PROTECTING PENSIONS AND ENSURING THE SOLVENCY OF PBGC

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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PROTECTING PENSIONS AND ENSURING THE SOLVENCY OF PBGC

WEDNESDAY, MARCH 2, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Todd R. Platts, (chairman of the subcommittee) presiding.

Present: Representatives: Platts, Towns and Duncan.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Tabetha Mueller, professional staff member; Jessica Friedman, legislative assistant; Nathaniel Berry, clerk; Adam Bordes, minority professional staff member; and Cecelia Morton, minority office manager.

Mr. PLATTS. The Subcommittee on Government Management, Finance and Accountability will come to order.

We are awaiting the arrival our ranking member. Mr. Towns will be here shortly as well as Mr. Belt, who is in the building or working his way into the building.

We are going to go ahead and get started because we expect the first vote on the floor to be at 2:45 or 3 p.m. Our hope is to get in at least an hour or more before any votes happen.

The solvency of the Pension Benefit Guaranty Corp. has become an issue of great concern. Over the past decade, the financial picture at the PBGC has shifted dramatically from surpluses of nearly $10 million in 2000 to a reported $24 billion deficit in 2004. Structural changes in the U.S. economy have put a disproportionate strain on firms that traditionally offer employees defined benefit plans, the type guaranteed by the PBGC.

As we look at the future for the affected sectors of the economy, specifically the manufacturing and the airline industries, Congress needs to take a hard look at pension reform. Without action, we risk not only jeopardizing the financial security of 44 million American pensioners with the possibility of a costly taxpayer bailout to fulfill the promises made to those workers.

With an estimated $400 billion in unfunded pensions, the need to act is urgent. It may not be a crisis today but if we do not act, it will become one.

President Bush, in his fiscal year 2006 budget, has proposed a variety of reforms aimed at meeting these challenges. My colleague and chairman on the Committee on Education and the Workforce, Chairman John Boehner, has taken the lead in vetting these proposals. As Congress discusses these reforms, there is a need to understand the structure of the PBGC, how it is managed and how it will implement new statutory tools.

Many in the financial community have expressed concern that problems at the PBGC are not a function of the economic downturn and that there are structural issues that need to be addressed if any reforms are to work effectively. Specifically, there is a concern that the statutory framework of the PBGC precludes it from responding to financial events that affect solvency and while the PBGC is, in essence, an insurer, it lacks the mechanisms employed by traditional insurance companies to mitigate risk. A clearer understanding of these and other structural management issues will ensure that Congress considers reform proposals in the most effective manner possible.

As a member of the Education and Workforce Committee, I look forward to working with Chairman Boehner and I hope to offer unique insights gleaned from this hearing today.

We have a very distinguished panel here today, Comptroller General, David M. Walker, former Acting Executive Director of the PBGC, who certainly brings a wealth of experience to our hearing. We will be joined by Mr. Brad Belt, the current executive director of the PBGC. Our second panel will consist of Mr. Doug Elliott, president, Center on Federal Financial Institutions.

We appreciate each of our witnesses being here today and the testimony they have provided to us in writing as well.

I will now yield to our ranking member, the gentleman from New York, Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman, for holding this hearing today on the current state and future challenges of the Pension Benefit Guaranty Corp.

I welcome our panel of witnesses and look forward to a candid exchange of ideas on how we can better address the challenges of both the PBGC and our Nation's retirees.

In 1974, Congress identified the long-term need to establish a Government-run program that would step in and manage and administer privately run, defined benefit pension plans for companies experiencing overbearing financial hardships. The principle was simple, by establishing a Federal program that would serve as a backstop for companies who sponsored pension plans, the private sector would continue to provide adequate retirement benefits for employees who have demonstrated loyalty and continued service to their firms. The financing mechanism for the program would be equitable and would ensure that both the Government and employers had a stake in the preservation of strong, defined benefit retirement systems.

As more beneficiaries become eligible for benefits and fewer workers participate in defined benefit plans, there is general consensus among analysts at PBGC that assets and cash-flow will provide insufficient improvements over the next two decades. Therefore, it is only appropriate for us to begin a serious debate about the future goals and objectives of the PBGC while developing appropriate remedies that are fair and equitable among employers and employees alike.

As we hear from our distinguished panel today, I hope we can be mindful of the broader themes that seem to be more pertinent over the long term as short term policy adjustments will fail to remedy the underlying deficiencies of the PBGC.

For example, I know there is a school of thought that believes the core economic challenge facing the PBGC can be resolved through premium adjustment alone. While I agree that premiums are a part of the problem, it fails to address whether the Congress believes the PBGC can remain an adequate safety net to the private marketplace in the future.

Specifically, we must carefully evaluate whether the PBGC is living up to its responsibilities as a pension fund regulator as plans continue to endure financial distress and damaging losses on their investments. Until these issues are resolved, the long term sustainability of the PBGC as a reliable safety net for the private sector and its workers cannot be ensured.

Once again, Mr. Chairman, thank you for holding this hearing and I am eager to hear from our witnesses.

Thank you.

Mr. PLATTS. Thank you, Mr. Towns.

We have been joined by Mr. Bradley Belt, current executive director, PBGC. Thanks for joining us here today.

Mr. BELT. My apologies, Mr. Chairman, for my tardiness. The President is actually visiting the Hill today and we got held up by his motorcade. I hope you will forgive me.

Mr. PLATTS. We always give him priority, that is for sure. We are glad to have you, and you are actually here just in time.

We are going to begin with Mr. Belt and Mr. Walker and then we will proceed to our second panelist and then go to Q and A for all three of you after we have heard from everyone.

If I can ask the two of you to stand and take the oath before you begin your testimony.

[Witnesses sworn.]

Mr. PLATTS. We will now begin with your oral testimony. I think we are going to limit it and try and stay around 5 minutes as best you can and we will get into Q and A.

STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; AND BRAD BELT, EXECUTIVE DIRCTOR, PENSION BENEFIT GUARANTY CORP.

STATEMENT OF DAVID M. WALKER

Mr. WALKER. It is good to be back before you this time to discuss the challenges facing the Pension Benefit Guaranty Corp. and the defined benefit pension system. I would like the entire statement to be included in the record and I will move to summarize.

Mr. PLATTS. Without objection.

Mr. WALKER. The PBGC issue as a subset of a broader challenge. One of the things you may be familiar with is that the GAO in the last 2 weeks has issued a document called “Twenty First Century Challenges, Reexamining the Base of the Federal Government.” I think if you, Mr. Towns and your colleagues haven’t had an opportunity to look at this document, I would strongly recommend that you do so.

Basically, among other things, it says we are on an imprudent and unsustainable fiscal path and that tough choices are going to have to be made with regard to discretionary spending, mandatory spending, entitlement programs and tax policies. I also note that a vast majority of the Federal Government is based upon policies, programs, functions and activities that made sense when they were put into place but in many cases have not been subject to fundamental review, reexamination, reprioritization and in some cases, reengineering since they were put into place.

The PBGC was put into place in 1974. A lot has changed in the world since 1974 and I think we have seen over the years, some things have worked and some things haven't work. So we need to fundamentally step back and reassess what makes sense for today and tomorrow.

In that regard, I include on pages 2 and 3 of my statement that in light of past trends and future challenges, there are some very fundamental questions I think have to be asked and answered about the PBGC which I won't take the time to repeat right now. I think they illustrate the fact that the PBGC is a subset of our broader reexamination challenge.

I think it is critically important that we recognize that while PBGC does not face an immediate crisis, it does have a large and growing financial problem and it would be prudent to address it sooner rather than later. I would respectfully suggest you cannot solve the problem merely through looking at additional revenues, premium or otherwise. There need to be reforms in the insurance program, changes in the funding standards, and enhanced transparency. In addition, you should consider providing PBGC with some additional authorities that insurance-type entities would normally have in order to balance the interests of the various parties.

I think it is also important to keep in mind that this is not just about the Pension Benefit Guaranty Corp. because the PBGC does not insure all promised benefits. It is not only important to ensure the long range, financial integrity and viability of the Pension Benefit Guaranty Corp., but also to try to enhance the retirement security of millions of Americans who are working and those who are retired because frequently when plans terminate and are assumed by the PBGC, participants do not receive all their promised benefits. Therefore, it is not just the PBGC we should be concerned about.

We almost have somewhat of the three bears theory here. Let me clarify what I mean by that. It is very important that actions be taken that are systemic in nature with regard to the PBGC. It is important they be effective enough in order to assure the long-term viability of the PBGC and the retirement security of workers and retirees.

On the other hand, care needs to be taken not to go too far because if you go too far, it can result in providing incentives for people to leave the defined benefit system and they are already leaving it in large numbers at the present point in time. That is one of the factors contributing to the PBGC's challenge.

There have been a number of reforms in the PBGC over the years, including during the time that I was Acting Executive Director of the PBGC as well as Assistant Secretary of Labor for Pensions and Health, to try to reduce the put option, the moral hazard, if you will, in trying to be able to offload obligations onto PBGC. Time has proven they are not adequate. While if markets return and interest rates rise, PBGC's current financial condition would be enhanced, I think it is pretty clear that reforms are necessary in order to put it on a sound and sustainable path in the future.

In conclusion, while I have a tremendous amount of information included in my testimony including a number of ideas for consideration by this subcommittee and the Congress at large, I think we have to recognize that action is necessary and the sooner we act, the better because the sooner you act, as long as we balance these interests, the less traumatic the changes will have to be, and the more time there can be for the transition.

In some ways, Mr. Chairman and Mr. Towns, I would respectfully suggest that the same thing goes for the Social Security system. It does not face immediate crisis, but it does have a large and growing financial problem. It would clearly be prudent to act sooner rather than later. There are frankly more than a few analogies between the challenges facing our Social Security system and the PBGC. I think it would be prudent for Congress to act on both sooner rather than later.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Government Management, Finance and Accountability, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 2:00 p.m. EST
Wednesday, March 2, 2005

PENSION BENEFIT GUARANTY CORPORATION

Structural Problems Limit Agency's Ability to Protect Itself from Risk

Statement of David M. Walker
Comptroller General of the United States

GAO
Accountability * Integrity * Reliability

GAO-05-360T

March 2, 2005

PENSION BENEFIT GUARANTY CORPORATION

Structural Problems Limit Agency's Ability to Protect Itself from Risk

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Highlights

Highlights of GAO-05-360T, a report to Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

Why GAO Did This Study

More than 34 million workers and retirees in about 30,000 single-employer defined benefit plans rely on a federal insurance program managed by the Pension Benefit Guaranty Corporation (PBGC) to protect their pension benefits. However, the insurance program's long-term viability is in doubt and in July 2003 we placed the single-employer insurance program on our high-risk list of agencies with significant vulnerabilities for the federal government. In fiscal year 2004, PBGC's single-employer pension insurance program incurred a net loss of $12.1 billion for fiscal year 2004, and the program's accumulated deficit increased to $23.3 billion from $11.2 billion a year earlier. Further, PBGC estimated that underfunding in single-employer plans exceeded $450 billion as of the end of fiscal year 2004.

This testimony provides GAO's observations on (1) some of the structural problems that limit PBGC's ability to protect itself from risk and (2) steps PBGC has taken to forecast and manage the risks that it faces.

www.gao.gov/cgi-bin/getrpt?GAO-05-360T.

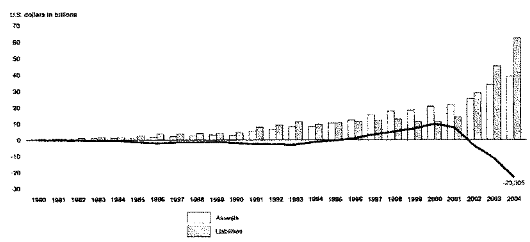
To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg, (202) 512-7215, bovbjergb@gao.gov.

What GAO Found

Existing laws governing pension funding and premiums have not protected PBGC from accumulating a significant long-term deficit and have exposed PBGC to "moral hazard" from the companies whose pension plans it insures. The pension funding rules, under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC), were not designed to ensure that plans have the means to meet their benefit obligations in the event that plan sponsors run into financial distress. Meanwhile, in the aggregate, premiums paid by plan sponsors under the pension insurance system have not adequately reflected the financial risk to which PBGC is exposed. Accordingly, PBGC faces moral hazard, and defined benefit plan sponsors, acting rationally and within the rules, have been able to turn significantly underfunded plans over to PBGC, thus creating PBGC's current deficit.

Despite the challenges it faces, PBGC has proactively attempted to forecast and mitigate its risks. The Pension Insurance Modeling System, created by the PBGC to forecast claim risk, has projected a high probability of future deficits for the agency. However, the accuracy of the projections produced by the model is unclear. Through its Early Warning Program, PBGC negotiates with companies that have underfunded pension plans and that engage in business transactions that could adversely affect their pensions. Over the years, these negotiations have directly led to billions of dollars of pension plan contributions and other protections by the plan sponsors. Moreover, PBGC has changed its investment strategy and decreased its equity exposure to better shield itself from market risks. However, despite these efforts, the agency ultimately lacks the authority, unlike other federal insurance programs, to effectively protect itself.

Assets, Liabilities, and Net Financial Position of PBGC's Single-Employer Insurance Program, 1980-2004



Source: Pension Benefit Guaranty Corporation.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the underlying structural problems and long-term challenges facing the defined benefit pension system and the Pension benefit Guaranty Corporation (PBGC). Before addressing these matters specifically, I would like to place these challenges in the context of the larger challenges facing the federal government today, which we discuss in our recently issued 21st Century Challenges report.[1] There is a need to bring the federal government and its programs into line with 21st century realities. This challenge has many related pieces: addressing our nation's large and growing long-term fiscal gap; deciding on the appropriate role and size of the federal government—and how to finance that government—and bringing the panoply of federal activities into line with today's world. Continuing on our current unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security. We therefore must fundamentally reexamine major spending and tax policies and priorities in an effort to recapture our fiscal flexibility and ensure that our programs and priorities respond to emerging security, social, economic, and environmental changes and challenges.

The PBGC is an excellent example of the need for Congress to reconsider the role of government organizations, programs, and policies. The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to respond to trends and challenges that existed at that time.[2] One impetus for the passage of ERISA was the failure of Studebaker's defined benefit pension plan in the 1960s, in which many plan participants lost their pensions.[3] Along with other changes, ERISA established PBGC to pay the

[1]See GAO, *21st Century Challenges: Reexamining the Base of the Federal Government,* GAO-05-325SP. (Washington, DC: February, 2005)

[2]ERISA has been amended a few times, notably in 1987 (Public Law 100-203) and again in 1994 (Public Law 103-465), to respond to challenges facing the defined benefit pension system and PBGC.

[3]The company and the union agreed to terminate the plan along the lines set out in the collective bargaining agreement; retirees and retirement eligible employees over the age of 60 received full pensions, and vested employees under age 60 received a lump-sum payment worth about 15 percent of the value of their pensions. Employees, whose benefit accruals had not vested, including all employees under age 40, received nothing. James A. Wooten, "The Most Glorious Story of Failure in Business: The Studebaker-Packard Corporation and the Origins of ERISA." *Buffalo Law Review*, vol. 49 (Buffalo, NY: 2001):731.

pension benefits of defined benefit plan participants, subject to certain limits, in the event that an employer could not.[4] ERISA also required PBGC to encourage the continuation and maintenance of voluntary private pension plans and to maintain premiums set by the corporation at the lowest level consistent with carrying out its obligations.[5] PBGC was thus mandated to serve a social purpose and remain financially self-sufficient.[6] When ERISA was enacted, defined benefit pension plans were the most common form of employer-sponsored private pension and were growing both in number of plans and number of participants. In 1974, Congress may well have expected continued growth of defined benefit plans in the years and decades to come. Today, defined benefit pensions cover an ever decreasing percentage of the U.S. labor force, a fact that raises several questions about federal policy on pensions in general, and defined benefit plans and the PBGC, in particular.

In light of past trends and future challenges, some of the fundamental questions that need to be addressed as we move forward include these:

- Should the federal government continue to promote defined benefit pension plans?
- What features of various pension plans should the government promote to meet retirement income security needs of increasingly mobile American workers?
- What changes should be made to enhance the retirement income security of workers while protecting the fiscal integrity of the PBGC insurance program?
- Should PBGC act as self-sustaining insurer, according to market-based principles, should it be a social insurance program, or should it be a hybrid entity? As defined benefit pension coverage declines, there is an

[4]Some defined benefit plans are not covered by PBGC insurance; for example, plans sponsored by professional service employers, such as physicians and lawyers, with 25 or fewer employees.

[5]See section 4002(a) of P.L. 93-406, Sept. 2, 1974.

[6]ERISA authorized PBGC to borrow up to $100 million from the U.S. Treasury to cover temporary cash shortfalls.

inherent tension between these two approaches that Congress presumably did not foresee when ERISA was enacted.

- What legislative changes are necessary to allow the pension insurance program and the PBGC to succeed in their missions? And how much authority and flexibility should be provided to PBGC to manage its risk and respond to the fiscal challenges it faces?
- Should the government's pension insurance program be used as a tool to provide restructuring assistance to industries that have been negatively affected by certain macroeconomic forces such as globalization and deregulation? Should such costs be handled differently than other pension insurance losses?
- What portion of the PBGC's premium revenue should be fixed versus variable rate premiums and for what purposes? Should variable rate premiums be more risk-related? If so, how can they be adjusted to accomplish this objective?
- What should PBGC's investment strategy be and what impact, if any, should that have on pension funding, recovery, premium, and other calculations?

It is critical that we address these fundamental issues as soon as possible so that we take actions consistent with our broader policy objectives. Furthermore, failure to enact the proper reforms could expedite the demise of the defined benefit pension system. As part of GAO's efforts to help Congress and other policymakers address such issues, I recently convened a group of pension experts at a Comptroller General's Forum entitled "The Future of the Defined Benefit System and the PBGC." We will convey the observations of the forum participants in a forthcoming GAO report.

I will now turn to the specific issues before this subcommittee today. In particular, I will discuss some of the structural problems that limit PBGC's ability to protect itself from risk and steps PBGC has taken to forecast and manage the risks that it faces. In summary, existing laws governing pension funding and premiums have not protected PBGC from accumulating a significant long-term deficit and have not limited PBGC's exposure to "moral hazard" from the companies whose pension plans it insures.[7] The pension funding rules, under ERISA and the Internal Revenue Code (IRC), were not designed to ensure that plans have the means to meet their benefit obligations in the event that plan sponsors run into financial distress. Meanwhile, in the aggregate, premiums paid by plan sponsors under the pension insurance system have not adequately reflected the financial risk to which PBGC is exposed. Accordingly, defined benefit plan sponsors, acting rationally and within the rules, have been able to turn significantly underfunded plans over to PBGC, thus creating PBGC's current deficit.

Despite the challenges it faces, PBGC has proactively attempted to forecast and mitigate its risks. The Pension Insurance Modeling System, created by PBGC to forecast claim risk, has projected a high probability of future deficits for the agency. However, the accuracy of the projections produced by the model is unclear. Through its Early Warning Program, PBGC negotiates with companies that have underfunded pension plans and that engage in business transactions that could adversely affect their pensions. Over the years, these negotiations have directly led to billions of dollars of pension plan contributions and other protections by the plan sponsors. Moreover, PBGC has changed its investment strategy and decreased its equity exposure to better shield itself from market risks. However, despite these efforts, the agency, unlike other federal insurance programs, ultimately lacks adequate authority to effectively protect itself.

Background

Before enactment of the Employee Retirement Income Security Act of 1974, few rules governed the funding of defined benefit pension plans, and participants had no guarantees that they would receive the benefits promised. Among other things, ERISA established rules for funding defined benefit pension plans and created the PBGC to protect the benefits of plan participants in the event that plan sponsors could not meet the benefit obligations under their plans. More than 34 million workers and retirees in about 30,000 single-employer defined benefit plans rely on PBGC to protect their pension benefits.

[7]Moral hazard surfaces when the insured parties—in this case, plan sponsors—engage in risky behavior knowing that the guarantor will assume a substantial portion of the risk. In the case of the pension insurance system, this might include the willingness of parties to enter into agreements that increase pension liabilities, rather than taking wage increases.

