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PROPOSED PBGC LEGISLATION

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The effectiveness of the 1987 minimum funding changes and the tools that PBGC used in the legislative development process.

MR. C. DAVID GUSTAFSON: There are some limits on what I can talk about. As some of you may be aware, we're under a new administration in Washington, D.C., a new administration that's formulating its policy in a lot of areas, and there are a lot of activities going on. To say anything definitive about particular proposals or particular approaches that might be taken, unfortunately might give some misimpressions. So I'm going to be bland, in fact, so bland that I'm going to repeat what I said at the Enrolled Actuaries meeting.

My topic at the Enrolled Actuaries meeting was to have been the PBGC's current legislative initiatives. As most of you know, Marty Slate, the former director of the IRS Employee Plans Division was just appointed executive director of the PBGC on March 22, 1993. Also, the new administration is beginning to develop its overall legislative program. Thus, it would be premature and possibly misleading for me to speak about any specific legislative proposals, past or present. Instead my script will cover two issues: the effectiveness of the 1987 minimum funding changes, and the analytic tools that we use in the legislative development process at the PBGC.

Strong but reasonable minimum funding standards are essential to the vitality of the defined-benefit (DB) pension universe regardless of the existence of the PBGC. The 1986 bankruptcy and subsequent multibillion dollar termination of four LTV Steel pension plans drew attention to the weaknesses in ERISA's funding standards.

The ERISA standards, though a very positive step at the time, were not responsive to chronically underfunded plans in which new liabilities are systematically added before old promises have been funded. The standards did not address the special problems of mature plans with large retiree liabilities and a declining and aging work force. And the standards did not deal with the possibility of pension plans running out of money as happened with one of the LTV plans.

In addressing these weaknesses, our basic analytic tool has been an open group forecast valuation model developed by our actuarial contractors. The model adapts the results of the Academy's 1985 "Pension Actuarial Cost Method Analysis" study to the major funding issues that we face. The Academy study defined several prototype participant groups. We have focused on two of them: Group I, the "Old Long Service Group," and Group A, the "Normal Group." Group I typifies what we fondly call PBGC's "problem children." These comprise flat benefit plans with high average age and years of service, a declining work force, and an initial active-to-retiree ratio of one to one. We've analyzed a "Normal Group" such as Group A in order to develop rules that have minimal impact on the vast majority of plans that have made satisfactory progress toward full funding.

Our initial reform effort in early 1987 was a proposal that produced full funding at the end of 20 years for Group I plans whether they started out 25%, 50% or 75% funded. With personal computer in hand, we visited the four Congressional committees that have jurisdiction over the PBGC: the two tax committees and the two labor committees. When we went to see them, we took graphs with us. The graphs were a product of the forecast model.

There are starting funded percentages of 25%, 50% and 75% for the Group I plans. In each case, the administration proposal was to produce an improvement in funded ratios. In this case, as in other flat benefit cases, this plan was amended fairly periodically such that the actives received in essence, a cost-of-living increase minus 1% each year, and the retirees received a cost-of-living increase every two years. The result under the ERISA funding standards was a deteriorating funded status over time with this maturing population.

When we took our proposals to the Hill and worked with these four Congressional committees, we found that, though our early efforts were elegant, they clearly violated the keep it simple, stupid (KISS) principle. Hill staffers almost unanimously told us that our three-part approach -- the funded ratio maintenance rule, the complement rule and the cash-flow-rule -- was too complex.

By the end of 1987, each of the four committees had produced much simpler and very different fixes to the problems. The tax committees prevailed in the Conference Committee for Omnibus Budget Reconciliation Act (OBRA) 1987, but not before some significant compromises had been made.

On the plus side, OBRA 1987 established a new funding mechanism, the deficit reduction contribution (DRC), that accelerated funding of new benefit promises made by mature, underfunded plans. It also produced new rules that significantly reduced the problem of missed contributions, and began to address overly optimistic actuarial assumptions.

The Group A plans and plans with fewer than 100 participants were not affected by the OBRA 1987 minimum funding changes. However, the compromise rules were now expected to improve the funding of the Group I plans at a slower pace than under our proposal. The Group I plans were to become 80-90% funded over 20 years. Unfortunately, even this more modest funding target may not materialize based upon our observations since the passage of OBRA 1987. The funded ratios do not get up to fully funded over the 20-year period, although that appeared to be the objective of the four jurisdictional committees.

What happened to OBRA 1987? The DRC was a modification of the complement rule in the Administration's proposal. Unlike the complement rule, the DRC liability was split into a new and an old component, the old component not being subject to the accelerated funding formula. This grandfathering of the old liability occurred because those most affected by it convinced key Hill staffers that the funding rules for the old liability were being unfairly changed in the middle of the game.

As is often the case, the drafting of statutory language occurred very late in the process after the conferees had agreed on the principles. In the drafting, the DRC,

which had been modeled only as a stand-alone rule, was integrated into the funding standard account for ease of administration. The DRC was thus subject to reduction by the "net amortization charge for certain bases," including charges attributable to funding waivers.

Additionally, the DRC became subject to the interest-rate corridor that had been imposed in the entirely unrelated measure to reduce the full-funding limit. The DRC had been modeled using assumptions that produced a current liability amount much closer to PBGC termination liability than the value produced by the interest-rate corridor.

