



CENTER ON  
FEDERAL FINANCIAL  
INSTITUTIONS

Suite 600  
2121 K Street, Northwest  
Washington, DC 20037

TEL: 202.775.6329  
WWW.COFFI.ORG

The Center On Federal Financial Institutions (COFFI) is a nonprofit, nonpartisan, non-ideological policy institute focused on federal insurance and lending activities.

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Douglas J. Elliott  
douglas.elliott@coffi.org

## PBGC: Policy Options

There is at least a \$23 billion hole to be filled in the finances of the Pension Benefit Guaranty Corporation (PBGC), the government insurer that protects the pensions of 44 million Americans. Without reform, our financial modelling shows this rising to roughly \$78 billion on our base case assumptions. With a little bad luck, this could grow to \$100 billion and require the second-largest taxpayer rescue in history of a U.S financial institution, exceeded only by that of the insurance fund for the Savings and Loan industry.

This paper attempts to comprehensively list the major policy options that have been proposed to solve the problem, with a brief explanation of each and a summary of their advantages and disadvantages. The intent is to neutrally present the range of alternatives; the Center On Federal Financial Institutions (COFFI) does not advocate any particular solution. Readers unfamiliar with PBGC may wish to read a series of papers available on our website, [www.coffi.org](http://www.coffi.org), particularly “PBGC: A Primer,” “PBGC: Fundamental Questions,” and the papers on COFFI’s independent financial analysis of PBGC.

We focus on fixing PBGC’s financial woes, but the analysis also attempts to encapsulate effects on the larger system of defined benefit (DB) pensions. Viewed in isolation, it would be possible to fix PBGC’s financial problems while damaging the larger system. On the flip side, fixing the larger problems in the defined benefit system will not necessarily eliminate PBGC’s money troubles. The issues are interwoven, but not identical.

The 15 policy proposals analyzed here are to:

- Raise the fixed premium rate at PBGC (p. 8)
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It is worth noting that this paper is written from the point of view of the consensus among policymakers that encouraging defined benefit plans is good public policy. However, there are those who believe that defined benefit plans are inferior to defined contribution plans. Others hold that defined benefit plans are doomed because employers are no longer willing to shoulder the investment and actuarial risks of providing a guaranteed level of benefit for life and are discouraged by red tape. (See "PBGC: Fundamental Questions" on [www.coffi.org](http://www.coffi.org), for a longer discussion of these issues.) Readers sharing those views may wish to disregard some of the arguments listed in this paper.

## Executive Summary

For 30 years there has been a significant imbalance between the risks imposed on PBGC and the level of premiums charged. Both the risks and premiums are determined by Congress and that body has passed several pieces of legislation intended to remedy this imbalance. Despite these reforms, no academic study has found that the premiums are more than half what they would need to be to cover the risks and some have concluded that the level was as little as one-sixth of that needed for self-sufficiency.

The imbalance between premiums and risk results from the inter-relationship of three factors: (1) premium levels; (2) the inherent risk in defined benefit pension provision; and (3) structural features that encourage risky behavior. Financially constrained companies have incentives to minimize pension contributions, increase their investment risk, and provide richer pension promises in lieu of other compensation that would require immediate cash.

PBGC now faces two problems. First, a very large deficit has accumulated due to the mismatch of premiums and risks operating over 30 years. Second, many future claims will come into PBGC. History, and our own financial analysis, shows that current premium levels are unlikely to be adequate to cover those future claims, absent reforms to lower the risks for PBGC. COFFI's model shows that plausible claim scenarios could cause the deficit to balloon to as high as \$100 billion in today's dollars. However, PBGC would not run out of cash for perhaps 15 years, since it starts with \$39 billion in assets and acquires more when pension plans terminate.

Action is needed now, despite the absence of a liquidity problem; regulators would already have seized control of any private sector insurer in a situation similar to PBGC. The longer we wait, the closer we get to the cliff edge where a massive taxpayer rescue would be necessary to avoid having PBGC payments of retiree pensions fall to pennies on the dollar.

This paper outlines 15 options to solve PBGC's financial problems. Any legislative solution is likely to combine a number of these alternatives, especially since every proposal inflicts pain on some party. The choices fall into several broad categories:

**Raise premiums.** All else equal, high enough premiums will provide the resources to pay future claims even under the present structure. However, an excessively large premium increase could chase out of the DB system some of the strong companies whose premiums support PBGC.

**Add more risk-based premiums.** One way of increasing premiums is to add extra charges for firms that pose the most risk to PBGC, either due to their generally weak creditworthiness or to a high proportion of stock investments in their pension funds. This should encourage less risk-taking by companies and lower claims on PBGC, but there are negatives that vary with the specific proposal.

**Change funding rules.** Various proposals look to encourage higher funding levels at pension plans or to make the contribution requirements less volatile. The pros and cons vary with the proposals.

**Improve PBGC's position in bankruptcy.** PBGC's net losses would be lower if it recovered more than a few cents on the dollar in bankruptcy court. However, higher recoveries would come out of the hide of other creditors and could cause them to take actions in anticipation of possible bankruptcy that would be costly to plan sponsors and PBGC.

**Limit PBGC's guarantee.** Reducing the amount covered by PBGC in certain circumstances would directly reduce its losses, at the expense of present and future retirees. Such proposals are generally aimed at perceived abuses, where pension increases are allegedly given in the knowledge that they are unaffordable but that PBGC will pick up part or all of the bill.

**Increase PBGC stockholdings.** PBGC could increase the proportion of stock that it holds in its own investment portfolio. This would increase the expected long-run return and reduce PBGC deficits, but it would expose PBGC to the risk of larger deficits if the stock market underperforms.

**Privatize PBGC.** Some argue that PBGC's financial problems are intrinsic to a government attempt to provide insurance of this type. A privatized PBGC would require a large cash infusion up-front (\$30 billion or more), but has at least the possibility of eliminating a future taxpayer rescue. There are many technical issues discussed below.

**Infuse taxpayer funds.** There is no question as to the effectiveness of such a plan in improving PBGC's financial condition. The arguments center around whether this is good public policy.

Evaluating many of the proposals requires a judgement as to whether, and to what extent, shifting costs or risks onto the companies that sponsor DB plans will cause them to stop offering these plans. There is a key technical point that is often not factored into this analysis. There is a strong incentive for companies with large pension plans not to terminate them, since termination at a healthy company requires paying an insurer to take over the obligation. Insurers price their policies based on an assumed investment return far below the returns that companies target for their existing pension investments. (Insurance pricing is currently at below 5% while most firms target 8% or more from their pension investments.) The opportunity cost would be over \$50 billion a year if all firms in the DB system were to buy such insurance. The cost may be relatively low for those companies with small plans, but the vast majority of PBGC's exposure is to firms that have large pension investments and could suffer a major earnings hit.