PBGC finances the liabilities of underfunded terminated plans partially through premiums paid by plan sponsors.[8] Currently, plan sponsors pay a flat-rate premium of $19 per participant per year; in addition, some plan sponsors pay a variable-rate premium, which was added in 1987, to provide an incentive for sponsors to better fund their plans. For each $1,000 of unfunded vested benefits, plan sponsors pay a premium of $9. In fiscal year 2004, PBGC received nearly $1.5 billion in premiums, including more than $800 million in variable rate premiums, but paid out more than $3 billion in benefits to plan participants or their beneficiaries.[9]

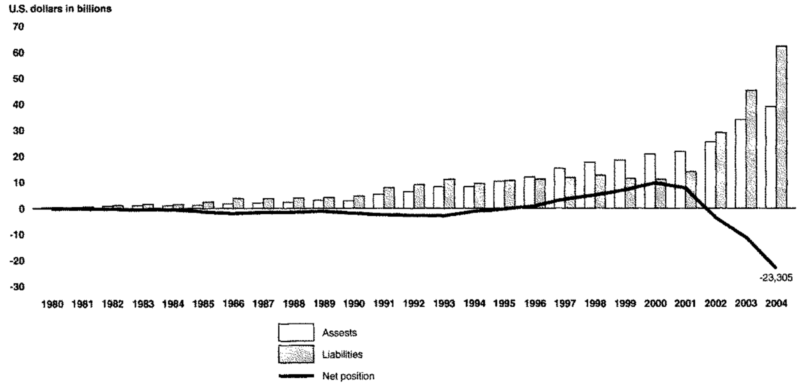
The single-employer program has had an accumulated deficit—that is, program assets have been less than the present value of benefits and other obligations—for much of its existence. (See fig. 1.) In fiscal year 1996, the program had its first accumulated surplus, and by fiscal year 2000, the accumulated surplus had increased to about $10 billion, in 2002 dollars. However, the program's finances reversed direction in 2001, and at the end of fiscal year 2002, its accumulated deficit was about $3.6 billion. In July 2003, we designated the single-employer insurance program as "high risk," given its deteriorating financial condition and the long-term vulnerabilities of the program.[10] In fiscal year 2004, PBGC's single-employer pension insurance program incurred a net loss of $12.1 billion and its accumulated deficit increased to $23.3 billion, up from $11.2 billion a year earlier. Furthermore, PBGC estimated that total underfunding in single-employer plans exceeded $450 billion, as of the end of fiscal year 2004.

[8]PBGC also assumes the assets of the plans it takes over in a plan termination and any investment income from these assets may be used to pay out benefits to participants of terminated plans.

[9]For most of its history, PBGC has received most of its premium income from flat-rate premiums.

[10]See GAO, *Pension Benefit Guaranty Corporation Single-Employer Insurance Program: Long-Term Vulnerabilities Warrant "High Risk" Designation*, GAO-03-1050SP (Washington, DC: July 23, 2003).

Figure 1: Assets, Liabilities, and Net Financial Position of PBGC's Single-Employer Insurance Program, 1980-2004



Source: Pension Benefit Guaranty Corporation.

Structural Problems Limit PBGC's Ability to Protect Itself from Risk

Existing laws governing pension funding and premiums have not protected PBGC from accumulating a significant long-term deficit and have not limited PBGC's exposure to moral hazard from the companies whose pension plans it insures. The pension funding rules, under ERISA and the IRC, were not designed to ensure that plans have the means to meet their benefit obligations in the event that plan sponsors run into financial distress. Meanwhile, in the aggregate, premiums paid by plan sponsors under the pension insurance system have not adequately reflected the financial risk to which PBGC is exposed. Accordingly, defined benefit plan sponsors, acting rationally and within the rules, have been able to turn significantly underfunded plans over to PBGC, thus creating PBGC's current deficit. Earlier this year, the Administration released a proposal that aims to address many of the structural problems that PBGC faces by calling for changes in the funding rules and premium structure, among other things. Meanwhile, employers who responsibly manage their defined benefit pension plans are concerned about their exposure to additional funding and premium uncertainties.

Minimum Funding Rules Do Not Prevent Plans from Being Severely Underfunded

As the PBGC takeovers of severely underfunded plans suggest, the IRC minimum funding rules have not been designed to ensure that plan sponsors contribute enough to their plans to pay all the retirement benefits promised to date.[11] The amount of contributions required under IRC minimum funding rules is generally the amount needed to fund that year's "normal cost" – benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years. Also, the rules require the sponsor to make an additional contribution if the plan is underfunded to a specified extent as defined in the law.[12] However, sponsors of underfunded plans may sometimes avoid or reduce minimum funding contributions if they have earned funding credits as a result of favorable experience, such as contributing more than the minimum in the past. For example, contributions beyond the minimum may be recognized as a funding credit. These credits are not measured at their market value and accrue interest each year, according to the plan's long-term expected rate of return on assets.[13] If the market value of the assets falls below the credited amount, and the plan is terminated, the assets in the plan will not suffice to pay the plan's promised benefits. Thus, some very large and significantly underfunded plans have been able to remain in compliance with the current funding rules while making little or no contributions in the years prior to termination (e.g., Bethlehem Steel).

Further, under current funding rules, plan sponsors can increase plan benefits for underfunded plans, even in some cases where the plans are less than 60 percent funded. This may create an incentive for financially troubled sponsors to increase pension benefits, possibly in lieu of wage increases, even if their plans have insufficient funding to pay current benefit levels.[14] Thus, plan sponsors and employees that agree to benefit increases from underfunded plans as a sponsor is approaching bankruptcy

[11]Pension funding rules include minimum funding requirements for all plans and additional funding requirements for underfunded plans that set minimum contribution requirements for plan sponsors.

[12]Under one of the amendments to ERISA in 1987, an additional funding requirement rule was added. Generally speaking, large single-employer plans are subject to a deficit reduction contribution if the value of plan assets is less than 90 percent of a standardized liability measure. To determine whether the additional funding rule applies to a plan, the IRC requires sponsors to calculate this liability using the highest interest rate allowable for the plan year. See 26 U.S.C. 412(l)(9)(C).

[13]See 26 U.S.C. 412(b).

[14]Some measures exist to limit losses incurred by PBGC from benefits added to a plan within the 5-year period prior to plan termination.

can essentially transfer this additional liability to PBGC, potentially exacerbating the agency's financial condition.

In addition, many defined benefit plans offer employees "shutdown benefits," which provide employees additional benefits, such as significant early retirement benefit subsidies in the event of a plant shutdown or permanent layoff. In general, plant shutdowns are inherently unpredictable, so that it is difficult to recognize the costs of shutdown benefits in advance and current law does not include the cost of benefits arising from future unpredictable contingent events.[15] Under current law, PBGC is responsible for at least a portion of any benefit increases, including shutdown benefits, even if the benefit was added to the plan within 5 years of plan termination. However, many of these provisions were included in plans years ago. As a result, shutdown benefits pose a problem for PBGC not only because they can dramatically and suddenly increase plan liabilities without adequate funding safeguards, but also because the related additional benefit payments drain plan assets.[16]

Finally, because many plans allow lump sum distributions, plan participants in an underfunded plan may have incentives to request such distributions. For example, where participants believe that the PBGC guarantee may not cover their full benefits, many eligible participants may elect to retire and take all or part of their benefits in a lump sum rather than as lifetime annuity payments, in order to maximize the value of their accrued benefits. In some cases, this may create a "run on the bank," exacerbating the possibility of the plan's insolvency as assets are liquidated more quickly than expected, potentially leaving fewer assets to pay benefits for other participants.

PBGC's Premium Structure Does Not Properly Reflect Risks to the Insurance Program

PBGC's current premium structure does not properly reflect risks to the insurance program. The current premium structure relies heavily on flat-rate premiums that, since they are unrelated to risk, result in large cost shifting from financially troubled companies with underfunded plans to healthy companies with well-funded plans. PBGC also charges plan sponsors a variable-rate premium based on the plan's level of underfunding. However, these premiums do not consider other relevant

[15]See 26 U.S.C. 412(m)(4)(D).

[16]Shutdown benefit payments begin immediately after a facility closes, using assets accumulated to pay other plan benefits.

risk factors, such as the economic strength of the sponsor, plan asset investment strategies, the plan's benefit structure, or the plan's demographic profile. PBGC is currently operated somewhat more on a social insurance model since it must cover all eligible plans regardless of their financial condition or the risks they pose to the solvency of the insurance program.

In addition to facing firm-specific risk that an individual underfunded plan may terminate, PBGC faces market risk that a poor economy may lead to widespread underfunded terminations during the same period, potentially causing very large losses for PBGC. Similarly, PBGC may face risk from insuring plans concentrated in vulnerable industries affected by certain macroeconomic forces such as deregulation and globalization that have played a role in multiple bankruptcies over a short time period, as happened in the airline and steel industries. One study estimates that the overall premiums collected by PBGC amount to about 50 percent of what a private insurer would charge because its premiums do not adequately account for these market risks.[17] Others note that it would be hard to determine the market rate premium for insuring private pension plans because private insurers would probably refuse to insure poorly funded plans sponsored by weak companies.

PBGC Is Subject to Moral Hazard

Despite a series of reforms over the years, current pension funding and insurance laws create incentives for financially troubled firms to use PBGC in ways that Congress did not intend when it formed the agency in 1974. PBGC was established to pay the pension benefits of participants in the event that an employer could not. As pension policy has developed, however, firms with underfunded pension plans may come to view PBGC coverage as a fallback, or "put option," for financial assistance. The very presence of PBGC insurance may create certain perverse incentives that represent moral hazard—struggling plan sponsors may place other financial priorities above "funding up" their pension plans because they know PBGC will pay guaranteed benefits. Firms may even have an incentive to seek Chapter 11 bankruptcy in order to escape their pension obligations. As a result, once a plan sponsor with an underfunded pension plan experiences financial difficulty, existing incentives may exacerbate the funding shortfall for PBGC while also affecting the competitive

[17] Boyce, Steven, and Richard A. Ippolitio, "The Cost of Pension Insurance," *The Journal of Risk and Insurance*, (2002) Vol 69, No. 2, pp.121-170.

balance within an industry. This should not be the role for the pension insurance system.

This moral hazard has the potential to escalate, with the initial bankruptcy of firms with underfunded plans creating a vicious cycle of bankruptcies and terminations. Firms with onerous pension obligations and strained finances could see PBGC as a means of shedding these liabilities, thereby providing them with a competitive advantage over firms that deliver on their pension commitments. This would also potentially subject PBGC to a series of terminations of underfunded plans in the same industry, as we have already seen with the steel and airline industries in the past 20 years.

In addition, current pension funding and pension accounting rules may also encourage plans to invest in riskier assets to benefit from higher expected long-term rates of return. In determining funding requirements, a higher expected rate of return on pension assets means that the plan needs to hold fewer assets in order to meet its future benefit obligations. And under current accounting rules, the greater the expected rate of return on plan assets, the greater the plan sponsor's operating earnings and net income. However, with higher expected rates of return comes greater risk of investment loss, which is not reflected in the pension insurance program's premium structure. Investments in riskier assets with higher expected rates of return may allow financially weak plan sponsors and their plan participants to benefit from the upside of large positive returns on pension plan assets without being truly exposed to the risk of losses. The benefits of plan participants are guaranteed by PBGC, and weak plan sponsors that enter bankruptcy can often have their plans taken over by PBGC.

Administration Has Proposed Reforms to Address PBGC's Long-Term Challenges

Earlier this year, the Administration released a proposal for strengthening funding of single-employer pension plans. The Administration's proposal focuses on three areas:

- reforming the funding rules to ensure pension promises are kept by improving incentives for funding plans adequately;
- improving disclosure to workers, investors, and regulators about pension plan status; and
- adjusting premiums to better reflect a plan's risk and ensure the pension insurance system's financial solvency.

Among other things, the proposal would require all underfunded plans to pay risk-based premiums and it would empower PBGC's board to adjust the risk-based premium rate periodically so that premium revenue is sufficient to cover expected losses and to improve PBGC's financial condition.[18]

Employer groups have expressed concern about their exposure to additional funding and premium uncertainties and have claimed that the Administration's proposal may strengthen PBGC's financial condition at the expense of defined benefit plan sponsors. For example, one organization has stated that in its view, the current proposal would result in fewer defined benefit plans, lower benefits, and more pressures on troubled companies.

PBGC Has Attempted to Improve Its Ability to Forecast and Manage Risk but Ultimately Lacks Adequate Authority to Properly Do So

PBGC has proactively attempted to forecast and mitigate the risks that it faces. The Pension Insurance Modeling System (PIMS), created by PBGC to forecast claim risk, has projected a high probability of future deficits for the agency. However, the accuracy of the projections produced by the model is unclear. Also, through its Early Warning Program, PBGC negotiates with companies that have underfunded pension plans and that engage in business transactions that could adversely affect their pensions. Over the years, these negotiations have directly led to billions of dollars of pension plan contributions and other protections by the plan sponsors. Moreover, PBGC has begun an initiative called the Office of Risk Assessment that combines aspects of both PIMS and the Early Warning Program and will enable the agency to better quantitatively analyze claim risks associated with individual plan sponsors. PBGC has also changed its investment strategy and decreased its equity exposure to better shield itself from market risks. However, despite these efforts, the agency, unlike other federal insurance programs, ultimately lacks the authority to effectively protect itself, such as by adjusting premiums according to the risks it faces.

[18]PBGC's board is composed of the Secretary of Labor, the Secretary of the Treasury, and the Secretary of Commerce.

PBGC Uses Its Pension Insurance Modeling System to Forecast Its Potential Exposure to Future Claims, but Forecasting Firm Bankruptcies Is Difficult

Over the long term, many variables, such as interest rates and equity returns, affect the level of PBGC claims. Moreover, large claims from a small number of bankruptcies constitute a majority of the risk that PBGC faces. Consequently, PBGC created the Pension Insurance Modeling System—a stochastic simulation model that quantifies risk and exposure for the agency over the long run. PIMS simulates the flows of claims that could develop under thousands of combinations of various macroeconomic and company and plan-specific data. In lieu of predicting future bankruptcies, PIMS is designed to generate probabilities for future claims.

In recent annual reports, PBGC has discussed the methodologies used to develop PIMS. Furthermore, as far back as 1998, PBGC has reported PIMS results that forecast the possibility of large deficits for the agency. For example, at fiscal year end 2003—the most recent year for which PBGC has released an annual report—the model's simulations forecasted about an 80 percent probability of deficit by the year 2013. This included a 10 percent probability of the deficit reaching $49 billion within this time frame. These forecasts, made at the end of fiscal year 2003, did not include the $14.7 billion in losses that PBGC experienced from terminated plans in fiscal year 2004. Therefore, PIMS appears to have understated the extent of PBGC's long-term deficit, given that by the end of fiscal year 2004, the agency's cumulative deficit had already grown to $23.3 billion.

The extent to which PIMS can accurately assess future claims is unclear. There is simply too much uncertainty about the future, with respect both to the performance of the economy and of companies that sponsor defined benefit pension plans. It is difficult to accurately forecast which industries and companies will face economic pressures resulting in bankruptcies and PBGC claims. Furthermore, because PBGC's risk lies primarily in a relatively small number of large plans, the failure or survival of any single large plan may lead to significant variance between PBGC's actual claims and the projected claims reported by PBGC in its annual reports. Academic papers report varying rates of success in predicting bankruptcy with various models that measure companies' cash flows or financial ratios, such as asset-to-liability ratios. One paper we reviewed reports that one model succeeded at a rate of 96 percent in predicting bankruptcies 1 year in advance and a rate of 70 percent for predicting bankruptcies 5 years in advance.[19] However, another paper concludes that no single

[19]Altman, Edward. "Predicting Financial Distress of Companies: Revisiting the Z-Score and Zeta Models," July 2000. Retrieved from http://pages.stern.nyu.edu/~ealtman/Zscores.pdf

bankruptcy prediction model proposed in the existing literature is entirely satisfactory at differentiating between bankrupt and nonbankrupt firms and that none of the models can reliably predict bankruptcy more than 2 years in advance.[20]

PBGC's Early Warning Program Is One Tool For Managing Risk

PBGC's Early Warning Program is designed to ensure that pensions are protected by negotiating agreements with certain companies engaging in business transactions or events that could adversely affect their pension plans. Companies of particular interest to the PBGC are those that are financially troubled, have underfunded pension plans, and are engaged in transactions such as restructurings, leveraged buyouts, spin-offs, and payments of extraordinary dividends, to name a few. The Early Warning Program proactively monitors financial information services and news databases to identify these potentially risky transactions in a timely fashion.

If PBGC, after completing an extensive screening process, concludes that a transaction could result in a significant loss to the pension plan, the agency will seek to negotiate with the company to obtain protections for the plan. The Early Warning Program thus raises awareness of pension underfunding, may change corporate behavior, and may allow PBGC to prevent losses before they occur. Under the program, PBGC currently monitors about 3,200 pension plans covering about 29 million participants. Since 1992, the program has protected over 2 million pension plan participants through about 100 settlement agreements valued at over $18 billion (one settlement accounted for about $10 billion). Some recent representative cases include the 2004 settlement with Invensys that provided for over $175 million of additional cash contributions to the pension plan and the 2005 agreement with Crown Petroleum whereby the plan has been assumed by a financially sound parent company and $45 million of additional cash will be contributed to the pension plan.

[20]Mossman, Charles, et al. "An Empirical Comparison of Bankruptcy Models," *The Financial Review*, (1998) Vol 33, pp. 35-54.

PBGC Has Developed an Initiative to Better Quantitatively Assess the Risk Associated with Individual Firms

PBGC has recently undertaken an initiative to create an Office of Risk Assessment, which will focus on improving the agency's ability to quantitatively model individual firms' claim potential. According to PBGC, neither PIMS nor the Early Warning Program provides this information. For example, PIMS projects systemwide surpluses and deficits and is not designed to predict specific company results. Meanwhile, the Early Warning Program targets specific companies, but in a manner that is qualitative in nature. The Office of Risk Assessment, however, will attempt to combine the concepts of both tools and better attempt to quantitatively analyze the claim risk associated with individual companies.

PBGC has consulted with other federal agencies, such as the Federal Deposit Insurance Corporation (FDIC), that have implemented similar approaches for assessing risk. In March 2003, FDIC established a Risk Analysis Center. Guided by FDIC's National Risk Committee, which is composed of senior managers, the center is intended to "monitor and analyze economic, financial, regulatory and supervisory trends, and their potential implications for the continued financial health of the banking industry and the deposit insurance funds." The center does so by bringing together FDIC bank examiners, economists, financial analysts, resolutions and receiverships specialists, and other staff members. These members represent several FDIC organizational units and use information from a variety of sources, including bank examinations and internal and external research. According to FDIC, the center serves as a clearinghouse for information, including monitoring and analyzing economic and financial developments and informing FDIC management and staff of these developments. FDIC officials believe that the center enables them to be proactive in identifying industry trends and developing comprehensive solutions to address significant risks to the banking industry.

PBGC Has Also Taken Steps to Better Protect Its Investment Portfolio from Certain Market Risks

In early 2004, PBGC adopted a new investment strategy to better manage its approximately $40 billion in assets. Although many factors that affect PBGC's financial health are beyond the agency's control, a well-crafted investment strategy is one of the few tools PBGC has to proactively manage the financial risks facing the pension insurance program. Under the new investment policy, PBGC is decreasing its asset allocation in equities from 37 percent as of fiscal year end 2003 to within a range of 15 to 25 percent. Since many of the pension plans that PBGC insures are already heavily invested in equities, some pension and investment experts have said that the agency can create more financial stability by establishing an asset allocation that can hedge against losses in the equity markets. The equity exposure reduction ensures that PBGC's own financial condition will not deteriorate to the same degree as the assets in the pension plans it insures. However, PBGC continues to benefit when equity markets rise because the plans it insures will rise in value. In addition, PBGC claims that this strategy moves the agency closer to the asset mix typically associated with private sector annuity providers. However, it is too soon tell what effects this new investment strategy will have on PBGC's long-term financial condition.