And finally, the integration of the DRC into the funding standard account produced the infamous "double counting" of actuarial gains and losses. The double counting, combined with OBRA's shortened amortization of gains and losses and the unprecedented simultaneous increases in stock and bond values, produced lower than anticipated contributions. Some sponsors of substantially underfunded plans have even taken "contribution holidays" under the OBRA 1987 rules.

The OBRA 1987 minimum funding changes became effective in 1989 and weren't initially reported on Schedule B until late in 1990. Thus, it has been only recently that we have been able to see their effect on plan-funding levels. Our observations have confirmed our concerns. Thus, we dusted off Academy Groups A and I and booted up the forecast model.

Virtually, all of PBGC's claims have come from plans that have been chronically underfunded. Despite the OBRA provision that permits funding up to 100% of current liability, these plans continue to minimize their contributions while routinely adding new benefits.

In creating the PBGC, the authors of ERISA anticipated that some plans might become underfunded and terminate as a result of sharp drops in asset values. To date we have had very few such terminations. But who knows what the future might hold.

The funded ratio targets that we have used in our modeling are based upon a plan's termination liability calculated on a termination basis. All of you are familiar with the difference between ongoing assumptions and termination assumptions. The termination assumptions that we use are derived from a market survey of group annuity prices.

Despite the OBRA 1987 changes, the funding standards do not require that plan liabilities be determined using termination assumptions as to interest, mortality and expected retirement age. Some have said that such a calculation is inappropriate, burdensome, costly and misleading for the vast majority of plans. However, without such a value, the real problems of underfunded plans remain hidden from public view. And without a true termination liability, we have to manipulate the provisions of funding reforms to indirectly produce the desired result.

The General Accounting Office (GAO) recognized the so-called hidden liabilities in a recent report to Congress. After an extensive survey of plan terminations in the late

1980s, the GAO concluded, "When a pension plan terminates with insufficient assets to cover its liabilities, PBGC is likely to absorb unfunded liabilities considerably greater than the plan reported on its most recent annual filing with the IRS. These hidden liabilities accounted for 37% of the claims against PBGC from the . . . plans in the study."

If 37% of the total underfunding was previously unreported, than conversely, the underfunding reported on the most recent Schedule B increased about 60% when the plan terminated. Not all of this 60% increase is due to the difference between ongoing and termination assumptions. Some is attributable to another PBGC nemesis -- the so-called death spiral.

When a company's financial condition begins to deteriorate, many actions are taken in an attempt to stop the red ink and to increase cash flow. Some of these steps provide temporary relief to the company but also burden the company's pension plans. Troubled companies often "downsize" (or as I heard recently, "right size") their work force. The consequences to the pension plan can be devastating if shutdown benefits are payable. Early retirement windows and the early payment of subsidized benefits also add to the pension burden -- a burden that will have to be borne by a smaller work force if the company survives.

Although reduced by the OBRA 1987 reforms, the nonpayment of contributions diminishes plan assets. Asset values can also drop if the plan is holding employer securities or if assets have to be liquidated prematurely to pay benefits.

The death spiral has been illustrated in a recent PBGC study. This study of over 200 terminations showed that after adjusting for PBGC termination assumptions, average funding ratios fell by over 20% during the three years prior to termination. The death spiral is a very real phenomenon that is also very difficult to address explicitly in the funding standards.

During the last two years, we have rerun the forecast models on Academy Groups A and I under a variety of scenarios. We have broadened our understanding of these generic runs by also performing a plan-by-plan analysis of a number of key plans.

Last spring we attempted to reexamine the origins of underfunding under ERISA. Relying solely on publicly available information, we looked at the assets and liabilities in the key plans over the period 1983-90. That observation period was chosen primarily as a function of the completeness of the Schedule B information available from the Department of Labor (DOL) and IRS.

Initially, we planned to analyze the frequency and size of significant "defunding events," such as plan amendments, liberalization of actuarial methods and assumptions, and major experience losses. We also hoped to assess the impact of significant distributions, either lump sums or annuity purchases, and of investments in company stock, defaulted GICs, and dedicated assets. And finally we wanted to examine the past in terms of several "what if" scenarios, such as "what if" some alternative funding rules had been in effect since the beginning of the observation period. We refer to the last exercise as "backcasting," which some have cynically observed sounds more like a fishing technique.

Twenty-six very large plans from 11 companies in the auto, steel and airline industries were selected for the analysis. The plans that we studied included seven terminated plans and two overfunded ongoing plans.

Liabilities were determined on two bases: the actuary's assumptions and the PBGC termination assumptions. The funding ratios for all years were calculated on a termination basis using the January 1, 1992, PBGC assumptions that included a 6.5% immediate annuity interest factor. That 6.5% factor translates to about an 8% rate under our proposed regulations. Use of a constant set of assumptions over the observation period eliminated distortions from year to year caused by annual assumption changes. Projections beyond 1990 were made by rolling forward the most recent Schedule B values without future experience gains or losses.

This is a cropped output of part of what we produced in this study (Table 1). Below were some comparable numbers for some of the legislative alternatives that we were testing at the time but which we blanked here for the sake of objectivity. This table summarizes the funding progress of all 17 underfunded ongoing plans in the study. Remember, these are extremely large plans in our key industries. Although there are some significant variances by company, overall current law produces little if any improvement in funded ratios, and permits nominal underfunding to increase 4-8% each year.

