



AMERICAN BENEFITS COUNCIL

August 5, 2014

TAKE-AWAYS FROM PBGC'S 2013 PROJECTIONS REPORT

The Pension Benefit Guaranty Corporation (PBGC) published its [Fiscal Year 2013 Projections Report](#) (formerly the Exposure Report) on June 30, revealing that the financial condition of the single-employer insurance program is likely to improve dramatically over the next decade, so that there is actually a 42.5% chance that the program will have a surplus, even under the PBGC's extremely conservative assumptions. However, the multiemployer plan system, poses serious concerns for the PBGC.

The PBGC's 2013 Projections Report provides actuarial evaluations and estimates of the financial status of the single-employer and multiemployer pension insurance systems for the next ten years - to 2023.

OVERVIEW

According to the report, the current deficit in the single-employer plan program of \$27.4 billion is projected to narrow to a *median* deficit of \$4.4 billion by FY 2023 - a roughly 85% decrease from last year's ten-year projected deficit of \$29.9 billion in FY 2022. Correspondingly, the *average* projected deficit declines by 77% from \$32.5 billion to \$7.6 billion.

For FY 2013, PBGC premium increases played a relatively small role in reducing the deficit, accounting for only \$4.7 billion of the reduction in the average deficit - less than 19% of the reduction. The biggest changes by far were simply the continued recovery of the economy, higher interest rates, and "data changes" from 2012 to 2013, accounting for \$18.3 billion of the reduction, *i.e.*, over 73% of the reduction. This confirms the point that has been made consistently about the PBGC deficit: it is a product of temporary adverse economic conditions and will recede as the economy recovers and interest rates rise.

Moreover, like the prior report, this reports states that “[o]ut of 5,000 simulations, none project that the PBGC’s single-employer program will run out of money within the next 10 years.”

However, the report also reveals that the multiemployer pension insurance program’s projected deficit rose markedly in 2013, putting that program at greater risk of insolvency in the near term.

SINGLE-EMPLOYER PROGRAM

The 2013 Projections Report concludes that the health of the single-employer pension insurance system will continue to improve over the coming decade.

PBGC’s most recent estimate of the single-employer program’s current deficit was \$27.4 billion in 2013. In 2012, the agency performed a ten-year projection of the deficit in 2022, finding a mean deficit of \$32.5 billion and a median deficit of \$29.9 billion. The new projection report, however, estimates that in 2023 the mean deficit will be \$7.6 billion and the median deficit will be \$4.4 billion.

Projected Single Employer Program Deficit		
	Mean	Median
Projected 2022 Deficit (as of 2012)	\$32.5 billion	\$29.9 billion
Projected 2023 Deficit (as of 2014)	\$7.6 billion	\$4.4 billion
Improvement	\$24.9 billion	\$25.5 billion

Ultimately, PBGC concludes that the median single-employer system deficit will decrease by 85% over the next ten years and could decrease by as much as \$10 billion in a matter of months.

Unrealistic assumptions continue to overstate liabilities

For purposes of valuing its obligations, however, PBGC continues to use interest rates underlying commercial annuity purchases, even though the agency does not buy annuities – they actually “self-annuitize.”

Those interest rates are based partially on a composite corporate bond rate (30 percent) and partially on the 30-year Treasury bond rate (70 percent). Congress has long rejected use of the 30-year Treasury bond rates because they tend to overstate liabilities.

For purposes of discounting future PBGC obligations and other future amounts to a present value, PBGC uses solely 30-year Treasury bond rates, which further inflates its deficit.

Low returns from overly conservative investment strategy

PBGC also predicts unrealistically low returns on its investments. PBGC projects annual investment income of approximately \$4.2 billion on assets that commence at \$83.2 billion and end at \$85 billion (on a present value basis), i.e., assumed rates of return of approximately 5%, which is significantly below the 6.6% return that PBGC assumes for plans. Either the PBGC's projections are too low or its investment strategy should be restructured to increase its return on investment.

Failure to take into account plan terminations and de-risking

A problem with PBGC's methodology is that it explicitly does not take into account either plan terminations or de-risking transactions. So if higher PBGC premiums and funding volatility can be projected to drive employers out of the defined benefit plan system, and erode the PBGC's premium base dramatically, PBGC would not take this into account at all. The PBGC has stated informally that higher premiums are indeed contributing to employers' desire to de-risk and exit the system.

MULTIEMPLOYER PROGRAM

In contrast to the single-employer program, the financial condition of the multiemployer pension insurance system has declined materially, with extremely low reserves. The PBGC report estimates that the current multiemployer deficit of \$8.3 billion will grow to \$49.6 billion within the next decade, primarily due to a small but significant number of underfunded plans.

Recent data suggests that – outside of these most troubled plans – multiemployer plan funding is improving. According to [Segal Consulting's Survey of Calendar-Year Plans 2014 Zone Status](#), the percentage of calendar-year multiemployer pension plans in the "green zone" is 65 percent, up from 61 percent in 2013, and the percentage of plans in the yellow and red zones has decreased. Any legislative action to address multiemployer plan funding should focus on the specific challenge posed by these most endangered plans.

CONCLUSION

The PBGC's 2013 Projections Report validates that the agency's future shortfall overstates its short-term as well as its long-term financial needs with respect to the

single employer plan program. Unrealistic estimates regarding discount rates and very low projected future investment gains have inflated its deficit.

Steep premium increases have been enacted in recent years in response to the perceived deficit of this program. The agency has also requested that it be permitted to set and raise premiums to protect it against the risk of a bailout. The 2013 Projections Report should call into question the notion that the PBGC should receive further premium increases or be permitted set its own premiums.