

October 11, 2018

The Honorable Orrin G. Hatch  
SH-104 Hart Senate Office Building  
Washington, DC 20510-4402

The Honorable Ronald Lee Wyden  
SD-221 Dirksen Senate Office Building  
Washington, DC 20510-3703

Dear Chairman Hatch and Ranking Member Wyden:

We are writing regarding a technical aspect of the determination of premiums owed to the Pension Benefit Guaranty Corporation (“PBGC”) with respect to single employer defined benefit plans. We are not writing to express any policy position regarding the proper level of PBGC premiums, or regarding the right mix of flat and variable rate premiums.

For 2018, the variable rate premium applicable to a plan is \$38 for each \$1,000 of the plan’s unfunded vested benefits (3.8%). This figure is scheduled to increase by \$4 for 2019, to \$42 (4.2%). In addition, this variable premium rate is indexed based on increases in the National Average Wage Index (“NAWI”), so that the \$38 figure could increase by more than \$4 in 2019, and is expected to increase indefinitely in future years as long as the NAWI increases. This indexing was first enacted in 2012; before the indexing and specified increases took effect, the figure referenced above had been \$9 (0.9%) for 23 years.

As discussed further below, our concern is that indexing the variable premium rate is inconsistent with fundamental insurance principles and will lead to inappropriate results, including eventually a variable rate premium that exceeds 100% of a plan’s underfunding. Indexing the premium rate is analogous to indexing an income tax rate. There is no need to index a tax rate, because the measure to which it applies (i.e., taxable income) already adjusts with time. If a tax rate were indexed, eventually the rate would exceed 100% of taxable income.

First, the indexing does not connect the premium with changes in PBGC’s exposure. The measurement of unfunded vested benefits is intended to reflect PBGC’s exposure to liability in the event of a distress termination of a plan, in which case unfunded plan liabilities are turned over to the PBGC. Under insurance principles, the variable rate premium should be set to reflect the risk posed to the PBGC, which is roughly proportional to a plan’s unfunded liabilities. If all plans are certain to undergo a distress termination in a particular year, the variable premium rate should presumably be 100% of the guaranteed amount. But that, of course, is not the case. The vast majority of plans have a very small chance of having to undergo a distress termination in a particular year, and that risk is unlikely to vary substantially from year to year. So the variable premium rate should be set in a way that reflects the risk posed by the system as a whole, using a constant rate to apply to unfunded liabilities, rather than an ever increasing rate.

Second, another way to frame the issue is that the indexed premiums are not connected with the value of what is insured. Generally, insurance premiums should be based on the value of the item or asset insured, like a car or a house, multiplied by a rate that reflects the chances that certain events will occur that will affect that value. Because the value of the asset can adjust over time, either up or down, indexing the rate does not make sense. The value of the asset is naturally already “indexed,” like the value of a house or car. So the rate should not be increased by any type of indexing; the rate should only be adjusted based on a change in the likelihood of the specified event, like damage to a house or car.

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We are not aware of any insurance premium rate that is indexed separately from the value of the item being insured. In the case of the variable rate premium, the item insured is a participant's claims to guaranteed benefits to the extent not covered by existing plan assets in a distress plan termination. The relevant values change year to year, as measured by actuaries. There is no technical basis to index the rate also, which can only lead to inappropriately high premiums, as illustrated above.

In summary, variable premium indexing is inconsistent with fundamental insurance principles. The point that best reveals the flawed nature of the rules is that, as noted, the current system will eventually lead to rates above 100%, which means that plans will be paying the PBGC more than the amount needed to cover the PBGC's exposure and will be paying that every year. This is not appropriate.

The points made in this letter are not to urge that indexing be capped somewhere below 100%. The points are made to illustrate the inappropriateness of *any* indexing.

As noted above, we offer no view on the proper variable premium rate. We only observe that any indexing of that rate is not appropriate. We would, of course, be pleased to engage in further technical dialogue on the issues addressed in this letter. It is our hope that together we can help strengthen the defined benefit plan system, which provides significant retirement security for American workers.

Sincerely,

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cc: Members of the Finance Committee