TABLE 1
Ways and Means Study

History/Current Law	1983	1992	1999
Total Underfunding	$14 B	$28 B	$ 36 B
Funded Ratio	71%	67%	67%

Chart 1 shows the result for one big plan for a series of runs. The bottom line of triangles shows this plan's actual history through 1990, and thereafter projects the values under current law. Clearly this plan has made no funding progress during the 1980s, and current law will not keep the situation from deteriorating. The three remaining symbolled lines illustrate what would have happened if a member of alternate funding schemes had been in place since 1983.

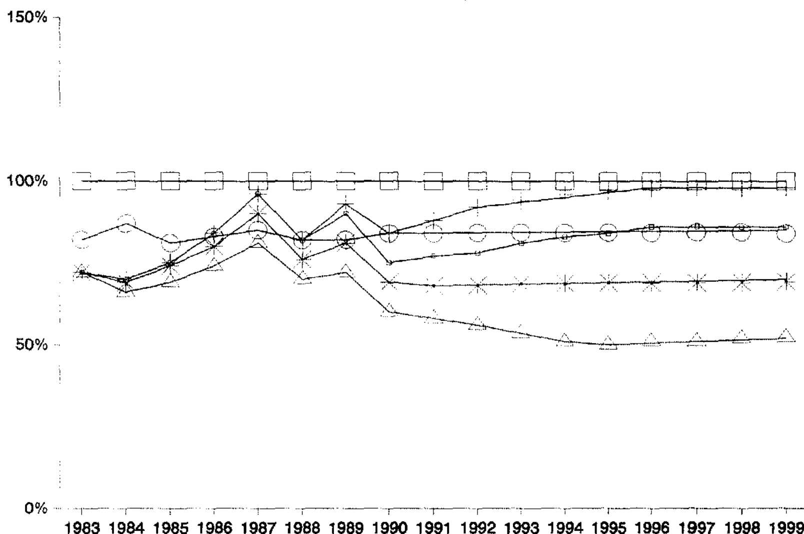
As you may have guessed, we have done a multitude of runs with the programs developed for this study. We've compared historic contribution levels with projected contributions in both nominal and real dollars. We have projected funding patterns under a variety of assumptions as to future benefit increases, and as to the application of existing credit balances.

So what lies ahead for PBGC? From our analysis of the recent past, we know that bankruptcy rates of large firms have increased substantially since OBRA 1987. Also, PBGC net claims have been more than five times larger after OBRA 1987 than during the prior five-year period. The underfunding has become concentrated among a small group of firms. Sixty-three percent of 1992 underfunding is found in only ten firms.

Since OBRA 1987, the number of insured participants has remained steady. However, the number of PBGC insured plans has dropped precipitously. Ultimately, the

number of insured participants will also fall as existing retirees die, and are replaced by a diminishing flow of new retirees.

CHART 1
Benefit Liability Funded Percentage (PBGC Assumption)



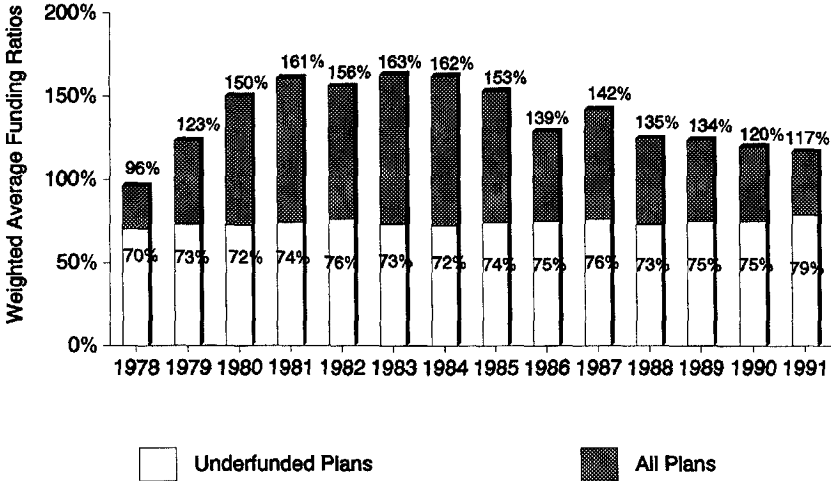
The funding ratios of underfunded plans have remained at the 70-80% level since the late 1970s (Chart 2). This is aggregate information from some Compustat numbers (10K numbers) adjusted to PBGC assumptions. The approximately $40 billion of current single employer underfunding is part of an otherwise healthy universe of DB plans. The funding status of all plans peaked during the early 1980s largely due to strong investment returns and high interest rates. Since then, overall funded ratios have come down as interest rates have dropped, and such factors as new funding limits have limited plan contributions. Still PBGC insured plans have about $850 billion in liabilities backed by over $1 trillion in assets.

The Office of Management and Budget (OMB) created a PBGC claim model about a year ago using option-pricing techniques that suggests that a portion of future claims may come from previously overfunded plans.

In order to explore this and other possible futures at the PBGC, we have undertaken several new modeling projects.

Both during and since OBRA 1987, the PBGC has relied upon the ad hoc modeling efforts of our actuarial contractors to test alternatives to the current funding standards. Their insights and guidance have been superb and their efforts have been indispensable. However, we have come to the point where we need the flexibility and control of an in-house, stand-alone model to respond to the many funding, premium pricing, budgeting, forecasting and reserving issues before us.