Firms that choose to stop offering DB plans are instead far more likely to "freeze" their plans by ceasing to accrue any new benefits for existing or future employees. However, this still leaves them with a large exposure to the DB system for many years, which changes the nature of their calculations as to the appropriate response to various policy options. For example, freezing a DB plan would do very little to alleviate an increase in the per participant premium rate paid to PBGC, since all current participants would remain participants after a freeze, whereas outright termination would eliminate all PBGC premiums.

## What is the Underlying Problem?

The 30 year history of PBGC's single-employer program demonstrates that there has been a significant imbalance between the risks imposed on PBGC and the level of premiums charged. Both the risks and premiums are determined by Congress and that body has passed several pieces of legislation intended to remedy this imbalance. Per-participant premiums have increased 19-fold over the 30 years (from \$1 per year to \$19), with the last increase taking effect in 1991. Variable premiums were added in 1988 and now charge 0.9% of the amount underfunded, under certain conditions. (Roughly 20% of total underfunding was subject to this charge in 2004, up from about 10% in 2003 and 5% in 2002.) Funding rules have also been tightened over the years to discourage the development of substantial underfunding levels that pose a risk to PBGC.

Despite these reforms, no academic study has found that the premiums are more than half what they would need to be to cover the risks and some have concluded that the level was as little as one-sixth of that needed for self-sufficiency.

The imbalance between premiums and risk results from the inter-relationship of three factors: premium levels, the inherent risk in defined benefit pension provision; and structural features that encourage risky behavior. The latter issue, often called "moral hazard" arises from interactions between flexible rules, low penalties for risk-taking, the high proportion of benefits covered by PBGC's guarantee, and bankruptcy law. Financially constrained companies have incentives to minimize pension contributions, increase their investment risk, and provide richer pension promises in lieu of other compensation that would require immediate cash.

PBGC now faces two problems. First, a very large deficit has accumulated due to the mismatch of premiums and risks operating over 30 years. PBGC's financial statements show a \$23 billion negative net worth at the end of Fiscal 2004. This figure does not include up to \$7 billion of future expenses required to operate PBGC while it paid off existing pension obligations.

The second problem is that many future claims will come into PBGC. History, and our own financial analysis, shows that current premium levels are unlikely to be adequate to cover those future claims, absent reforms to lower the risks for PBGC. COFFI's model shows that plausible claim scenarios could cause the deficit to balloon to \$100 billion in today's dollars. However, as noted in our previous papers, PBGC would not run out of cash for approximately 15 years, since it starts with \$39 billion in assets and acquires new assets when pension plans terminate. (Even severely underfunded pension plans bring enough investments to cover their own pensions for a number of years.)

However, the absence of a liquidity problem should not suggest waiting to solve the underlying flaws. Regulators would already have seized control of any private sector insurer in a situation similar to PBGC. The longer we wait, the closer we get to the cliff edge where PBGC payments of retiree pensions would be forced to fall to pennies on the dollar. No expert believes Congress would allow retirees to suffer such direct losses from financial problems at PBGC, but the remedies become fewer and harsher the closer we get to that cliff. In particular, a massive taxpayer rescue becomes more likely with each passing year.

## Accounting Effects on Company Decisions About Pensions

Evaluating many of the proposals requires a judgement as to whether, and to what extent, shifting costs or risks onto the companies that sponsor DB plans will cause them to stop offering these plans. There is a key technical point that is often not factored into this analysis, which is the effect of accounting rules on pension decisions.

Pension expense can be an important determinant of a company's reported income for firms with large pension plans. Under Generally Accepted Accounting Principles (GAAP), firms calculate their gross pension expense based on various actuarial assumptions and then reduce the expense by the income earned on pension investments. GAAP requires that firms do not directly use the actual investment income, which is likely to be volatile, but rather their expected long-term average return from the portfolio. Adjustments for actual investment returns that fall above or below this level are then averaged in over a period of years.

The long-term average investment return on high quality bonds is fairly objective, since they have a fixed interest rate and default rates on such bonds are low enough that they have minor impact. These bonds currently yield close to 5%, depending on their maturity and level of risk. Stock returns are harder to judge, since returns can be very volatile. Currently, companies generally estimate that they will be in the 8-11% range, based partly on long-term averages for the stock market as a whole.

Managers have a powerful incentive to hold stocks. Executives can plan on the basis that their short-term accounting results will show returns for stocks in their pension funds that will be 3-6 percentage points better than from bonds. In the short run, these returns are virtually locked in, since any shortfall will take years to pull down the reported returns. This accounting incentive magnifies the effects of a belief by most executives that long-term investment portfolios can and should hold a high proportion of stocks, since stocks have historically produced higher returns than bonds over long periods.

There are two important implications for an evaluation of the advantages and disadvantages of the proposed policy options. First, there are major disincentives for a healthy company to terminate its defined benefit pension plan, since this requires paying an insurer to take over the legal obligation. Insurers charge a price based on holding a portfolio of high quality bonds, with a further haircut for expenses, profit, and conservatism in their actuarial assumptions. The effective rate is currently less than 5%. If all DB sponsors terminated their plans, there would be an annual opportunity cost of at least 3 percent (8% or higher returns on pension investments minus 5% or less from the insurers). This would amount to at least \$51 billion a year on the \$1.7 trillion of pension investments last reported for the entire DB system. (For comparison, this is 34 times the total of PBGC premiums last year.)

Companies with large pension plans that wish to exit the DB system are far more likely to "freeze" their plans, ceasing to provide any benefits for additional years of service or wage increases. This eliminates costs for any future service, just as a termination would, but leaves the company with the advantages and disadvantages of holding pension assets to back pension promises. PBGC's exposure is slowly reduced over time, as pensions are paid out and retirees die, rather than ending immediately as with termination.

Second, companies have a strong incentive to maintain most of their pension investments in stocks, which produces considerable volatility in the market value of pension assets. This volatility is a critical underlying cause of pension underfunding and therefore of claims on PBGC.