Unlike Other Federal Insurance Programs, PBGC Has Limited Ability to Protect Itself From Risk

Although PIMS and the Early Warning Program help PBGC assess and manage risk to some extent, PBGC lacks the regulatory authority available to other federal insurance programs, such as the FDIC, to effectively protect itself from risk. Whereas PBGC's premiums are determined by statute, Congress provided FDIC the flexibility to set premiums and adjust them every 6 months based on its analysis of risk to the deposit insurance system. Furthermore, FDIC can reject applications to insure deposits at depository institutions when it determines that a depository institution carries too much risk to the Bank Insurance Fund.[21] By contrast, PBGC must insure all plans eligible for PBGC's insurance coverage. Last, FDIC may issue formal and informal enforcement actions for deposit institutions with significant weaknesses or those operating in a deteriorated financial condition. When necessary, the FDIC may oversee the re-capitalization, merger, closure, or other resolution of the institution. By contrast, PBGC is limited to taking over a plan in poor financial condition to prevent it from accruing additional liabilities. PBGC has no authority to seize assets of the plan sponsor, who is responsible for adequately funding the plan.

Conclusion

The current financial challenges facing the PBGC reflect, in part, the significant changes that have taken place in employer-sponsored pensions since the passage of ERISA in 1974. Given the decline in defined benefit plans over the last two decades, it is time to make changes in the rules governing the defined benefit system and reexamine PBGC's role as an insurer. In recent years an irreconcilable tension has arisen between PBGC's role as a social insurance program and its mandate to remain financially self-sufficient. Unless something reverses the decline in defined benefit pension coverage, PBGC may have a shrinking plan and participant

[21]Before granting access to the federal deposit insurance system, FDIC evaluates the potential risk to the funds. It assesses the adequacy of an applicant's capital, financial history and condition, and its future earnings potential, as well as the general character of its management.

base to support the program in the future and may face the likelihood of a participant base concentrated in certain potentially more vulnerable industries. In this regard, effectively addressing the uncertainties associated with cash balance and other hybrid pension plans may serve to help slow the decline in defined benefit plans.

One of the underlying assumptions of the current insurance program has been that there would be a financially stable and growing defined benefit system. However, the current financial condition of PBGC and the plans that it insures threaten the retirement security of millions of Americans because termination of severely underfunded plans can significantly reduce the benefits participants receive. It also poses risks to the general taxpaying public, who ultimately could be made responsible for paying benefits that PBGC is unable to afford.

To help PBGC manage the risks to which it is exposed, Congress may wish to grant PBGC additional authorities to set premiums or limit the guarantees on the benefits it pays to those plans it assumes. However, these changes would not be sufficient in themselves because the primary threat to PBGC and the defined benefit pension system lies in the failure of the funding rules to ensure that retirement benefit obligations are adequately funded. In any event, any legislative changes to address the challenges facing PBGC should provide plan sponsors with incentives to increase plan funding, improve the transparency of the plan's financial information, and provide a means to hold sponsors accountable for funding their plans adequately. However, policymakers must also be careful to balance the need for changes in the current funding rules and premium structure with the possibility that any changes could expedite the exit of healthy plan sponsors from the defined benefit system while contributing to the collapse of firms with significantly underfunded plans.

The long-term financial health of PBGC and its ability to protect workers' pensions is inextricably bound to the underlying change in the nature of the risk that it insures, and implicitly to the prospective health of the defined benefit system. Options that serve to revitalize the defined benefit system could stabilize PBGC's financial situation, although such options may be effective only over the long term. Our greater challenge is to fundamentally consider the manner in which the federal government protects the defined benefit pensions of workers in this increasingly risky environment. We look forward to working with Congress on this crucial subject.

Mr. Chairman, this concludes my statement. I would be happy to respond to any questions you or other members of the Subcommittee may have.

Contacts and Acknowledgments

For further information, please contact Barbara Bovbjerg at (202) 512-7215 or George Scott at (202) 512-5932. Other individuals making key contributions to this testimony included David Eisenstadt, Benjamin Federlein, and Joseph Applebaum.

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Mr. PLATTS. Thank you, Mr. Walker.
Mr. Belt.

STATEMENT OF BRAD BELT

Mr. BELT. Thank you.

I want to commend you for holding this hearing on the issues facing the Federal Pension Insurance Program and on the structural changes that would better enable the Corporation to better achieve its mission, as you noted, Mr. Towns, for us to live up to our statutory responsibilities.

I don't want to be too repetitive because I actually find myself very much in agreement with the Comptroller General in describing the issues facing the program.

I would note that today's hearing is very timely. In 2004, the Single-Employer Pension Insurance Program posted its largest year-end shortfall ever, over $23 billion. That is a major reason why GAO has once again placed the program on its list of high-risk government programs in need of urgent attention. We would agree with that.

This isn't just about the PBGC, it is about the retirement security of millions of American workers. The fact is the termination of underfunded pension plans can have harsh consequences for workers and retirees. When plans terminate, workers and retirees' expectations of a secure future may be shattered because by law, not all benefits promised under a plan are guaranteed.

Other companies that sponsor defined benefit plans also pay the price through higher premiums when underfunded plans terminate. Not only will healthy companies end up subsidizing weak companies with underfunded plans, they may also face the prospect of having to compete against a rival firm that has shifted a significant portion of its paper costs onto the Government.

In the worse case, PBGC's deficit could grow so large that the premium increase necessary to close the gap would cause responsible premium payers to exit the system which would only exacerbate the problem. If this were to occur, Congress would face pressure to have U.S. taxpayers pay the benefits of workers whose pension plans have failed.

In addition to the $23 billion shortfall already reflected on our balance sheet, the insurance program remains exposed to record levels of underfunding ND defined benefit plans, more than $450 billion in total. Not all of this underfunding poses a risk to participants and premium payers, but the shortfall in plans sponsored by financially weaker employers has never been higher as well, almost $100 billion.

Despite the structural problems inherent in the current system, the PBGC continues to do all it can to meet the challenges facing the pension insurance program, from strong financial management and robust internal controls to new system technologies and a sharper focus on risk management, the Corporation is prepared to meet its statutory responsibilities.

The PBGC's financial reporting continues to present a clear picture of the fiscal health of the insurance programs. For fiscal year 2004, the PBGC's financial statements received their 12th consecutive, unqualified opinion from the Corporation's independent auditors, PriceWaterhouseCoopers. I certainly can't take the credit for that since I have only been executive director for the agency for the past year.

Also, in recognition of the importance placed on sound financial reporting by the Sarbanes-Oxley Act, the PBGC was one of the first Federal Government entities to perform a comprehensive internal control assessment even though it was not required to do so.

The PBGC has also initiated several changes to enable it to better manage the financial risks facing the pension insurance program. The first was adoption of a new investment policy that would reduce the Corporation's risks resulting from a mismatch between assets and liabilities.

Another initiative will improve the PBGC's ability to gather, analyze and act on pension plan funding information and to respond to marketplace developments in a timely manner. As part of an overall reorganization, the Corporation is establishing a new Office of Risk Assessment to strengthen its capability to measure and manage risk to the pension insurance program.

The PBGC is also taking aggressive steps to monitor the financial condition of pension plans and their sponsors to minimize losses where possible for the insurance program. When necessary, the PBGC is prepared to negotiate or litigate to protect the benefits of plan participants and the interests of the insurance program.

Another top priority has been the establishment of on-line services that customers can access at their convenience through the Internet. In the past year, the Corporation unveiled new self-service accounts for participants and trusted plans and for administrators of insured plans and the pension practitioners who assist them. Participants and plan practitioners can conduct a range of transactions electronically at any time of day, year around.

I would note the PBGC also underwent its first program assessment rating tool, referred as the PART by the Office of Management and Budget. While the PBGC was scored as effective in areas under the Corporation's control, OMB noted "a risk that prevents it from following many insurance industry best practices regarding premium structure, risk management, funding rules and benefit determination," much as the Comptroller General noted.

Mr. Chairman, even as the PBGC does everything it can to meet its operational and financial challenges, it is not enough. The current legislative framework does not ensure sound pension funding and a strong safety net. We believe it is critical to enact the administration's reform proposal to strengthen the funding rules, enhance the information workers get about their pension plan and fix the PBGC premium system. Without these changes, the risk of loss for workers, responsible companies and taxpayers will remain unacceptably high.

We look forward to working with you and Congress to make necessary reforms this year.

Thank you for inviting me to testify and I would be pleased to answer any questions.

[The prepared statement of Mr. Belt follows:]

PBGC
Protecting America's Pensions

TESTIMONY OF BRADLEY D. BELT
EXECUTIVE DIRECTOR
PENSION BENEFIT GUARANTY CORPORATION

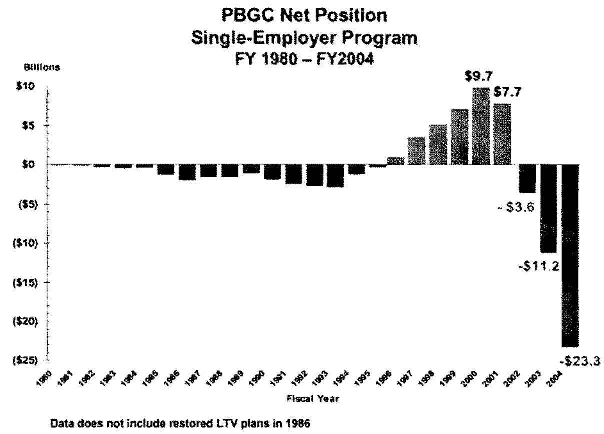
Before the Subcommittee on Government Management, Finance, and Accountability
Committee on Government Reform
United States House of Representatives
March 2, 2005

Mr. Chairman, Ranking Member Towns, and Members of the Committee: Good afternoon. I want to thank you for holding this timely and important hearing, and I appreciate the opportunity to discuss the challenges facing the defined benefit pension system and the pension insurance program, and the Administration's proposals for meeting these challenges.

The PBGC is the nation's guarantor of private-sector, defined benefit pension plans. The Corporation's pension insurance programs protect the retirement benefits of more than 44 million Americans. Indeed, these programs are the lone backstop for hundreds of billions of dollars in promised but unfunded pension benefits. The PBGC is also the trustee of nearly 3,500 failed defined benefit plans. In this role, it is a vital source of retirement income and security for more than 1 million Americans whose benefits would have been lost without the PBGC's protection.

Financial Challenges

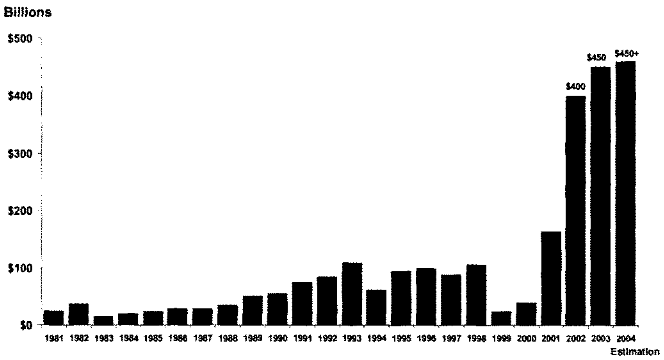
Today's hearing is especially timely. The pension insurance program administered by the PBGC has come under severe pressure in recent years due to an unprecedented wave of pension plan terminations. This was starkly evident in 2004, as the PBGC's single-employer insurance program posted its largest year-end shortfall in the agency's 30-year history. Losses from completed and probable pension plan terminations totaled $14.7 billion for the year, and the program ended the fiscal year with a deficit of $23 billion. That is why the Government Accountability Office (GAO) has once again placed the PBGC's single-employer insurance program on its list of "high risk" government programs in need of urgent attention.



Notwithstanding our record deficit, I want to make clear that the PBGC has sufficient assets on hand to continue paying benefits for a number of years. But the numbers are trending in the wrong direction. With $62 billion in liabilities and only $39 billion in assets, it is clear the single-employer program lacks the resources to fully satisfy its benefit obligations over the long term.

In addition to the $23 billion shortfall already reflected on the PBGC's balance sheet, the insurance program remains exposed to record levels of underfunding in covered defined benefit plans. As recently as December 31, 2000, total underfunding in the single-employer defined benefit system came to less than $50 billion. Two years later total underfunding exceeded $400 billion due to such factors as declining interest rates (which increase the current value of liabilities), declining asset values, benefit increases, and a lack of adequate employer contributions. As of September 30, 2004, we estimate that total underfunding exceeds $450 billion, the largest number ever recorded. (None of this underfunding is reflected in probable terminations already on our balance sheet.)

Total Underfunding
Insured Single-Employer Plans



PBGC estimates from Form 5500 and Section 4010 Filings

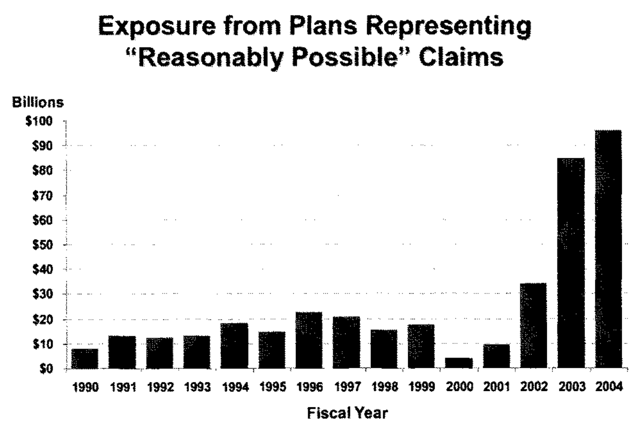
Not all of this underfunding poses a great risk to the PBGC. On the contrary, most companies that sponsor defined benefit plans are financially healthy and should be capable of meeting their pension obligations to their workers. At the same time, the amount of underfunding in pension plans sponsored by financially weaker employers has never been higher. As of the end of fiscal year 2004, the PBGC estimated that non-investment-grade companies sponsored pension plans with $96 billion in underfunding, almost three times larger than the amount recorded at the end of fiscal year 2002.

The most immediate threat to the pension insurance program stems from the airline industry. Just last month, the PBGC became statutory trustee for the remaining pension plans of US Airways, after assuming the pilots' plan in March 2003. The $3 billion total combined claim against the insurance program is the second largest in the history of the PBGC, after Bethlehem Steel at $3.7 billion.

In addition, United Airlines is now in its 27th month of bankruptcy and has said repeatedly that it must shed all four of its pension plans to successfully reorganize. The PBGC estimates that United's plans are underfunded by more than $8 billion, more than $6 billion of which would be guaranteed by the PBGC.

If United Airlines is able to emerge from bankruptcy free of its unfunded pension liability, serious questions arise as to whether other network carriers would feel competitive pressure to follow suit. In fact, Delta Airlines and Northwest Airlines recently expressed strong concern that their pension plans are unaffordable. According to published reports, non-bankrupt legacy carriers must contribute billions of dollars to their plans over the next several years. Additional pension plan terminations in the airline industry would put even more pressure on the PBGC at a time when the pension insurance program can least afford it.

Beyond the airline industry, the insurance program faces tremendous exposure from the manufacturing sector of the economy, which includes the auto and auto parts industry groups. Indeed, of the $96 billion in pension underfunding at financially weak firms, manufacturing accounts for $48 billion. It is alarming that so much of the insurance program's "reasonably possible" exposure - underfunding in plans sponsored by companies with below-investment-grade bond ratings - should reside in a single industry sector.



In the face of these unprecedented threats to the financial viability of the pension insurance program, the Corporation's premiums have simply not proven adequate. The annual insurance premium for single-employer plans has two parts: a flat-rate charge of $19 per participant, and a variable rate premium (VRP) of 0.9 percent of the amount of a plan's unfunded vested benefits, measured on a current liability basis.

Congress sets the premiums for the pension insurance program, and the $19 per-participant charge has not been increased in 14 years. In addition, as long as plans are at the "full funding limitation," generally 90 percent of current liability, they do not have to pay the variable-rate premium. [1] This is why Bethlehem Steel, the largest claim in the history of the PBGC, paid no variable-rate premium for five years prior to termination, despite being drastically underfunded on a termination basis.

Structural Flaws in the Defined Benefit System

The PBGC's record deficit and historic levels of pension underfunding underscore the structural flaws in the defined benefit system—flaws that must be corrected to better protect workers' benefits and strengthen the pension safety net.

The principal flaw is an overly complex and ineffectual set of funding rules that fail to achieve a necessary and appropriate level of benefit security for participants. The funding rules use multiple liability measures, multiple discount rates and varying amortization periods, imposing added complexity without achieving sound funding. Of particular concern are mechanisms such as credit balances and "smoothing" of assets and liabilities, which allow companies with underfunded plans to defer contributions for many years into the future. The bottom line is that we probably would not be here today if the funding rules worked properly.

The second flaw is "moral hazard." A properly constructed insurance system provides incentives for responsible behavior and disincentives for risky behavior. The federal pension insurance program does neither. If a financially weak company promises more than it is able to afford, it can shift the cost of the benefits to other companies—including competitors, at least indirectly—through the pension insurance program.

The third flaw is a lack of transparency. Publicly available information about pension plans is often stale and misleading. More current information about the

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[1] Employers are not subject to the deficit reduction contribution rules when a plan is funded at 90 percent of current liability, a measure with no obvious relationship to the amount of money needed to pay all benefit liabilities if the plan terminates. Generally, a plan's actuarial assumptions and methods can be chosen so that the plan can meet the "full-funding limitation."

In addition, in some cases employers can stop making contributions entirely because of the "full funding limitation." As a result, some companies say they are fully funded when in fact they are substantially underfunded. Bethlehem Steel said its plan was 84 percent funded on a current liability basis, but the plan turned out to be only 45 percent funded on a termination basis, with a total shortfall of $4.3 billion. US Airways said its pilots' plan was 94 percent funded on a current liability basis, but the plan was only 33 percent funded on a termination basis, with a $2.5 billion shortfall.

Despite substantial underfunding, in 2003 only about 17 percent of participants were in plans that paid the VRP.

funded status of plans isn't publicly available. The system's opaqueness discourages accountability and market discipline, and key stakeholders are prevented from responding effectively to current problems. Worst of all, workers are often the last to know of problems with their pension plans.

How the PBGC is Responding to its Challenges
Despite the structural problems inherent in the current system, the PBGC continues to do all it can to meet the challenges facing the pension insurance program. From strong financial management and robust internal controls to new system technologies and a sharper focus on risk management, the Corporation is fully prepared to meet its statutory responsibilities.

PBGC's statutory mandates are: (1) to encourage the continuation and maintenance of voluntary private pension plans; (2) to provide for the timely and uninterrupted payment of pension benefits to participants; and (3) to maintain premiums at the lowest level consistent with carrying out the agency's statutory obligations. Implicit in these duties and in the structure of the insurance program is the duty to be self-financing. *See, e.g.*, ERISA § 4002(g)(2) (the United States is not liable for PBGC's debts).

These mandates are not always easy to reconcile. For example, the PBGC is instructed to keep premiums as low as possible to encourage the continuation of pension plans, but also to remain self-financing. Similarly, the program should be administered to protect plan participants, but without letting the insurance fund suffer unreasonable increases in liability. The PBGC struggles daily to achieve the appropriate balance between these competing considerations.

Mr. Chairman, your staff also requested that I discuss the PBGC's financial management practices, and I am pleased to do so. The PBGC's financial reporting continues to present a clear and accurate picture of the fiscal health of the insurance programs. For fiscal year 2004, the PBGC's financial statements received their 12th consecutive unqualified opinion from the Corporation's independent auditors, PriceWaterhouse Coopers.

In preparing its financial statements, the PBGC conforms to Generally Accepted Accounting Principles (GAAP) in the United States, the same standards followed by all publicly traded companies. In certain quarters, this has drawn criticism. Because the PBGC has not yet taken over administration of plans booked as "probables," some suggest the Corporation's deficit is inflated. But under Financial Accounting Standard No. 5, the PBGC is required to reflect losses from "probable" terminations. Indeed, a failure by the PBGC to record these losses could jeopardize our clean audit opinion. If the financial history of the last five years has taught us anything, it is that these liabilities should be reported on the balance sheet, where they belong.

