RECORD OF SOCIETY OF ACTUARIES
1992 VOL. 18 NO. 4B

GOVERNMENT PENSION GUARANTEES

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A comparison of the pension guarantees provided by the PBGC in the United States and the Pension Benefit Guaranty Fund (PBGF) in Ontario, Canada.

- What has been the financial and legal experience of these agencies in the United States?
- In Canada?
- What changes may arise in the future?

MR. FREDERICK J. THOMPSON: Paul Jackson is an actuary widely known in actuarial circles for his contributions to the literature and for his well-articulated, if sometimes long-winded, views on a wide range of topics. In this discussion, Paul is going to be commenting on the U.S. government's efforts in the area of pension benefit guarantees and making some observations from the perspective of someone who is an outside observer. David Gustafson is the principal actuary for policy and analysis at the PBGC, and from that vantage point, he's going to give us some background on the PBGC, along the lines of where it came from and where it is. He is going to discuss some of the possible future developments and probably try to shoot down some of the things that Paul Jackson has said. Jacques Pelletier is an actuary with William M. Mercer Limited in Toronto, and he is going to outline the development of the PBGF in Ontario. The intent of this session is to look at government pension guarantees in an international context, and the only two we know of are the one in the United States and the one in Ontario. So, Jacques is going to add to the international flavor.

David will set the stage by talking about the development of the PBGC. Then Jacques is going to bring us up-to-speed on the PBGF. Then we will hear from Paul with some of his ideas for improving or strengthening the PBGC. And, finally, David is going to give us some background on what the PBGC thinks the future can or should hold. All of this should result in us coming away with a much better understanding of what can be considered state-of-the-art government guarantees, and if all goes according to plan, at the end of the session you'll all have a chance to refine your new knowledge by joining in the discussion.

MR. C. DAVID GUSTAFSON: I will direct my attention to the first order of business, which is the experience, both from a legal and a financial standpoint, for the PBGC since its inception. I am very pleased to be here to discuss the PBGC and its future.

The PBGC was established in 1974 under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and insures workers and retirees against the loss of their private sector defined-benefit pensions. Congress made substantial changes to the PBGC's programs with passage of the Multiemployer Pension Plan Amendment Act of 1980 (MEPPAA), with the Single-Employer Pension Plan Amendment Act of 1986 (SEPPAA), and with PPA in 1987.

Forty million participants in about 85,000 pension plans are covered by the PBGC in 83,000 single-employer plans and in about 2,100 multiemployer plans.

The PBGC guarantees most vested benefits in underfunded plans terminated because of financial distress of companies maintaining these plans, or because the PBGC is forced to terminate plans to assure continued payment of benefits or to avoid larger future losses for the PBGC.

In its 18-year history, the PBGC has assumed responsibility for the retirement benefits of about 400,000 participants in 1,654 plans.

The PBGC's multiemployer program, which has a more narrow scope than the single-employer program, is financially sound and currently has a surplus of $187 million. The PBGC's accumulated deficit in the single-employer program, as of the end of fiscal year 1991, was $2.5 billion.

The past year has been very challenging for us. Internally, we continued to make changes to improve our financial management and internal controls. There has been some concern that the lack of auditability of our financial statements by the General Accounting Office (GAO) has meant that the PBGC's liabilities may have been overstated. The work that we have just completed with a major accounting firm shows that the numbers in our annual report have been and are "materially accurate." We are making good progress toward our goal of auditable financial accounts for this fiscal year.

Externally, we face a growing problem from poorly-funded pension plans of troubled companies. Despite the PBGC's aggressive efforts to prevent losses to retirees and the insurance program, they continue to skyrocket. It took us 11 years to accumulate $1 billion in losses. In each of the last two years, we have had a billion dollars in losses.

The two largest claims in our history -- Eastern Air Lines (underfunded by $700 million) and Pan American Airlines (underfunded by over $900 million) -- were the primary causes. Our deficit is now $2.5 billion. Our 1991 annual report estimates underfunding at $40 billion, up from $30 billion reported the previous year.

ANALYSIS OF CURRENT EXPOSURE

Well over $30 billion of this underfunding is in the single-employer program and is concentrated in the plans of a relatively few firms, primarily in the steel, auto, tire, and airline industries. These underfunded plans cover about five million people. As our guarantee has limits, many of these people are at risk of losing promised benefits if their plans terminate.

Thirteen billion dollars of this underfunding is associated with financially troubled companies that present a near-term, serious risk to these participants and to the PBGC. The President's budget, using a model that incorporates a long view of the future, forecasts net claims of $30-45 billion over the next 30 years.

The financial problems in the single-employer program are a consequence of fundamental weaknesses in the insurance principles supporting the program. The "moral hazards" of inadequate minimum funding rules, liberal guarantees, and the probability of low recoveries from employers in bankruptcy continue to encourage financially weak companies to underfund their pension plans. Because of these moral hazards:

- Companies in financial difficulty view pension increases as cheap compensation, and their workers agree to these empty promises because of our pension insurance. TWA and Continental Airlines have amended their plans while in bankruptcy, adding over $100 million to their already sizable pension shortfalls.

- Some companies, such as Continental Airlines and CF&I Steel, have stopped making required contributions while in bankruptcy, with the judges' approval.

- Some companies, such as LTV Steel and Blaw Knox Steel, have allowed their plans to run out of money without violating the minimum funding standards.

- Lenders rarely put pressure on those companies to fund their plans, believing in optimistic funding assumptions and expecting pension claims will have no priorities. Creditors sometimes pressure distressed companies to terminate plans rather than fund them.

- Companies have failed to accumulate a "rainy-day reserve" for subsidized benefits triggered by plant closings and early retirements.

One of our largest present cases, Trans World Airlines, illustrates many of these hazards. By using TWA's actuarial assumptions, its plans were underfunded by only $190 million in its last annual report. But on a termination basis, the plans are underfunded by over $1.2 billion. And yet TWA has complied with all the minimum funding requirements. Despite its underfunding, in April 1992, TWA increased benefits while in bankruptcy by over $50 million in lieu of wage increases, which it said it couldn't afford.

Until recently, TWA's creditors and Carl Icahn, who owns 90% of TWA, have downplayed their underfunding and our claims in bankruptcy. Mr. Icahn is trying to extract his group of affiliated companies -- also known as the controlled group -- from joint and several responsibility under the law for those pension plans. We will not allow him to do that. Our goal is to protect the pensions and to have a viable, ongoing TWA; but the situation is extremely serious. As Mr. Icahn is attempting to break up the controlled group, it may leave us with little alternative, except to terminate the plans to protect participants, TWA, and our premium payers.

