Examining the Challenges Facing PBGC and Defined Benefit Pension Plans

Testimony of PBGC Director Joshua Gotbaum before the Health, Employment, Labor and Pensions Subcommittee House Committee on Education and the Workforce

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Thank you for holding this hearing and inviting me to speak about the PBGC and defined benefit pensions. I'll be speaking to these concerns against the backdrop of retirement security more broadly. These retirement security issues are important to the nation, because it is clear that the retirement world is changing and that more needs to be done to strengthen our retirement system and help Americans achieve a secure retirement.

Challenges to Retirement Security

It's no secret that people are concerned about retirement. Each day some 10,000 baby boomers turn 65.[1] Baby boomers are the largest generation that's ever faced retirement. But the concern isn't limited to baby boomers. According to a 2011 Gallup Poll, the number one financial concern for Americans is not having enough money for retirement. Gallup found that *77% of Americans age 30-49* are worried about not having enough money for retirement.

Thanks to better health, better technology, and better lifestyles, today we're living longer, healthier lives.

That's great news, but it also means that retirement costs more. Fifty years ago, by our estimates, the average person retired at age 62 and lived to be 79: about 17 years. Today, after retirement at about 63, the average person can expect to live about 21 years – some 30% longer. And that's just average life-spans; about a quarter of us will live into our 90s.[2]

Once we do the math, it's clear that retirement is going to cost more, not less. Unfortunately, pensions haven't kept up.

- About one-third of American workers have no access to employer-provided retirement benefits; about one-half actually have such benefits.[3]

- Of those that do, the majority have only have a defined contribution (DC) plan, usually a 401(k). Many of these plans lost value during the recent economic downturn.

- The tens of millions of Americans that have DB pension plans are better off, but employers have been turning away from such plans.

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[1] Pew Research Center, "Baby Boomers Approach Age 65 – Glumly," December 2010 http://pewresearch.org/pubs/1834/baby-boomers-old-age-downbeat-pessimism.
[2] These are PBGC calculations based on our own actuarial analysis of a 2011 Boston College study.
[3] Bureau of Labor Statistics, DOL, "Employee Benefits in the United States – March 2011" (July 26, 2011).

An important trend has been the replacement of traditional DB plans with DC plans. DC plans provide portability benefits for those who change jobs frequently and allow people to set and invest their own savings. Unfortunately, DC plans also shift a number of investment and other risks onto the shoulders of American workers. Furthermore, we tend to forget about the chance that we'll live longer than average and don't buy annuities, so the chances of people running out of money are rising.

Today, most people don't think they have enough money to retire – and they're right. The Administration is committed to do what we can to strengthen retirement security, which is an important priority not only for workers and retirees but also for our economy and our nation.

PBGC: Safety Net and Preserver of Pensions

PBGC was founded in 1974 to patch a hole in America's retirement security system. We ensure that once a company makes a pension promise, it does not vanish: it's protected up to legal limits.

Today, PBGC guarantees payment of basic pension benefits earned by nearly 44 million participants in more than 27,000 private-sector DB pension plans.

Working to Preserve Plans

But the best outcome, for workers, retirees, their families, and our pension insurance programs, is for companies to be able to keep their own pension plans.

When a company is in trouble, we try first to see whether it can reorganize successfully and still keep its pensions. We work with companies both before and during bankruptcy, so that they continue to keep their own pension promises after the sponsor reorganizes, or after a new owner assumes operations. Companies that continued their plans following bankruptcy in FY 2011 include Chemtura Corp. with 15,000 participants and Visteon Corp. with 23,000 participants.

Of course, we don't always succeed, but PBGC would rather prevent pension losses than pick up the pieces.

The Pension Safety Net

When a plan cannot keep its pension commitments, we make sure the plan's participants get their benefits, up to the limits of federal pension law, on time. When we take over a plan, we make sure that pension checks don't stop, even while we're figuring out people's benefits. In fact, our 2006 study estimated that 84 percent of people receive their full pension benefits.