CHART 2
Funding Ratios 1978-91



Thus, in 1992 we purchased the Winklevoss Projection System, which has since been installed at the PBGC. The Winklevoss system performs both the deterministic and stochastic forecast valuations, and produces the essential Schedule B, FASB and PBGC values.

Our agreement with Winklevoss Consultants also provides that they will modify the model to permit a PBGC actuary to simulate, without their assistance, alternative legislative proposals. When modified later in 1993, the model will be made available to other executive and legislative branch personnel. This should increase the credibility of both the model's results and any related legislative proposals.

Also last year, we began development of the pension insurance management system or PIMS. PIMS is a simulation model that will quantify both the risk and the distribution of claims that the PBGC could encounter over the next 30-50 years. It will simulate alternative legislative proposals, and will identify the aggregate economic conditions most likely to lead to worst- and best-case scenarios. PIMS will employ Monte Carlo techniques based upon historic nominal interest rates and employment levels.

The bankruptcy component of PIMS, which is nearly complete, will forecast the financial future of 2,000 major corporations that maintain DB plans. The Winklevoss projection system is now being integrated into PIMS to simulate the financial condition of these corporations' pension plans. When finished later in 1993, PIMS will be a very powerful tool to further our understanding of the PBGC's future. The new models have permitted us to update and expand upon our previous work.

This is a very exciting time to be involved in funding issues. The GAO and the IRS are currently conducting studies of minimum-funding standards. The Pension Committee of the Academy is about to release a position paper on minimum funding.

The Research Committee of the Society is compiling a series of papers on funding matters. And the Pension Committee of the Actuarial Standards Board (ASB) is grappling with standards of practice in setting actuarial assumptions. We look forward to working with these groups.

And, as some of you may know, Secretary of Labor Robert Reich, Chairman of PBGC's Board of Directors, has set up a task force to examine PBGC issues. The group represents the Departments of Labor, Treasury and Commerce (that is the PBGC's Board) as well as the OMB and the National Economic Council. They are intensely gathering and analyzing information on a wide variety of subjects including the trends in pension funding. We expect the work of the task force to culminate in recommendations to Secretary Reich and our Board of Directors.

MR. THOMAS J. HOLM: I intend to discuss some of the current legislative proposals. In January 1993 there were identical bills introduced in the House and the Senate. In the House, the sponsor of the bill was Representative Pickle of Texas. In the Senate, the bill was sponsored by Senator Jeffords of Vermont. Those two identical bills primarily addressed accelerated funding for underfunded plans. In March, another bill was introduced in the Senate by Senator Heflin of Alabama. This bill addresses bankruptcy reform, and it has some provisions concerning pensions and the PBGC.

The Jeffords and Pickle bills were introduced with the title "The Pension Funding Improvement Act of 1993." As the title implies, the main thrust of these bills is to increase funding for underfunded pension plans. However, these bills also have some other provisions. They would make significant changes to the requirements for security upon adoption of plan amendments. The bills also give the PBGC the right to request financial information from plan sponsors. In addition, the bills require the PBGC and the Congressional Budget Office to make reports to Congress on necessary premium levels.

The minimum funding proposals in the Jeffords-Pickle bills are defined as the greatest of three separate stand-alone measures. The first is the funding standard account. The second is the underfunding reduction requirement. The third is the solvency maintenance requirement. The proposed effective date for all these is for plan years beginning after December 31, 1993.

The first of the three was the funding standard account, and it's essentially the same as under current law. However, the DRC in 412(l) has been pulled out and is now a stand-alone requirement. It's now called the underfunding reduction requirement. It's still under 412(l). This requirement is now defined as the sum of four components. The first is a percentage of the unfunded current liability. This percentage will vary from 13.75-30% depending on the funded status of the plan. The percentage is determined in the same manner as the percentage currently used for unfunded new liability. But it's important to note there's no longer a distinction between unfunded old liability and unfunded new liability. The second component is the expected increase in the current liability due to benefits accruing during the year. In other words, this is the current liability normal cost. The third component is any amortization amount for funding waivers. The final component is any unpredictable contingent event amount. As I read it, it appears to be defined as under existing law, but I

never understood it under existing law, so I'm not sure it's 100% the same. The maximum for the underfunding reduction requirement is the unfunded current liability plus the current liability normal cost. In other words, the maximum is enough to fully fund the current liability at the end of the year. Essentially, this requirement won't impact overfunded plans.

The third stand-alone requirement is a new requirement that would be under Section 412(o). It's also comprised of four components. The first component is disbursements from the plan, and this includes benefit payments as well as administrative expenditures. There is a special rule for lump sums and annuity purchases. You only need to consider a portion of those payments depending on the plan's unfunded percentage. For example, if your current liability is 80% funded, you would only need to recognize 20% of the lump sums or annuity payments during the year. The second component is interest on the unfunded current liability, and that's determined using the current liability interest rate. The third component is the current liability normal cost. The final component is any amortization amount for funding waivers. As was the case with the underfunding reduction requirement, the maximum here is the unfunded current liability plus the current liability normal cost. So this new requirement also should only impact underfunded plans. There's a special rule with regard to the solvency maintenance requirement. If it exceeds the underfunding reduction requirement, the excess would get phased in. It would be 20% in 1993, 40% in 1994, and so on.

