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Pension guarantee arrangements in West Germany and Canada

by M. David R. Brown

Most *Actuary* readers are familiar with the Pension Benefit Guaranty Corporation, which was established under ERISA in 1974 to administer the benefits of terminated employee pension plans in the United States and to operate an "insurance" plan intended to protect the benefits of participants in such plans from inadequate funding.

Much less well known are the somewhat similar arrangements in West Germany and in the Canadian province of Ontario. In West Germany, the Pensions-Sicherungs-Verein (PSVaG) was established under the 1974 "Law on the improvement of employee retirement benefit programs" as the carrier for a mandatory system of insurance for the pension benefits of employers who become insolvent. (The following account is based on a presentation by Dr. Eckart Windel, a member of the board of PSVaG, to the July 1988 conference of the International Association of Consulting Actuaries.)

Most German pension plans are financed through the "book reserve" system; pension plan liabilities are a direct obligation of the employer, and there is no external fund to secure the benefits. Some plans are financed through external funds, but the tax treatment of such financing is much less favorable than for the book reserve arrangement.

Coverage by the PSVaG is generally limited to insolvencies. Other plan terminations are not insured events. Payment of guaranteed pensions is handled through a consortium of life insurance companies, based on single premium annuity contracts with the PSVaG. The whole arrangement is financed by employer contributions at rates that are redetermined each year. The contribution rate is applied to a base for each plan that is roughly equivalent to the plan's liability for accrued pension benefits. The numerator of the contribution rate calculation is the terminal funding cost of annuities for guaranteed benefits to be purchased during the year plus the operating expenses of the PSVaG and allocations to an equalization fund and a loss reserve. Supplementing its income from employer contributions, PSVaG also receives substantial investment income from its accumulated assets, as well as some recoveries from bankruptcy proceedings and surplus distributions from the insurance company consortium. PSVaG does not fund for the vested rights to guaranteed benefits of the participants of terminated plans until such time as an annuity for these benefits is purchased and benefit payments begin. At the end of 1987, there were 135,000 benefit recipients and 186,000 employees with vested rights to future guaranteed benefits.

Given the basis of financing, the PSVaG has achieved substantial stability at moderate cost. The scheme covers about 35,000 plans with 2.5 million benefit recipients and 4.0 million employees with vested pension entitlements. In recent years, the plan has experienced 300 to 400 insured events (insolvencies) per year. The contribution rate has generally been in the range of 0.10% to 0.20%, except for one year (1982) when it reached a peak of 0.69%. The plan had assets at the end of 1987 of 1,022.5 million DM. The value of the vested rights to future guaranteed benefits was about 2,500 million DM.

Despite its apparent financial health, PSVaG does face some problems. It has recently had some substantial claims resulting from insolvencies in declining industries, particularly steel and shipbuilding. PSVaG is also concerned about a 1987 court decision that weakens the financial obligation of employers in certain types of plans established before 1974 and about its inability to transfer back pension obligations to a company that survives an insolvency and eventually becomes profitable again.

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The Ontario Pension Benefits Guarantee Fund (PBGF) was created by a 1980 amendment to the Pension Benefits Act. PBGF coverage is usually limited to insolvency cases, since the Pension Benefits Act imposes a requirement for continued funding on an employer who terminates a pension plan with insufficient assets but remains in business in Ontario. Benefits guaranteed are the accrued benefits of Ontario employees that must be vested under the Act, subject to a maximum of $1,000 per month. All benefits on plan termination must be fully funded, usually through a single premium annuity contract with a private insurance company. The PBGF has not, to date, undertaken the payment and administration of the guaranteed benefits of a terminated plan.

Until recently, the PBGF was financed by contributions from employers with defined benefit plans (multi-employer plans are not covered) at the rate of 0.2% of the unfunded accrued liabilities. In 1988, a per capita contribution of $1 per member was added. That meant employers with fully funded plans were required for the first time to contribute.

At March 31, 1988, the PBGF had accumulated assets of $6.7 million and operated at a surplus in all years but one since its inception. It had paid out $5.2 million to provide benefits for the members of six terminated plans, with more than $5 million for two of those plans.

However, in March 1988, Massey Combines Corporation collapsed. The PBGF now faces its largest claim. The amount of that claim has not been determined, but it has been estimated to be as high as $25 million. The Pension Benefits Act provides for loans to the PBGF from the provincial government should the assets of the PBGF be insufficient. It is expected that such a loan will be forthcoming to cover the Massey claim, but future operations and financing of the PBGF are now under intensive government review.

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