And, we do it without taxpayer money. Our benefits are funded by premiums, by the assets of the plans we take over, investment earnings on our assets, and by recoveries in bankruptcy.

Over the years we've become responsible for about 1.5 million people in more than 4,300 failed plans. In FY 2011, 873,000 people received benefits from PBGC. Every month, on average, we pay benefits totaling $458 million. We are also responsible for future payments to about 628,000 people who have not yet retired. During FY 2011, we assumed responsibility for more than 57,000 additional workers and retirees in 134 failed pension plans.

Continuing Reforms to PBGC

In the 37 years since ERISA became law, both the retirement landscape and PBGC have changed dramatically. When it started, the agency had fewer than 50 personnel. Some 25 years later at the end of FY 1999, PBGC had just over 1,400 personnel (some 750 federal employees and 680 contractors) and about a $7 billion surplus, with assets of $19 billion and liabilities of $12 billion. Today, the agency is operated with about 2,300 personnel, including some 980 federal employees as of the end of FY 2011. However, PBGC also now has a $26 billion deficit, with assets of $81 billion and liabilities of $107 billion.

Congress has continually made changes, both in PBGC's organization and programs, and in other parts of the law. For example, under the original ERISA structure, PBGC was required to assume responsibility for a plan even if the plan sponsor could afford to keep it. In 1986, Congress added a financial distress test.

Furthermore, in the past Congress has recognized that PBGC premiums are too low, and has raised them repeatedly. As this Committee knows, we think it is again time to reconsider and reform premiums.

PBGC's Current Financial Position and Future Prospects

PBGC is funded entirely through insurance premiums paid by plan sponsors, assets from failed plans, investment earnings on our assets, and recoveries in bankruptcy. The agency does not take even a dime of taxpayer funds.

Each year, we report our financial position, as well as estimates of our future exposure. As one who has spent a lifetime in finance, I'm pleased to report that PBGC's accounts have been approved and given a clean opinion by independent accountants and its Inspector General for two decades.

Over the past twenty years, accounting for large financial institutions has become more realistic. Assets and liabilities are now marked to current market. We can no longer pretend that assets are worth their "average over the past three years." Nor can we estimate our liabilities based on the average of past decades or on a hope that interest rates will rise.

Long before this was required of other financial institutions, PBGC accounts were marked to market. The discount rates used to determine the agency's liabilities are derived from market quotes for annuities – the same type of annuities that PBGC's benefits provide.

On this basis, PBGC reports a very substantial deficit (i.e., our liabilities exceeded our assets). This past year it increased to $26 billion, as of September 30, 2011.

There are some who suggest that PBGC should use other methods to estimate its liabilities than the market test. We don't agree.

No matter how PBGC's deficit is calculated, the agency's liabilities exceed its assets. Some have suggested that we use corporate bond rates, like ongoing pension plans; if we had, our FY 2011 deficit would still have been some $21 billion. If we had used the discount rate of private insurance companies, the deficit would be approximately $28B.

It is important to emphasize that none of these deficit figures includes any exposure for future claims that we think could easily run into the tens of billions of dollars. But PBGC's liabilities are paid out over decades, and we have sufficient funds to pay benefits for the near future. Nonetheless, our obligations are clearly greater than our resources.

Premium Reform Proposal

If PBGC's finances aren't reformed, the agency will eventually run out of money to pay benefits. We cannot ignore our own future financial condition any more than we would of the pension plans we insure.

That is why, a year ago, the Administration proposed that Congress reform PBGC premiums. We think that doing so is necessary to the financial soundness of PBGC and important to encourage the preservation of responsible pension plans.

Since the agency was founded, its premiums have been set by Congress. ERISA's original annual premium was one dollar per participant for the single-employer program and 50 cents per participant for the multiemployer program. Congress has repeatedly raised premiums, and made other changes.

Unfortunately, neither the level nor the form of premiums has kept up with changes in retirement plans. For some companies and plans, our premiums are far lower than any private insurance company would charge. American Airlines provided only the latest and most graphic example. American sought and received funding relief from Congress. Instead of funding their pensions, they set aside a cash pool of over $4 billion.[4] Since their bankruptcy filing, they have made it clear that they would like to terminate their pension plans. Doing so would increase PBGC's deficit by some $9 billion. For this insurance, American has paid a total over 37 years of about $260 million in premiums.

