Never Again

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Abstract

After a very brief synopsis of the Bader (2004) rationale for full funding (solvency) at all times, this paper develops a multi-year transition program. The transition will introduce capital market discipline immediately while using the traditional actuarial "unfunded liability" asset to pay off the time-zero shortfall over the life of the transition.

This paper considers corporate plans only and does not address multi-employer plans or plans sponsored by governmental employers. Some of the concepts may be easily ported to these other environments.

The program includes a pension guaranty authority (e.g., the PBGC) that is already on the hook for plans that are not solvent at time zero. The exposure is capped at current levels and paid off under rules that do not permit the exposure to increase. There is no reason why the transition program could not be adopted in conjunction with the start up of such an agency, e.g. the PPF under consideration in the U.K.

All values are at market and the program charges exposed (underfunded) plans based on the degree of time-zero shortfall and the borrowing strength (borrowing cost) of the sponsor. Prepayment of the unfunded liability may be permitted when the sponsor is able, through capital financing or internally generated funds, to do so.

The program contains incentives to diminish moral hazard to the guaranty authority. The program is neutral in an important fashion: there is no immediate change in the aggregate indebtedness of plan sponsors, nor to the priorities in bankruptcy, nor to the exposure of the guarantor. Because all plan assets, liabilities, and the unfunded liability are measured at market, the system is highly transparent. This transparency may cause the capital markets to reassess the aggregate indebtedness of the sponsors.