Additional validation of the PBGC's financial reporting comes from the Department of the Treasury's Financial Management Service. Using its "traffic light" grading system, they awarded the PBGC scores of "green " to signify that the agency had successfully met all standards for the accuracy and timeliness of its financial reporting for the first quarter of FY 2005. Less than two-thirds of the agencies rated received a green rating for timeliness of reporting, and less than half of the agencies received a green rating for accuracy of reporting.

In further recognition of the evolving emphasis on sound financial reporting in the wake of the Sarbanes-Oxley Act, the PBGC was one of the first federal government entities to perform a comprehensive internal control assessment, even though it was not required. The PBGC contracted with KPMG to help identify, document, test, correct and report on all of the Corporation's key financial controls. Its conclusion that the PBGC has sound financial controls provides another level of assurance about the accuracy and integrity of the PBGC's financial systems and information.

The PBGC also has initiated several key changes to enable it to better manage the financial risks facing the pension insurance program. The first was adoption of a new investment policy that will reduce the Corporation's risks resulting from a mismatch between assets and liabilities. The policy calls for the Corporation to increase its investment in fixed-income securities that match the duration of its liabilities. When fully implemented, the PBGC's investment strategy will result in less volatile financial performance and a reduction in the agency's overall risk. Through this strategy, any change in the value of the PBGC's existing liabilities will be more closely offset by a corresponding change in the value of the fixed-income assets, reducing the risk of an increase in PBGC's deficit resulting from interest rate changes.

Another initiative will improve the PBGC's ability to gather, analyze and act on pension plan funding information and to respond to marketplace developments in a timely manner. As part of an overall reorganization, the Corporation is establishing a new Office of Risk Assessment to strengthen its capability to measure and manage risks to the pension insurance program. This office, which will report directly to the Executive Director, will analyze industry and economic risks to the PBGC's financial strength and the pension insurance system.

The PBGC is also taking aggressive steps to monitor the financial condition of pension plans and their sponsors more closely to limit risks and minimize losses for the insurance program. When necessary, the PBGC is prepared to move forcefully, in negotiation or litigation, to protect the benefits of plan participants and the interests of the insurance program.

Management and Operational Challenges

The PBGC's financial losses are only one of the challenges confronting the insurance program in the current climate. In fiscal year 2004, the PBGC also faced a swelling workload as it assumed administrative responsibility for the benefits of nearly 150,000 additional participants in failed single-employer pension plans. Despite this surge of new participants, the Corporation was able to issue more than 137,000 benefit determinations to retirees in trusteed plans, nearly 50 percent more than the previous record of 92,000 issued the year before.

Another top PBGC priority has been the establishment of online services that customers can access at their convenience through the Internet. In the past year, the Corporation unveiled two new self-service accounts, one for participants in PBGC-trusteed plans and the other for administrators of PBGC-insured plans and the pension practitioners who assist them. These new facilities, available through the PBGC's website, enable participants and plan practitioners to interact electronically with the PBGC and conduct a range of transactions any time of day, year-round.

For participants, this service is called My Pension Benefit Account (My PBA). It allows all participants to review and change their personal information, and retirees may use it to sign up for electronic direct deposit of their benefit payments, change banking information, and change information on their federal tax withholding. Future improvements to My PBA will allow participants to electronically access, complete and submit the Corporation's most frequently used forms and to submit online requests for benefit estimates.

Plan administrators and practitioners may now use My Plan Administration Account (My PAA), the other new self-service application, to electronically create, route, sign and submit premium filings and payments to the PBGC. This system, which requires no special software, offers a number of advantages over paper submissions: improved data accuracy, easier filing preparation, shared electronic access to filings (which eliminates manual routing and mailing), e-mail notification of required actions, and confirmation that the filing and payment were received by the PBGC. The Corporation is examining ways to expand this service to allow, for example, the electronic filing of other required submissions.

The population of people owed a guaranteed benefit from the PBGC includes a growing number for whom Spanish is the primary language. To improve service and the availability of understandable information to the Corporation's growing population of Spanish-speaking customers, within the past year the PBGC created a dedicated section on its website for Spanish-language content.

All of these initiatives to improve the services we provide to our customers have led to higher customer satisfaction ratings for the PBGC. The Corporation uses the American Customer Satisfaction Index (ACSI) to measure customers' satisfaction with its services and to gain insight into needed improvements. In 2004, the PBGC's customers provided the Corporation with an overall ACSI score of 78 (on a scale of 0 to 100), exceeding the score of 72 for the federal government as a whole.

Similarly, the PBGC recently underwent its first Program Assessment Rating Tool review by the Office of Management and Budget. PART is a systematic method of assessing the performance of program activities within agencies and across the federal government with the goal of improving program performance. This review holds programs to high standards – simple adequacy or compliance with the letter of the law is not enough. Rather, a program must show it is achieving its purpose and that it is well managed. The PBGC's overall PART rating was "moderately effective," the second highest rating possible.

While the PBGC performed well in areas under the Corporation's control, OMB's official summary noted that "ERISA prevents it from following many insurance industry best practices regarding premium structure, risk management, funding rules, and benefit determinations. The Administration supports legislative reform to remove the statutory barriers to improving these areas."

The GAO also specifically exempted the PBGC's internal management practices when it put the single-employer insurance program on its "high-risk" list in 2003, pointing instead to structural challenges in the defined benefit pension system. When GAO updated its "high-risk" list last month, it put the emphasis squarely on legislative change: "Comprehensive reform will likely be needed to stabilize the long-term finances of the single-employer program. The Congress should consider revising current pension law to mitigate the financial risk posed by financially troubled sponsors with underfunded plans, perhaps by strengthening funding rules, restricting the use of credit balances and lump-sum distributions, revising the PBGC's premium structure, and increasing plan transparency. . . . The administration has recently introduced a proposal that would address many of the challenges facing the PBGC."

Administration's Reform Proposal

Mr. Chairman, we hope that Congress will take action this year to address the challenges facing the PBGC. For even as the PBGC does everything it can under current law constraints, it is not enough. No amount of tinkering will achieve the lasting solution we need to restore the confidence of workers and retirees who rely on pension promises and to put the PBGC on a sound footing. We need a considered and comprehensive approach that will restore the financial health of the defined benefit pension system, strengthen the pension safety net, and improve pension disclosure. The Administration's comprehensive pension reform proposal, announced by Labor Secretary Elaine Chao on January 10 and elaborated in the President's Budget on February 7, would accomplish all three goals.

On pension funding, the proposal would streamline and strengthen the current rules to ensure that promises are backed by sufficient assets. Weaknesses in current law would be eliminated to ensure troubled plans are fully funded, and the rules would provide greater flexibility to all plan sponsors to encourage them to remain in the defined benefit system.

On pension insurance, the proposal would implement a rational premium structure that will gradually restore the PBGC to fiscal balance. The new structure would meet the program's long-term revenue needs, provide incentives to fully fund covered plans, and appropriately reflect the risks faced by the program.

On pension disclosure, the proposal would require more timely, meaningful information on pension plans' funding levels. This will ensure that those with a stake in the pension system—workers, retirees, investors and regulators—can make decisions based on current, accurate information. Additional detail on the Administration's proposal is available on the Web at http://www.dol.gov/ebsa/pensionreform.html.

Conclusion
Mr. Chairman, the proposal we have put forward represents a responsible, balanced approach that will restore the defined benefit pension system to health. Our proposal will encourage companies to offer and maintain defined benefit pension plans, while ensuring that those plans are able to honor their commitments. Enactment of the Administration's proposal will strengthen the finances of defined benefit plans, shore up the pension safety net, and improve the retirement security of America's workers. We look forward to working with Congress to make the necessary reforms in 2005, and I thank you for inviting me to testify. I will be pleased to answer any questions.

Mr. PLATTS. Thank you, Mr. Belt.

We are going to have Mr. Elliott come up and offer his testimony.

In addition to the testimony we are receiving today, we have agreed to enter into the record statements from the American Benefits Council, the American Society of Pension Professionals and Actuaries and the U.S. Chamber of Commerce. We appreciate these organizations providing their perspectives on this important issue. Without objection, I move these three statements be entered into the record of this hearing.

[The information referred to follows:]

AMERICAN BENEFITS COUNCIL

March 1, 2005

The Honorable Todd Russell Platts
Chairman
United States House of Representatives
Committee on Government Reform
Subcommittee on Government Efficiency
and Financial Management
B349C Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

We wish to thank you for holding this hearing on protecting pensions and insuring the solvency of the PBGC. We hope the hearing will also address the advantages that private sector pension plans provide to both employers and employees. The discontinuance of the Treasury Department's 30-year bond in late 2001 has had a dramatic impact on defined benefit pension plans across the nation. In April 2004, the Congress played a key role in enacting a temporary replacement rate for the 30-year Treasury bond based upon long-term, high quality corporate bonds and we are grateful to you, and all the Members of the House of Representatives for your work on that legislation. Accordingly, we respectfully submit to you that the long-term corporate bond should permanently replace the 30-year Treasury bond. This and many other recommendations are outlined in the material we are submitting for the hearing record.

The American Benefits Council is a public policy advocacy organization representing over 250 organizations whose members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans. Our purpose is to provide in-depth information, analysis and opinion of the current legislative and regulatory situations and emerging trends in employee benefits policy.

The vast majority of our members sponsor at least one defined benefit pension plan. Some of our members sponsor numerous plans for their employees. These plans hold many billions of dollars in assets. Our members continue to sponsor these plans despite the trend among many companies to discontinue sponsorship of their defined benefit plans. As a consequence, our members have a strong interest in any legislative consideration of defined benefit pension plan funding. Any changes to pension plan funding that would unduly burden corporate sponsors or discourage continued sponsorship of these plans are not merely bad for corporate America, they are bad for American workers and retirees.

As of 1999, (the most recent year for which official Department of Labor statistics have been published) more than 20 million retirees were receiving benefits from defined benefit pension plans, with over $119 billion in benefits paid out in that year alone[1]. These payments are not only good for the individuals who received them, they are also good for the American economy. Through these retirement payments, money that was once scored as "lost revenue" is returned to the economy as retirees purchase goods and services, pay their bills and mortgages, and best of all, maintain their standard of living during their post-employment years.

We take very seriously, however, news reports regarding failures of certain pension plans and we believe that reform of the current system is needed. However standards for funding should not be set so high that they make plan sponsorship unaffordable. The objective of reform cannot simply be immunization of the Pension Benefit Guaranty Corporation (PBGC). It must make the defined benefit pension plan system healthier and more vibrant, as well.

In analyzing the effects of any funding reform recommendations, it is important to bear in mind that current law does not now, nor should it ever, require an employer to sponsor a benefit plan as a condition of being in business. If the government imposes excessive burdens on a benefit voluntarily provided, employers will have little choice but to discontinue them at their earliest possible convenience.

The American Benefits Council respectfully submits the attached report, "Funding Our Future," for the record of this hearing. This report was recently published by the Council. It was developed by the member companies of the Council over many months of study and consultation.

We thank you for the opportunity to submit these comments to you and the Members of the House Committee on Government Reform. If you would like to discuss these matters further, please do not hesitate to contact us.

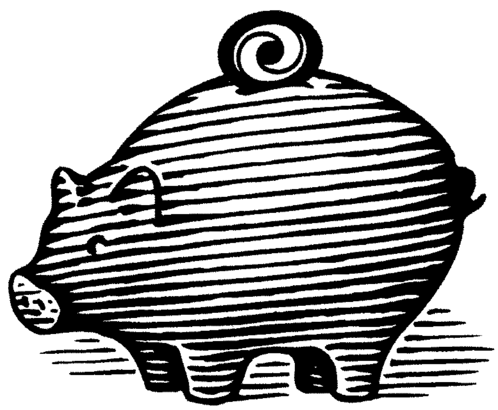
Sincerely yours,

James A. Klein

James A. Klein
President

[1] U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin*, Number 12, summer 2004, pages 8, 10.)

Funding our Future:



A Safe and Sound Approach to Defined Benefit Pension Plan Funding Reform

American Benefits Council

February 2005

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FOREWORD

At its October 2001 meeting, the Board of Directors of the American Benefits Council identified as an urgent priority the need for replacement of the 30-year U.S. Treasury bond interest rate used for defined benefit pension plan funding and other purposes.

Over the subsequent several months the Council, working in concert with other like-minded organizations, identified a long-term investment grade corporate bond rate as the appropriate permanent replacement rate. The Council has testified before Congress numerous times over the past few years on the need for replacement of the interest rate and other related pension funding reforms. The Council's work in recent years follows a long tradition of engagement on legislative reform efforts to improve pension funding, better secure the financial integrity of the Pension Benefit Guaranty Corporation (PBGC) and advocate for policies that will protect and promote defined benefit pension plans.

In 2004 Congress passed, and President Bush signed, legislation that addressed, on an interim basis, the need for replacement of the interest rate used for plan funding calculations. This year with the temporary legislation expiring and with heightened concerns over pension funding and the liabilities inherited by the PBGC, it is clear that broader pension reforms should and will be a priority issue for the Congress and the executive branch.

The American Benefits Council has drawn upon the expertise and varied perspectives of its corporate membership, and developed what we firmly believe is a safe and sound approach to defined benefit pension plan funding. In addition to setting forth our own proposals, this document also critiques many of the Administration's proposals and indicates the principal areas where our views and Administration's are aligned, and where they differ. This analysis is based upon a review of the Administration's detailed proposals that were made available in early February as a comprehensive follow-up to the Administration's initial proposals previously released.

With adoption of the American Benefits Council's recommendations set forth in this paper, policymakers will take crucial steps toward *"Funding our Future."*

James A. Klein

James A. Klein
President
American Benefits Council

FUNDING OUR FUTURE:

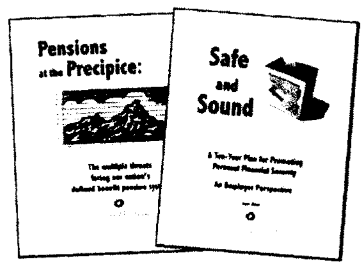
A SAFE AND SOUND APPROACH TO DEFINED BENEFIT PENSION PLAN FUNDING REFORM

INTRODUCTION

The American Benefits Council believes strongly in defined benefit pension plans. A recent Council publication enumerates in substantial detail the very serious challenges facing the defined benefit plan system. (See *Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System* (May 2004)).

Moreover, the Council also last year issued a comprehensive long-term public policy strategic plan, *Safe and Sound: A Ten-Year Plan for Promoting Personal Financial Security – An Employer Perspective* (June 2004) that discusses the importance of a vibrant employer-sponsored retirement system (both defined benefit and defined contribution plans) and personal savings in meeting the income security needs of an aging population.

As discussed in more detail in both the *Safe and Sound* strategic plan and the *Pensions at the Precipice* report, the Council believes several legislative steps are needed to revitalize and support the defined benefit pension system.



Among these legislative steps are reform of the funding rules so that:

(1) benefits promised to participants are funded, thus protecting participants and the Pension Benefit Guaranty Corporation (PBGC);

(2) funding obligations are neither artificially inflated nor volatile, thus preventing employers from abandoning the system because of adverse effects on business planning;

(3) plan participants are provided clear, timely information about the funded status of their plan; and

(4) the funding rules do not unreasonably increase burdens on companies during economic downturns, since the best "insurance" for participants' benefits is a healthy company that recovers from such downturns.

It is critical that reforms be focused on our ultimate goal: retirement security. Because of PBGC deficits, there is a risk that the reform efforts will be focused only on the PBGC.

While we wholeheartedly agree that the PBGC must be protected, it is critical that we not lose sight of the fact that the PBGC was set up to strengthen retirement security through the defined benefit plan system. In other words, if we protect the PBGC at the expense of the strength of the system, we will have failed in an ironic and sad manner.

The Administration has issued its funding and premium proposal. We believe that the proposal has strengths, but also has serious flaws that would have extremely adverse effects on plans, participants, companies, and the PBGC itself. The primary flaws of the Administration's proposal are:

If we protect the PBGC at the expense of the strength of the defined benefit pension plan system, we will have failed in an ironic and sad manner.

(1) a dramatic decrease in funding and premium predictability;

(2) a counterproductive and troubling use of credit ratings;

(3) creation of a strong disincentive to pre-fund; and

(4) an increase in PBGC premiums that unjustifiably burdens the defined benefit plan system.

We look forward to the opportunity to work with the Administration on its proposal. In its current state, however, we believe that the flaws noted above would result in far fewer defined benefit plans, lower benefits, and far more pressures on troubled companies that jeopardize the companies' ability to recover.

Our proposals

This paper outlines our proposals for funding reform for plans other than multiemployer plans. There is a threshold question as to whether reform should be based on modifications of current law or whether the current-law rules should be replaced in their entirety with a new structure. We support the former approach.

In a complex area that needs reform, there is always some temptation to throw out all the rules and to start from scratch. However, certainly in this case, that would be both unnecessary and imprudent. The funding questions that must be addressed are the same regardless of which path is chosen. For example, how should liabilities be measured; how quickly should underfunding be funded; what contributions should be deductible; and what disclosure should be required? Starting from scratch does not make answering questions like this easier. On the contrary, starting from scratch makes it more difficult by requiring that all funding rules be reinvented in the new context. And the risks are far greater with wholesale reform because there will inevitably be issues missed, such as subtle important rules reflected only in regulations that are inadvertently omitted from the new regime.

Finally, modification of the current rules involves far less cost and disruption for plan sponsors. And it is critical to remember that this is a voluntary system. If plan sponsors face large and uncertain costs in adapting to an entirely new set of rules, many will abandon the defined benefit plan system.

"Permanent replacement of the 30-year rate is critical if employers are to create new jobs and help grow the economy."

—from the Council's Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System

In short, every important issue can be addressed by modifying the current rules without the uncertainty and cost of creating a whole new system.

Permanent Replacement of the 30-Year Treasury Rate

The long-term corporate bond rate
Prior to the Pension Funding Equity Act of 2004, the 30-year Treasury bond interest rate was required to be used to determine the "current liability" of a defined benefit plan. "Current liability" is, in turn, used in certain circumstances to determine how much the plan sponsor must contribute in a year to fund the plan. The 30-year Treasury bond interest rate was also required to be used for various other pension purposes, including determining the amount, if any, that is owed to the PBGC as a variable rate premium.

The 30-year Treasury bond rate has become artificially low compared to other interest rates because of Treasury's buyback program (which started in the late 1990s) and because of the discontinuance of the 30-year Treasury bond in 2001. The use of this low rate for pension purposes artificially inflates pension liabilities and funding obligations. If applicable, these inflated obligations will have adverse effects on the nation's economy.

In addition, concerns regarding unrealistic funding obligations have already led companies to freeze plan benefits and many more companies will likely do so if a permanent replacement for the 30-year Treasury bond rate is not enacted soon.

Congress recognized that the 30-year Treasury bond rate was a "broken rate" in 2004 and enacted a temporary solution, permitting the use of a long-term investment grade corporate bond rate for 2004 and 2005. That was the right action at the time. Now is the time to make that change permanent.

Businesses need to be able to make projections about future cash flow demands so that they can make sound plans for the future. The temporary nature of the rule in effect today makes planning difficult and can undermine a company's commitment to the defined benefit plan system.

The Council strongly recommends that the 30-year Treasury bond rate be permanently replaced by the long-term investment grade corporate bond rate. As under current law and as discussed further below, for funding purposes, the four-year weighted average of such rate would be used.

The Administration's yield curve proposal does not reflect the real yield curve applicable to defined benefit plans.

This rate is a conservative estimate of the rate of return a plan can expect to earn and thus is an economically sound and accurate discount rate. In addition, it is a clear, simple rule that can be understood and administered easily by employers of all sizes.

The yield curve proposal

The Administration has proposed, as an alternative to the long-term corporate bond rate, a "yield curve." This proposal differs in two fundamental respects from the Council's proposal.

