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Is the U.S. Pension-Insurance System Going Broke?

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(address)

The PBGC, which was established in 1974 under the Employee Retirement Income Security Act (ERISA) to guarantee the benefits of employees who participate in certain types of pension plans, faces a severe financial crisis. The PBGC currently has $8.50 billion in assets, but its liabilities are estimated to be $35 billion. The PBGC is also funded by a premium paid by participating employers. The premium is currently $1.3 trillion per year, and it is expected to increase to $7.5 trillion per year by 2020.

The PBGC is in a difficult position because it is relying on a combination of premiums and assets to fund its operations. The PBGC has been able to manage its expenses and liabilities for a number of years, but it is becoming increasingly clear that the PBGC cannot continue to operate in this manner. The PBGC has already begun to take steps to address its financial problems, including increasing its premiums and divesting its assets.

There are a number of possible solutions to the PBGC's financial problems. One option is for Congress to increase the PBGC's premiums, which would provide additional funds to the PBGC. Another option is for the PBGC to divest its assets, which would reduce its liabilities. The PBGC could also consider increasing its funding standards or reducing its benefits.

The PBGC is in a difficult position, and its financial problems are likely to become worse in the coming years. It is important for policymakers to consider a range of options to address the PBGC's financial problems, including increasing its premiums, divesting its assets, and increasing its funding standards or reducing its benefits. The PBGC's financial problems are likely to have significant implications for the pension industry, and it is important for policymakers to act quickly to address these problems.
The PBGC is self-financed; it does not receive any regular government funding. The pension-guarantee fund is financed from several sources: (1) from annual premiums per participant from insured pension plans; (2) from assets valued at the current actuarial assumptions; (3) from investment income, including appreciation of investment assets; and (4) from employer-liability payments. The flat-rate premium charged by the PBGC is its primary source of revenue. Under the employer-liability provisions of ERISA and recent legislation, the PBGC has a legal claim of 100 percent of its insurance costs, up to 30 percent of the sponsor’s net worth and its controlled group. The PBGC also has a claim that the difference between 75 percent of the insurance costs and the recoverable proceeds under its first claim.

To illustrate: assume that company A, which has net worth of $500 million, terminates a PBGC-insured pension plan that is underfunded by $1 billion. The PBGC has a claim against 30 percent of the $500 million net worth or $150 million. The PBGC also has a claim of 75 percent of $1 billion minus the recoverable proceeds of $150 million, or $600 million.

In our example, the PBGC thus has total legal claims of $750 million against the underfunding of $1 billion. The agency’s first claim has priority status in bankruptcy, and thus may have some value if the reorganization process results in a sale of the bankrupt company. The PBGC’s second claim has lower status in bankruptcy than its net worth claim, and is subject to various limitations that further reduce its value. Finally, PBGC’s assets include a $100 million line of credit with the U.S. Treasury, which is small compared to the PBGC’s $1.44 billion and had $2.74 billion in total liabilities, leaving it with an accumulated deficit of approximately $1.2 billion at the September end of its fiscal year. This unprecedented escalation of accumulated deficit is attributed primarily to two large claims by two companies: the Allis-Chalmers Corporation and the Wheeling-Pittsburgh Corporation. Although Allis-Chalmers was the PBGC with claims of approximately $600 million, although the agency’s negative net worth soared in 1985, it still had a positive cash flow.

The decision of Allis-Chalmers Corporation to terminate 11 of its pension plans in a non-bankruptcy action, the bankruptcy of Wheeling-Pittsburgh Corporation, and the recent bankruptcy petition by LTV Corporation could be justified on the basis that the companies had no other financial choice. However, it is equally plausible for corporations to simply delay payments and wait for PGBG to lose its legal battle to the courts. The PBGC does not have the full truth and credit of the federal government to help it fight these battles.

PBGC’s Financial Condition: Pre-LTV

Since its beginning in 1974, the PBGC has had negative net worth, its actual liabilities exceed its assets. This accumulating deficit was largely income-generating until 1982, when it began to escalate, except for brief pauses in fiscal years (FY) 1980 and FY1984, when the PBGC posted positive net operating results—which slightly reduced its deficit. Despite having negative net worth, the PBGC has not terminated any plans, however, the PBGC generally has had a positive cash flow; current income has been sufficient to cover its current expenses.

Most of the agency’s cumulative deficit is attributed to rising liabilities incurred in terminating single-employer plans, which represents 95 percent of its total assets (see chart 1A). In contrast, PBGC’s multi-employer fund, which insures private pension plans covering employees of more than one employer, usually has reported surpluses, which have mitigated what otherwise would have been an even larger deficit (see chart 1B).

In 1985, PBGC’s cumulative deficit nearly tripled. According to its latest financial statement (the latest available), the corporation had total assets of $1.00 billion and $2.74 billion in total liabilities, leaving it with an accumulated deficit of approximately $1.3 billion at the September end of its fiscal year. This unprecedented escalation of accumulated deficit is attributed primarily to two large claims by two companies: the Allis-Chalmers Corporation and the Wheeling-Pittsburgh Corporation. Although Allis-Chalmers was the PBGC with claims of approximately $600 million, although the agency’s negative net worth soared in 1985, it still had a positive cash flow.