I have a few additional notes on these new requirements. We talked about the fact that they apply only to underfunded plans as is the case with the existing DRC. The underfunding reduction requirement and the solvency maintenance requirement can be offset by certain funding standard account amortization amounts, although it appears that you'll only be allowed to use bases established before 1994. Also, as under the existing 412(l), these provisions don't apply to small plans under 100 lives, and they get phased in between 100 and 150 lives. David touched on the fact that the current liability range wasn't part of the original PBGC proposal. The idea was to tie it more closely to termination assumptions. Under Jeffords-Pickle, the current liability interest rate range would change. As you know, it's currently 90-110% of the four-year Treasury average. It would change to 90-100% of the four-year average. At January 1, 1993, this would have meant that the high end of the range would have been 8.07% instead of 8.88%. As a result, we're going to see more plans that are deemed underfunded. And plans that were underfunded are going to be considered to be even in worse shape.

Another key section in the Jeffords-Pickle bills is the change in required security for plan amendments. OBRA 1987 included provisions that required plan sponsors to provide security, such as cash or surety bonds, for certain plan amendments. In other words, if a plan adopted an amendment to increase benefits and the funded current liability percentage was under 60%, the employer was required to provide security. The amount of the security was an amount equal to the additional current liability under post-1987 amendments or, if less, the amount necessary to bring the funded ratio up to 60%. In addition, there was a $10 million cushion. So those provisions only affected severely underfunded plans. Jeffords-Pickle proposes several changes.

The first is that the 60% threshold would be increased to 90%. And you have to note that the current liability interest-rate change applies here as well. The $10 million cushion is dropped to $1 million, and the exclusion for the pre-1988 amendments is dropped. That means that plan sponsors will have to post security for past deficiencies as well as the current amendment.

It might be helpful to look at an example (Table 2). As you'll note, my example is a severely underfunded plan. First look at the column labeled "Current Law." This is a plan that adopted an amendment that increased the current liability by $20 million from $500 million to $520 million. Assets were currently $250 million. In order to reach a 60% funded level, assets would have to be increased by $62 million. However, under the current law, security would only have to be posted for the $20 million amendment because that was less. And bear in mind, there was a $10 million cushion in place so the actual security required would only be $10 million. This was a severely underfunded plan with a $20 million amendment, and you're looking at a $10 million security requirement.

TABLE 2
Jeffords/Pickle
Required Security Example
(in $ millions)

	Current Law	Proposed Law
Current Liability (BC)	$500.00	$550.00
Current Liability (AC)	$520.00	$575.00
Assets	$250.00	$250.00
% of Current Liability	$312.00 (60%)	$517.50 (90%)
Assets Required	$62.00	$267.50
Post-1987 Amendment	$20.00	N/A
Preliminary Requirement	$20.00	$267.50
"Cushion"	$10.00	$1.00
Required Security	$10.00	$266.50

Under Jeffords-Pickle, because of the lower current liability interest rate, the current liabilities are larger, and the increase is now $25 million. And now the plan must look to a 90% funded level. In order to reach that, assets would have to be increased by $267.5 million. There's no longer an exclusion for the pre-1988 amendments, so all past deficiencies have to be made up. Since there's only a $1 million cushion, the security requirement would be $266.5 million. That's going to severely inhibit underfunded plans from making amendments, which is clearly the intent of the law.

The third component of Jeffords-Pickle is that the PBGC can request financial information from plan sponsors under certain conditions: if underfunding exceeds $10 million, if there are more than 2,000 participants, or if large funding waivers have been granted. This part of Jeffords-Pickle may be of concern to plan sponsors who are reluctant to release what they feel are confidential business plans to the PBGC.

The final component of Jeffords-Pickle is one that requires the PBGC and the Congressional Budget Office to submit reports to Congress on necessary premium

levels. I don't think the bill asks for annual reports. I think it just asks for both organizations to submit separate reports.

This is a recap of Jeffords-Pickle -- what are its implications? Due to the lowering of the current liability interest-rate range, we have more plans that would be considered underfunded. Underfunded plans will generally see higher contribution requirements.

I looked at the impact of these bills on two of my clients that have underfunded plans. The underfunding reduction requirement had a fairly significant impact on one plan and not that great of an impact on the other more mature plan. However, the solvency maintenance requirement had a somewhat significant impact on the more mature plan. Even though that impact could be phased in over five years, it would ultimately be a significant impact. In that regard, I mean, underlying contributions for those plans more than doubled.

As we just discussed, the security requirements in Jeffords-Pickle will severely inhibit the ability to amend underfunded plans. Since a number of these plans are collectively bargained, that's a consideration your clients may want to know about.

That's about all I had on Jeffords-Pickle. We can move on to the Heflin bill. As I said, this bill primarily addresses bankruptcy issues and has a few provisions concerning the PBGC and pension plans. First, the bill would allow the PBGC to be added to the list of possible members on the Chapter 11 creditors' committee. Second, minimum-funding contributions after bankruptcy would be deemed "administrative expenses." This means that contributions could be made ahead of payments to other creditors. Third, minimum contributions would continue to be made after bankruptcy unless they're postponed in a hearing. Although Heflin is a fairly substantial bill, that's about all I saw in there as it related to pension and PBGC issues. As far as I know, there's not a companion bill in the House.

In 1992, there were some legislative proposals that weren't enacted. The Pickle-Jeffords bills and the Heflin bill were introduced in virtually the same form as this year. There was an additional proposal that was introduced that would have limited the PBGC's liability in the event that shutdown benefits were granted.

In other nonlegislative activity, Dave touched on the Task Force that the administration has announced. There has been a statement from the PBGC Advisory Committee, Congressional Budget Office as well as this GAO report on hidden liabilities.