Earlier this month, we reached an understanding on key terms of an agreement with the Unsecured Creditors Committee of TWA. It would prevent further deterioration of the company's two defined-benefit pension plans, which are already underfunded by $1.2 billion, and it will keep TWA flying and jobs secure.

The LTV and Continental Airlines cases clearly demonstrate that positive results can be achieved when companies negotiate with us responsibly. Our settlement with Continental, for Eastern Airlines' pension plans, will enable it to reorganize, keep flying, and keep people working while Continental's own underfunded pensions remain ongoing.

LTV offers an even better example. After lengthy negotiations, we worked out a settlement agreement for the funding of the three pension plans, which the U.S. Supreme Court ordered restored. Under the agreement, LTV will contribute $1.5 billion to the restored plans and fund the remaining pension liabilities over the next 30 years. This settlement, which is a major success for us, clears the way for LTV to emerge from bankruptcy with better funded, ongoing pension plans.

Many have asked why plans continue to be underfunded 18 years after ERISA's minimum funding standards were enacted and five years after the funding reforms of 1987. Despite the extremely strong equity and bond returns of the 1980s, underfunding is stuck at mid-1980s levels. Some companies are even backsliding. The unsettled legal status of our bankruptcy claims and the absence of sufficient co-insurance in the program lessen the interest that creditors or workers have in plan funding. Also, the funding rules themselves continue to fall short:

- In "flat-benefit" plans, which represent about 25% of the universe, benefits are often increased at three- or five-year intervals in contract negotiations. Amortization of such increases under current law is not fast enough to prevent funding deterioration, especially in plans with a high percentage of retirees and older workers. These plans are only about 75% funded on average. Although funding rules do not allow these plans to anticipate future benefit increases, there is nothing preventing them from being 100% funded. Some are over-funded. In contrast, pay-related plans are about 145% funded on average.

- The rules also allow a company, regardless of funding levels, to reduce contributions immediately if it has better-than-expected investment or actuarial experience. Consequently, companies whose plans are billions of dollars underfunded can and have taken multiyear funding holidays.

Despite our deficit of $2.5 billion, problems like TWA, and the projected losses of up to $45 billion, some say that there is no reason to be alarmed. Certainly, the overall defined-benefit system is healthy in terms of funding, with $1.3 trillion in assets to cover $900 billion in liabilities. As is so often the case, averages are deceiving and there are significant problems.

One such problem is that every year for the last several years, almost 10% of the plans we insured terminated and dropped out of the system. This cannot continue. Without action, the Congress will have to raise premiums yet again, which will drive more well-funded plans out of this voluntary defined-benefit-plan system. Even some of the opponents of reform admit that this type of "en-masse" withdrawal could cause an S&L-type crisis.

ADMINISTRATION'S PROPOSALS

Earlier this year, the administration proposed the Pension Security Act of 1992, which addresses the moral hazards present in the three key areas -- minimum funding rules, our guarantee, and bankruptcy rules. These reforms will contain the growing deficit in the single-employer program. These reforms have received strong editorial support from many newspapers, including *The Wall Street Journal*. The journal editorial, which ran last month, said the reforms "would shoo America toward a pension system more suitable to a dynamic society of intelligent people. And yes, they would eventually save taxpayers money." Also last month, *The Washington Post* weighed in with the observation that: "The reforms are sensible."

In the funding area, we are proposing to strengthen the 1987 change by making it a stand-alone rule and creating a new alternative funding rule targeted to mature plans with large numbers of retired participants. Logically, it says company contributions should match the benefits paid plus interest on the underfunding. Second, we want to restrict the growth of our hidden liabilities by only guaranteeing future benefit increases if a plan is fully funded. Last, we want to put into the bankruptcy code the priorities already in ERISA and the tax code and then gradually increase them. The impact on our deficit of these three reforms is quite dramatic, producing a small surplus in the next five years, rather than the projected $18.4 billion deficit on an accrual basis.

Before discussing these reforms in detail, I would like to mention another important administration initiative; that is, to change the federal budget treatment of the PBGC from a cash basis to an accrual basis. It would greatly increase awareness of the real cost of the insurance program.

FEDERAL BUDGET ACCOUNTING

Cash-flow budgeting is the same budgeting that helped obscure the S&L problem for so many years. In the year that Pan Am's plans terminated with a $900 million underfunding, Pan Am's plans caused an outlay increase of only $10 million in the federal budget.

The cash approach simply ignores our growing future liabilities. It is no more appropriate for us than it is for the insurance companies that some of you work with. The administration is proposing to shift the budgetary treatment of the PBGC (along with the other federal insurance programs) from cash budgeting to accrual budgeting to reflect the long-run risk to the insurance program. Under accrual budgeting, the PBGC's outlay costs will reflect both its accrued liability outstanding at the time of conversion to accrual accounting for already-terminated plans and its accruing liabilities with respect to expected future losses. This will show the real financial position of the PBGC.

Both the Congressional Budget Office (CBO) and the GAO have recognized that the federal budget treatment of the PBGC needs to be changed. CBO director Robert Reischauer testified last month that, "In the case of PBGC, the current budgetary treatment fails on all counts: it does not accurately characterize the use of, motivate the control of, or provide for future resources." Joseph Delfico, director of income security issues at the GAO, testified at the same time that "the concept of reporting of accruals in the federal budget is sound."

I will now describe the administration's proposal to contain our growing deficit by enacting reforms to the funding, guarantee and bankruptcy rules.

MINIMUM FUNDING RULES

The current minimum funding requirements have proven inadequate in a number of respects and, if left unchanged, will not significantly reduce the "funding gap" in chronically underfunded plans. Subject to certain limits, this funding gap is the difference between termination liability (the benefits owed by the plan in the event the plan terminates) and plan assets.

As we observed earlier, in the vast majority of pay-related plans, there is no funding gap. This is because pay-related plans, which are about 75% of the universe, generally fund toward projected benefits that anticipate future compensation and benefit increases. Consequently, these plans are usually overfunded on a termination basis, with funding ratios typically about 145%.

In "flat-benefit" or "flat-dollar" plans, which represent about 25% of the universe, the funding gap can be considerable. As most of you know, these plans provide a flat benefit per year of credited service. Benefits do not increase automatically, as in a salary-based plan, but instead are increased by plan amendment. We estimate that the 1990 round of negotiations in the auto, steel, and tire and rubber industries may have increased underfunding by $8-9 billion.

Most flat-benefit plans are the product of collective bargaining. Because benefits are often increased at three- or five-year intervals in contract negotiations, new liabilities can be added before old ones are funded, leaving the plan chronically underfunded. Typically, these plans are only about 75% funded. Although funding rules do not allow these plans to anticipate future benefit increases, there is nothing preventing them from being 100% funded.