The decision of Allis-Chalmers Corporation to terminate 11 of its pension plans in a non-bankruptcy action, the bankruptcy of Wheeling-Pittsburgh Corporation, and the recent bankruptcy petition by LTV Corporation could be justified on the basis that the companies had no other financial choice. However, it is equally plausible for corporations to simply delay payments and wait for PGBG to lose its legal battle to the courts. The PBGC does not have the full truth and credit of the federal government to help it fight these battles.

PBGC’s long-term viability because, in effect, it forces the PBGC to accelerate the cash outflows of the PBGC above the cash inflows. As a consequence, the agency is now forced to reduce its reserves by selling investment assets so that it can pay its legally mandated claims. This is a no-win scenario.

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The PBGC’s Potential Future Liabilities

Alicia H. Munnell investigated the prospective financial condition of the PBGC in 1982, and she observed that the business of guaranteeing private pension plans was an expensive. Munnell’s investigation found that the PBGC was financially vulnerable in 1982 to the termination of major pension plans, despite the apparent financial soundness of the overall pension system.

Munnell’s study revealed that the majority of terminated plans with insufficient assets were terminated because of adverse business conditions, such as poor economic conditions, business liquidations, or plant closings. The majority of the plans with insufficient assets were terminated as a result of bankruptcy—an unpredictable event. Although plans with terminations were relatively small, she found that the worst underfunded plans are those that the courts confirm reorganization claims the surplus pension assets.

In a reversion, the pension-sponsoring corporation claims the surplus pension assets. According to PBGC data, pension plan reversions have removed approximatively $11 billion in excess assets from the private pension system since 1980. Pension-asset reversions have not contributed to any significant degree to the PBGC’s financial plight. However, if the recapitalization of the PBGC fund imposes a disproportionate burden on overfunded pension plans, then pension-asset reversions might rise rapidly. This, in turn, would aggravate PBGC’s financial troubles.

The Tax Reform Act of 1986 will partially underwrite the incentive to terminate underfunded pension plans because it requires employer to pay an additional tax of 10 percent on asset reversions. However, there are other ways in which corporations can obtain access to surplus pension assets without terminating their pension funds. For example, Cleveland-based Sherwin-Williams Company recently received approval from the U.S. Department of Labor to

In late 1986, the PBGC issued a report that the agency was financially vulnerable in 1982 to the termination of major pension plans. The report identified a number of factors that contributed to the agency’s financial vulnerability, including:

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   - Insufficient reserves to cover future obligations
   - Rising costs of guaranteeing pension plans
   - Adverse economic conditions affecting pension plan sponsors

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The PBGC is self-financed; it does not receive any regular government funding. The pension-guarantee fund is financed from several sources: (1) from annual premiums per participant from insured pension plans; (2) from assets valued at book and market; (3) from investment income, including appreciation of investment assets; and (4) from employer-liability payments. The flat-rate premium charged by the PBGC is its primary source of revenue. Under the employer-liability provisions of ERISA and recent legislation, the PBGC has a legal claim of 100 percent of its insurance loss, up to 30 percent of the sponsor's net worth and its controlled group. The PBGC legal claim defines its recovery status and the PBGC's potential losses to future employers. To illustrate: assume that company A, which has net worth of $500 million, terminates its PBGC-insured pension plan that is underfunded by $1 billion. The PBGC has a claim against the PBGC's financial condition: Pre-LTV.

Since its beginning in 1974, the PBGC has analyzed the PBGC-insured plans' terminated pension plan's net worth gap or surplus upon plan termination. The PBGC has concluded that the PBGC generally has had a positive cash flow; current income has been sufficient to pay current expenses. To balance the accounts, the PBGC has surpluses, which have mitigated what otherwise would have been a larger deficit (see chart 1B).

In 1975, the PBGC's cumulative deficit nearly tripled. According to its initial financial statement (the latest available), the corporation had total assets of $8.5 billion, total liabilities of $2.7 billion, and total net worth of $5.8 billion. The PBGC's balance sheet for 1975 showed that it would be unable to pay its total legal claims of $750 million (which includes $8.50 per employee pension) if the PBGC were to terminate its pension plans. In 1985, the PBGC's cumulative deficit had nearly tripled (chart 1A). The PBGC's potential liabilities have increased to 30 percent of its insurance loss, and its PBGC-insured plan's net worth has increased from $500 million to $1.44 billion; however, the PBGC's financial condition has decreased from $2.74 billion to $800 million. Although the agency's net worth soared in 1985, it still had a positive cash flow. The decision of Allis-Chalmers Corporation to terminate 11 of its pension plans in a non-bankruptcy action, the bankruptcy of Wheeling-Pittsburgh Corporation, and the recent bankruptcy petition by LTV Corporation indicates that the PBGC has a $100 million cash pool. However, unlike the FDIC, the PBGC does not have full and credit of the federal government behind its obligations.

