



AMERICAN BENEFITS COUNCIL

July 5, 2011

MYTHS AND FACTS: PENSION BENEFIT GUARANTY CORPORATION "DEFICIT" AND PREMIUM PROPOSALS

MYTH: *The proposed "premium" increase reflects employers' responsibilities to close a deficit those employers have created.*

FACT: The argument that premiums should be increased to close a deficit for which current plan sponsors of defined benefit pension plans are responsible is flawed. It ignores the fact that the alleged deficit (see discussion of faulty assumptions below) primarily includes amounts to be paid by the PBGC resulting from its takeover of underfunded plans terminated in the past by employers who either no longer exist or, if they are still in business, no longer sponsor a pension plan.

When one taxpayer is asked to pay expenses attributable to the past actions of another, that is a tax, not a premium. It is certainly fair to require defined benefit pension plan sponsors to pay the cost of the insurance protection they receive from the PBGC. But neither Congress nor the PBGC has held a hearing or examined the cost of the protection, making it exceedingly clear that this is a revenue-raising effort; not an effort to determine the true cost of PBGC's services.

If Congress approves this proposal, it will have voted to increase taxes on those corporations who, despite all the compelling reasons to exit the defined benefit pension system, are still sponsoring plans for their workers and retirees.

MYTH: *PBGC is in danger of a taxpayer bailout.*

FACT: PBGC's own annual report states: "Since our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future."

This fact is by no means a reason for Congress to delay examining the issue of premiums. But it does give policymakers the opportunity and obligation to thoughtfully consider how to protect plan benefits in ways that will not discourage employers from sponsoring plans, and also to ensure that an undue burden is not placed upon the PBGC in the future.

MYTH: *PBGC has a deficit of \$23 billion.*

FACT: There is no public record to support this assertion.

The \$23 billion number is based on a study of the cost of buying annuities to satisfy pension liabilities, despite the fact that PBGC *does not purchase annuities*. This can have a very material effect on determining the size of a deficit. PBGC actually resembles an ongoing pension plan in that it pays out benefits over many years.

PBGC determines its deficit based on very aggressive interest rate and other assumptions that it uses in the context of “distress” plan terminations and in its strategy to sue employers. In that context, the aggressive assumptions increase PBGC’s claims against employers and *minimize benefits paid to retirees*. It would be completely inappropriate to increase premiums without examining this issue.

PBGC’s annual report states that almost 30% of its deficit is solely attributable to the drop in interest rates over 12 months. Interest rates have been low as part of a national strategy to address recent economic challenges. Those historically low interest rates do not suggest any failure on the part of employers to responsibly fund pension plans; nor do those rates bear any resemblance to likely interest rates that will prevail over the forthcoming decades.

Moreover, even if it were true that PBGC has a \$23 billion deficit, raising premiums would be the wrong response. First, as noted above, PBGC’s “deficit” is highly dependent on current interest rates and also the current equity markets. Anytime one looks at a long-term obligation like a pension at a snapshot point in time, it will give a very skewed picture of the actual situation. When the PBGC was boasting a nearly \$10 billion surplus, the American Benefits Council did not advocate a premium *reduction*, and Congress quite properly did not pursue one. A reduced premium at that time would have been as imprudent as an increased premium is now.

PBGC will pay benefits to current and future retirees of plans for which it is responsible, literally, over the next several decades. In this respect, the PBGC guarantee is not anything like the Federal Insurance Deposit Corporation (FDIC) guarantee for banks that fail. In that instance, FDIC immediately pays depositors. By contrast, PBGC will be paying benefits to participants in plans that have *already* terminated (let alone any that might terminate in the future) over numerous economic cycles for years to

come. It makes no more sense to evaluate PBGC's financial condition at a single point in time right now, when interest rates are low and the stock market has not fully recovered, than it was to do so when interest rates were higher and the market was booming. It is the long-term outlook, not one point in time, that is relevant.

Second, if an individual or a corporation purchases an insurance policy of any type, its premium is not based on the profit or loss of the insurance company in that year. Moreover, the premiums do not rise or fall based on the insurance company's profitability as the policy is renewed each year. PBGC deserves a premium that reflects the risk it bears that an underfunded plan may terminate and the agency will assume the plan's obligations to pay benefits. That is what exists today with the variable rate premium; and it is the proper way to determine the agency's risk.

MYTH: *The proposed premium increases are modest and would not have a material effect on businesses.*

FACT: **The criticism that employers are complaining about an increase that amounts to pennies per hour per worker is not true.**

As the Administration has described its proposal, it appears that premiums could, by the end of a phase-in period, increase by over \$1,000 per participant, per year for some companies. This calculation is based on the following assumptions derived from the PBGC's description of a likely way the premium increase would apply: (1) the entire additional premium increase could be imposed on plans maintained by employers that are below investment grade, (2) approximately 20% of plan sponsors are below investment grade, (3) the premium increase will be phased-in, so to raise the full \$16 billion, the premium amount will be extremely high by the end of the phase-in period, and (4) the treatment of a plan sponsor as below investment grade will also be phased-in, so companies that have been below investment grade for many years will pay comparatively higher premiums, even though they will have maintained their pension plans throughout the period they have been below investment grade. A \$1,000 per participant annual premium increase is by no means insignificant; and it is particularly unjustified, if the company's plan is well-funded, but the company has, for whatever reasons, received a low credit rating.

MYTH: *Like any other insurance company, the PBGC should be allowed to determine the premium it charges its customers.*

FACT: **It would be a serious mistake for Congress to relinquish its authority to set premiums.**

It has often correctly been noted that unlike other insurance companies that can refuse to accept a prospective customer, PBGC is required to provide termination insurance for all pension plan sponsors. But the reverse is also true. An employer that sponsors a pension plan for its workforce cannot shop around for another agency/insurer with whom to do business. By law, it must pay PBGC premiums. In this respect, the relationship is not like the private sector insurance marketplace from either the agency's or the employer's perspective. It is therefore fundamentally unfair to vest one party to this required relationship (i.e. PBGC) with the unilateral authority to decide the amount its customers (i.e. employers) must pay. Moreover, even private sector insurers must get approval from state insurance regulators for the premiums they charge. Why, then, with the retirement security of millions of Americans dependent upon the willingness of employers to continue sponsoring pension plans would Congress give an executive branch agency the power to set premiums?

MYTH: *The government would not be involved in rating companies under the Administration's proposal.*

FACT: **By necessity, the government would have to approve the actions of the private credit rating agencies and, by implication, the government would be rating private companies and tax-exempt organizations.**

Employers appreciate PBGC's intent to insulate companies with high credit ratings from having to pay an undue share of higher premiums. But this well-intended policy is fraught with problems, which is why companies with the highest credit ratings, that would ostensibly benefit from the proposal, oppose it. Many employers, like Congress itself in recent years, have concerns about various determinations made by credit agencies. Companies, and certainly Congress as well, should be concerned about the role the government would be playing in evaluating the creditworthiness of private entities.