First, the yield curve interest rate is a "near-spot rate" rather than a four-year weighted average rate. This aspect of the Administration's proposal is discussed in a subsequent section of this paper.

Second, the yield curve proposal would apply a different interest rate to every expected payment to be made by the plan based on the date on which that payment is expected to be made. For example, the interest rate applicable to a liability to be paid in 19 years would be based on a 19-year corporate bond.

The yield curve proposal is flawed in several respects. First, the proposal would generate hundreds of different interest rates for *each* participant. This level of complexity may, at best, be manageable by some large companies; it would impose an unjustifiable burden on small- and mid-sized companies across the country.

Second, the proposal is intended to reflect the market and thus be "accurate;" in fact, the markets for corporate bonds of *many* durations are so thin that the interest rates used would actually need to be "made up," *i.e.*, extrapolated from the rates used for the other bonds.

Moreover, the Administration's proposal does not reflect the real yield curve applicable to defined benefit plans. A real yield curve would reflect the fact that for long-term obligations, plans generally invest in equities in order to lower their costs (since over time equities earn a greater rate of return). For mid-term liabilities, plans generally invest in a mix of equities and bonds; plans invest more in non-equities for short-term liabilities.

Accordingly, if a real yield curve were used and it were simplified so that it could be administered by plans of all sizes, it might look something like the following:

Mid-term liabilities (*e.g.*, five to 20 years) would be valued based on the four-year weighted average of the long-term corporate bond rate; long-term liabilities (over 20 years) would be valued based on the four-year weighted average of the long-term corporate bond rate plus a specified number of basis points (such as 100); and short-term liabilities (less than five years) would be valued based on the four-year weighted average of the long-term corporate bond rate minus the same number of basis points.

> "The yield curve should not be adopted, particularly in light of the many unanswered questions about the approach and the incomplete analysis of its ramifications on funding volatility and asset allocation."
>
> —*from the Council's* Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System

The long-term liability basis point adjustment would reflect the fact that ongoing plans generally invest in equities to provide for long-term liabilities, and equities historically have a higher rate of return than long-term corporate bonds. The short-term basis point adjustment would reflect the fact that investments to meet short-term liabilities generally have a rate of return lower than long-term corporate bonds.

The Council strongly opposes the yield curve proposal, especially if it were to reduce the effective discount rate for the typical plan. Even the simplified version described above would introduce unnecessary complexity and disruption. The vast majority of plans would attain almost the same results using the long-term corporate bond rate alone; those few plans that would have a higher liability using the simplified yield curve are the most mature plans in industries that can least afford to have a sudden required increase in funding obligations.

Definition of Plan Liability

Use of "current liability" versus "termination liability"

As noted above, under present law, current liability is used for funding and other purposes. Current liability is a type of "snapshot liability," *i.e.*, it does not include future liabilities based on future compensation or service. Current liability is, in this respect, similar to termination liability. Termination liability is the value of the benefits that would be owed if the plan terminated, measured using PBGC standards and assumptions. Some in the executive branch agencies have argued that current liability should be replaced or supplemented by termination liability; they argue that termination liability, which is greater than current liability, is the proper measure of a plan's liability.

For the vast majority of plans that are not terminating, the use of termination liability for funding and other purposes would be inappropriate and would grossly overstate plan liabilities. There are clear examples of this overstatement. Generally, under present law, the biggest difference between current liability and termination liability is the interest rate used to value liabilities.

The 'termination liability' interest rate developed by the PBGC is generally too low even for terminating plans.

For example, for October 2004, the four-year weighted average of the long-term corporate bond rate (which, as noted above, is used to determine current liability) was 6.21 percent; the termination liability interest rate developed by the PBGC for October 2004 was 4 percent for liabilities of 20 years or less and 5 percent for longer liabilities. The termination liability interest rate is far below even the 30-year Treasury rate, which was 5.14 percent (four-year weighted average) or 4.9 percent (spot rate) for October 2004.

The termination liability interest rate developed by PBGC is generally too low even for terminating plans, as will be addressed by a future Council paper. The numbers set forth above demonstrate that it is *extremely* low for an ongoing plan.

Termination liability also includes "shutdown benefits" and other similar "unpredictable contingent event benefits." Generally, those are additional benefits contingent on an adverse business event, such as the closing of the facility where a participant works. Because of the speculative nature of these benefits, they are very difficult to value and thus are not included in current liability. Without any practical way to value such contingent benefits, the Council opposes any proposal to include them in current liability.

The Council has reviewed the differences between current liability and termination liability and recommends that current liability be reformed in one significant respect for all plans (not just "at-risk plans"). Under present law, current liability is determined based on the assumption that all participants receive their benefits in the form of an annuity.

To the extent that the plan offers lump sums, current liability should take into account lump-sum distributions reasonably projected to be taken (subject to a transition rule to prevent a sharp increase in current liability). For this purpose, reasonable projections could be made regarding the applicable lump-sum discount rates, provided that the projected discount rates may not be higher than the interest rate otherwise applicable in determining current liability.

The Administration's proposal would create a new type of termination liability for at-risk plans, based on the assumption that all employees take lump-sum distributions (to the extent available) and retire early. The lump-sum issue is discussed above. The proposed early retirement assumption would be unrealistic in the vast majority of cases, and would severely burden any "at-risk company," thereby jeopardizing the company's ability to recover. This is contrary to the interests of participants, the company, and the PBGC.

Preventing the Volatility that Would Be Created by Spot Valuations

From business' perspective, perhaps the most important issue relating to defined benefit plans is predictability. Companies need to be able to make plans based on cash flow and liability projections. Volatility in defined benefit plan costs can have dramatic effects on company projections and thus can be very disruptive. It is critical that these costs be predictable.

The critical elements facilitating predictability under current law are:

(1) the use of the four-year weighted average of interest rates discussed above; and

(2) the ability to smooth out fluctuations in asset values over a short period of time (which is subject to clear, longstanding regulatory limitations on such smoothing).

The Administration has testified before Congress that the measurement of assets and liabilities should be based on spot valuations and that volatility can be addressed through smoothing contribution obligations. This approach is seriously flawed in three respects.

First, spot valuations are not necessarily accurate. For example, the spot interest rates from late 2002 were very poor indicators of interest rates for 2003. It simply is not logical to conclude that a spot interest rate for one short period is "the" accurate rate for a subsequent 12-month period.

Second, the Administration's proposal does not contain any smoothing mechanism to make contribution or premium obligations predictable.

Third, the Administration has not even acknowledged the *numerous* other rules that do not relate to contribution obligations that would become volatile if asset and liability measurements were based on spot valuations (*e.g.*, deduction limits, benefit restrictions). It is critical that the current-law smoothing rules be preserved.

Disclosure

The Council strongly supports enhanced disclosure of a plan's funded status. In fact, the Council's disclosure proposal would provide disclosure to more plans on a more timely basis than any other proposal (including the Administration's).

The current-law disclosure tool, the summary annual report (SAR), provides information that is almost two years old. That is inadequate. Under our proposal, within 2½ months after the end of the year, *all* plans would be required to disclose to participants year-end data on the plan's funded level.[1]

Year-end data would consist of year-end asset valuation, as well as beginning-of-the-year current liability figures projected forward to the end of the year, taking into account any significant events that occur during the year (such as a benefit increase). Plans would have the option to use year-end SFAS 87 data in lieu of the above data.

Other proposals achieve less disclosure, and some of the other proposals have serious adverse effects. Some proposals have been based on the SAR and thus give rise to disclosures that are out-of-date.

Other proposals require disclosure only from employers with plans that are more than $50 million unfunded. Those proposals are inadequate. For example, those proposals would not apply to a plan with $60 million of assets and only $20 million of liabilities. Moreover, those proposals inappropriately target large plans. A large plan that is 99 percent funded could be subject to disclosure under the proposals (*e.g.*, in the case of a plan with over $5 billion of liabilities) with the accompanying inappropriate stigma of being "so underfunded" as to be one of the few plans subject to this additional disclosure.

Certain executive branch agencies have discussed using termination liability (instead of current liability) for disclosure purposes, which is significantly higher than current liability. That could mislead and alarm participants in the vast majority of plans that are not terminating. The executive branch

[1] Because of the need to collect data from so many sources with different circumstances, more than 2½ months should be permitted for multiple employer plans and multiemployer plans.

agencies' concerns can be addressed, to the extent appropriate, by moving current liability closer to termination liability, as discussed above.

Critics of present law point out that although the vast majority of plans are ongoing, participants in plans that may well terminate in the near-term need information about their plans' funding status on a termination basis. We recognize this concern. We believe, however, that in conjunction with any expansion of the use of "termination liability," there would need to be a thorough reexamination of the assumptions used by PBGC to determine termination liability. As discussed previously, PBGC's assumptions are clearly unrealistic. These assumptions can have adverse effects on participants' benefits and should not be broadened in their application until corrected.

Even after the termination liability assumptions are corrected, we urge that any disclosure of termination liability be restricted to severely underfunded plans. As noted, in the case of a well-funded ongoing plan, disclosure of a plan's funded status on a termination basis will only alarm and mislead participants.

Finally, H.R. 5006 (the Labor-Health and Human Services appropriations bill, in the 108th Congress) would have required disclosure of confidential corporate information, pursuant to an amendment offered by Rep. George Miller (D-CA). This was clearly inappropriate and we assume unintended, as it departs sharply from the Administration's proposal on which it was expressly based.

Avoid Direct or Indirect Incentives to Move Plan Investments Away From Equities

There has been a significant amount of discussion by government officials and members of the media indicating that defined benefit plans should be invested in bonds rather than in equities. The bond proponents argue that this would address business' concerns with volatility, as well as protect PBGC and plan participants. In the strongest possible terms, the Council opposes any legal structure that penalizes plans for investments in equities. For the reasons discussed below, we believe that any such structure would be disruptive and harmful to plans, companies, participants, and the economy as a whole.

Effect on the markets

If a yield curve or other fundamental change in the pension funding rules should force a movement of pension funds out of equities and into bonds or other low-yielding instruments, it would have a marked effect on the stock market, the capital markets, and capital formation generally. Hundreds of billions of dollars could move out of the equity markets with economic consequences that could potentially be staggering.

Effect on the cost of defined benefit plans

Over time, pension plans earn more on investments in equities than in bonds. If plan earnings decline because plans are compelled to invest in bonds or other low-yielding instruments, plans' overall costs will rise. As plans become more expensive, it goes without saying that there will be fewer plans and lower benefits in the plans that remain.

The myth of immunization

One primary argument made by the bond proponents is that plan investment in bonds can be used to "immunize" the plan with respect to its liabilities. The bond proponents contend that employers can insulate themselves from both volatility and liability by investing in bonds.

'Immunization' is theoretically viable until a company encounters difficulties, at which time it will *inevitably* become underfunded.

First, it is far from clear that there could ever be enough bonds or other instruments available to permit plans to immunize in this manner. But even if there were enough, the immunization arguments do not hold up to scrutiny. When asked, even the staunchest bond proponents admit that there are numerous pension liabilities that cannot be immunized. For example, because mortality cannot be predicted with precision, it is not possible to immunize a plan that makes life annuity payments. Even more problematic are early retirement subsidies. Again, the number of people who retire and take available subsidies can only be estimated and thus that liability cannot be immunized.

Bond proponents answer by saying that in a large pool, mortality and retirement assumptions can be predicted with reasonable accuracy. This answer contains two gaping holes. First, it is not applicable to small- and mid-sized plans where there is not a large pool. Second, retirement assumptions are made based on reasonable predictions regarding a business' future prospects. Obviously, these assumptions do not anticipate the retirement of substantially all early retirement eligible employees. To do so would be both unrealistic and enormously expensive.

However, when the sponsoring company's business deteriorates, there may well be layoffs and possibly widespread use of the subsidy by substantially all early retirement eligible employees. In those circumstances, the plan will, *by definition*, be substantially underfunded. And, with the company having difficulties, it is at exactly this time that the plan may well be turned over to the PBGC with significant unfunded liabilities.

In other words, "immunization" is theoretically viable until a company encounters difficulties, at which time it will *inevitably* become underfunded.

Thus, the end result of "immunization" is:

(1) a lower rate of plan earnings and correspondingly higher company costs,

(2) resulting lower benefits, and

(3) a system that systematically ensures large PBGC liabilities whenever a company's fortunes decline.

This is not an answer but a formula for disaster for participants and for the PBGC.

The higher long-term rate of return available with equities is what makes plans affordable for companies. These rates of return also are the most effective means for all affected parties to weather a downturn in the business of the sponsoring employer. Investing in equities involves some short-term volatility but is critical to the successful functioning of the defined benefit plan system for companies, participants, and the PBGC. Thus, it is critical that the law not establish rules that adversely affect plans investing in equities.

Preventing Volatility by Smoothing the Transition Between the ERISA Funding Rules and the DRC

Overview

Under present law, generally, there are two distinct funding regimes. All plans are subject to the "ERISA funding rules." In addition, plans that fall below certain funding levels are required to make deficit reduction contributions (DRCs) to the extent such contributions exceed the amount required under the ERISA funding rules.

The DRC and ERISA funding rules serve distinct purposes and, in general, should both be preserved. The ERISA funding rules reflect the long-term nature of the pension promise by incorporating future projections. With respect to this aspect of the funding rules, current law provides appropriate flexibility to apply assumptions based on reasonable plan-specific projections regarding, for example, plan rates of return and mortality.

> **definition**
>
> **Deficit Reduction Contribution (DRC)**
> An amount in addition to the required minimum annual contribution if the pension plan is less than 100 percent funded. It consists of old liabilities (such as benefit increases granted before 1988), which are to be amortized over 18 years, and a share of new liabilities (resulting from benefit increases or plan amendments)
>
> — *Source: International Foundation on Employee Benefits,* Employee Benefits: A Glossary of Terms

The DRC rules were designed to function as a backstop to the ERISA funding rules. The DRC rules ensure that on a snapshot basis, the plan does not become too underfunded. Because of the backstop nature of the DRC rules, plans are restricted with respect to their discount rate and mortality assumptions. In other words, it may make sense to prohibit the use of plan-appropriate assumptions under the DRC so as to create a mechanically applied backstop. But such a prohibition would not make sense under the ERISA funding rules, which serve a different purpose based on each plan's circumstances and accordingly are structured to apply in a more plan-specific manner.

Although we believe that the basic structure of the DRC and ERISA funding rules should be preserved, we believe that the rules should be reformed in certain important respects.

ERISA funding rules

In certain aspects, the ERISA funding rules permit funding to be made over too long a period. Specifically, the ERISA funding rules permit the cost of a plan amendment to be amortized over 30 years. Yet amendments typically have the greatest effect on employees who have had significant service with the employer already and accordingly tend to be older. A more appropriate amortization period would be related to such employees' expected future service with the employer. One approach would be to determine the amortization period using a methodology based specifically on such expected future service. However, a comparable result can be achieved much more simply by reducing the amortization period for plan amendments to a shorter period representative of typical workforces, such as 15 years.

DRC rules tend to put far too much pressure on businesses in cyclical industries or other companies experiencing a temporary downturn.

Deficit Reduction Contribution (DRC)

The DRC requirements generally only apply to plans that are less than 90 percent funded on a current liability basis. However, a plan that is less than 90 percent funded is exempt from the DRC requirements if (a) the plan is at least 80 percent funded, and (b) for two consecutive years (out of the preceding three years), the plans was at least 90 percent funded (the "90 percent/80 percent rule").

Under the main component of the DRC regime, an employer subject to the regime generally must contribute a specified percentage of its unfunded liability. The percentage varies from 30 percent for the worst funded plans (plans at 60 percent or less) to just over 18 percent (for plans just below the 90 percent level).

At the same time that the ERISA funding rules are made more demanding by shortening the amortization period for plan amendments, the DRC rules should permit more funding flexibility. This is important for two reasons. First, employers experience jarring volatility when they first move from the ERISA funding rules to the DRC regime. The sudden increase in funding attributable to the application of the DRC rules can be difficult to foresee and can be very disruptive for an employer attempting to revitalize its business. Accordingly, it is important to smooth out the transition from the ERISA funding rules to the DRC regime by making the ERISA funding rules more demanding (as described above) and by permitting more flexibility under the DRC rules.

Second, the DRC rules tend to put far too much pressure on businesses in cyclical industries or other companies experiencing a temporary downturn. Requirements to fund up to 30 percent of a plan's funding shortfall in one year may simply be unmanageable for such companies. On the other hand, it is very important that the funding status of underfunded plans improve. Weighing these two competing considerations, the Council makes the following recommendations.

The Council recommends stricter rules with respect to the benefits provided by underfunded plans.

The DRC requirements should not be so severe as to hinder the recovery of the company and thus the plan. Accordingly, the percentage of the funding shortfall that must be contributed should be reduced so that it ranges from 20 percent (for plans funded at 60 percent or less) to just above 8 percent (for plans just below 90 percent funded) (instead of the current-law range of 30 percent to just over 18 percent). The 20 percent figure corresponds in an approximate manner to the five-year amortization of experience gains and losses under the ERISA funding rules, which is the shortest amortization period applicable under those rules.

At the same time, we recommend that the universe of plans to which the DRC rules apply be expanded. Specifically, we recommend reexamining the 80 percent component of the 90 percent/80 percent rule (except for purposes of related disclosure rules). And, as discussed in the next section of this paper, the Council recommends stricter rules with respect to the benefits provided by underfunded plans.

It is important that the 90 percent/80 percent rule not be replaced with a 100 percent rule subjecting all plans below 100 percent funded to the DRC rules. A 100 percent rule would unreasonably discourage new plans and benefit increases, as well as unduly "punish" normal fluctuations of interest rates and asset values. Such a rule would also materially increase the number of plans subject to the volatile movement between the ERISA funding rules and the DRC regime.

Finally, it is important to focus on the purpose of the DRC rules. The DRC regime is a backstop to the ERISA funding rules and, as such, is based on an artificial snapshot measurement of the funded status of an ongoing plan; it would not be appropriate to turn this artificial measurement into an overly restrictive rule that controls the funding of most plans, the vast majority of which are not terminating.

Restrictions on Underfunded Plans

The Council has significant concerns regarding benefit increases in underfunded plans. If a plan is significantly underfunded, that is the time to improve its funded status, not to exacerbate the underfunding.

Under present law, an employer must provide security to a plan to the extent that a plan amendment causes the plan's funded level to fall below (or further below) 60 percent. The 60 percent figure should be raised to 75 percent (instead of 80 percent, as proposed by the Administration).

Also, underfunded plans that permit lump-sum distributions can spiral downward very quickly. In some circumstances, there can be a "rush to retire" by employees who fear that the last participants in the plan will not receive their full benefit.

Even if there is not such a rush, lump-sum distributions can drain a plan of assets at a low point in the market and deprive the plan of a realistic chance to recover. Accordingly, under a possible proposal, lump-sum distributions would be suspended for plans that fall below 75 percent funded. However, the Council remains very concerned that a forthcoming freeze could trigger an even greater move to retire and thus have a counterproductive effect on the plan. This possibility should be carefully evaluated before moving forward on this proposal (or on the Administration's *similar* proposal).

Permitting and Encouraging Additional Contributions in Good Times

The lesson of the last 10 years is that companies need to be permitted and encouraged to make additional contributions in "good economic times" so that plans have a funding cushion to rely on during "bad economic times." Trying to squeeze huge contributions from companies during a downturn in the economy will only lead to freezes on benefits, company bankruptcies, and large liabilities shifted to the PBGC. The time to build up pension assets is during good economic times, not bad times.

In this regard, the Council strongly recommends the following.

Increase in the deduction limit
The Finance Committee pension bill (the National Employee Savings and Trust Equity Guarantee (NESTEG) Act of 2004, S. 2424 in the 108th Congress) provided that an employer may always

deduct the excess of 130 percent of current liability over the value of plan assets. This proposal increases the deduction limits currently in Code section 404(a)(1)(D) from 100 percent of current liability to 130 percent. The Administration includes this provision in its proposal as well.