Two factors may decrease the importance of these incentives. First, there is an increasing likelihood that accounting rulemakers will eventually base pension expense on the actual investment returns. However, this would be some years away and is not certain to occur. Second, some executives already believe the point that most financial economists make, which is that investment returns cannot be viewed in isolation from their risk. Put another way, one dollar of stock is worth the same as one dollar of bonds, even though they are expected, on average, to produce different future returns. The higher expected return from stocks must be adjusted in some way to reflect the risk, which is done very indirectly and only over time under present accounting rules. Nonetheless, reported earnings are powerfully important to executives, which makes them responsive to the incentives produced by present accounting rules.

## Policy Options

### Raise the fixed premium rate at PBGC

PBGC currently charges \$19 per year for each participant in a pension plan. Participants include current employees, former employees who retain a right to future benefits, and retirees. The fixed premium contributed \$0.7 billion of PBGC's total premiums in 2004, with the rest derived from a variable premium addressed below.

When PBGC was established in 1974 under the Employee Retirement Income Security Act (ERISA), Congress set this fixed charge at \$1 per participant. It has raised the level periodically, with the last increase occurring in 1991. Legislation would be required to raise the level further, as PBGC has not been given authority to set its own premium rates. Such legislation could either set a new fixed rate to be used indefinitely or could provide an automatic indexation for inflation, PBGC deficit levels, or other factors.

#### Pros

**Higher premium revenues would directly improve PBGC's financial position.** This would be particularly useful in offsetting the existing deficit, since other options are very limited.

**Wage increases since 1991 have increased PBGC's legal obligations.** ERISA mandates that the cap on the maximum level of pension payments guaranteed by PBGC increases at the same rate as the Social Security Wage Base, which has grown by 69% since 1991. Raises earned by individual employees since 1991 have also substantially increased the size of the pensions guaranteed by PBGC.

**Arguably, insufficient premium levels were a major contributor to current PBGC deficits.** As noted, there has been a large mismatch between premium levels and the risks imposed on PBGC. Some of this mismatch presumably derived from the premium rate, although allocating responsibility between premiums and other factors is subjective.

#### Cons

**Higher premiums would be a modest disincentive to offering defined benefit pensions.** PBGC premiums currently represent about 1% of the annual cost of providing a DB plan. A significant rate increase might theoretically cause companies that are on the fence to choose to exit their DB plans. However, plan sponsors would only escape the premium increase if they terminated their plans by paying an insurer to take over the legal obligation. As noted earlier, there are strong incentives for big companies not to do this, since they expect to earn 8-9% on their large pension investments while an insurance policy will essentially lock in a bond-like return, currently less than 5%.

Large firms that do exit the DB system are much more likely to do so by "freezing" their plans, (ceasing to provide any benefits for additional years of service or wage increases). However, freezes have little immediate effect on PBGC's fixed rate premiums, since they are based on the number of participants, including retirees. This figure would decline slowly over time as deaths were no longer offset by the addition of new participants to the plan.



**Higher premiums could slightly increase bankruptcies and distress terminations.** Firms which are on the edge of viability may not be able to afford to pay increased premiums. However, few firms are so vulnerable that an increase in an item that may represent only 1% of their pension payments is likely to push them over the line.

**Arguably, an increase in the fixed rate is unfair to low-risk plans.** Companies have considerable control over their riskiness to PBGC and the vast majority of plan sponsors will never produce a claim on PBGC. Management decisions on debt levels and operational risks have major influence on their ability to avoid a future bankruptcy. Decisions on pension contributions and the riskiness of pension investments similarly influence the risk of underfunding. Some argue that companies that minimize PBGC's risk provide a level of subsidy to riskier firms that is at least fair and may be excessive already.

**Premium increases remain a political “hot button,” perhaps because of the perceived fairness issue.** The strong employer reaction against premium increases cannot be adequately accounted for by the relative size of these premiums compared to other economic factors related to pensions. This may represent a negotiating tactic, it may represent a profound dislike of paying premiums to support weak companies that may be viewed as irresponsible, or there may be other factors.

## Charge a one-time premium

At least one economist has suggested that Congress charge a one-time levy on plan sponsors as a way of filling PBGC's deficit on past insurance provision without overpricing for future insurance. This would probably need to apply to all plans in existence as of a date prior to passage of the legislation, in order to avoid encouraging a rush of plan sponsors exiting the DB system.

### Pros

**Alleviates PBGC's deficit.**

**Holds down future premium levels.** Plan sponsors would not need to be overcharged for the risk of future claims in order to make up for past losses, if the level is set to eliminate the existing deficit. A lower one-time premium would still reduce the need for overcharging.

**Reduces federal budget deficit.** Such a levy could potentially be of a size that would be more than a rounding error on the federal deficit. PBGC premiums are reflected as revenues in the Unified Federal Budget.

### Cons

**Arguably, it is unfair to plan sponsors that have stayed in the DB system.** If premiums were too low in the past, many of the beneficiaries were sponsors that have since exited the DB system.

**There are also fairness issues among remaining plan sponsors.** Would a levy be based on number of participants, size of pension obligations, underfunding levels, credit risk, or some other factor(s)?

**Some firms might exit the DB system out of fear of future extraordinary premiums.** The precedent could frighten many plan sponsors.

**The charge might be enough to push some companies into bankruptcy.** If the charge fell particularly heavily on troubled firms, it might be enough to push some over the edge.

## Raise the level of variable premiums

PBGC also collects an annual premium equal to 0.9% of the underfunding at certain plans. In 2004, roughly 20% of systemwide underfunding was in plans that met these conditions, double the 10% figure from 2003. PBGC took in \$804 million of variable premiums in 2004, a dramatic increase from \$301 million in 2003. The level has averaged \$242 million annually since its inception in 1988.

Plans are subject to the variable premium based on a complicated test. In simplified version, the plan must have a liability for vested benefits that exceeds the actuarial value of the plan's assets. Many plans that meet this condition escape the variable premium because the sponsor's calculations show their contribution for the preceding plan year was at least equal to the "full-funding limitation." Although the full funding limitation was intended to avoid overfunding, companies have considerable room to calculate it in a manner that eliminates their ability to contribute even if other tests would show the plan to be underfunded. Many firms that have, or soon intend, to present large claims to PBGC have never paid variable premiums.

Premiums could be increased by raising the 0.9% rate or by applying the rate to more of the underfunding.

### Pros

**Higher premium revenues would directly improve PBGC's financial position.**

**Variable premiums encourage full funding.** Companies with good access to capital at reasonable rates have an incentive to borrow and contribute to the pension funds, in order to avoid the cost of the variable premium. However, this logic fails at current rate levels for weaker credits, which are generally the firms PBGC must worry about. For those firms, an annual charge of 0.9% is a small price to avoid borrowing at high rates to fund the plan. For both strong and weak companies, the potential ability to avoid being in the 10-20% that actually would be required to pay such a premium also weakens the incentive to fully fund.