While helpful, the "deficit reduction contribution" that was enacted in 1987 does not adequately address the problems posed by these flat-benefit plans. In flat-benefit plans, it is possible to be in full compliance with existing minimum funding rules, even when annual benefit payments far exceed annual contributions to the plan. Firms with large amounts of underfunding can continue to take contribution holidays, provided that the plan's investment returns exceed expectations or funding assumptions are changed. Most of the largest underfunded plans, especially those in the automobile industry, have taken such holidays since 1987.

The administration is proposing legislation to increase minimum funding for plans presenting the greatest exposure and risk to the PBGC. The rules for fully-funded plans, which make up the vast majority of defined-benefit plans, and for small plans with under 100 participants, would not be changed.

These minimum funding proposals have been crafted to improve funding in chronically underfunded plans. Further, they are structured to assure that a greater portion of investment gains will result in improved plan-funding ratios, rather than inuring to the benefit of the sponsor through reduced contributions.

Based on our actuarial analysis, these proposals, had they been enacted in the early 1980s, would have substantially reduced underfunding in most of the major underfunded plans that constitute our current exposure. If we assume that we continue to have strong investment returns over the next decade or so, enacting these proposals should reduce the time span for full-funding of plans to 15 years on average.

BANKRUPTCY
The second major area of proposed program reforms would improve the PBGC's recoveries from bankrupt sponsors of terminated plans. The PBGC has long asserted that much of unpaid employer contributions and a certain portion of the PBGC's claims for employer liability for unfunded benefits are priority claims. It should be remembered that any recoveries the PBGC receives in a bankruptcy are shared with participants who have nonguaranteed benefits.

A 1991 district court decision in the LTV case, if allowed to stand, effectively precludes payment of pension contributions during bankruptcy, strips the PBGC's claims of their priority status, and denies the PBGC the right to specify the actuarial assumptions used to determine the amount of our claims. This decision, which relies solely on interpreting the bankruptcy code and ignores related provisions of ERISA and the Internal Revenue Code, will lead in a number of ways to more and larger terminations of underfunded plans. In particular, the decision removes one of our key coinsurance features, which is the incentive for creditors to encourage better funding to limit the PBGC's priority claims when an underfunded plan terminates.

On average, less than 20% of our claims in bankruptcy are entitled to priority treatment. Although small, these priority claims result in the PBGC's claims being treated seriously before and during bankruptcy. Clearly, without priority, the PBGC's recoveries in bankruptcy would be drastically reduced, and the coinsurance principles will be eviscerated.

Bankruptcy protections obviously help reduce the PBGC's losses once an underfunded termination occurs, but also encourage better funding before bankruptcy. Companies would have less incentive to terminate underfunded plans if the PBGC could recover significant amounts when plans terminate. Creditors would treat underfunded pension plans as real debt, creating a market-based incentive for better plan funding.

RESTRICTIONS ON THE PBGC GUARANTEE
Finally, to further improve funding incentives and limit the PBGC's exposure, the administration is also proposing to restrict the future growth in the PBGC's guarantee for benefits promised in underfunded plans.

Under the proposals, the PBGC would not guarantee new benefits or benefit increases due to plan amendments for plans that are not fully funded for vested benefits. Once the plan becomes fully funded for vested benefits, however, the benefit or benefit increase would be guaranteed, subject to the existing statutory limits. Future increases in unpredictable contingent-event benefits, such as shutdown benefits – which have cost the PBGC's premium payers over $0.5 billion to date – would not be guaranteed at all.

Sponsors of underfunded plans and their employees would continue to be free to agree to future benefit increases, but they would do so knowing that they will not be guaranteed until the plan is fully funded. This should encourage better funding and more realistic benefit promises. Furthermore, the proposal will curb the practice of accumulating unfunded benefit increases over many years for which the PBGC's premium payers then have to foot the bill when the plan terminates.

CONCLUSION

The PBGC needs these legislative changes to reduce the threat that growing pension underfunding poses to the insurance program and to the defined-benefit system that we insure. If we do not make legislative reforms, premiums will need to increase again, which would be counterproductive.

At the time the PBGC was created, it was envisioned that a low level of premiums would be needed to support the insurance system. Obviously, either the crystal ball was cracked or there was not a qualified actuary massaging the crystal ball. We now estimate that without reforms, the original $1 premium per participant would have to be $70 or more for a well-funded plan, and $100 per participant for an underfunded plan.

As this is a voluntary system, that high a premium might drive out the well-funded plans, leaving the PBGC and potentially the taxpayer holding a bag of empty promises. A recent economic report published by the Federal Reserve Bank of Atlanta points out that if deposit insurance makes banking institutions unprofitable, their only option is to relinquish their banking charters. On the other hand, companies facing unacceptably high PBGC premiums may find it a less difficult choice to switch from defined-benefit to defined-contribution plans.

Already, we are seeing a trend in this direction -- a trend confirmed by the recently released survey of the Academy of Actuaries. The survey points out that pension plan terminations have increased at an extraordinary rate in just the last few years. The survey and a Hay/Huggins study that we commissioned both point to another factor as a major contributor to this termination trend; that is, the administrative expense caused by an unsettled and often burdensome set of laws and regulations. Every year for the last several years, almost 10% of the plans we insured were terminated and dropped from the system. This is very troubling.

A recent study by Professors Zvi Bodie of Boston University and Robert Merton of Harvard concluded that overcharging sponsors of well-funded plans to subsidize the underfunded plans of financially distressed companies could cause a flight of healthy sponsors from the defined-benefit system that could leave the United States "with bankrupt defined-benefit plans financed directly by taxpayers."

A recent report by the Employee Benefit Research Institute (EBRI), while acknowledging that the PBGC faces serious long-term problems and that reforms are needed, cautions about undermining confidence in the defined-benefit system.

The overall defined-benefit system is healthy in terms of funding, but this can't permit us to ignore the problems that are there. Unless we stop the growth of the PBGC's exposure and our deficit, the specter of ever-increasing premiums looms in our future. We must take the steps necessary to shore up the insurance fund and make the PBGC financially strong so it can do the job for which it was created -- provide a safety net for the defined-benefit pension system. You cannot have one without the other.

Escalating premiums could accelerate the current defection rate from the defined-benefit pension system even more, ultimately leaving only underfunded plans. Such an "en-masse" exodus, denying the PBGC a base of premium payers, could result in a general taxpayer bailout as EBRI has pointed out.

To avoid this result, we need to enact program reforms to improve pension plan funding, limit growth in insurance exposure, and clarify the status of the PBGC's claims in bankruptcy. Very productive hearings on our legislative package were held before the House Ways and Means Subcommittee on Oversight in August 1992 and before the Senate Finance Subcommittee on Private Retirement Plans in September 1992. The question we face now is not whether the PBGC needs reforms, but when they can be enacted.