We strongly support this proposal. In fact, we would recommend increasing the 130 percent figure to 150 percent based on the following analysis. For deduction purposes, current liability is today based on the 30-year Treasury bond rate, not the long-term corporate bond rate.

The time to build up pension assets is during good economic times.

Under our proposal, current liability would in the future be based on the long-term corporate bond rate for all purposes. This would, in isolation, actually decrease the deduction limit for many plans by 10 percent or 15 percent (and by more for a few plans). Accordingly, to ensure that the deduction limit for most plans is increased by 30 percent compared to current law, the limit should be increased to approximately 150 percent.[2]

It would be appropriate for both policy and revenue reasons to limit the increase in the deduction limit to plans insured by the PBGC.

Repeal of the excise tax on nondeductible contributions

Under current law, an excise tax is imposed on employers that make certain nondeductible contributions. This tax was enacted when the tax on reversions was much lower. With a very high excise tax on reversions, there is no reason to be concerned about excessive funding of defined benefit plans. On the contrary, the excise tax on nondeductible contributions can only discourage employers from desirable advance funding. Accordingly, the excise tax on nondeductible contributions should be repealed with respect to defined benefit plans.

Repeal of the combined plan deduction limit on employers that maintain both a defined benefit plan and a defined contribution plan

Under present law, if an employer maintains both a defined contribution plan and a defined benefit plan, there is a deduction limit on the employer's combined contributions to the two plans. Very generally, that limit is the greatest of:

(1) 25 percent of the participant's compensation;

(2) the minimum contribution required with respect to the defined benefit plan; or

[2] This increase will, *inter alia*, allow employers to fund collectively bargained benefit increases more quickly than under current law.

(3) the unfunded current liability of the defined benefit plan.

This deduction limit can cause very significant problems for an employer that would like to make a large contribution to its defined benefit plan. And there is no policy reason for preventing an employer from soundly funding its plan.

Repeal of the combined plan deduction limit is the simplest, most direct solution to the problems created by the present law limit.

Accordingly, the Council recommends that the combined plan deduction limit be repealed for any employer that maintains a defined benefit plan insured by the PBGC. Defined benefit plans and defined contribution plans are each subject to appropriate deduction limits based on the particular nature of each type of plan. There is no policy rationale for an additional separate limit on combined contributions.

In many ways, repeal of the combined plan deduction limit is a conforming change to the repeal in 1996 of the combined plan benefit limit, which limited the combined benefit that an individual participant could receive from a defined benefit plan and a defined contribution plan.

We believe that repeal of the combined plan deduction limit is the simplest, most direct solution to the problems created by the present law limit. However, in general, other proposals would also effectively address the problems being encountered.

Specifically, the current combined plan deduction limit could be modified to disregard employer contributions to defined contribution plans up to 6 percent of the participants' aggregate compensation. (See Section 204 of The Pension Presentation and Savings Expansion Act of 2003, H.R. 1776 as passed by House Ways and Means Committee in the 108th Congress and Section 407 of S. 2424 (as passed by the Senate Finance Committee in the 108th Congress.)) In addition, the current-law reference to unfunded current liability should be conformed to the change recommended above, so that contributions to a plan insured by the PBGC would always be deductible to the extent necessary to increase the plan's funded level to 150 percent.

We are supportive of the proposals passed by the Ways and Means Committee and the Finance Committee in 2004. But, as noted, we recommend repeal of the combined plan deduction limit. We do not believe that the additional complexity of the narrower proposals is necessary. Those proposals would create significant issues for multiemployer plans; since multiemployer plan benefits are not based on participants' compensation, deduction rules based on percentages of participants' compensation can be difficult to apply.

Preservation of credit balances

Under current law, an employer maintaining a defined benefit plan is generally required to make certain minimum contributions to the plan. An employer may, however, choose to contribute amounts in excess of the minimum required. Such "extra" contributions give rise to a "credit balance," *i.e.*, a type of bookkeeping record of the excess contributions made by an employer.

Present law neither encourages nor discourages "extra" contributions. Instead, in years after a credit balance is created, an employer's minimum funding obligation is determined as if the amount of any credit balance were not in the plan. Then, the credit balance is applied against the minimum funding obligation determined in this manner.

In this way, the law is carefully crafted to be neutral with respect to a company's decision whether to make extra contributions. The law is structured to treat a company that makes an extra contribution in one year and uses the resulting credit balance in a subsequent year in the same manner as a company that only makes the minimum contribution in all years.

If credit balances were not available to satisfy future funding obligations, employers would have a clear economic disincentive to fund above the minimum levels; funding above the minimum levels would, in the short term, decrease funding flexibility and increase cumulative funding burdens. If an employer does not receive credit for extra contributions, the employer would have an incentive to defer making contributions until they become required.

The credit balance system has been criticized on the following grounds: Critics have pointed to examples of underfunded plans that have not been required to make contributions because of credit balances. Some of those plans have had their liabilities transferred to the PBGC.

> **"Current pension funding rules ... severely limit the ability of companies to fund their plans during good economic times, while requiring additional contributions during difficult economic times."**
>
> **—*from the Council's* Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System**

One possible reaction to this criticism would be to prohibit the use of credit balances in the case of underfunded plans, as the Administration has proposed. At first blush, this type of proposal would seem to increase funding. In fact, the opposite is true. Such a proposal would lead to more underfunding and more PBGC liability. If contributions above the minimum amount are discouraged, few if any companies will make extra contributions. That can only lead to more underfunding.

For example, if the use of credit balances were restricted, the companies cited by the critics would likely not have made extra contributions and accordingly, even greater liabilities would have been shifted to the PBGC and the PBGC would have assumed these liabilities sooner.

The other criticism of credit balances is that they are not adjusted for market performance. For example, assume that a company makes an extra $10 million contribution. Assume further that the plan experiences a 20 percent loss with respect to the value of its assets during the following year. Under current law, the $10 million credit balance grows with the plan's assumed rate of return (*e.g.*, 8 percent) until it is used. So after a year, the credit balance would be $10.8 million. The critics argue that the credit balance should actually be $8 million in this example, to reflect the plan's 20 percent loss.

This concern regarding market adjustments is a valid concern that should be addressed legislatively on a prospective basis and should apply to increases and decreases in market value.

As noted above, employers need to be encouraged to make extra contributions in "good times" so that they will have a sufficient cushion for the "bad times." If the use of credit balances is restricted, companies would not make extra contributions except in unusual circumstances. It goes without saying that that would be a major step backward. If we want companies to fund more in good times, it is essential that we preserve the credit balance system.

Credit balance terminology

One cosmetic issue could actually help put the credit balance discussion into perspective. The term "credit balance" does not appropriately capture the clear policy justification for the structure of the rules. It may be more appropriate to refer to a credit balance as a "pre-payment account." That would highlight the inconsistency of the credit balance critics' two positions:

(1) they seek to deny companies the ability to use their funding pre-payments; and

(2) at the same time, they express a desire to encourage companies to make such pre-payments.

Credit balances under the DRC

As discussed above, present law is structured to be neutral with respect to a company's decision whether to make contributions above the minimum required amount. From a policy perspective, we believe that companies should actually be encouraged to make such additional contributions. On the other hand, we need to be careful not to create incentives that can permit underfunding in later years.

With this delicate balance in mind, we recommend that for purposes of determining the percentage of the funding shortfall that must be funded under the DRC rules, credit balances not be subtracted from plan assets.

Assume, for example, that a plan with $75 million of assets is 75 percent funded and has a $5 million credit balance. Under present law, the DRC would apply as follows. The funding shortfall would be determined by subtracting the $5 million credit balance from the $75 million in assets. Thus, the funding shortfall would be treated as $30 million, not $25 million. The percentage of that shortfall that must be contributed would be determined on the same basis, *i.e.* as though the plan had only $70 million. Thus, the percentage would be 26 percent (rather than 24 percent, which would have applied if the plan were treated as having $75 million of assets).

In short, under present law, the DRC required contribution would be 26 percent of $30 million, *i.e.*, $7.8 million. The company could offset its credit balance against that amount and would be required to contribute the remaining $2.8 million.

We recommend a modification of this structure to provide a small incentive for companies to pre-fund. Under our proposal, the percentage of the funding shortfall that would be contributed would be based on the plan's actual assets, *i.e.*, $75 million rather than $70 million in the above example. The funding shortfall would not be affected; it would be treated as $30 million, as under present law. In the example, this would mean that the DRC required contribution would be 24 percent (as opposed to 26 percent) of $30 million, *i.e.*, $7.2 million (as opposed to $7.8 million). As discussed above, the company would be required to contribute the excess of this amount over its credit balance, *i.e.*, $2.2 million.

Our proposal would tilt the rules slightly to favor pre-funding without disturbing the fundamental purpose of the DRC rules. In fact, by basing the DRC percentage on actual plan assets, the proposal would actually make the rules more solidly grounded in the actual funded status of the plan.

The credit balance system has been criticized on the grounds that some underfunded plans have not been required to make contributions.

PBGC premiums

The Administration has proposed dramatic increases in PBGC premiums in order to address the PBGC deficit. This proposal gives us great concern for several reasons.

First, the large proposed increase in the flat-dollar premium and its indexing is strikingly inappropriate. This is a very large increase on the employers that have maintained a well-funded plan through the "perfect storm" of lower interest rates and a downturn in the equity markets. It is wrong to "reward" these employers with the obligation to pay someone else's debt.

Second, the unspecified increase in the variable rate premium will become a source of great volatility and burden for companies struggling to recover. This could well cause widespread freezing of plans by companies that would otherwise recover and maintain ongoing plans.

"The substantial assets the PBGC holds — and the relatively modest size of its deficit when viewed in the context of the economic cycle and its capped and long-term liabilities — ensure that the PBGC will remain solvent far into the future — a point the PBGC itself has acknowledged repeatedly."

—from the Council's Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System

Third, a premium increase misses the point of the last 10 years. The solutions to underfunding is better funding rules, not higher premiums that, on a dollar for dollar basis, hurt the defined benefit plan system.

Fourth, there has been a striking lack of clarity about the real nature of the PBGC deficit. The PBGC's numbers are based on a below-market interest rate. Our questions are:

(1) with a market-based interest rate, what would the deficit be?

(2) What effect would a small increase in interest rates and the equity markets do to address the PBGC deficit? and,

(3) Why has PBGC unilaterally moved away from equities to lower-earning investments that hinder its ability to reduce its deficit?

These are troubling questions that should be addressed before the very harmful step of increasing PBGC premiums is taken.

Shutdown Benefits (or Other Unpredictable Contingent Event Benefits)

Shutdown benefits generally occur in collectively bargained plans and are a form of "unpredictable contingent event benefits." They are analogous to a severance benefit; they generally "spring into existence" if and only if a unit, division, or workplace is closed and workers are laid off. A company cannot effectively pre-fund shutdown benefits for two reasons. First, there are clear difficulties and problems with a healthy company making funding judgments based on its determination of the likelihood that a unit will be shut down in the future. Second, even if such a likelihood could be determined, the plan would still be woefully underfunded if there is actually a shutdown since the likelihood would presumably have been fixed far below 100 percent (at least until shortly before the shutdown).

Thus, it is difficult to pre-fund shutdown benefits. On the other hand, shutdown benefits are guaranteed by the PBGC, subject to the generally applicable five-year phase-in. This phase-in appears to commence when the plan document first provides for shutdown benefits, not when the shutdown occurs. Thus, if the shutdown occurs when the employer is declaring bankruptcy, the PBGC can become liable for shutdown liabilities that have not been funded.

Shutdown benefits, a form of 'unpredictable contingent event benefits,' are clearly a problem area.

Shutdown benefits are clearly a problem area. Some have suggested that the law be changed so that the phase-in of the PBGC guarantee of shutdown benefits begins when the shutdown occurs. With respect to shutdown benefits that have not yet been bargained for and included in a plan document, that might be the right answer. But it seems unfair to apply this rule to benefits already contained in plans.

The Council recommends consideration of alternative solutions. For example, currently the variable rate premium payable to the PBGC by underfunded plans is determined without regard to shutdown benefits (where the shutdown has not occurred). Thus, PBGC is not even collecting premiums on these insured benefits.

One alternative that could be considered is requiring shutdown benefits (and other unpredictable contingent event benefits) to be taken into account at full value (or at a percentage of full value) for purposes of determining the variable-rate premium payable to the PBGC. Before moving forward on such a proposal, it would be critical to assess possible repercussions (such as benefit freezes to avoid variable rate premiums).

Lump-Sum Distributions

The discount rate used to determine the amount of a lump-sum distribution should be conformed to the funding discount rate (which, as discussed above, should be the long-term corporate bond rate).

Under current law, a rate no higher than the 30-year Treasury rate must be used to determine the lump-sum distributions payable to participants in defined benefit plans that offer lump sums. As the 30-year Treasury rate has become artificially low, it has had the corresponding effect of artificially inflating lump-sum distributions (*i.e.*, the lump sum projected forward using a reasonable rate of return is more valuable than annuity on which it was based). This has had very unfortunate consequences. First, these artificially large sums are draining plans of their assets. For example, if a plan determines its funding obligations based on the long-term corporate bond rate, but pays benefits based on a much lower rate (such as the 30-year Treasury rate), the plan will be systematically underfunded. For the defined benefit plans that offer lump sums (roughly half the plans), the centerpiece of funding reform — the replacement of the 30-year Treasury bond rate — will simply be illusory unless the lump-sum discount rate is conformed to the funding rate.

definition

Lump-Sum Distribution
A distribution that qualifies for forward averaging or rollover treatment. The basic requirements are that the distribution be made within one taxable year of the recipient, that it include the entire balance to the credit of the employee, and that it be made on account of the employee's death, attainment of age 59½, separation from service (except for the self-employed), or disability (self-employed persons only).

— *Source: International Foundation on Employee Benefits,* Employee Benefits: A Glossary of Terms

Second, participants have clear economic incentives to take lump-sum distributions, instead of annuities. The discount rate should not artificially create an uneven economic playing field that discourages annuities.

We recognize that the artificially large lump sums of recent years have built up employee expectations. For employees near retirement (*e.g.*, within 10 years of normal retirement age) who have made near-term plans based on present law, transition relief is clearly appropriate.

But in the strongest terms, we urge policymakers not to go further than that. If over the next 10 to 15 years, plans are required to give inflated distributions to retirees, that can only hurt the defined benefit plan system and future participants. In the competitive world we live in, pensions are *at best* a zero-sum arrangement. If employers have to pay inflated benefits for 10 or 15 years, they will have to recoup that cost in some way. It is our fear that many will feel compelled to reduce benefits for the next generation, a reduction that will likely carry forward to all future generations.

The Administration's proposal to apply the yield curve to determine lump sums would

(1) appear to further increase the value of lump sums and thus exacerbate the current law problems described above;

(2) increase benefits for higher paid employees who can afford to let their benefits remain in the plan longer; and

(3) force a significant reduction in cash balance plan benefits.

We cannot support this proposal.

Defined Benefit Plan Valuation Date

Prior year rule

The Administration's proposal would repeal the rule enacted in 2001 permitting well-funded plans to use a valuation date in the preceding plan year. This prior-year rule was carefully limited so as not to unintentionally encourage underfunding. Repealing it is, accordingly, unjustified and would hurt those well-funded plans that have relied on this rule to make business planning more efficient.

Asset valuation

Under present law, a defined benefit plan's assets and liabilities must be valued as of the same date. Subject to certain exceptions (such as the prior year rule discussed above), that date must be within the plan year for which the valuation is being performed. This valuation is performed for purposes of determining the funding requirements and deduction limits with respect to the plan.

For large defined benefit plans, it is generally impractical to have a valuation date other than the first day of the plan year.

For large defined benefit plans, it is generally impractical to have a valuation date other than the first day of the plan year. Because records are kept on a plan year basis, the only other potentially practical alternative generally is the last day of the plan year. The last day, however, is impractical because valuing a plan's liabilities is an extensive process. If that process were to begin on the last day of the plan year, an employer would be unable to complete the valuation in time to satisfy certain funding requirements. The one item used in the valuation that is readily obtainable on the last day of the plan year is the value of the assets.

In a falling market, using the first day of the plan year as the valuation date inordinately delays the recognition of asset losses occurring during a plan year. For example, assume that assets are valued at $100 million on the first day of the plan year but have fallen to $80 million on the last day of the plan year. For funding purposes, the employer must treat the plan as if it had, as of the last day of the plan year, $100 million plus the assumed rate of return for the year, for a total of, for example, $108 million. With $108 million in the plan, there may, for instance, be little or no funding obligation; in fact, any amount contributed may be nondeductible. This could leave the employer in the odd position of being unable to fund the plan while knowing that the plan has $28 million less funding than the valuation implies. The $28 million shortfall will eventually trigger an additional funding obligation in later years.

We recommend that an employer be permitted to elect to value assets as of a later date than it values liabilities, but no later than the end of the plan year for which the valuation is being performed. (See sections 704(a)(2) and 704(b)(2) of the Pension Preservation and Savings Expansion Act (H.R. 1776, as introduced in the 108th Congress). This is appropriate because updated asset values are much more readily available than new liability figures.

As a practical matter, for an employer that uses this new rule, the proposal will generally mean that liabilities will be valued as of the first day of the plan year and assets will be valued as of the last day of the plan year. In the falling market example described above, use of this new rule would enable — and in many cases compel — the employer to make additional contributions to the plan. This will allow — or compel — a better matching of the need for increased funding with the requirement to fund.

The Council's recommended proposal would not undermine funding in rising markets and would significantly improve funding in falling markets.

In a rising market, the proposal would not undermine funding. Briefly stated, the increased asset value that can be taken into account under the proposal never decreases a funding obligation on a greater than dollar-for-dollar basis, thus resulting in no overall asset shortfall.

Moreover, the proposal is not subject to abuse or manipulation. First, a plan's valuation date is part of the funding method, which can only be changed with IRS approval. Thus, an employer cannot switch in and out of this new rule in order to use it only when it meets the plan sponsor's current wishes. Second, in order to compare "apples to apples," plan liabilities would be projected forward actuarially to the last day of the year (*i.e.*, the date as of which assets are valued).

In short, this proposal would not undermine funding in rising markets but would significantly improve funding in falling markets. In addition, the proposal has safeguards to ensure that it cannot be manipulated to avoid funding obligations.

Reform of Funding Waiver Rules

Generally, under present law, employers are technically able to obtain a short-term waiver of the funding requirements upon a showing of temporary substantial business hardship. These rules were intended to provide a safety valve to accommodate downturns in the business cycle.

In practice, the rules have not worked well. There are no clear standards for obtaining a waiver and the application process is long, difficult, and unpredictable. The rules governing funding waivers should be made more mechanical and less dependent on IRS discretion. For example, a waiver should be available where, in the absence of plan amendments or similar events, there is an excessive increase in funding requirements from one year to the next.

In certain circumstances, an employer may need a waiver of only a portion of its funding obligation. Current law does not technically permit partial waivers, though informally the IRS has on occasion permitted partial waivers in an indirect manner. We recommend formally allowing partial waivers. It is important to formalize the partial waiver system so that partial waivers do not count as a full waiver for purposes of the rule limiting waivers to no more than three of any 15 consecutive plan years (five of 15 in the case of a multiemployer plan).

Interaction with Potential Accounting Rule Changes

The accounting issue is discussed at greater length in *Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System* (May 2004) prepared by the Council. That document discusses the possibility that the accounting rules will be changed to require that pension assets be marked to market.

Enhanced disclosure regarding the financial repercussions of pension sponsorship is appropriate to ensure shareholders have the information they need. However, because of the adverse effect mark-to-market accounting would have on defined benefit plan sponsorship, accounting standard setters should be extremely cautious when evaluating this approach and should recognize that adoption of a mark-to-market standard could lead to a reduction in the pension promises made by employers to better insulate themselves from the volatility injected into pension funding, or possibly a wholesale abandonment of defined benefit plans.

Mortality Assumptions

The Treasury Department has begun the process of evaluating issues related to mortality assumptions used with respect to defined benefit plans. The Council looks forward to a meaningful dialogue with Treasury as the administrative process moves forward.