**Arguably, variable premiums are fairer.** Companies whose decisions have led to greater underfunding are required to pay more for the risk they represent to PBGC. However, this argument does not apply to the extent that external factors created the difficulties.

### Cons

**Higher variable premiums could lead to more bankruptcies and job losses.** One cause of underfunding is economic distress at the plan sponsor. In such cases, higher variable premiums will impose an additional financial burden on an already stressed company. To put this in perspective, had UAL paid the 0.9% variable premium on the entire \$8.3 billion of underfunding as calculated by PBGC, it would have cost approximately \$75 million a year or 0.4% of its operating costs.

**Higher variable premiums would encourage weak companies to freeze their pensions.** Weaker firms would be more inclined to stop accruing additional pension benefits, since they would have less economic flexibility to underfund their plans in bad times. This would hasten the shrinking of the DB system, although it would likely help PBGC by lowering the size of future claims from those weak firms that collapse eventually. Note that we do not suggest that plan terminations outside of bankruptcy would rise appreciably, since weaker firms are in the worst position to pay an insurer to take over the obligation.

## **Base the variable premium partly on credit risk**

The variable premium currently charges firms for underfunding, but not for other aspects of the risk they present to PBGC. Some propose relating the premium to the creditworthiness of the plan sponsor. For practical purposes, firms must enter bankruptcy before they can pass their pension obligations to PBGC. Statistics clearly show that a firm with high creditworthiness today is much less likely to enter bankruptcy in subsequent decades than is a firm that is already weaker. (There are always exceptions, of course. Railroad bonds were once viewed as the safest corporate bonds in the world, but virtually all railroads eventually went bankrupt.)

Credit ratings from Standard & Poor's, Moody's, and other rating agencies would likely be used to measure creditworthiness, although quantitative tests, such as ratios of debt to equity, could theoretically be used. Unfortunately, it is very difficult to devise ratios that fit all circumstances, which is why investors pay attention to the more nuanced analyses of rating agencies.

This proposal could be combined with the current underfunding test and/or with a test based on the composition of a pension fund's investments, discussed below.

### **Pros**

**Arguably, this approach is fairer than current law.** Firms make many choices about how aggressively to borrow, and about their business plans, that substantially affect their credit. For example, aggressive borrowing can significantly raise returns to shareholders while shifting risk to creditors such as PBGC. Most creditors, such as banks, are able to charge more for this increased risk, but PBGC is not.

**Stronger companies would be encouraged to retain their pension plans.** This approach helps cover PBGC's deficit without inflicting significant cost on stronger companies that offer pension plans.

### **Cons**

**There could be more bankruptcies and layoffs.** Troubled companies would be hit the hardest and might find themselves paying higher and higher rates as their problems mounted. The extent of this effect would depend on how sharply premium rates change with credit ratings and what absolute levels were chosen.

**Arguably, this approach is less fair than current law.** Sometimes firms are hit by external events beyond their control, such as an oil price shock. Raising premiums in those cases is like raising auto premiums for someone who has been hit by a drunk driver.

**Government involvement in evaluating corporate credit risk will make some uncomfortable.** There are likely to be at least some situations where government administrators would have to make judgement calls about corporate creditworthiness. Some will view this as "industrial policy" that should be avoided.

**Some technical problems exist.** Rating agencies are fallible. For example, they sometimes take too long to recognize the seriousness of an industry problem and then over-react once they do. Also, some plan sponsors that do not have public debt would not have a pre-existing rating from one of the agencies.

## **Base the variable premium partly on investment allocation**

As financial economists have shown, a substantial portion of the risk to PBGC results from volatility in the investment returns of pension funds. In particular, stocks may have a higher average return, but they can experience major declines, such as after the bursting of the recent bubble.

Some propose that incentives be put into place to encourage bond investments, which are well-matched to the underlying pension liabilities. (A promise to pay money monthly for the life of the retiree can be matched with bonds that promise an equivalent income stream from principal and interest payments. Even the uncertainty of life expectancies does not destroy this matching, since large groups have relatively predictable mortality rates.)

These proposals are more likely to be viewed as creating *disincentives* for investing in stocks, given the strong bias of most corporations to invest their pension funds heavily in stocks. One disincentive would be a higher variable premium for plans owning a high proportion of stock.

### **Pros**

**Claims on PBGC should go down.** Some firms would be likely to lower their holdings of stocks, reducing the volatility of their investment returns and the likelihood of future substantial underfunding. Additional firms might freeze or terminate their pension plans (see Cons below), which would also reduce PBGC claims.

**Variable premium revenue might go up.** Other firms would be willing to pay the penalty in order to retain the potential upside of stock investments. They would be subject to a higher premium rate. This increase would likely more than offset any loss of revenue from firms freezing their plans (which produces little immediate premium decrease) or switching to lower stock holdings. However, the details of the rate structure would determine the actual outcome.

**Arguably, it is fairer to conservative pension sponsors.** Companies CAN choose the investment strategies of their pension plans, so it would seem fairer for them to bear the consequences, positive or negative, of the level of risk they choose to create for PBGC.

### **Cons**

**Selling stocks and buying bonds could substantially raise accounting costs.** As noted, accounting rules allow firms to calculate their pension expense by assuming that they are earning investment returns consistent with a long-term expected average. Thus, executives can currently plan on the basis that their accounting results will show returns for stocks in their pension funds in the 8-10% range, while bonds only show 5-6% returns. Therefore, selling stocks and buying bonds would hurt near-term earnings. The hit could be substantial for companies with large pension funds.

**Firms that do not reallocate face higher premiums, which would be particularly hard on troubled companies.** Higher variable premiums would produce both a cash and an accounting hit that could be significant for firms with large pension funds.

**Some firms may exit the DB system due to these higher costs.** One of the remaining attractions of DB plans to many large companies is that they can benefit from stock returns on a large pool of pension assets under their control. If the disincentive to own stocks in the variable premium structure is too strong, many firms may find the game no longer worth the candle.

**The change could hurt the stock market modestly.** A reduction in demand for stocks by large pension funds should, by definition, decrease stock prices. However, that change in demand is likely to be quite small compared to the size of the financial markets and any fall in stock prices should encourage other investors to buy more stocks at the cheaper price, largely counteracting the decline by bidding stocks back up towards their original levels.

**Stocks are sacred politically.** It sometimes seems that politicians and the public place stock ownership on a pedestal otherwise reserved for homeownership and the concept (but not practice) of savings.