The PBGC Advisory Committee was established under ERISA to advise the PBGC. In February, the committee issued a statement with ten somewhat broad proposals or statements:

1. Public policy should encourage DB plans.
2. Regulatory and legislative actions need to consider PBGC impact.
3. Advanced funding is desirable.
4. Nature of DB plans must be understood.
5. Law should provide as much incentive for DB plans as for defined-contribution (DC) plans.
6. PBGC should have strengthened position on creditor committees.
7. Financing should come from premiums. Law should emphasize better funding.

8. PBGC should use accrual accounting.
9. PBGC needs more timely information.
10. PBGC accounting and forecasting systems should be completed.

I've listed them all but I only want to comment on some. The first statement was one for all of us DB practitioners to applaud. The committee said that DB plans are the best method of providing assured retirement income at a lower cost. As such, DB plans should be encouraged as public policy. The third statement about advanced funding called for strengthened minimum funding and revisions to the full-funding limit. If the sponsor is able to contribute more, the full-funding limit shouldn't necessarily restrict him from doing so. The fifth statement also supports DB plans. The sixth statement addressed strengthened position on creditor committees. We saw that in the Heflin bill. Statement seven contrasts something we'll hear later. The committee felt that all financing should come from premiums. However, there was a caveat. Care should be taken before raising premiums in order to avoid discouraging DB plans. In the ninth statement, the committee felt the PBGC needs more timely information. It recommended perhaps electronic filing of 5500s.

The Congressional Budget Office also listed its proposed PBGC reforms. Unlike the PBGC Advisory Committee, the Congressional Budget Office recommends that the PBGC could look to Congressional appropriations when necessary. The PBGC Advisory Committee had suggested that all financing come from premiums.

What I want to do now is just review some of the options that are available. If you feel that PBGC needs some shoring up, how should it be accomplished? We've talked about some of the legislative proposals. I just want to review some of the underlying issues.

One basic option is to improve PBGC funding. Another option is to increase pension-plan funding much as we see in Jeffords-Pickle. Third is to limit PBGC guarantees. We should phase in the guarantees more slowly, and shouldn't cover shutdown benefits, things like that. The fourth option is something that we also saw in Jeffords-Pickle, which is to require security before you adopt amendments. In other words, don't let the funded status of plans get worse. Fifth, as we saw in the Heflin Bill, was to improve the PBGC's rights in bankruptcy, and let the PBGC sit on the creditors' committee. One of the concerns with improving the PBGC rights in bankruptcy is that you're impinging on some other creditors. Some plan sponsors may find it difficult to get loans at times when they really need them. Therefore, it may actually speed up some bankruptcies.

There are several options for increasing PBGC funding. The first is to increase DB premiums. The risk there is that you'll get more plans leaving the system. The question is, if that's the option you want to follow, which premium should be increased? Some feel that it's the flat premiums that should be increased. The theory is that this is a social program and everyone should contribute equally. I think you'll find overfunded plans will say, if anything's increased, it should be the variable premiums. They feel that's fair because it ties the premiums more closely to the PBGC's risk.

Other options are to increase the cap on the premiums. Right now you have a lot of plans at the cap, and they have different degrees of risk to the PBGC. It seems like a flaw in the current structures that the variable premiums don't really reflect the plan sponsor's financial condition. Clearly if you have two underfunded plans and one is with a healthy organization and the other one's with a company near bankruptcy, it's obvious that the PBGC's risk is much greater for the plan sponsor that is near bankruptcy. But right now, those two plans could very well pay the same premium.

If you want to improve PBGC funding, another option is to expand the premium base. We had comments that there should possibly be exit premiums charged for DB plans that terminate and convert to DC plans. Another option which I've heard for a number of years is to require DC plans to pay premiums. This doesn't make a lot of sense to me because these plans don't bear any risk to the PBGC. It just gets back to this policy of not favoring DC plans over DB plans.

Historically the GAO has found problems with the PBGC's enforcement of the existing rules. There's some thought that better enforcement could lead to some increased revenue.

The final option for increasing PBGC funding would be (as the Congressional Budget Office recommended) to use general revenue.

To improve plan funding, we saw in the Jeffords-Pickle bill rules to increase funding requirements. One of the risks there is that these requirements could also drive plan sponsors into bankruptcy more rapidly.

Another option is to revise the full-funding limitations and allow more aggressive funding. When plans are able to contribute more, the rationale is let them contribute more. When there is a downturn, you're covered. The problem with this one is that there's some revenue loss attached to it.

Regarding prospects for change, clearly it's too early to guess what's going to happen in 1993. Personally, I wouldn't be surprised to see some legislation this year. As Dave mentioned, the topic is getting more interest. We've seen the IRS initiate studies of underfunded plans, and seen articles recently in trade publications. For example, the April 5, 1993, issue of *Business Week* had an article on the PBGC, and there's a cover article in the American Association of Retired Persons (AARP) bulletin on PBGC. One thing to watch for is what's going to come out of the Administration task force, what kind of proposals it is going to have. I think after we see that, we'll have a much better idea of what the prospects for change really are.

MR. MICHAEL E. SWIECICKI: Can you give us a sense of the chances of passage of this type of legislation, and who if anybody would lobby for it, outside of the PBGC?