But what's just as disturbing is that financially sound companies are asked to make up the difference. And if Congress were to increase those premiums just to cover the actions of other companies, it would make the situation worse. Think how hard it is to convince companies to keep their plans while you're asking them to pay for the losses of others.

We recognize that there are many issues involved in making PBGC responsible for establishing premiums that are both fair and financially sufficient. The Administration proposed a range of safeguards to allay the legitimate concerns of businesses and plans that rates might rise too quickly or unfairly. No increases at all would be permitted until after a year of consultation with the affected constituencies. No increases would be allowed without a vote of PBGC's board. The increase on any individual company or plan would be strictly limited and all increases would be phased in over a period of years as the Board may determine. Furthermore, unlike the current variable rate premium, the Board would be charged, to the extent feasible, with setting premiums to minimize increases during times when the economy or markets are weak.

[4] See AMR's news release on filing bankruptcy: http://aa.mediaroom.com/index.php?s=43&item=3397.

It is not surprising that companies and plans would like to avoid increases in their premiums; all of us would. However, the arguments against doing so are weak. Some claim that allowing PBGC to set premiums this way would be "unprecedented" – even though most other government insurance programs in our nation, every pension insurance agency in other nations, and every private insurance company in the world already does so.

Some claim that PBGC doesn't need the money yet. In one sense, that's true: PBGC has sufficient current funds to meet its obligations for the near future. *But* deferring action now will necessitate more drastic actions in the future. Without the tools to set its financial house in order and to encourage responsible companies to keep their plans, PBGC's may face, for the first time, the need for taxpayer funds. That's a situation no one wants to face.

PBGC Challenges

PBGC is now a $100 billion financial institution, one that like other financial institutions operates in a changing and complicated environment. There are plenty of challenges; I'll mention some of the more important ones.

Companies that Take Advantage of the Current System

Termination of a pension is not something a company should do lightly. We work hard to make sure that terminations are necessary and that companies understand the consequences. However, there are some aspects of the current system that make it easier for companies to terminate plans.

One, already mentioned, is that PBGC's premiums are neither high enough nor individually calibrated to discourage terminations. There are other examples. Often when an investor buys a company in bankruptcy, it structures the transaction as a purchase of assets and refuses to assume the pension obligations. Unfortunately, there are also instances where investors that are already owners of bankrupt companies arrange to "sell the company to themselves" in order to avoid their pension commitments.

In some cases, investment firms design transactions to avoid being part of a controlled group, so that, should a plan be terminated, the investment firm's assets cannot be reached. The only real tool that PBGC has at that point is to go to court and threaten plan termination, which is far from optimal.

Improving Service Quality

When people first come in contact with PBGC, their lives have already been turned upside-down. They face the possibility of losing some pension benefits, and may have already lost the benefits PBGC does not guarantee, such as retiree health plans. All too often they have also lost their jobs.

PBGC works hard to help them with compassion and professionalism. And I'm pleased to say that, by and large, the agency does so exceedingly well. For over a decade, PBGC has surveyed its customers using the same measures of service as private industry, the American Customer Satisfaction Index (ACSI). Our customer satisfaction scores are among the highest of any government agency and higher than many private companies.

In 2011, retirees receiving benefits from PBGC scored us at 90. Participants who called us with questions rated us at 86. Our online tools for participants and plan administrator were scored 83 and 79, respectively. An ACSI score of 80 is considered excellent, whether for government or private business.

But this doesn't mean there isn't plenty of room for improvement. Under ERISA, rather than offering a uniform benefit, like the Social Security Administration, we are required to calculate each person's benefit under their own former plan, and then apply the intricate limits and provisions of the pension law. Getting those personalized calculations right is a core part of what we do.

Correcting Our Mistakes. The benefit determination process is complex and, over time, as plans themselves got more complex, PBGC didn't always keep up. The agency made mistakes. Even worse, PBGC didn't catch them; our Inspector General did.