## Tighten funding rules for defined benefit plans

Many people have proposed that rules on pension funding be “tightened” in one manner or another. (Existing pension funding rules are too complex to describe here, but interested readers can see “PBGC: A Primer”, available at [www.coffi.org](http://www.coffi.org).) Tightening in this context generally means either (1) requiring maintenance of a higher average level of funding or (2) requiring contributions more quickly when underfunding occurs, or both. One argument for tightening is that funding rules currently use a measure of the pension liability that has often proven to be substantially lower than the pension fund’s liability as determined in bankruptcy.

The details of tightening proposals will matter greatly, but, for simplicity, we will deal here with the generic concept of “tightening.”

### Pros

**Claims on PBGC would be lower than under current law, all else equal.** There would be lower levels of underfunding that might result in claims on PBGC.

**Lower claims on PBGC would also mean fewer participants losing non-guaranteed benefits.** When PBGC has a claim, there are generally individuals whose benefits are cut back because they exceed those guaranteed by PBGC.

**Healthy companies might benefit from slightly lower borrowing costs.** As noted under “Cons,” weak companies might have to divert cash away from new investment or wages and into pension contributions. The flip side is that there would be more money in pension funds looking for investment opportunities. Healthier companies might find a slight lowering of their cost of borrowing and a slight increase in their stock price. Thus, a small group of companies might be hit hard, while a large number of firms were helped a bit.

### Cons

**More firms would exit the DB system.** There would be greater cash demands placed on companies, particularly during difficult economic times. (There is some correlation between recessions and poor stock market performance.) Many firms might freeze or terminate their plans in order to minimize the potential impact of higher cash needs.

**Weaker companies might need to downsize.** Weaker firms with large pension plans might find that cash demands from pension contributions precluded new investments and spurred layoffs.

**The most troubled companies might go bankrupt.** Additional cash demands for pension contributions could drive particularly troubled firms into bankruptcy, because they no longer had enough cash to pay debt and make pension contributions. In bankruptcy they could restructure their financial debt and also eliminate the cash drain from pension contributions through a distress termination.

## **Change funding rules to reduce volatility of contributions**

Current funding rules, in combination with pension portfolios that are heavily invested in stocks, have produced swings in required contributions that discourage companies from offering defined benefit pension plans. Many have therefore insisted that reducing the volatility of contributions must be a goal of any pension reform. This is difficult to analyze without a specific proposal, but a few general points can be made.

### **Pros**

**Companies might be more inclined to retain DB plans.** Executives would be able to plan further in advance and to communicate clearly to the financial markets what the cash cost of contributions would be. This would mitigate a major expressed concern of managements and markets.

### **Cons**

**All else equal, claims on PBGC would be larger.** Unless other actions are taken, there will be no reduction in the underlying volatility of pension fund adequacy. Funding adequacy changes with the value of investments, changes to benefit formulas, company-specific actions such as layoffs or hirings, changes in lifespans and other demographic factors, and other variables. Reducing the risk of one party by stabilizing company contributions merely shifts the risk to other parties, principally PBGC, but also participants with benefits exceeding guaranteed levels.

For example, contribution requirements went up sharply after the stock market losses of a few years ago. If contributions had been held more stable, then the level of underfunding would have remained higher than it has, increasing the likely size of claims on PBGC from distress terminations from that time until such point as the stable contribution rules had caught up with the underfunding.



## Raise the maximum pension funding limits

The Internal Revenue Code and ERISA place limits on the extent to which firms can make tax-deductible contributions to their pension funds. These limits are intended to reduce the loss of tax revenue while still allowing adequate funding. Many argue that the current limits are based more on maximizing taxes than on ensuring sufficient funding and that the limits should therefore be raised.

### Pros

**Claims on PBGC might decrease modestly in number and size.** Some companies would make more pension contributions during good times, giving them a greater margin for error if trouble struck. Even if they subsequently went bankrupt, pension funding levels would be higher, reducing losses to PBGC and participants.

**Sponsors might find it marginally more attractive to retain DB plans.** Firms that were interested in using this provision, and financially able to do so, would be able to reduce their risk of sharp increases in future contribution requirements, since they would have built up a margin for error. They would also have a larger tax break from the tax-exempt status of pension investments, as well as from deductions for their extra pension contributions.

### Cons

**The budget deficit would widen, at least temporarily.** Higher pension contributions would reduce taxes initially. This might be offset over the long run by minimizing or avoiding a taxpayer rescue of PBGC. The tax losses would be highest in the early years, as those companies that wanted to prefund built up their desired margin of overfunding. After that, contributions should revert roughly to the levels required to match newly accrued benefits.

**The companies presenting the most risk to PBGC are unlikely to prefund.** From the point of view of PBGC as a credit insurer, it would benefit most from additional pension funding at weaker firms. These are generally firms with high levels of debt already, the ones least likely to borrow more to increase their contributions and the ones most likely to prefer using cash flow to pay down existing debt or invest in urgently needed projects. GM's massive borrowing to pay down its pension underfunding might be cited as a counter-example, but key parts of their argument to the financial markets would not apply here. They argued that they were substituting financial market debt for an equally real liability representing pension underfunding and that eliminating underfunding also avoided the risk of paying variable premiums to PBGC. Neither of these critical points would be true for overfunding. That said, there could be some firms in cyclical industries that choose to prudently build a margin of error during good times and that are weak enough credits that they pose a risk to PBGC.

**The "wrong" companies are likeliest to increase funding.** Firms with excess cash for which they do not have immediately attractive investment opportunities are the most likely to park the money in their pension funds, accelerating a tax deduction and increasing tax-free investment income. They can potentially retrieve the funds when investment opportunities arise by skipping future contributions, although there could be timing problems. Needless to say, firms strong enough, and conservative enough, to have excess cash tend not to be the ones that present claims on PBGC down the line.

## **Raise PBGC's overall priority in bankruptcy**

Under current bankruptcy law, the vast bulk of PBGC's claims receive no special treatment. This results in a bankruptcy recovery rate of a few cents on the dollar, while higher priority creditors, such as those with a lien on fixed assets like airplanes, may be fully paid or at least receive a much higher payout ratio. Some have proposed a super-priority status for PBGC that would result in substantially higher average recoveries.

As explained below, such a change could have powerful effects on PBGC's position and on the DB system, assuming the exact change in priority were sufficient to substantially change PBGC's recoveries. There would be less effect on PBGC if the details of the legislation left room for other creditors to take actions that would put them back above PBGC.