Rules Based on an Employer's Creditworthiness

Under the Administration's proposal, the application of pension funding and premium rules would turn on the creditworthiness of the employer sponsoring the plan. Very briefly, the Council is strongly opposed to this proposal and the dramatic expansion of government regulation that underlies this proposal.

Use of credit ratings to determine funding or PBGC premium obligations would be harmful to plans, companies, participants, and the PBGC. Such use would put severe additional pressures on companies experiencing a downturn in their business cycle. Those pressures will undermine companies' ability to recover which adversely affects all parties, including the PBGC.

Use of credit ratings to determine funding or PBGC premiums would be harmful to plans, companies, participants and the PBGC.

This proposal would clearly lead to some level of government oversight of the credit rating entities and to some form of government approval of such ratings. This would be a frightening precedent. In addition, having PBGC premium levels or funding rules turn on an employer's creditworthiness would also exacerbate the downward spiral currently experienced by companies that are downgraded. Finally, there is no practicable way to apply a creditworthiness test to non-public companies.

Surplus Assets

We fully recognize the political sensitivities involved in the issue of employers' access to surplus assets in their defined benefit plans. And because of that sensitivity, we do not put forward any specific proposal on this topic. However, we urge Republican and Democrats together to reexamine this issue in a bipartisan manner.

It seems inevitable that new funding rules will require significant new defined benefit plan contributions. If the equity markets recover, these new contributions could well result in large surpluses that are virtually unusable. The fear of creating unusable capital will clearly discourage many employers from maintaining defined benefit plans.

On the other hand, if our objective is to encourage both sound funding and defined benefit plan sponsorship, few proposals would be more effective than proposals allowing employers tax-free access to surplus assets to pay for other benefits.

Restructuring for Troubled Plans

In certain circumstances, a combination of economic forces — such as competitive changes within an industry, the aging of a company's workforce, falling interest rates, and a downturn in the equity markets — can result in a dramatic change in the viability of a company's defined benefit plan. In those cases, following the otherwise applicable rules can only lead to plan termination and severe economic troubles for the company sponsoring the plan. It is critical that we develop a different solution for these troubled plans.

The Council recommends that alternative approaches be developed that would address this situation in a way that does not increase PBGC exposure, but rather is structured to reduce that exposure. In this regard, proposals should be developed that generally permit a company in this situation to cease benefit accruals (or pay for any new accruals currently) and to fund the funding shortfall over a longer period of time. This benefit-freeze approach can help revitalize the company, increase the funding level of the plan, avoid termination of the plan, and correspondingly avoid shifting liabilities to the PBGC.

Multiemployer Plans

Multiemployer plans serve a unique and critical role in the private pension system. As the population of employers participating in these plans changes, new challenges arise for the plans and participating employers. This is especially true in the case of plans where employer departures have thinned the number of participating employers considerably.

The Council looks forward to working with the multiemployer plan community to address the critical issues facing these plans.

Transition Rules and Phase-ins

As pension funding reform moves forward, transition issues need to be carefully studied. Large additional funding burdens that are suddenly imposed can disrupt business plans and cause otherwise viable companies to become insolvent. Such insolvencies would only increase burdens on the PBGC.

Fairness also dictates that the rules be phased in slowly for participants, unions, and companies that have structured their arrangements based on present-law rules.

"Concerns about the volatility of the funding liability have complicated the task of preserving [defined benefit] plans and pose a challenge for designing new plans that will be attractive to employers."

—*from the Council's* Safe and Sound: A Ten Year Plan for Promoting Personal Financial Security

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Comments Presented to the Committee on Government Reform
Subcommittee on Government Management,
Finance and Accountability
United States House of Representatives

Hearing on Protecting Pensions and Ensuring the Solvency of the Pension Benefit Guaranty Corporation
March 2, 2005

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates the opportunity to submit our comments to the House Committee on Government Reform Subcommittee on Government Management, Finance and Accountability on several important elements of defined benefit reform. ASPPA is a national organization of almost 5,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants, and attorneys. Our large and broad based membership gives it unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

ASPPA applauds the Committee's leadership in exploring defined benefit funding reform. The Committee's consistent focus on pension issues over the years has advanced improvements in the employer-sponsored pension system, as well as led to an increased awareness of the need to focus attention on the retirement security of our nation's workers. ASPPA looks forward to working with Congress and the Administration on strengthening the defined benefit system.

Maximum Deductible Contribution Limit

The Administration has stated that their defined benefit reform proposal is intended to strengthen workers' retirement security by ensuring that defined benefit plans are adequately funded. To this end, they have proposed a maximum deduction amount using a combination of a plan's new ongoing liability funding target and a 30 percent cushion of such new funding target. ASPPA believes that this new maximum deduction limit does not adequately address the needs of small to medium-sized companies.

For a healthy plan sponsor, the Administration's new maximum deductible contribution would be equal to the present value of all accrued benefits, (assuming a salary increase factor and computed using the proposed yield curve), plus a 30 percent cushion of this amount. The

Administration has stated that their suggested reforms to the current defined benefit funding rules, including the maximum deduction rules, ensure adequate funding and would provide greater flexibility for employers to make additional contributions in good economic times.

After close analysis of the Administration's proposed maximum deductible contribution limit, in conjunction with the allowable actuarial assumptions for such a calculation, ASPPA has discovered that in certain circumstances involving small to medium-sized companies, the Administration's proposed maximum deductible contribution limit would actually be *decreased,* rather than *increased,* as compared to current law. This would preclude small to medium- sized employers from funding their plans sufficiently as they can under current law. Thus, rather than strengthening the funding rules, the proposed reform would, in some cases, actually weaken them.

Consider the following example: A defined benefit plan has been established with 21 participants (6 highly-compensated and 15 non-highly compensated), with a defined benefit formula based on 4 percent of average pay for each year of participation up to a maximum of 25 years. Under current law, and based on allowable actuarial assumptions, the maximum deductible contribution that could be made to this defined benefit plan would be $382,914. The maximum deductible contribution allowable under the Administration's formula, based on a yield curve and allowable actuarial assumptions, would be $273,048. This amounts to a funding difference of $109,866, which is certainly significant for a small business. Although this funding difference occurs when a plan is first established, it is important to keep in mind that this funding deficiency will have to be made up later, when the small business may not be in a financially-sound position to do so.

The reason for this discrepancy in the maximum deductible contribution is based on the fact that the Administration's proposal, although allowing for an assumption for salary increases for workers, does not allow the plan to assume salary increases for many small business owners. This is because the Administration's proposal does not permit the plan to assume the statutorily provided inflation increases in the compensation limit for determining benefits [IRC section 401(a)(17)].[1] As a consequence, some plans will not be able to fund for these small business owner benefits, even though the law allows such benefits to be accrued. The resulting funding mismatch is a particular problem for successful small businesses. While some plans would be able to take advantage of the 30 percent cushion provided under the Administration's proposal, many others, such as the small business in this example, would not.

For many small and medium-sized companies, not being allowed to assume the statutorily provided inflation increases in the IRC section 401(a)(17) compensation limit will create an inappropriate funding deficiency when a plan is first established. Thus, since the Administration's current proposal effectively discriminates against the benefits of many small business owners, the plan will potentially have a funding shortfall just as it starts. Significantly, under the above example, if the statutorily provided inflation increases in the IRC section 401(a)(17) compensation limit were allowed to be assumed, the maximum deductible contribution limit under the Administration's proposal would increase to $363,313, a contribution limit similar to current law.

[1] The annual compensation limit under the "401(a)(17)" limit cannot generally exceed $200,000, to be adjusted for cost-of-living increases beginning in 2002. The current 401(a)(17) limit for 2005 is $210,000.

Based upon these results, **ASPPA recommends** that the Administration funding proposal be modified to permit the statutorily provided inflation increases in the IRC section 401(a)(17) compensation limit to be assumed for purposes of calculating the maximum deductible contribution limit in order to assure funding adequacy for all plans, including small businesses. As we have shown, the Administration's proposal would unfairly discriminate against successful small businesses and hinder the creation of new defined benefit plans. Concurrently, ASPPA supports an increase in the deduction limit of a plan's ongoing liability funding target from the proposed 130 percent to 150 percent of such target. By increasing this cushion, employers would be provided with more flexibility in determining their pension contributions, particularly in good economic times. Being able to make additional pension contributions in good times would also be consistent with the Administration's proposal that defined benefit plans be adequately funded.

Disclosure under Schedule B of the Form 5500

A main concern of the Administration is that the asset and liability information provided under the current Schedule B of the Form 5500 annual report/return does not adequately provide an accurate and meaningful measure of a plan's funding status. Under the Administration's proposal, all single-employer defined benefit plans covered under the Pension Benefit Guaranty Corporation (PBGC) with more than 100 participants, and required to make quarterly contributions for the plan year, would be required to file a Schedule B with their Form 5500 by the fifteenth day of the second month following the close of the plan year (if calendar year, February 15). Where a contribution is subsequently made for the plan year, an amended Schedule B would be required to be filed under the Form 5500's existing requirements.[2] Under the Administration's proposal, these plans would be required to use a beginning of plan year valuation.[3]

ASPPA recognizes that while some accelerated information would be helpful to provide an early warning system to protect the PBGC, an expanded exemption from the new Schedule B filing requirement should be made for small to medium-sized plans, similar to the Administration's exemption for plans subject to the at-risk liability calculation based on a plan sponsor's financial health. An earlier reporting requirement for many small to medium-sized plans that do not pose a potential risk to the PBGC would unnecessarily increase administrative complexity and costs. In addition, requiring an earlier valuation date for certain small to medium-sized plans *not* subject to Administration's accelerated filing date would further expand an unnecessary administrative burden on these plans.

ASPPA recommends that only plans with 500 or more participants that are required to make quarterly contributions be required to file a report on the funded status of the plan within 90 (ninety) days after the close of the plan year (if calendar year, March 31). This reporting would be done using a newly-created form Schedule B-1 (which would be filed electronically, if possible) and would provide only the asset and liability information

[2] Under current law, defined benefit plans subject to minimum funding standards are required to file a Schedule B with the Form 5500, which is generally due seven months after the end of the plan year (if calendar year, July 31), with a two and a half month extension available (if calendar year, October 15).
[3] Under current law, defined benefit plans are allowed to use any valuation date of a plan year for disclosure purposes.

necessary to disclose the plan's funded status as of the valuation date in the prior plan year (retaining the current law structure of allowing any plan valuation date in a plan year.) Any additional reporting information, such as the annual contribution information, should continue to be reported on the regular Schedule B filed with the Form 5500. In addition, we recommend that plans *not* subject to the Administration's accelerated filing date with less than 500 participants be allowed to retain the current law structure of allowing any valuation date.

Consistent with the interests of the Administration, this new Schedule B-1 would allow the dissemination of more accurate and timely information regarding the funded status of a plan, without causing a substantial administrative or financial hardship on small to medium-sized plans that pose little potential risk to the PBGC.

The Impact of Fluctuating Interest Rates on Lump Sum Calculation

As sponsors of defined benefit plans promise a guaranteed benefit to their participants, a plan sponsor must calculate on a year-by-year basis the extent to which contributions are required to fund those promised benefits. Under current law, when a benefit will be paid in the form of a lump sum—a common occurrence for defined benefit plans—the calculation of the annual contribution requirements consists of several elements. First is the requirement that a promised benefit not exceed a specified amount (the "415 limit")[4], which is expressed in terms of a life annuity. Second, if a participant in a defined benefit plan elects benefit payment in a form other than a life annuity (*e.g.*, lump sum, term certain), the 415 limit must be converted to reflect this alternative form of benefit.

Prior to 1995, the interest rate assumption generally used when making this conversion was 5 percent. Thus, for example, the 415 limit for a lump sum distribution could be determined mathematically in advance of the participant's retirement. This permitted an employer to know exactly, upon performance of a relatively simple calculation, what its annual plan contribution obligations would be. This was particularly crucial for smaller defined benefit plans, since the payout to even one single participant can have a dramatic impact on overall plan funding, and thus on annual contribution obligations.

From 1995 to 2003, the 415 limit for forms of benefit other than a life annuity was determined by using the 30-year Treasury bond rate, which produced a fluctuating month-to-month interest rate. The Pension Funding Equity Act of 2004 (PFEA '04) amended IRC 415 to provide that for plan years beginning in 2004 or 2005, an interest rate assumption of 5.5 percent was to be used in lieu of the applicable interest rate. This temporary interest rate assumption was a welcome relief to smaller defined benefit plans, as it provided much needed simplicity and predictability in making lump sum calculations.

The Administration's proposal, while not expressly addressing the 415 issue, does not appear to extend this 5.5 percent interest rate assumption in determining the 415 limit for lump sum calculations. Instead, the proposal seems to contemplate that the contribution amount to fund a lump sum payment subject to the 415 limit be calculated by using interest rates drawn from

[4] The annual benefit limit under IRC 415 (the "415 limit") is the lesser of (1) 100 percent of the participant's average compensation over the highest three consecutive years, or (2) $160,000 (indexed for inflation), expressed in terms of a life annuity beginning at age 65.

a zero-coupon corporate yield curve.

The complexity of the yield curve calculation would create a significant volatility problem facing small and medium-sized defined benefit plan sponsors. Using the yield curve to determine funding obligations for the 415 limit based on monthly fluctuating interest rates would make it very difficult for smaller businesses to properly fund their plans and virtually impossible to project funding obligations into future years. It would create confusion to plan sponsors and plan participants whose lump sum payment amounts may bounce up and down as these rates change. It would also cause plans to be unable to reasonably determine their liabilities with regard to benefits payable in a lump sum and other forms of payment.

Affordability issues are also raised—a plan sponsor will justifiably wonder whether it will be able to afford to guarantee the defined benefit. There would be a chilling effect on a plan sponsor's willingness to establish a plan because of the impossibility of predictability for the plan's obligations. The problems arising from being wholly dependent on the whims of a widely-fluctuating interest rate would be a major deterrent to the establishment of defined benefit plans, especially for small businesses.

In order to provide for a more predictable funding requirement for small defined benefit plans, **ASPPA recommends** that the use of the current 5.5 percent interest rate assumption for benefit forms other than a life annuity (*i.e.,* lump sums) for purposes of the 415 limits as set forth in PFEA '04 be made permanent. This use of a flat interest rate would remove the volatility from the determination of lump sums and other form of benefits, ensure consistency for planning purposes, pave the way for the potential establishment of new defined benefit plans by small businesses, and be no more generous than current law.

Reduced PBGC Premiums for Small and New Plans

Finally, while ASPPA agrees that some reform of the PBGC premium structure is necessary to increase the PBGC revenue needed to meet expected claims and improve their underlying financial condition, an exception from the Administration's proposed fixed and risk-based premium (which would replace the current Variable Rate Premium) should be created for small and new defined benefit plans that pose no significant risk to the PBGC. These plans expose the PBGC to little, if any, liability, and accordingly should be charged minimal premiums.

The Administration's defined benefit reform proposal would increase the current fixed rate to reflect the cost of living adjustment (COLA) from 1991, and index the fixed premium thereafter. The Administration would also assess a new risk-related premium on all plans with assets less than their funding target. While the premium rate per dollar of underfunding would be identical for all plans, the Administration has, however, suggested an unorthodox system that would allow this premium rate per dollar of underfunding to be set, reviewed, and revised periodically by the PBGC Board. The Administration represents that these premium increases are necessary to mitigate future losses and retire PBGC's deficit (currently valued at $23 billion) over a reasonable time period.

This new premium structure would create a great deal of uncertainty for plan sponsors every year in budgeting for PBGC premiums. Further, with unprecedented authority being provided to the PBGC Board to set the risk-related premium, there is a potential that these premiums could unnecessarily escalate for certain plan sponsors who do not pose a significant risk to the PBGC, under the pretext of decreasing the PBGC deficit. It would not only force many plan sponsors, especially small to medium-sized companies, to exit the system, it would also restrict the creation of new plans and future PBGC premium-payers.

ASPPA recommends that an exception be provided to small and new plans from these proposed PBGC premium reforms. These two non-controversial exceptions have been introduced by Congressional lawmakers in prior legislation. Most recently, they were included in the Senate Finance Committee's reintroduced pension protection legislation, the National Employee Savings and Trust Equity Guarantee (NESTEG) Act, introduced by Committee Chairman Charles Grassley (R-IA) and ranking member Max Baucus (D-MT) on January 31, 2005. They were also included in the House pension reform bill, the Pension Security Act of 2004 (H.R. 1000), introduced in the 108th Congress by House Education and Workforce Chairman John Boehner (R-OH) and passed by the House on May 14, 2003.

ASPPA proposes for new small plans[5] (maintained by controlled group with 100 or fewer employees), that the premium for each of the first five years of existence be set at $5 per participant with no risk-related premium owed. For new plans that have over 100 participants, the PBGC premium should be phased in at a variable rate over the first five years (20 percent for first year, 40 percent for second year, and so on).

Further, for very small plans (maintained by controlled groups with 25 or less employees), ASPPA proposes to either: (1) cap their variable rate premium payments for each participant to an amount equal to $5 times the number of plan participants; or (2) allow the exclusion of substantial owner benefits in excess of the phased-in amount from their variable rate premium calculations.

Conclusion

ASPPA appreciates the opportunity to offer its perspective on these very important defined benefit reform issues. We believe any new reforms should be designed to stimulate and protect the defined benefit system. ASPPA looks forward to working with the Committee and the Administration on a comprehensive solution to defined benefit reform.

[5] A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as in the new plan.

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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March 1, 2005

The Honorable Todd Russell Platts
Chairman
Subcommittee on Government Efficiency and Financial Management
House Committee on Government Reform
B-371 C
Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Platts:

On behalf of the U.S. Chamber of Commerce, I would like to thank you for holding a hearing on the issues concerning the private pension system. This letter offers views on the current situation facing sponsors of defined benefit pension plans and the issues that our members feel must be addressed. This statement focuses only on issues pertaining to defined benefit plans and does not address the Chamber's position with respect to any issue affecting defined contribution plans. I would like to request that this letter be included in the hearing record.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses. The Chamber's membership includes businesses and organizations of every size and in every sector of the economy. Chamber members with interest in employer-provided retirement plan issues include companies and organizations in the energy and technology industries, manufacturing companies, and businesses in the service industries.

The pension funding rules are a set of very complex and involved rules that have taken over twenty years to formulate. Thus, we believe that this process will require significant time and effort and that this statement is only the beginning of our conversations. Consequently, we have primarily provided principles and guidelines that should shape ensuing discussions. In particular, we believe that the single most important principle behind any funding reform should be the continued viability of the defined benefit plan system. In this vein, we do have specific recommendations that respond to immediate issues facing defined benefit plans. Also, we believe that it is vitally important to bring the funding issues of multiemployer plans into our discussions.

Guidelines and Principles

Pension Reform Must Contribute to the Viability of the Defined Benefit Plan System.

Defined benefit plans allow employers to provide an important retirement benefit to workers. In a defined benefit plan, employers bear the investment risk. In the event that plan assets are insufficient to pay benefits, the employer and its affiliated companies must do so. Even when a company is liquidated in bankruptcy, plan benefits are guaranteed by the Pension Benefit Guaranty Corporation (PBGC). Moreover, defined benefit plans must offer an annuity form of payment. Annuities provide a lifetime payment stream that ensures that retirees do not outlive their retirement benefit. Thus, defined benefit plans provide a fixed, guaranteed, and secure retirement benefit.

The number of defined benefit plans, and the workers covered by them, has been decreasing since the 1980s. In 1980, there were 148,096 defined benefit plans. In 1996, the number of defined benefit plans decreased to 63,657. In 2002, the number decreased even further to 32,321 plans. Nonetheless, for employers that are committed to providing these benefits, they are an important part of the compensation package. As has been noted over the past year, companies that are dedicated to providing defined benefit plans for their employees, for a variety of reasons, are having an increasingly difficult time doing so. The pressure on defined benefit plan sponsors was reflected in a recent AON survey that suggests that some benefits have been (since 2001), or soon will be, frozen in one out of every five defined benefit plans. There is plainly an urgent need for legislative action to encourage these employers to continue to provide these benefits and counteract the forces driving them out of the defined benefit system.