When I joined PBGC a year and a half ago, it was clear that changes needed to be made. Over the years, PBGC had done a bad job on some parts of some benefit determinations (making sure we knew the values of the assets of the plans we took over). These affected benefits paid to people who worked at United Airlines, at National Steel, and other plans. As a result, some people have been overpaid, and others underpaid.

We're now going back and correcting our mistakes. If we underpaid a person, we'll pay what we owe them with interest – and an apology.

Equally important, we've made and are making changes so that similar mistakes don't happen again. We changed the people who were tracking plan assets, we put reviewers on each plan processing team, and we're training people more and more carefully. I also began a top-to-bottom review of the entire benefits operations, including processes, organization, and personnel. We have begun making changes, and will implement more in the coming year.

Being More Responsive to Companies and Plans

PBGC is acutely aware that this is a *voluntary* system and is taking steps to be more responsive. After complaints from industry that premium election procedures had confused them, PBGC has allowed some companies to correct their submissions. PBGC also provided relief from some premium penalties.

PBGC is also being more responsive to companies and plans in enforcing ERISA section 4062(e) – a statutory provision that imposes liability in certain situations when plan sponsors downsize. In light of comments, the agency plans to issue a re-proposed regulation on 4062(e). We have also begun to consider changes in how resources are directed within the 4062(e) enforcement program, in order to focus on the real threats to the retirement security of people in traditional pension plans.

Multiemployer Plans

More than 10 million of America's workers and retirees participate in and rely on multiemployer plans. Small businesses depend especially on these plans to provide retirement security to their employees. Some plans are in relatively good health – and have been for decades, even in the face of industry decline. But many are substantially underfunded; and for some, the traditional remedies of increasing funding or reducing future benefit accruals won't be enough.

We have been studying the challenges facing multiemployer plans and listening to stakeholders about possible approaches to address them. It is clear that as Congress considers multiemployer plans in the coming months, PBGC's multiemployer program will also have to be reviewed and revised. We are working with Congress to begin to address these major challenges and will publish a Multiemployer Plan report soon to help advance the process.

Improving Retirement Security

Going forward, the challenge is not only to preserve the many valuable parts of our current retirement system, but also to rethink and enable new forms of retirement security.

In December, PBGC held a forum on the future of retirement security. We invited leading thinkers from the pension community to discuss the present and future of retirement security, including the place of defined benefit plans. We structured the forum as an opportunity to begin a conversation and to listen. What we heard was illuminating.

Some employers, who have seen overall benefit costs rise, are looking for ways to limit costs and risks, and share them with employees. Some who have shifted to DC plans are considering ways to get some of the benefits common in DB plans. For example, they are looking at auto-enrolling their workforce, so that workers participate by default. Some employers with DB plans have told us they would consider hybrid DB options with some features of DC plans as an alternative to freezing their plans.

Retirement experts across the spectrum agreed that delivering pooled risk was a key to providing retirement security, whether that meant finding a way to build it into a DC plan or making DB plans more attractive.

What Can Government Do?

There are many approaches that government can take to encourage more secure retirements. Some of these options include finding ways to strengthen existing plans, facilitating new options, helping individuals understand their retirement choices, and reducing administrative and regulatory burdens.

In the year and a half I've been at PBGC, I've learned a bit about the rhythm of pension policymaking. Pensions are so complicated that legislative consensus has taken years to develop. Legislative changes have been bipartisan and usually involved both the labor and tax committees of both houses.

We all recognize that the Congress has many priorities this year. Nonetheless, it is significant that you are holding this hearing. America's workers are already concerned about the adequacy of their retirement programs and hearings like this help advance the discussion we will need to respond to them.

Those deliberations must involve all constituencies in a spirit of cooperation. They must be both far-sighted and practical. PBGC has broad expertise both in retirement programs and in business's ability and willingness to provide them, and looks forward to assisting.

Thanks very much for the opportunity to report on our agency and to raise some of the concerns about retirement security that we share. I would be happy to answer any questions.