MR. L. JACQUES PELLETIER: The PBGF in Ontario was created in 1980, and, in fact, it has been leading a fairly simple life ever since, at least for its first 12 years, and there has not been much written about the PBGF. The PBGF has not been able to make the front page of any newspaper. Maybe it has been able to make the front page of the business section of a newspaper once in its life, but that is about it. So, to find out about the history of the PBGF, in fact, I found a speech that was given in 1984 by Gemma Salamat, who was then the Superintendent of Pensions for Ontario. She gave some clues as to why the PBGF was established and how the premiums were set. I thought that since we do not have too many problems with the PBGF, a bit of trivia might be interesting.

She said, and that basically much parallels what the situation is in the U.S., that the PBGF was established because the government was concerned about the funding or the insufficiency of funding of flat-dollar benefit plans. Because these plans were typically renegotiated every two or three years, and they still are, and because they are improved and employers normally choose to fund the benefit improvements, in Canada over the maximum period of 15 years instead of over the duration of the bargaining period, the government was concerned that the piling up of layers over layers of amortization payments might become a tough burden to bear. Therefore, the payment of benefits promised might be in jeopardy if an employer in difficulty became unable to meet its obligations. In other words, flat-dollar benefit plans were viewed, and that's not too far off the reality, as disguised final-pay plans and funded in a very risky way. As a matter of fact, I think in the 1970s, there had been a few situations of flat-dollar benefit plans collapsing and benefits being lost, and that is what the government wanted to remedy.

The first year of funding of the PBGF was 1983, and at the time Ms. Salamat spoke, the PBGF was doing reasonably well. In early 1985, there were a few million dollars in assets and very few claims made by plans. The premium, in 1983, was 0.2 of 1% of the plan's unfunded liabilities based on the valuations that were filed with the Pension Commission of Ontario. The assessment in the first year produced revenues of $2.6 million. Employers whose plans were in deficiency at the time of the regular valuations could avoid the assessment, and a number of employers did avoid the assessment by having their actuary perform what was then called a test valuation, which was some kind of an attempt at determining whether the PBGF was at risk or not with respect to a wind-up of the plan.

I found it quite interesting to read Ms. Salamat's comments explaining how the commission arrived at an assessment rate of 0.2 of 1%. She said that it had considered a per-member assessment similar to that of the PBGC, and the premium would have been $3 per member. She said that the flat-fee approach was rejected as unjustifiable. It also rejected an assessment based on a percentage of employers' contributions. It rejected that because, obviously, good employers who pay their unfunded liabilities faster would have been penalized. It recognized that the amount of the unfunded liability that was revealed by an ongoing valuation was not a good measure of the PBGF's exposure to claims, and it had offered the test valuation as an alternative. It chose that basis anyway for ease of administration because, she said, "we did not want to put plan sponsors through the extra burden of a wind-up valuation purposely for the PBGF assessment." She went on to say that "to impose yet another costly requirement over and above everything that was already imposed was inappropriate, unrealistic and unfair." Times have changed. We now have an assessment formula that's equal to $1 per plan member plus 0.2 of 1% of the excess of solvency liabilities over the market value of assets. To establish a solvency liability, of course, you now have to perform a solvency valuation. Anyway, it had estimated also that the premium should have been 0.1 of 1%, and based on that compelling logic, it established it at 0.2 of 1%.

Facts proved it right, though. There is currently a proposal which, if adopted, will increase significantly the valuation work and the amount of the assessment for most pension plans. I will get back to that later, but let me talk briefly about the coverage under the PBGF. Who is covered? Well, most of you are aware that, in Canada, the legislation on pensions is a provincial matter. Eight provinces have pension legislation and there will soon be ten, plus federal legislation governs a certain number of employers. Only Ontario has implemented a pension guaranty program, and, still, it is fairly significant, because Ontario is the largest province in Canada, and that's where the majority of employers and employees reporting for work are.

What is being covered? Essentially, most accrued pension benefits in respect of employment in Ontario; I think it is a bit easier to describe what is not covered than what is covered. Not covered are payments under plans that are less than three years old, increases in benefits that have been made in the three years prior to a plan wind-up, and benefits including bridging supplements that exceed $1,000 a month. Multiemployer plans are excluded, and negotiated defined-benefit plans where the contribution is fixed -- the fixed-benefit/fixed-contribution plans -- are excluded. Not much happened, in fact, to the PBGF until 1990, and if my calculations are correct, the PBGF had collected at the time about $11.4 million in premium and paid $11.6 million in claims. So, that just proved that the 0.2 of 1% was just about the right number.

The assets of the fund at the end of March 1989, the end of its fiscal year, were $2.5 million. This is when the Massey Combines left the PBGF with a $29 million claim. The government made a loan to the PBGF, and now with the assessments collected since and the few claims that have been paid, the PBGF was in a deficit of $22.2 million at the end of March 1991. I should mention that the Pension Commission has a lien on the assets of the employer that sponsors a plan that is involved in the PBGF claim, and there was a recovery of $3 million by the PBGF in 1991, and that is presumably from the Massey Combines assets.

Let's move on to where we are now and where the PBGF seems to be going. The Massey Combines claim was a disaster for the PBGF, but in absolute numbers, this was a disaster of fairly modest proportion. The government of Ontario is now extremely nervous about the claims that may be made to the PBGF, if the economy does not come back to life soon to prevent the financial collapse of a few major Canadian employers, particularly in the steel and the automobile industry, and other businesses that seem to have a much tougher time than the benefits consulting business. As a number of plans provide that special additional benefits are triggered upon a plant shutdown, the PBGF's exposure to truly big claims cannot be ignored. As I said earlier, that makes the government a bit nervous.

How is this being addressed? Well, the Pension Commission of Ontario has produced a draft paper that deals with the problems in two ways: the revisions to the solvency funding rules and increased contributions to the PBGF. On the solvency valuation side, which triggers the PBGF assessment, the government is introducing a bit of flexibility that was not there before. In brief terms, to determine the solvency payments that were established under the current rules, that is, before the new rules come into effect, we will be allowed to amortize them over the period between the date of the determination and 2002. In fact, this will allow a lengthening of the amortization periods. For new solvency deficiencies, five years would be the rule. Employers will be allowed to recalculate, retroactively to 1988, their solvency funding under the new rules, but they will not be allowed to recalculate their PBGF assessment. A different method for valuing the solvency liabilities will be allowed by permitting a smoothing of the assets and liabilities for purposes of the valuation, but in that case, the interest rate that is being used to determine the solvency deficiency will have to be in line with the smoothing method being used. Certain large plans will be allowed to opt out of the solvency funding, for a price, and, likewise, employers sponsoring plans that provide for plant-closure benefits will be allowed to exclude those plant closure benefits from solvency funding, again for a price. I will spare you the details of the rules for the solvency funding, but I will be happy to answer questions. Let me merely mention that annual valuation filings will now be required, if the solvency ratio is less than 80%, or if the solvency deficiency exceeds $5 million, or if the plant closure benefits are excluded from the solvency valuation.