MR. GUSTAFSON: It's tempting to predict the chance of any legislation. The task force that I mentioned is doing an extensive analysis of all the factors and many alternatives proposed for addressing the PBGC's ills. It's also analyzing the true needs of legislation and issues, such as who would be supportive of such legislation. But until the task force has completed its work and sent its recommendations to Secretary Reich and to our Board, it would be premature to even speculate on that.

MR. THEODORE W. KONSHAK: With regard to PBGC reportable events and people not reporting them, are there ideas at the PBGC on changing PBGC reportable events or changing the rules on reportable events?

MR. GUSTAFSON: Changing the reportable event rules has been something that's come up in a number of contexts -- largely in terms of them being a way for us to monitor troubled companies, to deal with them earlier (as in the case of the many major terminations) before all the assets of the plan or of the company are pledged or sold off and used to pay creditors who in a bankruptcy would be behind us in line. So the reportable events regulation was designed to be an early warning system for us. It wasn't as effective as it could have been up until I think 1987 when we were given the right to assess penalties for noncompliance with that reportable events regulation. But even there, the level of the penalties, particularly in the largest cases, isn't sufficient necessarily to deter anybody from just continuing to not report. The extent of events that are considered to be reportable events is rather narrowly focused. From time to time, we've looked at expanding the definition of a reportable event not only to give us an early warning, but also when a reportable event occurs, we then require that the plan sponsor send us financial information and the most recent actuarial valuation report so that we have a much better handle than we currently do on the company's status and plan status.

FROM THE FLOOR: Dave, you pointed out the effect that the history of a particular steel company had on the formulation of a lot of this policy because of its effect on the future of the PBGC. That particular steel company also had a great influence on the passage some years ago of a piece of legislation relating to retiree health benefits of companies that are in bankruptcy. Frequently, when the PBGC goes into a troubled company, your interests are not only balanced against creditors' interest but also in some cases possibly against the very participants that you're dealing on behalf of. That is to say, at the same time that you're trying to protect their pension benefits, some of the things that the PBGC does may be affecting the employees' rights with respect to the retiree health benefits. Perhaps it's too premature for you to discuss if that becomes a direction where the legislation goes in 1993, but I'd be interested if you have any comments about the balance between retiree health and the PBGC's interest even if to point out some of the factors and some of the things that you think may be looked at?

MR. GUSTAFSON: You've pointed out a very important issue at the PBGC that's among the many that are very difficult to reconcile. A dollar to a retiree to pay for health care is not a lot different than a dollar from his pension plan to pay for his mortgage or his groceries or whatever. And in a bankruptcy context, bankruptcy judges, at least in the recent past and especially since the passage of the bill that Senator Metzenbaum initially introduced, have been sympathetic to the needs of the retirees for the retiree health coverage. In many cases, in mature industries like steel and to a lesser extent the auto industry, the very two largest claims when a bankruptcy occurs are the retiree health claim and the PBGC claim for underfunding. So in a sense they end up competing against one another. That puts us in a very awkward position of trying to convince the bankruptcy judge or other creditors that we should either stand equally in line with them or have priorities over them. The rejoinder generally is that the retiree health people don't have a PBGC to guarantee their benefits. Perhaps the health-care task force at the White House is going to

address some of the issues of retiree health coverage and modifications of supplementary coverages to Medicare, but I don't have any particular knowledge of that. It's a difficult issue and one that we face more and more with these mature companies.

MR. DONALD S. GRUBBS, JR.: I'd like to say a couple of things about the Jeffords-Pickle bill. First as you pointed out, it was identical to last year's bill. That was irresponsible because last year's bill had numerous problems, clear goofs in the writing that the sponsors knew about before introducing this year's bill. For example, under one of the alternatives, if the employer had an obligation to contribute a million dollars and contributed the million dollars, the employer would have a funding deficiency of a million dollars because the sponsors forgot to enter the credit for the contribution in determining the funding deficiency. The fact that the sponsors knew about this and a number of other problems before the bill was introduced this year and introduced it any way I thought was just irresponsible.

One of the big problems that we've talked about is the need to encourage DB plans. One of the things that has discouraged plans is the increasing complexity. This bill would increase the complexity and the cost of doing actuarial work, and that concerns me. In ERISA, the first requirement, the first purpose of PBGC (and I realize that PBGC didn't write the Pickle bill) is to encourage DB plans. And indeed we've got to find some way to do that if we're going to be at all successful. One of the troublesome things to me in the Pickle bill is this solvency maintenance requirement, which relates to benefit payments that we don't really know until after the year is over. That creates a timing problem, and the sponsors don't make any exception in relating that to the quarterly contribution requirement which we have to have known about in the prior April. Another of the things we see in here is that, although the problems only relate to the single employer system, portions of the bill apply to multiemployer programs as well. Section 401(a)(29) of the Code about plan amendments would apply not only to single employer plans but also to multiemployer plans.

Finally, of the solutions that were just mentioned, one of the category of things that wasn't on your list of solutions is to improve the investment income of the PBGC. Like any pension program, the cost is related to the rate of investment income. In the last couple of years, PBGC has moved away from equity investments entirely, in spite of the fact that in the long run, they've always had higher returns. Of our clients, most of them have decided to invest a substantial portion of the fund in equities in the hope of reducing the cost of the program. I would think that would tend to reduce the cost of the PBGC's program as well. Anyone who wants far more detailed comments on this than I've prepared, I would be glad to present them to you.

