AMERICAN BENEFITS COUNCIL

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Concerns Regarding PBGC: Will Its Own Policies Trigger a Need For a Bailout?

A sound and balanced analysis of the financial condition of the single-employer program of the Pension Benefit Guaranty Corporation ("PBGC") leads to two striking conclusions:

- Based on its current assets and liabilities, the PBGC will be able to pay all of its liabilities indefinitely.

- The largest threat to the PBGC's ability to weather future plan terminations is the exodus of plans from the system, which has been largely triggered by the PBGC's own policies.

The Current Strength of the PBGC's Single-Employer Program

It is clear that the PBGC's multiemployer plan program is facing grave challenges, but that program is entirely separate from the PBGC's single-employer program, which is quite healthy. Specifically, as of September 30, 2013, the single-employer program had assets of $83.2 billion and paid claims of $5.4 billion.

Because of premium income of $2.9 billion in fiscal year 2013, PBGC only needed to earn 3.5% on its assets to cover its claims and expenses ($0.4 billion) and turn an additional profit. However, in a good year for the financial markets, PBGC's investments yielded only 3.3%. Assuming that PBGC can earn more than 3.3%, PBGC stands to make significant future ***profits*** that would add to its reserves, not deplete them.

In fact, PBGC has made dramatic profits over the last 10 years. During that period, assets in the single-employer program have grown by 111% (from $39 billion to $83.2

billion). At the same time, benefit claims have only grown by 80% (from $3 billion to $5.4 billion).

Thus, PBGC asset-to-claims ratio has grown dramatically by almost 20%, making PBGC far stronger than it was 10 years ago. Yet PBGC maintains that its deficit has grown by 18% (from $23.3 billion to $27.4 billion). Briefly stated, the facts do not support PBGC's deficit reports.

- The PBGC's self-reported deficit applies today's artificially low interest rates to liabilities that will be paid over 50 or 60 years. Today's low interest rates have absolutely nothing to do with PBGC's ability to pay a benefit over 50 or 60 years, just as the higher interest rates that created a reported $9.7 billion surplus as of September 30, 2000, had no relevance to PBGC's ability to pay long-term obligations.

- For 2013, the PBGC used interest rates of 3.25% and 3.32% to value its liabilities (2013 Annual Report, p. 80). For 2000, the PBGC's interest rates were 7% and 6.75%. 2000 Annual Report, p. 38. ***If PBGC's interest rates from 2000 were used to value PBGC's current liabilities, PBGC's "liabilities" could fall by more than 40%, from $110.6 billion to a figure far below total assets of $83.2 billion.***

- PBGC's deficit reports exacerbate the above problem by actually basing the calculations on a secret survey of insurers to determine the interest rates charged in setting commercial annuity purchase rates, even though PBGC does not buy commercial annuities.

In short, the PBGC has made large profits over the last 10 years, but that fact has been obscured by its use of artificially low snapshot interest rates, which have no relationship to the PBGC's ability to pay future claims. In fact, as PBGC has recently said, it has "sufficient funds to pay benefits for the foreseeable future."

THE TRUE THREAT TO THE PBGC

The most significant threat to the PBGC's ability to cover future terminations may be PBGC's own policies. The premium base of the PBGC is steadily declining. An alarming number of plans have been frozen and many plans have exited (or will exit) the system.

This very real reduction in the PBGC's premium base has been fueled largely by PBGC's own policies. Plan sponsors have left the system primarily for three reasons: (1) funding volatility, (2) accounting volatility, and (3) in recent years, the rising cost of PBGC premiums.

Yet, PBGC has continued to be an active voice in public policy discussions supporting policies that give rise to funding volatility and PBGC premium increases (including advocating for PBGC control over premium levels, which our membership strongly opposes). In fact, the catalyst for the 2012 de-risking transactions was the Administration's 2011 budget proposal to raise premiums by $16 billion. It is a virtual certainty that the Administration's recent request for another $20 billion this year will fuel more departures from the system.

In the next five to 10 years, another issue will contribute heavily to the exodus from the system. PBGC has used an obscure provision of the law (ERISA Section 4062(e), aimed at very narrow downsizing situations) to interfere in — and in many cases actually prevent — critical business transactions, such as mergers, business sales, and consolidations of operations. PBGC uses this obscure power to require employers to overfund their plans if the employers want to engage in the business transactions. Within five to 10 years, a very large portion of plans will become subject to this obscure rule. As awareness of this problem grows, more employers will leave the system.

Paradoxically, not only is PBGC driving employers out of the system, but the only ones that can afford to fully exit are those with stronger, better funded plans. So PBGC will be left only with unhealthy plans that are unable to pay for their own failures. ***In fact, the PBGC has confirmed that it has not even considered the long-term implications of current trends***. See PBGC's 2012 Annual Exposure Report at Page 4:

> The use of annuity buyouts and lump sums by companies seeking to "de-risk" significant portions of liabilities has recently become quite visible. … We have not yet investigated the potential that this would decrease PBGC premium income … [The] PIMS … model … does not account for the possibility that a plan sponsor will offer a significant portion of its participants (retired or otherwise) a transfer of assets either through annuity purchases or payments of lump sums.

Today, PBGC's single-employer program is very strong. If healthy plans and companies are driven out by the continuation of current PBGC policies, PBGC's revenue sources will dry up, leaving it unprotected against future losses.

OUR RECOMMENDATIONS

The Council recommends that Congress:

- Examine the true nature of the PBGC's financial condition, based on its assets and its dramatic profits over the last 10 years.

- Reduce the excessive premium increases enacted in 2012 and 2013, the latter enacted without input from the committees of jurisdiction.

- Join bicameral efforts to stop PBGC from interfering in business transactions.

- Take steps to address the volatility that is driving employers out of the defined benefit system.

- By doing all of the above, send a signal to employers contemplating leaving the pension system that it may be safe to stay in.