In the new environment, the PBGF assessment will be based on the portion of the solvency liabilities that are attributable to employment in Ontario. This is what we call the PBGF liabilities, to the extent that they exceed the corresponding share of the market value of assets. The deficit will be called the assessment base, and the assessment will be equal to $1 per Ontario plan beneficiary. That means that active employees and inactive members will now be subjected to the $1 assessment, when previously only active members were considered. In addition, there will be a 0.5% assessment on the portion of the base up to the first 10% of the PBGF liabilities, 1% on the portion of the base between 10-20% of the PBGF liabilities, and 1.5% on the portion of the base over 20% of the liabilities. So, the further away from full-funding from a solvency standpoint the plan is, the greater the premium. There will be an overall limit of $100 per Ontario plan beneficiary and a further overall limit of $4 million, in any event. If plant-closure benefits are excluded, an assessment of 2% of the value of those benefits for Ontario plan members who are eligible to receive them will be required, with a provision to offset this assessment in the case of plans that show assets exceeding solvency liabilities. Likewise, plans with assets that have a market value in excess of $500 million may opt out of the solvency funding completely, but in that case, they would have to pay an assessment of $1 per Ontario plan beneficiary plus 2.5% of their assessment base, including the plant-closure benefits, to the PBGF, up to a maximum of $5 million. If those plan sponsors do not like the amount of the assessment under the opting-out provision, they will be allowed to opt back in, into the regular solvency-funding rules, but once they are back in, they will not be able to go out again.

This is basically much what I had to say about the PBGF. As you can see, it is a simple program. Will these new rules be adopted? I would think yes, by and large. The draft regulations were first submitted for discussion on May 15, 1992. They have been revised. They have been resubmitted now to the public on August 23, and all we can do is wait, but I do not think we will have to wait long.

MR. PAUL H. JACKSON: I have some things I want to say in two areas. One is primarily actuarial, relating to the experience that the PBGC has had and how you interpret it. The other is tangentially related to the PBGC and really relates more to ERISA as it was originally passed. That is the pension-loser issue. In 1973, I testified before the House Committee on Education and Labor, on plan-termination insurance, which at that time was in a chaotic, developing condition. My conclusions were that first, plan-termination insurance, to operate properly, would require federal control of actuarial assumptions and investments, would impose a tax on private pension funds, the premium, and would require some pledging of corporate assets to back unfunded liabilities at termination. Now, I do not see that was off-base, or controversial, or long-winded, for that matter.

Second, while such a program would avoid lost benefits at future plan terminations and would encourage funding, the various controls and pledging of corporate assets would severely discourage the adoption of new plans and the improvement of current programs. On that score, I might add that starting in July 1, 1974, and ending January 1, 1977, the IRS figures in the U.S. indicated there was a net zero defined-benefit plan formation in the United States – new plans minus terminations – versus 30,000 a year up to that point.

Third, the design of plan termination insurance was concentrated on the plan terminations of the future and ignored those employees who had already lost benefits. This prospective design also resulted in an investment problem and in an insurance risk that is hopelessly unstable. If the government is to be involved in any such program, it should be set up on a basis where the money that is collected will be immediately disbursed as benefits to all persons of all ages who have lost private pensions, regardless of the date of plan termination. Essentially much of my testimony then was about the pension losers, and let me give you a simple example of a pension loser.

Let's take Joe Six Pack. He has 20 years with Studebaker. He is 57 years old in 1964 when the plan terminates. He has a pension that has probably a single-sum value at that point of, let's say, $5,000, and the plan is 60% funded. So, you would think all Joe gets is $3,000 to retire on instead of the full $5,000. The UAW and Studebaker, however, negotiated a set of termination provisions that was quite common in those days. It was agreed that when the plan terminated, all of the money would be used to first provide the retired employees with their full benefit, not just 60%. Second, if there was enough, the people eligible for early retirement would get 100%. Now, Joe happened to be in the third tier. He had vested rights, but he was not eligible to retire. He was in the third tier, and for that tier there was not enough money to provide full benefits; there was only 15% available. So, Joe got \$750. His pension was worth \$5,000, and if it had not been for this plan-termination provision, he would have gotten \$3,000. I will come back to that point later.

I felt, at the time of the adoption of the program, that charging pension plan sponsors a specific premium for plan-termination insurance was wrong, and I suggested to the Dent Committee that this was an appropriate add-on to the corporate income tax. My reason was not that Studebaker promised pensions, but when Studebaker went bankrupt, people lost pensions because Studebaker was forced out of business. And GM, Ford, and Chrysler each would sell a few extra cars in the coming years, make a few dollars extra profit, so the corporate income tax on those companies was a reasonable source of funds to cover losses due to the plant closings, the bankruptcies and such that go on in a free-market economy. At that point, I think I proposed adding 0.05% to the then 46% corporate income tax. So, it would have been 46.05%. Most companies would not have noticed it.

The goal, originally, when the PBGC was established, was to bolster confidence in the private pension system, take fear away from the employees to the extent possible, and avoid benefit losses. The PBGC was not established as an investment of the federal government in an insurance company that was going to compete with the Aetnas and Liberty Mutuals of the world. It is a government program and, as such, I think should be measured by more than simply how solvent it is, or what sort of deficit it has, but rather what it does. When we look at Housing and Urban Development, for example, we do not ask them at the end of the year "What is your budget and what is your bank balance?" We look at what they do. So, in the case of the PBGC, in addition to looking at the numbers, we should be looking at the purpose society had in having the PBGC set up by the federal government with the right to charge employers amounts of money and to do various things. What is it accomplishing?

Initially, there were a number of concerns about setting up the PBGC, because the insurance companies felt this was the camel's nose under the tent, and the government was going to be controlling the insurance industry or taking it over at some point. There was concern that if funds built up and there were substantial investments to be made, the government could invest so much in various private companies, that simply by voting the common shares on management issues it would be controlling the private sector too much. There was also some concern about limitations on variation in plan detail, because there is so much variation in industries as to the retirement needs. Police officers and fire fighters do not have the same retirement needs as school teachers, for example. Auto workers were concerned about automation and job loss, and they put in early-retirement subsidies to help minimize that.