MR. GUSTAFSON: Don, you've raised an issue that a lot of people do raise – that the statutory charge of PBGC, the very first charge, is to promote the DB pension system. That's not how it literally reads, but that's functionally what it says. What do you think the PBGC can do to do that? Many people raise that issue and say "PBGC, do it," but maybe you have some thoughts as to how we could do that.

MR. GRUBBS: One is to decrease premiums which would encourage DB plans. Another is simplification. Most of the simplification problems aren't in your area.

Some are and I would think that this kind of proposal with respect to solving the funding problems is something that's in the area where you can have input to make sure that any kind of proposal isn't going to increase the complexity of funding the plans. For example, one thing you can do to improve funding that doesn't have any complexity at all is to say, we're going to have shorter funding periods for amendments. That doesn't solve all the problems, but it's an easy one which tightens up funding. If we can find easy solutions, I think it helps. Third, I would suggest that the PBGC, because of its mandate, could initiate studies of the things that encourage that DB plans that go far beyond the range of the things that are directly in the plan termination insurance. Because PBGC has a statutory requirement to encourage plans, that would at least provide it a mandate to have some sort of study -- perhaps bringing in the IRS and the Labor Department into this program, a study of what do you do to encourage DB plans.

MR. HOLM: I'm a little curious if anybody has any serious problems with the new security requirements. In some respects, that's the provision that seemed to make the most sense. I mean if you're underfunded, don't promise bigger benefits -- catch up first.

That is one that doesn't affect your annual funding calculations, so it's simpler than some of the other funding issues. But I'm not sure that I know all the implications beyond the fact that my client is going to go into negotiations, and he won't be able to give a pension increase. But is that bad?

MR. GRUBBS: In response to that, I think it's important that we limit the increase of guarantees in one way or another, and this is one possible approach to it. You mentioned changing the phase-in rules. We could, for example, change the five-year graduated phase-in to a five-year cliff rule. In addition to helping with this problem, this would simplify the law further. And another would be to cap the PBGC maximum -- say it would go up with inflation in the future only when the program is fully funded. That would stop the growth of the guarantees. You could say that's not going to have much effect. It may not have much in the early years, but you can say it would be having a big effect now if we had done it in 1974. But with respect to this particular thing, the object is to cap the growth of guarantees, not the growth of benefits. An alternative approach would be to say, you can amend your plan, but if you're not fully funded at the time you amend your plan, those additional benefits don't start phasing in until you get fully funded. I ask, is it better for 100 employers to offer additional benefits when one of them falls down and doesn't make it and 99 of them deliver, or to have 100 employers that don't make those increased benefits at all?

FROM THE FLOOR: In your handouts, one of the suggestions to improve the situation is to liberalize the Section 412 limits, and you pointed out the argument against that is the loss of revenue. I think that's a specious argument because really you can't overfund the plan anyway. If you put more money in now, ultimately that means less money later on. Particularly for companies that have extremely variable profits, a feast or famine, as they do in the Cleveland area where I come from. The smaller companies will have a loss one year and a big bonanza the next. And quite apart from PBGC, those Section 412 limitations are really a handicap. In any event, for the IRS to say they're going to lose revenue, they probably will for a particular

year. But if more money goes into a plan today less will be contributed tomorrow. It's really just a timing thing. So I think really you should get after the legislators and encourage liberalization of the Section 412 limitations.

MR. HOLM: I agree. It's primarily a timing issue, but I don't know what the time frame is that the government's looking at right now. Just the fact that the liberalization of limits cuts revenue in the following year may be enough so the government would be against it.

Let's get back to the first question on the prospects for change. One person who feels the prospects are better than last year is Congressman Pickle. He's made some statements that the bill has a much better chance this year than in the past. We were at some crossroad as far as would it happen because most of the senior positions at the PBGC were unfilled at the time. Now probably with the exception of maybe one, every senior position is filled. There may be more impetus again from the PBGC to push this, but clearly Congressman Pickle thinks the bill has a better chance this year.

MR. GUSTAFSON: It may be worth pointing out that the jurisdictional committees in the House and Labor and Ways and Means are holding hearings this month where they've invited Marty Slate to testify, and they've issued a number of questions relative to the state of health and the future of the PBGC that will be raised at those hearings. It's likely that Marty will defer immediate answers again because of the work of the task force. That may join the debate.

MR. HOLM: I was curious for your response to recent press. I happen to have the *AARP Bulletin* for April. It's a hot topic, and it's surprising that the headline here is "Pension Agency Bailout Not Needed, Experts Say." One of the first paragraphs is that pension experts say that the PBGC and the private pension system are in stronger financial condition than at any time in history. It wasn't what I expected to read. There was a similar tone in the *Business Week* article as well -- that the system isn't in bad shape and doesn't need bailing out.

MR. GUSTAFSON: That AARP article had an interesting headline because I didn't think the article really was consistent with the headline. All the articles end up talking about on the one hand and on the other hand. Maybe there has been some hyperbole but on the other hand, there are some real problems here that have to be dealt with. This is a longer-range issue that can't be ignored. The conclusion I think you draw from most of the articles that I've seen most recently, and there have been a whole host of them, is that there's a need for very deliberate, extensive analysis of how to go about analyzing these problems. But ultimately there is an underlying sentiment that the PBGC's deficit is going to grow in the future, and that has to be addressed. Probably there will be no immediate problems, but over the longer term, we have to deal with that expected deficit to assure workers' pension security.