the financial strength of the single employer plan program. According to PBGC itself (using its own extremely conservative assumptions), the single employer program is projected to likely have a surplus of $2.6 billion by 2025. In fact, PBGC’s most recent annual report shows that annual premium income alone more than covers all PBGC expenses (including benefits), so that PBGC can pay all expenses without using any of its $99 billion of assets or the investment income generated by those assets.

With such newfound clarity on the strength of the PBGC’s single employer program, it is time to revisit the dramatic premium increases that have applied to single employer defined benefit plans. These increases have had very adverse effects:
- Adverse effects on business recoveries, especially in the case of small family-owned businesses that are struggling with legacy costs associated with pension plans established in a wholly different economic climate.
- Adverse effects on the defined benefit system, as high premiums are driving companies out of the system and discouraging new plans.
- Adverse effects on employees, who see jobs cut and benefits reduced to pay for these premiums.
- Adverse effects on the PBGC itself, which is seeing its premium base erode with employers exiting the system. This issue has been highlighted as possibly needing study in 2015 and 2016 by PBGC’s Participant and Plan Sponsor Advocate. This threat has also been confirmed by the following:
  - In 2014, Quantria Strategies prepared a report for the American Benefits Council in which it found that PBGC premium increases “are not only unnecessary, but they also threaten the long-term viability of both the defined benefit… pension system and the PBGC’s plan termination insurance program by further driving away employers that present no risk to the system.”
  - The disturbing findings in the American Benefits Council’s report were confirmed by a 2015 poll highlighted in a PLANSPONSOR article, which found that almost half of all large defined benefit plans have actually taken steps to exit the defined benefit system in whole or in part. And the same poll found that the biggest reason for such exits is PBGC premium increases.
- Adverse effects on the important missions served by charities and cooperatives participating in CSEC plans, which are being grossly overcharged by the PBGC, according to the PBGC’s own data.
  - PBGC previously projected making more than a 3,000% profit on CSEC plans for the 2014-2018 period.
  - The same facts that led Congress to adjust the funding rules for CSEC plans in the Cooperative and Small Employer Charity Pension Flexibility Act (Pub. L. 113-97) strongly support adjusting the PBGC premiums charged to CSEC plans. Since CSEC plans pose far less risk to the PBGC than single-employer plans, it does not make sense for such plans to be subject to the same premium structure.

**Proposals.**

**Fair treatment of small businesses.** Under the proposal, the premiums paid by small businesses (500 or fewer employees) would return to the levels in effect prior to the massive increases of the last 11 years, i.e., $19 per participant flat premium and a variable rate premium equal to .9% of unfunded vested benefits, with neither amount indexed. To avoid a costly cliff when an employer hires a 501st employee, the small business rates would be phased out gradually between 501 and 600 employees.

**Fair treatment of CSEC plans.** Under the proposal, the premiums paid by CSEC plans would also be returned to the levels in effect before the increases of the last 11 years, which were prompted by concerns regarding plans posing far greater risk to the PBGC than CSEC plans. Also, the measure of liability for determining the variable rate premium owed by CSEC plans would be conformed to the measure applicable to CSEC plans for funding purposes. It does not
make sense to measure CSEC plan liabilities in an entirely different way for funding and premium purposes.

**Measure PBGC’s “funded status” based on Congress’ rules established for private pension plans (without pension smoothing) and adjust premiums based on PBGC’s funded status.** In the past, PBGC has been free to determine its own non-transparent rules for measuring its “funded status,” i.e., the ratio of its assets to its liabilities. This has worked very poorly, with PBGC using inappropriate measurements of liabilities with no relationship to Congress’ measures of funded status. Accordingly, under this proposal, PBGC’s funded status would be determined under the same rules that Congress applies to private pension plans, except that pension smoothing would not apply. For this purpose, only actual PBGC liabilities would be taken into account; liabilities of plans that have not been turned over to the PBGC would not be taken into account in determining PBGC’s funded status. Since Treasury administers the funding rules applicable to private pension plans, Treasury would also determine PBGC’s funded status after consultation with the PBGC.

Under this part of the proposal, premium levels for all businesses (other than small businesses and CSEC plans) would logically be reduced as PBGC’s funded status improves.

- **Current law regarding premium levels – including scheduled increases.** These levels would be in effect whenever the average funded status of PBGC’s single employer plan program over the prior two fiscal years was less than 90%.

- **Premium levels without regard to the increases in the 2015 Budget Act.** If such average funded status was at least 90% but less than 100%, PBGC premium levels would revert to these levels (generally, a flat premium of $64 and variable rate premium of 2.8%, both indexed).

- **Premium levels without regard to the increases enacted in 2012, 2013, and 2015.** If such average funded status was at least 100% but less than 110%, PBGC premium levels would revert to these levels (generally, a flat premium of $30 (indexed) and a variable rate premium of .9%).

- **Premium levels in effect without regard to the increases in 2006, 2012, 2013, and 2015.** If such average funded status was at least 110%, PBGC premium levels would revert to these levels (generally, a flat premium of $19 and a variable rate premium of .9%).

Congress’ ability to modify premium levels would not be affected in any way. For example, assume that PBGC is 100% funded in 2017 but Congress decides that a premium increase is needed because of other risks. Such a premium increase would not be precluded by this proposal. And Congress remains able at any time to modify any feature of the proposal, such as raising the 90% trigger or changing the effect of being over the 90% level.

The proposal thus does not tie Congress’ hands in any way. The proposal would simply establish a default mechanism for setting premiums based on a straightforward commonsense structure. The primary benefit of doing this is to send a message to plan sponsors that premiums will not continually go up, but rather will be based on PBGC’s actual financial condition. Without this type of positive message for plan sponsor, the exodus from the defined benefit plan system and the erosion of PBGC’s premium base are likely to accelerate dramatically.
Correction of the budget process. Under current law, premiums paid to the PBGC cannot be used for any other government purpose. Yet for budget purposes, premium increases are taken into account to pay for other expenditures, such as highways. This is not appropriate since premiums could never be used for such other expenditures. Similarly, reductions in PBGC premiums do not reduce the funds available to the government to pay for other expenditures. Thus, there is no reason to treat PBGC premium reductions as reducing the funds available to pay such other expenditures.

Accordingly, under the proposal, premium increases and decreases would not be taken into account for budget purposes.