One of the first decisions made by Congress was to exclude the pension losers. The plan-termination program was put in on a basis where it covered pension losses under any plan-terminated after July 1, 1974. Now, that came as a shock to all of the people who came in and testified before Congress. Imagine the reaction last fall if the victims from Hurricane Andrew came in and testified before Congress, and at the close, Congress said "We are delighted that you came in and brought this problem to our attention. You will be glad to know we have set up a wonderful new program that is going to prevent this sort of thing from impacting on people in the future. Unfortunately, we cannot do anything for you at all." That was my feeling at the time, and a pension-losers' group was formed at the time to attempt to get these people covered under this plan-termination insurance program. That was 20 years ago, of course. At that time, it was estimated that 65,000 people in the United States lost vested rights under pre-ERISA terminations. At this point, there are probably 30,000 of them left, something on that order of magnitude. They are dying at the rate of about six or eight a day. And many of the close friends who worked very hard on this, like Jim Christy, who was the insurance manager at Upjohn, and Ed Johnston, who was the business manager of the IAM Local at Perkins' Machine and Gear, are now dead.

Last fall this pension-losers' legislation came before Congress for the first time. It appeared on the floor of the Senate as an amendment to the Older Americans Act. The PBGC convinced the Secretary of Labor and the White House to make a full-court press against this proposal, and, as a result, it lost. It lost because of the perception that this was a giveaway. Orrin Hatch said in the debate over the pension-losers that this group "had not paid one, thin dime for their insurance. They were not entitled." Well, my position is that these people paid for 100% of the plan-termination insurance that was in effect pre-ERISA. Why did the Studebaker retirees get 100 cents on the dollar? Because pension losers, like Joe Six Pack, gave up a couple thousand dollars of their own pension rights.

One other issue along the same lines: shortly after ERISA was passed, there were two lawsuits, the Collins and Page cases, or Collins and Rettig. These plans terminated after ERISA was passed, but either the employers had not yet amended the pension plans like they were supposed to under ERISA, or they failed to pay a premium to the PBGC, and the PBGC denied the claim. A few years later, Congress passed legislation saying, "we will not penalize the covered participants for this, but we will do that on a prospective basis only." I lump all of these in one, broad category. I do not think the PBGC is doing the full job that it should do, and I do not see why it opposes legislation that would permit the full job. I understand that there is much fuss and bother in getting the details on the pension losers.

Getting back to the actuarial matters, at the beginning, the PBGC had to define what a basic benefit was. Single employer and multiemployer were two funds. Two more funds were going to be optional for single employers and multiemployers. The first two funds were going to cover only basic benefits, benefits common to everybody. The second two funds were going to provide extra coverage for extra benefits that would be optional, where a union could negotiate for some special benefit and then negotiate for PBGC coverage of them. Well, it turned out that everything was a basic benefit, and when they got to defining the basic benefit, there was not anything left over for these other two funds, so they were dropped.

Contingent employer liability insurance was also a great idea. This was something that was going to put employers in a position, where for a specified sum each year, they did not have to worry about claims on their net worth. A long study resulted in the conclusion that was not possible. And, finally, and this decision I think should be revisited by the PBGC, the PBGC had a study done by Ed Friend, a Washington consulting actuary, on how to set interest rates and premiums to cover the cost at plan termination. Matt Lind gave me the study to look at. I thought it was a good study, but the PBGC was unsatisfied with it -- it was too complicated -- and so it decided, as a practical matter, to get its plant shutdown rates by asking private-sector insurance companies for the rates they were charging. I think the Life Insurance Association of America (LIAA) gets rates and maybe 20 companies contribute. I thought this arrangement at the outset was reasonable, but now that the PBGC has $8 billion in total obligations, I would think it would want to set its own rates.

Initially, many theorized about abuse, and I have to admit, I had more faith in the American people and the average American businessman than was warranted. I did not think people were going to play around with pensions, and there were not very many who did, but the ones who did got attention, I'm afraid. One of the early ones was seen in the Facit case. A large organization spun off a small group and spun off its pension plan with inadequate assets. In short order, that organization handed it to the PBGC and said to take it over. Besides, there was no net worth for the PBGC to get, so it had to take care of the pension loss. LTV was another, and in cases of abuse like that, the law has been changed a number of times, and I have favored most of the changes. One of the problems, however, is that every time you try to change the law to cover abuse, you do not really put a penalty on the person who is abusing. You put prospective penalties on anybody who might abuse in the future. So, instead of capturing the speeder who's going over 55 miles an hour, you put a governor on everybody's car that permits them to drive at only 40 miles an hour.

One of the problems that has existed for the PBGC, and this was one that I have to admit I had not foreseen, is the problem with rising pensions, declining heads, and a flat-dollar premium. The flat-dollar premium did not bother me initially. I might add that, in October 1975, I said at an American Pension Conference meeting, "And, of course, PBGC is now collecting a dollar. The cost is probably more like five." I did not say five indexed, and I don't think anybody else did at the time, the reason being that it was assumed that the plans would gradually be funding in the future, and that this problem would work its way out.

The PBGC publishes an annual report. It looks like a Fortune 500 annual report, with all sorts of pictures, but in the back is a financial summary, and this is the only place you can really get a handle on what is going on. It shows some things that are interesting for an actuary. For example, the premium income in each of the last 10 years is shown. The losses or gains from completed and probable terminations are shown. This permits you to set down the premiums and claims back to inception and work out the loss ratio. It also has a deficit. The accumulated deficit has risen from $1.1 billion at the end of 1989 to $1.9 billion as of September 1990, to $2.5 billion in September 1991. Of course, it was $3.8 at the end of 1986.

The deficit is an important item, but the report also shows the assets. When its deficit was $3.8 billion, it had assets of $1.7 billion. Now its deficit is $2.5 billion, and it has assets of $5.6 billion. As a private insurance company, it would have been out of business at the end of the first year of operation. It would have been insolvent, and it would not have been permitted to write insurance. It is not an insurance company. It is a federal agency. As such, it can operate like a private pension plan, in effect, and it has benefit promises out there that are not yet funded. It does not have to pay those promises immediately, as in the case of the savings and loan and the banking situation. There, you have to have the money now because anybody can come in and ask for their full amount in a lump sum. The PBGC does not pay lump sums. It pays pensions spread out over 30 years or more. It has $5.6 billion in assets, it is paying benefits at the rate of about $500 million a year, and it has administrative expenses of $70 million. It has to have enough money on hand to pay benefits for a 10-year period.

Now, in the testimony I gave to the Senate Finance Committee, I said that the PBGC's claims in 1990-91 were much higher than previous levels, due to the recession. You can see it in the loss ratio. The loss ratios are 142% in each of those years, compared with an average to date of 116%. Year-by-year claims are very erratic. This is an understatement. They go from a negative $1.8 billion to a positive $2.4 billion, while pensions paid, and this is the basis that I felt the government ought to be basing its financing on, tend to increase steadily. Deficits appear to be increasing.