The PBGC's financial condition has been adversely affected by the LTV Corporation's bankruptcies on plan terminations. When a pension fund is overfunded, the PBGC is required to pay a penalty tax of 10 percent on the surplus pension assets. Since the PBGC is self-funded, it has the option to terminate overfunded pension plans. However, if the recapitalization of the PBGC fund imposes a disproportionate burden on overfunded pension plans, then pension-asset reversions might rise rapidly. In turn, would aggravate the PBGC's financial troubles. The PBGC's financial condition has been adversely affected by the LTV Corporation's bankruptcies. Munnell's study revealed that the agency's financial condition has deteriorated because of adverse business conditions, such as poor economic conditions, business liquidations, or plant closings. The PBGC's decision to terminate overfunded pension plans is pushing the cash outflows of the PBGC above its cash inflows. It is equally plausible for companies to terminate overfunded pension plans and pay a penalty tax of 10 percent on the surplus pension assets. However, if the recapitalization of the PBGC fund imposes a disproportionate burden on overfunded pension plans, then pension-asset reversions might rise rapidly. In turn, would aggravate the PBGC's financial troubles. The PBGC's financial condition has been adversely affected by the LTV Corporation's bankruptcies. Munnell's study revealed that the agency's financial condition has deteriorated because of adverse business conditions, such as poor economic conditions, business liquidations, or plant closings. The PBGC's decision to terminate overfunded pension plans is pushing the cash outflows of the PBGC above its cash inflows. It is equally plausible for companies to terminate overfunded pension plans and pay a penalty tax of 10 percent on the surplus pension assets. However, if the recapitalization of the PBGC fund imposes a disproportionate burden on overfunded pension plans, then pension-asset reversions might rise rapidly. In turn, would aggravate the PBGC's financial troubles.
A financial distressed corporation may seek a funding waiver (subject to IRS approval) to delay or reduce a contribution payment into the pension fund. The IRS grants a waiver if it determines an employer cannot meet the minimum funding standards without incurring substantial financial hardship. The PBGC plays no formal role in the waiver process.

Providing a Safety Net
The PBGC was established in 1974 under the Employee Retirement Income Security Act (ERISA) to guarantee the benefits of employees who participate in the funded private pension systems. Congressional approval is necessary in certain types of pension plans. The idea was to design a government-sponsored insurance mechanism that would allow plan administrators to use PBGC guarantees to cover the underfunding. It is unclear at what rate they could be used to support a corporation’s pension obligations.

One of the most significant provisions in ERISA is the Multi-employer Pension Plan Amendments Act of 1980 (MPPAA). The act, which became law in 1980, is the most sweeping provision of pension benefits during the next decade is strongly linked to the long-term financial health of the sponsoring corporations. Almost all of the total number and total assets of all multi-employer pension plans are held by plans covering workers in manufacturing industries. Thus, the viability of a large percentage of defined-benefit pension plans during the next decade is strongly linked to the long-term outlook of this industry group in particular. Due to low performance, however, it is unreasonable to predict future bankruptcy filings and pension fund problems in the manufacturing sector.

Congressional Budget Committee

1. Congress also enacted the Multi-employer Pension Plan Amendments Act of 1980 (MPPAA). MPPAA raised the annual premium for a $100 annual premium per employee. The PBGC requested a premium increase to $7.50 based on a projected fund deficit in 1985 of less than $600 million, but that low estimate excluded the unusually large claims of LTV Corporation. Allis-Chalmers, Wheeling-Pittsburgh, and LTV Corporation.

2. The other SEPPA provisions make it more difficult to terminate an underfunded plan and require sponsoring companies that terminate an underfunded plan to assume more liability for underfunding. If Congress waits too long before providing a solution, however, it could find itself faced with some very unpleasant and very expensive choices.

3. The current maximum level for individual PBGC-guaranteed payments is $1,857.96 per month. The PBGC guaranty, which was originally set at $750 in 1974, is adjusted each year in accordance with increases in the Social Security wage base. The guaranteed ceiling varies from year to year. As of the end of 1986, the PBGC’s accumulated deficit, plus impending terminations, approached $4 billion.

4. The critical public policy issue resulting from the fund’s worsening financial condition centers on how Congress will choose to fix the problem. For example, will the ultimate burden to make pension payments for deficient plans be shifted to private companies to the taxpayer? Will the PBGC system continue to be self-funded by using the pension fund premium paid by participating employers? Or will new legislation reform the entire pension-insurance process?

5. It is a one-year premium pricing mechanism, coupled with the legal provisions that govern the operation of the plan, that makes ERISA a viable benefit plan. If Congress chooses to enhance the PBGC’s role by extending the PBGC’s definable contributions to new plans, it will be well on its way to preserving this plan.

6. The PBGC has committed $8.50 annual premium per employee. The premium increase to $7.50 was based on a projected fund deficit in 1985 of less than $600 million, but that low estimate excluded the unusually large claims of LTV Corporation. Allis-Chalmers, Wheeling-Pittsburgh, and LTV Corporation.

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