### **Pros**

**All else equal, PBGC's finances could improve markedly.** PBGC might easily recover half or more of the underfunding from the estates of bankrupt firms, rather than the current average of a few cents on the dollar.

**Weaker firms would have a strong incentive to avoid underfunding.** As noted in "Cons" below, other creditors would substantially raise their rates for weak firms with large pension underfunding. Companies would therefore wish to avoid such underfunding.

### **Cons**

**Weak firms with large underfunding would have to pay substantially more to other creditors.** Higher PBGC recoveries would come out of the hide of other creditors. These creditors would raise their rates significantly to compensate for the risk of receiving less if the firms do go into bankruptcy. In many ways, the financial markets would be imposing the equivalent of a credit-based variable premium. Of course, some creditors, such as people who were promised retiree health insurance benefits, might not be in a position to charge more going forward.

**Some weak firms could be pushed into bankruptcy that would otherwise have survived.** Higher funding costs could force some weakened companies under. In general, there would be an increase in the speed of decline of firms that are flirting with bankruptcy. Each step down in credit rating would incur a higher cost for those firms with large underfundings, as other creditors increasingly focused on the possibility of bankruptcy in an environment where PBGC would take a larger piece of the pie.

**Lenders may over-react.** Pensions are complicated and not well understood by all lenders and capital markets. Some creditors may over-react and shy away altogether from lending to firms with the potential to develop large pension underfunding, or they may charge exorbitant rates. Companies will not always have the time and resources to find an alternative lender who does understand pensions.

**Many companies may exit the DB system.** Executives at all but the strongest firms pay serious attention to their funding sources. A threat that their pension funding situation could lead to difficulties in borrowing may be enough to trigger the freezing or termination of pension plans.

**Severe transition problems are possible.** It would be unfair, and politically impossible, to immediately vault PBGC ahead of other creditors who had lent on the expectation that existing bankruptcy rules would remain. However, any transition arrangement is subject to at least three potential problems. One, creditors might force firms into bankruptcy in advance of the change, even though some of these companies might have otherwise pulled through. Two, longer transition periods that minimize the first problem would fail to protect PBGC from major claims that might arise in the next decade. Three, even a long transition period might not be long enough to be fair to existing creditors with very long-term obligations.

**Bankruptcy proposals face two additional political hurdles.** First, the Judiciary committees of both Houses would become involved, adding another party to already complicated negotiations. Second, financial institutions and others interested in bankruptcy legislation would add their voices.

## **Raise PBGC's priority for pension contributions skipped during bankruptcy**

PBGC has already requested help with a very specific bankruptcy-related issue. Companies that miss required pension contributions before entering bankruptcy are forced to allow PBGC to create a lien that gives PBGC priority in bankruptcy for that amount. PBGC, however, does not receive that benefit for contributions missed during the bankruptcy process, since there is an automatic stay of new liens or other credit-related claims. UAL, for example, is continuing to accrue pension benefits for some employees that would need to be honored by PBGC, but it has ceased making contributions that would fund those accruals.

Bankruptcy law could be changed to force pension contributions to be made or, more likely, to place a higher repayment priority on contributions missed during bankruptcy proceedings. It should be noted that PBGC contends that existing law already creates a higher priority. This contention has not been firmly established in the courts to this point.

### **Pros**

**Firms might fund more during the bankruptcy process.** Management decisions about funding would depend on a complex set of factors involving cash levels and the influence and desires of the various creditors. However, the proposed change would reduce the interest of some creditors in having the company skip contributions and would therefore tilt the calculations at least somewhat towards funding.

**PBGC would benefit from either higher recoveries or lower underfunding.** If contributions are made that would otherwise be skipped, PBGC would take over a lower level of underfunding. If contributions are still skipped, PBGC would have higher recoveries than if its claim remained at a low priority.

### **Cons**

**Bankrupt companies would be quicker to do distress terminations.** Skipped contributions would have a real cost to other creditors, who would pressure the firm to cease accruing benefits which incur contribution requirements.

## **Increase PBGC's flexibility to negotiate with troubled firms**

PBGC has a limited arsenal of negotiating tools under current law. The biggest is one they have referred to as the "nuclear option", the right to terminate a pension plan involuntarily if they can show a reasonable probability that allowing the plan to continue will produce an unreasonable increase in the claim on PBGC. This is a politically very unpalatable option. It puts PBGC, rather than the company that arguably created the problem, in the position of denying employees future pension accruals and cutting back pensions to participants who have amounts above the guaranteed levels. Nonetheless, PBGC has used the nuclear option, most recently moving at the end of 2004 to involuntarily terminate the pension plan for UAL's pilots.

PBGC also has negotiating flexibility in regard to various technical legal and actuarial issues that arise in given cases, although there they are often bound by the fear of setting an unfavorable precedent for other cases where they would not be receiving any quid pro quo for being flexible as they might in the specific case.

Some argue that PBGC should have more room to strike bargains with weak or bankrupt companies, as private insurers and lenders do. One proposal is to allow firms to make up their underfunding over a longer time period if they, and their unions, agree to freeze their pension plans and accept a freeze of the PBGC guarantee level. That is, if a plan were frozen today under this proposal, each participant would be subject to the current \$45,614 cap on annual pension benefits paid by PBGC, even if the plan were terminated in five years, when the cap might otherwise have risen to \$50,000. Note that these companies are already able to freeze their plans with union consent. The change is that the proposal would allow firms that freeze plans to contribute less money each year to catch up on the underfunding than is allowed under the current Deficit Reduction Contribution rules. In exchange, PBGC's cap would also be frozen.

Another proposal, which we will not examine in depth here, would give a bankruptcy judge the ability to modify funding obligations in exchange for freezing or lowering pension promises and limiting PBGC obligations. A bankruptcy judge theoretically has the neutrality and expertise to judge what is a reasonable balance.

### **Conceptual Basis**

There is an underlying policy point that does not fit easily into the Pros and Cons below. This option principally makes sense from a public policy viewpoint if one accepts a key argument of the proponents. They argue that the companies that would take advantage of this option would be ones that *should* freeze their pension plans, but are unable practically to achieve this without the incentive of lower contribution rules, generally due to union opposition. This option is a non-starter from a policy viewpoint if one believes it would be a mistake to encourage these plans to be frozen. Accepting this argument is a necessary, but not sufficient, condition. Other policy hurdles remain.

### **Pros**

**Some companies might avoid bankruptcy, based on lower pension contributions.** Cash demands for pension contributions would be lower, which might allow some firms to successfully navigate through hard times.