"Probable" claims represent a significant part of year-end deficits. At the end of 1990, when the deficit was $1.9 billion, probable claims were $1.1 billion. Now, probable claims are not really claims. The PBGC does not use Aristotle's law of the undivided middle, either A or not A -- it is either a claim or it is not a claim. The PBGC uses fuzzy set theory for claims, which says either (1) it is a claim or (2) it is not a claim, but it is close enough to being a claim in a near-enough period of the future and likely enough that we will call it a claim anyway, or (3) it is not a claim and not close enough, and so we will not call it a claim.

On that point, I'd like to mention an item that I read in *The New York Times*, August 19, 1992, on our banking system. The article was entitled, "Why Haven't More Banks Failed?" and when I got through reading it, I wondered, yes, why haven't they? William Taylor, who was the chairperson of the FDIC, had recently pushed the FDIC to revise downward its forecast for its own financial condition. Instead of accounting only for losses it would suffer at banks that are on the verge of failure, the agency now casts its net wider, to include losses from banks that it estimates are likely to fail, even though the event is not imminent. He said, "I operated on the simple principle that the losses are there whether the bank gets closed today or some time in the future." I think the PBGC does a little of this with its use of probable claims. This means, in effect, that when you get to the year-end deficit, it can be almost anything you want. If you want a bigger year-end deficit, cast your net wider, as Mr. Taylor suggested. Put a few more plans in. Make it $40 billion, as Professor Bodie suggested. Make it $20 billion, as Jim Smalhout suggested. Make it $13 billion. It is an entirely arbitrary form of accounting.

I think the PBGC ought to account for the claims that have happened. A claim is a claim. If it is not a claim, it is not a claim. A life insurance company also has insurance in force, and every single policyholder is certain to die some time. You could put your insurance in force down and book it as a liability, and not many companies would be solvent. Or you could, if you wanted to, as the PBGC seems to do, call around and find out how many of your policyholders are in the hospital or sick on December 31, because if they are close to being a claim, you could put them in, too.

The PBGC has a very difficult job here. They are insuring the residual pension obligation at the economic death of a sponsoring company. The first question is, when is the company going to go bankrupt? When is it going to reach that point? That is a tough-enough thing to decide. How well will the plan be funded? Well, that depends on how fast the employer was funding it, the conservatism in assumptions, the condition of the security markets at that time, the number of IRS waivers, whether there are early-retirement subsidies or lump-sum options, and how much will be recovered from the employer. That was what I had in mind in my original testimony when I said I thought the insurance risk was just ridiculous.

Now, how did we get this $2.5 billion deficit, and what does it mean? We have a $19 premium in 1992. How can that premium possibly cover a liability for pensions that are rising with inflation all the time? When you have inflation, salaries go up. Salary-related pensions go up. Hourly plans are negotiated. The benefits go up. The PBGC's maximum is tied in, automatically indexed. It goes up. How can you have a flat-dollar premium that covers that? A flat-dollar premium should be indexed to inflation.

Suppose we assume that the $19 premium was indexed in the past. It would have started at $7, roughly, and it was raised to $19. Where would we be now? The answer is, we would have a 61% loss ratio, and we would have $3 billion of surplus in 1991, rather than a $2.5 billion deficit. That suggests to me that the real problem we have with the PBGC has been cured by Congress's increasing the premium to a realistic level, and that if you index the $19 premium, you could run on for some years. How many years? On what I consider the most pessimistic of conditions, the PBGC runs out of cash prospectively with a $19 indexed premium in the year 2016. On what I consider a realistic basis, in the year 2020, it has $100 billion of cash on hand, and it is paying about $15 billion a year in benefits.

Is the PBGC in dire straits? Do we have to increase the premium from $19-70? I do not think so as an actuary. I have worked with plans of this sort, and I think that the PBGC is in surprisingly good shape considering the position it started from.

I was in Washington in 1974, 1975, and 1976. The PBGC hired many qualified people. The first thing they had to do was start an insurance company. There was nothing in place. The agency has done a marvelous job over the years. It is now paying a hundred-and-some-odd-thousand benefit checks every month. It has administrative procedures in force. It has controls in force. It has $5.6 billion in cash, and it has a premium that is up at a level that is realistic, at least currently. So, my assessment is that with an indexing of the premium to cost-of-living adjustments, we are probably out of the woods.

One concern I had about the PBGC was the investment policy. Two years ago, the PBGC decided, after an investment study, that it would immunize its liabilities. It would invest in bonds having a duration similar to the duration of its liabilities. That resulted, in round numbers, in a shift of 30% of its assets from common stocks into bonds. I think that was wrong. I do not think it should be investing to minimize the fluctuation in its surplus or deficit. I think it should be investing to maximize annual return, and I think it has, in this process, probably lost a full hundred basis points in prospective return that can only be made up by higher charges to terminating plan sponsors.

The PBGC has put in what I consider absolutely vicious minimum funding requirements and vicious PBGC premiums. If we get to a point, where employers that have funded their plan at a reasonable rate all along, all of a sudden find that the market value of assets has dropped like the Tokyo index, maybe down to 30 or 40% (and at such time, business conditions are not going to be that great), everybody's PBGC premium goes up. All of a sudden, their minimum funding requirements go up, and that is precisely the wrong time. We ought to have funding on a counter-cyclical basis. It is like saying we will only charge high unemployment premiums when we have high unemployment, because when we do not have unemployment, we do not need any money at all.

I hear some rumors from people that I know at the PBGC. One worries me. It says the PBGC would really like to get rid of many small plans that it has. The PBGC can focus on the big companies that are about to go bankrupt, but when they have 80,000 plans, they cannot focus on all the little ones. I think the little companies need pensions as much as the others. The PBGC has also, from time to time, talked about privatizing the benefit, buying annuities from the private sector. I think that by not buying annuities, it gives itself a financial cushion that enables it to ride out any storm.

I think its proposal to freeze the insurance on benefit improvements for flat-benefit plans is wrong. Hourly-rate workers have pension benefits in the neighborhood of $6,000-10,000 a year. Pensions at that level are particularly sensitive to the cost of living. When the cost of living rises, the union has to negotiate for an increase in the benefits. To say it will not insure them, but will insure a salaried employee's benefit when the individual gets a pay increase as a result of cost-of-living, is wrong.

I think the PBGC, in other words, as a federal agency, should be focusing less on where the financial results are and more on what this program is doing for people. I am not saying that it should not have a AAA credit rating. I am not saying it should not be a sound, financial, private-sector insurance company. If that is possible, fine. I do not knock it. But that is not the objective. The objective is to provide benefits for the retired people.

MR. THOMPSON: I have to tell you we have a different political situation in Canada. So, this is my first filibuster, but it's great, Paul.

MR. JACKSON: There is much publicity in the papers about the PBGC, and in July 1992, I pulled out an article from *The Washington Star*. The headline reads: "Private Pension Funds in Peril as Federal Backing Runs in Red. Massive Bailout May Be Needed. Imminent liabilities for the Pension Benefit Guaranty Corporation total as much as $13 billion and will amount to $35-45 billion over the next 30 years if current conditions continue." Now, I would say if current conditions continue for the next 30 years, we have lots of other problems, but why does the agency do this?

The answer is, it has this flat premium. It has some other legislative changes it wants to make, and under our political system, the only way the PBGC could apparently get the attention of Congress is to pass this out to all the newspapers. The newspapers have people calling up, and they tell them to call their congressional representatives. The congressional representative, then, will listen to the PBGC. Now, the PBGC is located at 2121 K Street. It is only about 20 blocks from Capitol Hill. Why can't these people get together, look at this program, decide what has to be done, and not scare everybody who has a private pension plan because the system is in peril?

A second article, which came out last Sunday in *The Washington Post*, says "Pension Struggle puts TWA Chief's Fortune on Line," and the comment that really hit me between the eyes was when Diane Berkeley warned Icahn across the ovalshaped conference table, "Indeed, we are prepared to bankrupt all your companies." Now, the article goes on, and it says to underscore their determination, sources said Lockhart and Berkeley had placed Icahn at the board room table so that he faced photos of plans from the defunct Pan Am and Eastern Airlines on the wall. The message was clear. TWA would suffer its fate if Icahn did not take out his check-book and solve the airline pension problems. That is just a bunch of middlerange bureaucrats exercising their power. It is shouting fire in a crowded theater, and it is not adding to the confidence that the American workers have in their private pensions.

MR. GUSTAFSON: I feel like I have this long grocery list, and I do not know which aisle to start in. Let me go back just quite briefly to what the PBGC's statutory purpose is. Paul said that it is not doing what it was charged with doing. The law says the PBGC is supposed to do three things. First, we are to provide for the timely and uninterrupted payment of pension benefits to the people whose plans we take over. Second, we are to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants. Third, we are to maintain premiums at the lowest level consistent with carrying out our obligations under the program. Those are often inconsistent objectives, and they lead to conflicts and create some of the concerns that Paul has raised here. It is not an easy program to administer, because you have to take out of one pocket to put into another pocket, and whenever you do that, people will protest.

I'd like to go through some of the things that struck me most from what Paul said, starting first with the pension-losers' bill. I agree that they have a very compelling case for receiving benefits. I, too, met with Ed Johnston and other pension losers. The reasons that the administration opposed the pension-losers' bill, this last time around, were multifold. First, it was being portrayed as a cost-free bill. They were not asking for additional income from the Congress. They were just going to reduce the PBGC's trust assets. That was, among other things, a breach of the budget accord, and it was budget gimmickry at its worst. Second, this bill has never had a full hearing in any committee in the Congress, bar once in 1982 before Senator D'Amato. The pros and cons have not been heard. And finally, the bill itself kept changing from one month to the next. In the form it was debated, few senators understood which version they were considering.

Now, let me get to Paul's rumor about us getting rid of small plans. That is just not the case. When we put out regulations on premiums, when we put out our proposals on funding, we try to encourage, as best we can, the maintenance of small plans. We exempt the small plans from as much complexity as possible. We try to provide streamlined administrative procedures for the premium calculation. We say you do not have to perform these additional funding requirements. That is, fortunately, a rumor that has no basis in truth.

In the matter of the PBGC's accounting practices, Paul suggested that an insurance company would not do it this way. We have an insurance company type of accounting paradigm that we think is more valid than Paul's current cash-flow approach. Insurance companies for long-term obligations take the present value of future claims, and they compare it to the present value of future premium income and investment income, and they establish a reserve. The long-term nature of the obligation is what we are arguing about here. We are talking about this issue because it is central to assessing a premium that equitably reflects when losses arose, to attribute the cost to the appropriate generation that produced the loss. It is a different approach that Paul takes when he considers the PBGC's finances on a solvency basis.

Paul also mentioned that the premium should be indexed. We would welcome the premium being indexed. We have suggested that the premium be indexed, but the Congress will not permit us to do that. Congress wants to maintain control over the setting of the PBGC's premium. If the premium were indexed, the future premium needs would probably be on the order of about half of that $70 that we talked about earlier, based upon our studies.

MR. HOWARD YOUNG: I am currently associated with the University of Michigan and partly retired, but those who know me know that I had something to do with the development of the PBGC. I only wanted to comment on two points that Dave read, and I know it is not your own statement, it is from Dave Lindeman's statement. One was on the cracked crystal ball. I do not think anybody wants to defend the $1 premium that came out of the political process. If you go back and read the proposals, it was quite different. But, more importantly, if anybody had suggested when all of this was under discussion that we would have had the kind of economic situation in the United States and in Canada that we have had in the past 10 or 12 years, they would have been dismissed as being totally unreasonable. If people had suggested that companies like AT&T would be a shell of their former selves, if people had suggested that a company like General Motors would even be rumored to be considering bankruptcy, they would have been committed to an institution. The problem the PBGC has faced is not that there has been some abuse, the problem has been the economy in the United States and Canada, and no one was anywhere near close on that. I agree with Paul that one of the goals is to spread experience over time, as well as over companies.

The second point I want to make is in reference to an editorial in *The Wall Street Journal.* I never read them carefully, but I did look at this one. Assuming you are referring to the same one I am, I think it really indicates where the interest is, because that editorial was not talking about improving defined-benefit plans. It really was indicating we should go more heavily toward defined-contribution plans, and I think that is part of the underlying agenda that many people have.

MR. GUSTAFSON: I think that you are right, Howard. In fact, that editorial also digressed into Social Security issues, if I recall correctly. My point, however, was the Journal's semi-endorsement of our legislative program -- that we were doing something that was sensible for the defined-benefit system. We are attempting, whenever we can, to reinvigorate the defined-benefit system. We talked in our last legislative proposal, for instance, of trying to do away with the quarterly contribution requirement for overfunded plans, something that will likely reappear in the next legislative package.

But back to your first point, overriding all factors relative to the adequacy of the initial premium is the fact that the nature and size of the risk has changed drastically since this program began. As Howard says quite rightly, nobody could foresee the bankruptcies of major corporations when this program was put together. Now, major bankruptcies occur almost routinely and are spoken of almost casually as possibly occurring in the future. Unfortunately, some of these major corporations have $10 and $20 billion of underfunding in their pension plans. We are not talking about small numbers. It is a troubling situation.