**Other companies might defer bankruptcy.** The change might buy time, even if it does not prevent bankruptcy. PBGC would benefit from any contributions the company has made to pay down its underfunding, since no new benefits would have accrued to add to the claim. The wild card would be the investment performance of the pension fund in the interim, which may or may not have exceeded what PBGC would have earned with the assets if there had been an earlier termination.

**All else equal, frozen guarantee limits would reduce PBGC claims.** PBGC would benefit, at the expense of participants, if a company terminates in a later year. The lower PBGC cap would reduce its payments.

**PBGC's negotiating position would improve, since it could choose whether to allow the option.**

Negotiations between PBGC and the companies would allow PBGC to determine when it felt there would be an advantage to allowing this choice. It would also have room to negotiate other changes, such as a more conservative investment policy, as a quid pro quo for approval. Political constraints might reduce PBGC's flexibility, but it would at least be a negotiating tool that does not exist now.

#### **Cons**

**As noted, this option would encourage exit from the DB system.** Companies would have to cease awarding new DB pension benefits in order to qualify. This might be limited by constraining the option to a particular industry, although it may be politically difficult to maintain this constraint over time.

**PBGC claims might be higher than without the eased contribution rules, if firms go bankrupt anyway.** If lower pension contributions do not prevent bankruptcy, they would increase the underfunding and claim on PBGC as compared to freezing the plans today without benefit of the eased contribution rules. Depending on how much easing of the rules is allowed, PBGC might even have been better off with continuing benefit accruals, but considerably larger Deficit Reduction Contributions.

## Limit PBGC's guarantee further

There are already limits to the level of pensions guaranteed by PBGC, of which the principal one is a cap of \$45,614 of annual benefit for employees retiring at age 65 under plans taken over by PBGC in 2005. This figure is substantially reduced for early retirees and is lower for plans taken over in preceding years. See "PBGC: A Primer" for details on this and other limitations.

There are proposals to disallow or not guarantee improvements to pension formulas in plans that are very severely underfunded. This is an attempt to deal with the specific moral hazard issue of troubled companies that offer pension increases as a sweetener for employees to accept less attractive cash compensation than they otherwise would. Even if employees, or their union representatives, believe there is a high probability of bankruptcy by the plan sponsor, they know that PBGC will pick up some portion of the benefit increases. Current law already reduces this incentive by phasing in the full PBGC guarantee for benefit increases that occur within 5 years of a subsequent bankruptcy. However, proponents believe that this limitation has not been successful in eliminating the moral hazard issue.

There are also questions, not addressed here, about how to treat increases in pension benefits triggered by plant closings ("shutdown benefits") and whether existing law is fair in how the 5-year phase-in works, since it effectively treats union plans less favorably than non-union plans. Finally, some have suggested that lower general guarantee levels in theory would increase participants' incentives to force firms to fund more fully. We are not aware of a specific policy proposal in this regard.

### Pros

#### **PBGC claims would be lower.**

**Arguably, the change would be fairer to "good" plan sponsors.** It may be that some of PBGC's losses, come from severely underfunded companies that promise excessive benefits and pass the cost to PBGC. Since PBGC is, by law, supposed to be self-supporting, this cost definitionally would eventually be passed to employers.

### Cons

**Pension increases might be constrained unnecessarily at some companies.** In some cases, it may be reasonable to raise pension benefits at companies that are likely to survive, despite a short-term cash crunch that precludes bringing their pension funding to appropriate levels.

## Increase PBGC investment returns

Some maintain that PBGC's financial problems are exaggerated by an investment policy that relies heavily on bonds, rather than stocks. The current investment policy at PBGC is to target an allocation of 15-25% of investments in stocks. Virtually the entire remaining amount is in bonds, usually Treasury bonds. Premiums are required by law to be held in bonds, but there is no such limitation on other assets, primarily investments taken over from failed pension plans.

Proponents believe that increasing the allocation to stocks will raise average returns and reduce the need for more premiums or a taxpayer rescue. Opponents, such as PBGC, believe that it is inappropriate to introduce the additional level of exposure to volatile stock markets. They prefer to match promises of future pension payments with known future principal and interest payments from bonds, minimizing interest rate and financial market risks.

A variant of this approach would be to own more high-quality corporate bonds, which would have nearly the certainty of the payments from Treasury bonds, but would yield perhaps half a percentage point more each year. (Some of this added return would be eliminated, in practice, by the occasional unexpected default on these high-quality, but not riskless, bonds.) This would have a much smaller effect than increasing stock allocations, but would similarly increase expected returns at the expense of risking worse results.

### Pros

**Stock returns are expected to exceed those of bonds, on average.** Since 1928, the U.S. stock market has returned an average of 9.7% per year versus 5.0% for long-term government bonds and 3.8% for short-term bonds. Most financial economists expect a smaller difference going forward for reasons too numerous to describe here. Our informal survey of the literature suggests an average forecast of perhaps 3 percentage points greater return from stocks than from long-term government bonds.

### Cons

**Investors receive a higher EXPECTED return because they risk LOWER actual returns.** No matter how long the time-frame, there is a risk that stocks will underperform government bonds, or even lose money. That risk is considered to be lower for long time horizons, but it does not vanish. As an extreme example, an investor buying at the peak of the market in 1929 would have been a net loser for 25 years, through 1954. It would have been some years after that before they caught up with bond investors.

**The stock market may be over-priced by historical standards.** The author does not pretend to know which way the stock market will go, but it is important to dispel a common misperception that the bursting of the bubble has resulted in a currently "cheap" stock market. First, the broadest measure of the stock market, the Russell 3000, is only 12% below its all-time peak. Second, the price/earnings ratio on the S&P 500 is now 22, 41% above the historical average of 15.6. In simple terms, this would mean that stocks are 41% over-priced if the historical average represented fair value.



## Infuse taxpayer funds

General revenues, provided by taxpayers, represent one potential source of funds to fill PBGC's deficit.

### Pros

**There would be less pressure on companies to exit the DB system.** Every dollar of taxpayer funds that is infused is one dollar less that has to be charged to plan sponsors. As noted, filling PBGC's current hole through premiums means significantly over-pricing future pension insurance in order to make enough profit to pay for the past.

**Arguably, the government created much of the problem and should bear much of the cost.** There are at least two variants of this argument. First, some contend that the deficit really represents failed government industrial policy that has helped sink a large part of the steel and airline industries. Take away these two sectors and PBGC would likely not have a deficit. Second, the government has set the premium rates and funding rules, including allowing the steel and airline industries extra leniency in funding. Perhaps the government should bear the consequences of its decisions.

**Arguably, it is not fair to remaining plan sponsors to bear the full cost of past losses.** A small number of companies are responsible for PBGC's deficit. It may not be fair to transfer that burden onto the plan sponsors that have promoted good public policy by continuing to voluntarily offer defined benefit plans. Unfortunately, the government is the only other entity that might reasonably pick up the bill.

### Cons

**There may be better uses for taxpayer money.** Given the dramatic budget deficits already in existence, adding to those deficits is not appealing.

**Arguably, plan sponsors have been the beneficiaries of the underpricing and should not be bailed out.** PBGC, by law, is supposed to charge premiums sufficient to pay its bills. Industry and union lobbyists have been instrumental in persuading Congress to set the rates as low as they are, often arguing that even these levels were too high. Plan sponsors then benefited from the low premium rates and perhaps ought to bear the costs.

**Arguably, taxpayers should not be asked to bail out a group more affluent than the average taxpayer.** People in defined benefit plans tend to be better off than the average taxpayer. To the extent that they are, it exacerbates the perceived unfairness of asking taxpayers who have never had a chance to be in a defined benefit plan to bail out others who have had that opportunity. On the other hand, given the progressive nature of taxation, it is not clear that the percentage of taxes coming from each segment of the income spectrum is distributed any more progressively than is the percentage of pension income going to each participant.

## Privatize PBGC

Richard Ippolito, former Chief Economist of PBGC, has proposed that the federal government remove itself from the business of guaranteeing pensions. (His paper is available at [www.cato.org](http://www.cato.org).) Taxpayers would pick up the existing deficit, near-term expected claims, and future operating expenses related to existing and near-term expected claims. At the time of his proposal, he estimated this at \$18.7 billion, based on runs of PBGC's PIMS financial model done as of the end of fiscal 2003. Based on PBGC's 2004 results, this would likely be at least a \$30 billion rescue, since PBGC reports a \$23 billion deficit, there would be billion of dollars of run-off expenses, and there are probably a number of companies that are likely to bring a claim in the next few years. In fact, the number could be well above \$30 billion if, for example, the remainder of the airline industry were to go through bankruptcy. (It will not be possible to duplicate Ippolito's methodology to produce an updated number until PBGC releases model results reflecting fiscal 2004 results.)

The core of the idea is that companies would be required to form a true self-insurance pool, with no possibility of further federal aid. (He believes that companies should be allowed at some point to buy private market insurance and exit the pool, but he does not address the mechanisms for this.) Ippolito postulates that under those conditions the pool members would set a variable premium that would apply to all underfunding, calculated on a true market basis. This variable premium would be at the same rate for all firms, with no gradations for creditworthiness. The rate would change from year to year, being set at the level necessary for the risk based on that year's business and financial market conditions.

### Pros

**Taxpayer costs would be limited to the initial rescue.** If the pool is truly self-sufficient, no further funds would be forthcoming from the government. (However, see "Cons" for doubts about how this would work.)

**Companies could not "game" the system.** Firms that took actions which increased underfunding would soon find themselves paying substantially higher premiums to compensate other pool members for that risk.

**Well-funded pension plans would draw low premium costs, encouraging the continuance of sound plans.** All premiums would be based on underfunding, so firms with little underfunding would pay very little.

### Cons

**Taxpayers would be faced with a major up-front cost.** As noted above, the cost is unlikely to be less than \$30 billion and could easily be \$50 billion or more, depending on near-term business conditions and actions triggered by transition considerations. Note that the proposal itself does not necessarily increase the present value of the eventual costs, but it does cause them to be borne by the taxpayers up-front.

**Taxpayers would likely remain an implicit guarantor.** It is difficult to envision how companies would be persuaded not to lobby for a rescue if the pool developed a large deficit, particularly in the first decade. A large deficit in the early years of operation would almost certainly be blamed on an insufficient initial payment from the government. Even if the problem occurred later, or could not reasonably be tied to the initial funding, lobbyists would likely assert that the pool was established by the government and that companies were forced to participate in a scheme that proved unsound. It is instructive to remember that PBGC technically is supposed to act like a self-insured pool now, since premiums are intended to be set at break-even levels and federal support is limited by law to a potential \$100 million loan.

**Variable premium levels could prove very high, forcing some firms into bankruptcy.** If the pool were to encounter years such as the last three experienced by PBGC, it would need roughly \$10 billion a year in variable premiums to stay even. Spread over 2004's estimated \$450 billion in underfunding this would come to a roughly 2% charge on each dollar of underfunding. However, anticipation of the possibility of high variable rates would likely lead the stronger companies to fully fund, leaving only the weaker credits still underfunded. This might leave a \$10 billion charge to be spread over perhaps \$100 billion of underfunding (a bit over 2004's level of underfunding by companies with junk credit ratings) which would be a 10% charge on each dollar of underfunding. Faced with that calculation, even the strongest of the weak credits would find a way to borrow and fund, but that would leave the weakest companies with an overwhelming premium burden that could be 20% or more of the underfunded amount.

Admittedly, the proposal would over time encourage better funding so that there would likely not be many years with \$10 billion in claims, but it is hard to see how this would have been accomplished in the first years of operation, given how many weak companies have major underfunding today. It might also be possible to deal with this problem by running deficits at the pool and spreading the premium cost over time, but this could produce other severe problems, including a higher likelihood of a government bailout of the pool.

**Incentives to fund would be so strong as to be equivalent to extremely tight funding rules.** All of the potential disadvantages of tight funding rules would exist in great measure.

**It appears politically infeasible.** Even if policymakers determined that the pool concept was desirable, it would likely be opposed strongly by virtually every segment of the pension community. All firms would dislike the pressure to fully fund so quickly. Strong firms would worry about being stuck with excessive losses from weak firms, without hope of government aid. Weak firms would worry about overwhelming cash contribution requirements and high premium rates.

### **Other generic proposals**

Other ideas have been advanced that are difficult to assess without specific details. For example, virtually everyone agrees that greater “transparency” would be helpful. Participants and financial markets could then better understand a company’s situation and would have incentives to encourage sensible behavior that would protect these stakeholders. The devil, however, will be in the details and these are not yet available.

The idea has been raised of giving PBGC some regulatory authority over pension funds. For example, it might be allowed to limit the level of investment risk taken by seriously underfunded plans. Again, this is difficult to judge without a specific proposal and would need to be compared to existing authority held by the Department of Labor to ensure prudent management by pension trustees.