Funding Rules Should Be Realistic.

For the protection of workers and the defined benefit system, the funding rules should ensure that there is adequate funding for the promised pension benefits. As such, funding requirements should track investment practices and choices as much as possible and allow employers freedom in making funding choices. It is very important that funding rules not impose unrealistic requirements or burdens that would create an administrative and financial drain on plans.

The Pension Benefit Guaranty Corporation Must Remain a Viable Institution.

We believe that the existence of the PBGC as a viable insurance institution is of paramount importance to the defined benefit plan system. For those workers who must deal with the bankruptcy of an employer, the PBGC provides security for their retirement benefits. We also believe the viability of the PBGC is closely linked to the continued participation of corporations and their plans in the defined benefit system. It is the ongoing plans that provide the premiums that allow the PBGC to continue its work. Funding reform that drives sponsor companies and plans out of the system is at odds to the goal of protecting the PBGC. Thus, funding reform should aim to help healthy companies and plans stay in the system and support the PBGC.

Disclosure Obligations Should be Relevant and Germane.

In order to make informed decisions, it is important that workers have pertinent information about their retirement benefits and plans. Information about the consequences of an abrupt termination—that is neither scheduled to occur nor even likely to occur—is not a reliable or reasonable basis for employee retirement planning. Moreover, the cost involved in routinely generating such unusual reports is antithetical to the objective of conserving plan resources and reducing the burdens of plan sponsorship. Such calculations will merely upset employees by raising undue alarm about unrealistic events. Information about plan funding must be relevant and germane to the health of the retirement plan as an ongoing entity. Also, disclosure obligations should not require significant allocations of costs and administration that otherwise could be used to enhance benefits.

In addition, the disclosure requirements should be reviewed comprehensively to ensure clear, simple, and meaningful disclosures that are appropriate for each interested audience. Information in a disclosure should provide employers, participants, the investment community, and the government with relevant, helpful, and timely information concerning the long-term viability of the company's pension plan. As such, redundant and conflicting rules should be eliminated.

Specific Recommendations

Employers Need a Permanent Replacement for the 30-year Treasury Bond Rate.

There is agreement among all parties that the 30-year Treasury rate is a broken measure and needs to be replaced. Employers need to make long-term financial decisions and cannot accurately estimate their future pension obligations without a permanent replacement. Even now, there are employers who have not been able to wait out the uncertainty and have instead decided to freeze or terminate their plans. To avoid further loss of benefits, it is necessary to implement a permanent replacement.

There has been considerable debate over the proper replacement for the 30-year Treasury rate. Our concern is that the rate should be a reliable indicator of long-term expected returns on long-term investments for permanent defined benefit plans and should not be subject to significant short-term fluctuation. The Chamber believes that a composite corporate bond rate is the appropriate replacement for the 30-year Treasury rate and addresses these concerns. Nonetheless, we are committed to engaging in discussion and considering all alternatives.

In conjunction with finding a permanent replacement, it is extremely important that the discount rate for lump-sum calculations be made equivalent to the interest rate used for calculating pension liabilities. The current inequity in the rates is causing an asset drain for many plans. In addition, it encourages workers to choose a form of benefit that may not be in their best interest.

The Maximum Deductibility Rules Should Allow for Increased Contributions.

Some plan sponsors that are currently experiencing funding deficiencies would have liked to have made increased contributions when they had cash on hand. However, they were limited by the maximum deductibility rules. Not only would their additional contributions not have received a tax advantage, but they would have had to pay a significant excise tax on the contributions. This cap on contributions works against companies and plan participants by requiring contributions when companies are financially strapped and prohibiting contributions when companies are prosperous. Thus, companies cannot insulate themselves and their plan participants against cyclical changes in the economy. We strongly urge the Administration to consider reforming the maximum deductibility rules immediately in order to allow companies to increase their contributions to their pension plans.

Multiemployer Plan Funding

Multiemployer plans must deal with many of the same issues listed above, but also have other concerns that are specific to their structure. In addition to the current economic situation, multiemployer plans are contending with a long-term issue of declining participation by workers and employers. Thus, as the pool of retirees is increasing, the pool of contributing workers is decreasing. This is causing significant burdens upon employers who continue to participate in these plans. In addition, as bankrupt employers withdraw from multiemployer plans, the remaining U.S. employers are left to pay liabilities for people who never worked for them, which puts U.S. employers at a competitive disadvantage to foreign competition in the same industries that are not burdened by such assessments. Obviously, this is an unfair drain of resources on these employers and their workers. The issues surrounding multiemployer plan funding are complex and require both short-term and long-term solutions. We hope that by discussing these issues, we can find resolutions that are satisfactory to all.

Hybrid Plans

Recently, hybrid plans have been the focus of further debate and controversy. However, we believe it is important to say a word about the importance of these plans. One way to encourage continued participation in the defined benefit system is to allow employers the flexibility of plan design. Despite the ongoing controversy surrounding cash balance and other hybrid plans, employers find that these plans offer the best designs for their workers. For an increasingly mobile workforce, steady accruals under a cash balance plans provide greater benefits than under a traditional pension plan where accruals are back-loaded. Moreover, workers desire cash balance plans because of the similarities to 401(k) plans. If employers do not have design options that meet the needs of their workforce, they will leave the defined benefit system.

The number of workers covered by a cash balance plan has been steadily increasing even though the number of workers covered by defined benefit plans generally has been decreasing. The percentage of full-time workers covered by a defined benefit plan has dropped from 32% in 1996 to 22% in 2000. Of those covered by a defined benefit plan, the number covered by cash balance plans has risen from 4% in 1996 to 23% in 2000. These numbers confirm that cash balance plans are becoming an increasingly larger part of the defined benefit system. To discourage the continuation of cash balance plans would destroy the most vital aspect of the defined benefit plan system.

Conclusion

We appreciate the Committee's continued attention to these very important issues that affect millions of workers and retirees. We look forward to a continued dialogue and exchange of ideas on these issues.

Sincerely,

Randel K. Johnson
Vice President
Labor, Immigration & Employee Benefits

Aliya S. Wong
Director
Pension Policy

Mr. PLATTS. Mr. Elliott, we will now move to you. If I could first ask you to stand and take the oath.

[Witness sworn.]

Mr. PLATTS. We appreciate your being with us and the wealth of your real life, private sector experience in the field we are discussing today. We appreciate the written testimony as well.

Would you like to begin with your opening statement?

STATEMENT OF DOUG ELLIOTT, PRESIDENT, CENTER ON FEDERAL FINANCIAL INSTITUTIONS

Mr. ELLIOTT. Thank you for inviting me.

I commend you for addressing this very important topic from the point of view of government efficiency and effectiveness, a point of view often neglected elsewhere.

I am president of the Center on Federal Financial Institutions. We are a non-partisan, non-profit think tank that focuses on the Federal Government's immense lending and insurance activities. We do not advocate positions. Instead, we try to inform you so you can make your own decisions. All opinions expressed today, therefore, are my own and not those of COFFI.

COFFI has published the only detailed public model of PBGC's finances outside of PBGC itself. Our base case showed that PBGC would need a $78 billion infusion in today's dollars in order to avoid running out of cash over the next 75 years assuming present law and policy. This would make it the second largest financial bailout in history after the savings and loan crisis.

Without reforms or rescue, our model shows the cash running out in 2021. This is consistent with PBGC's 30-year history which shows a cumulative loss of $23 billion, demonstrating that its premiums are insufficient for the risks it has been required to take on.

What should Congress do? I recommend that Congress examine six areas. First, Congress should stop making infrequent, ad hoc decisions about PBGC. Instead, it should make some major strategic choices that are still unresolved 30 years after passage of ERISA. Most importantly, should PBGC premiums fully cover its costs? ERISA requires that premium levels be adequate to cover full costs and explicitly does not give PBGC access to taxpayer funding except for a nominal borrowing amount.

However, Congress sets premium levels and has consistently chosen to set them at levels that have proven to be inadequate. Congress could improve the situation by either affirming its intention that premiums fully cover costs and creating a mechanism to ensure this happens or determining an upper limit to premiums with the recognition that taxpayers would subsidize any shortfall.

My written testimony spells out a number of other important issues involving premiums. My key point is they should be decided based on sound, underlying principles, not as the result of ad hoc compromise. Similar issues arise in the area of funding rules and restrictions on benefit increases for severely underfunded plans.

Congress currently sets hard and fast rules that cannot be altered by PBGC to reflect changing conditions. These rules are also immensely complicated since they result from political compromises and not an agreement on overall principles.

Second, Congress should ensure the most effective coordination of pension fund regulation. Pension funds and pension plans are overseen by the Department of Labor, the IRS, other parts of Treasury, PBGC and the SEC. Perhaps this division of responsibility works perfectly but it is worth seriously examining simplification.

Third, Congress could optimize PBGC's ability to negotiate with troubled companies. Under present law, the Federal Government has little negotiating flexibility and that flexibility requires the coordination of multiple agencies.

Fourth, Congress should provide clear, overall investment guidelines for PBGC and eliminate micromanagement. The big question is whether PBGC should try to minimize risk by holding mostly bonds or should invest primarily in stocks like the pension funds it insures.

On the other hand, while leaving PBGC great flexibility on the big issue, Congress has made an artificial distinction between the investment of funds obtained through premiums, which must be invested in bonds, and those obtained from failed plans where PBGC has great freedom to choose its investments.

Fifth, Congress should encourage PBGC to focus careful attention on developing an optimal strategic plan for the big growth spurt it is growing through. PBGC's job will be more than five times bigger by 2006 than it was in 2000. Perhaps PBGC's management, who I respect, has everything well under control but I have never seen a company that did not perform better with vigilant oversight.

I am sometimes asked about PBGC's expense levels and I must confess that I have no idea whether there is a great deal of fat or management is performing brilliantly at expense control. The information to make this judgment is seriously lacking. This is particularly concerning since the Federal budget rules do not provide strong incentives to watch expenses closely as the large majority of expenses are allocated to the off-budget, quasi-trusts.

This brings me to the final item. Congress should align Federal budget rules relating to PBGC with economic reality. According to Federal budget rules, PBGC has contributed $12 billion to deficit reduction over its life, even though generally accepted accounting principles, which better reflect economic realities, shows a cumulative loss of $23.3 billion. Bad accounting creates bad incentives. For example, Congress might have been more vigilant to balance premium and risk levels if the budget had reflected PBGC's true economic losses.

Thank you for the opportunity to testify. I look forward to your questions.

[The prepared statement of Mr. Elliott follows:]

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

Testimony by Douglas J. Elliott, douglas.elliott@coffi.org

Subcommittee on Government Management, Finance, and Accountability

House Government Reform Committee

March 2, 2005

Thank you Chairman Platts, Ranking Member Towns, and committee members, for inviting me to appear today. I commend you for addressing this very important topic, particularly from the point of view of government efficiency and effectiveness -- a point of view sometimes neglected elsewhere.

I am President of the Center On Federal Financial Institutions, which we call COFFI. We are a non-partisan, nonprofit think tank that focuses on the federal government's immense lending and insurance activities, including PBGC. We do not advocate positions, instead dedicating ourselves to providing objective financial expertise to help policymakers such as yourselves evaluate the pros and cons of potential actions. COFFI has published a large volume of reports on PBGC, which are available on our website, www.coffi.org. All opinions expressed today are my own and not necessarily those of COFFI.

I was an investment banker for almost two decades, principally with J.P. Morgan. My clients were insurance companies and banks, and I have analyzed hundreds, if not thousands, of insurers in that capacity. There are many relevant parallels with PBGC, although it also differs from private sector insurers in important ways.

Let's start by examining why PBGC exists. It is the third layer of protection to ensure that retirees who are promised a traditional pension benefit will actually receive that pension. The first layer of protection is the legally binding promise of the sponsoring company. Since corporate bankruptcies do occur, negating this promise, federal law requires a second layer of protection through the establishment and funding of a pension trust.

The intention is that pension funds will have enough assets to pay the full pension benefits even if the company were to go broke. However, pension funds can become underfunded for at least three reasons. First, pension investments can fall in value. A typical pension fund has 50% or 60% of its investments in the stock market, which we have all seen can be very volatile. Second, companies hike their retirement promises from time to time through union negotiations or in response to the labor market. Finally, companies have some flexibility in how much they contribute to their pension funds each year and sometimes choose to remain underfunded for some time.

Claims on PBGC arise when companies go bankrupt at a time when their pension funds are underfunded. PBGC takes over the assets and the pension promises of the terminated pension plans. On average, the assets have been about half as big as the liabilities.

PBGC charges pension funds a premium, set by Congress, for protecting their participants. PBGC's 30 year history demonstrates that its premiums are insufficient for the risks it is required to take on. It has a cumulative loss of $23 billion, which is somewhat more than the $21 billion, in today's dollars, of premiums it has collected over its entire life. This is consistent with a range of academic studies, which have concluded that the premium level is, at best, half of what it would need to be to cover expected claims. Some studies concluded that premiums covered as little as one-sixth of the costs.

COFFI has published the only detailed, public model of PBGC's finances. Our base case showed that PBGC would need a $78 billion infusion, in today's dollars, in order to avoid running out of cash over a 75 year time horizon, assuming present law and policy. This would make it the second-largest financial bailout in history, after the Savings & Loan crisis. Absent reforms or a rescue, our model shows the cash running out in 2021. PBGC has indicated that they do not expect cash exhaustion quite this quickly, but I believe we differ by only a few years. I encourage PBGC to make public the results and key assumptions of its own financial modeling.

So, what should Congress do? In keeping with the focus of your subcommittee, I recommend that Congress examine six areas where it could usefully help improve PBGC's effectiveness and efficiency.

First, Congress should stop making infrequent, ad hoc decisions about PBGC and the pension system, usually at times of crisis. Instead, it would be helpful to make some major strategic choices that are still unresolved 30 years after the passage of ERISA. Most importantly, it is unclear to what extent Congress wants PBGC to be a "social insurer" and to what extent a regular insurance company.

One of the marks of a social insurer, like Medicare, is that it spreads costs fairly equally across its insureds, with minimal regard for their relative risk. PBGC fits that pattern, since most premiums historically have been collected from a per capita charge. Even its additional variable premiums are related to only one aspect of risk, the level of underfunding, without regard for bankruptcy risk or the risk of a pension fund's investments.

Regular insurers try to charge premiums that will cover their future claims and expenses. PBGC theoretically fits *that* pattern as well, since ERISA requires that premium levels be adequate to cover costs and explicitly does not give PBGC access to taxpayer funding, except for a minimal ability to borrow from the Treasury. However, Congress retains the right to set premium levels and has chosen to set them at levels that have proven inadequate.

Congress could improve the situation by either affirming its intention that premiums be adequate to cover costs, and creating a mechanism to ensure this happens, or determining an upper limit to premiums, with the recognition that taxpayers would subsidize any shortfall.

Unfortunately, we now have the related issue of deciding whether premiums are intended to cover the existing $23 billion shortfall as well. Realistically, there are only two sources of funding for this sunk cost – employers and taxpayers. To the extent that employers are to bear the burden, there is a further issue of how quickly to collect the extra premiums. Many economists would argue for a one-time charge, in order to avoid distorting future decisions about benefit plans, but this creates the real possibility that such a shock would encourage many departures from the defined benefit system.

The next logical step would be to decide the principles on which the actual premium structure would be based. There appears to be a broad consensus that premiums should continue to be divided between a fixed, per capita, premium and a variable premium with some relationship to risk. However, no principle has been laid out as to what the purpose is of each element. Instead, there has been an ad hoc approach to the level. It would be good to decide on a principle to follow. For example, perhaps we want the fixed premiums to cover the costs of a normal year of claims, recognizing that most PBGC losses come from a few very bad years. Variable premiums would then be set to build a reserve in advance for abnormal losses or to defray them after the fact. Alternatively, fixed premiums could cover PBGC's general expenses, with all claims covered from variable premiums. These are just two of the logical possibilities.

Variable premiums could be further tailored to reflect the three main risks: bankruptcy, underfunding levels, and investment risk. Underfunding levels are the key to current-law variable premiums. The Administration proposes adding an element of bankruptcy risk to this by changing liability calculations for weaker companies. Finally, some academics and think tankers are pushing for investment risk to be included.

If Congress would make these strategic decisions, then it might comfortably delegate to PBGC the setting of the actual rates, after public hearings and with at least the possibility of a Congressional veto. Current law puts Congress in the position of setting rates, despite the fact that I am unaware of any economist or political scientist who believes this is a strength of Congress. Some authority has been delegated to other federal insurance entities, such as FDIC, to set premium levels based on specified criteria.

Similar issues arise in the areas of funding rules and restrictions on benefit increases for severely underfunded pension plans. Congress currently sets hard and fast rules that cannot be altered by PBGC to reflect changing conditions. These rules are also immensely complicated, since they result from political compromises and not an agreement on overall principles.

Second, Congress should ensure the most effective coordination of pension fund regulation. Pension plans are overseen by the Department of Labor, the IRS, other parts of Treasury, PBGC, and, at least for accounting, by the SEC. Perhaps this division of responsibilities works perfectly, but it is worth comparing it to the regulation of other financial institutions. This is a reasonable analogy, since a pension fund is very similar to a life insurer. It takes in money today and invests it in order to meet pension promises spread over many future years. It is worth noting that states, which are the primary regulators of insurance companies, generally have a single Insurance department to regulate all aspects of insurer behavior.

Third, Congress could optimize PBGC's ability to negotiate with troubled companies. When a private company runs into financial problems it will often negotiate a rescue by its banks that reduces the principal and interest on its loans, but allows the banks to collect more than they would in a bankruptcy proceeding. Under present law, the federal government has little negotiating flexibility and that flexibility requires the coordination of multiple agencies. One possibility would be to give PBGC the authority to grant waivers of contributions on a broader basis than currently resides with IRS.

Fourth, Congress should provide clear overall investment guidelines for PBGC and eliminate micro-management. The big question is whether PBGC should try to minimize risk by holding mostly bonds, which is the current strategy, or to invest more like the pension funds it insures, by holding a considerable proportion of its investments in stocks. Every new PBGC Executive Director reconsiders this issue and there have been several switches back and forth. It appears that each change has been based on philosophical views about PBGC's role and not by differing views of market conditions.

On the other hand, while leaving PBGC great flexibility on the big issue, Congress has made an artificial distinction between the investment of funds obtained through premiums and those obtained from failed plans. If the money walks in through one door, labeled "Premiums", it can only be invested in bonds. If the money walks in through the door marked "Plan Takeovers", then it can be invested in almost anything. No private financial institution would voluntarily operate this way and there appears little purpose in forcing PBGC to do so.

Fifth, Congress should encourage PBGC focus careful attention of developing an optimal strategic plan for the big growth spurt that it is going through. PBGC's job will be more than 5 times bigger by 2006 than it was in 2000, measured by annual pension payouts. Perhaps PBGC's management, whom I respect, has everything well under control, but I have never seen a company that did not perform better with vigilant shareholders. Congress can play that role here.

I am sometimes asked about PBGC's level of general expenses and I must confess that I have no idea whether there is a great deal of fat or the management is performing brilliantly at expense control. There is not good information publicly available to allow a comparison with the costs of those entities most similar to PBGC. Nor is it clear precisely how PBGC is estimating its costs going forward. This is particularly concerning since the federal budget rules do not provide strong incentives to watch expenses closely, as the large majority of expenses are allocated to the off-budget quasi-trusts.

However, I would also advise Congress not to be "penny wise and pound foolish". It may be time to give PBGC greater flexibility in compensation and hiring decisions for certain key positions. I understand that PBGC is currently looking for three top officers, a Chief Financial Officer, a General Counsel, and a Head of Risk Assessment. Legally, PBGC can offer top salaries that fall some $50,000 below what the SEC, for example, could offer for the same positions. This may be an unfortunate limitation at a time of dramatic challenges for PBGC.

This brings me to the final item. Congress should align federal budget rules relating to PBGC with economic reality. According to federal budget rules, PBGC has contributed $12 billion to deficit reduction over its life, even though GAAP accounting, which better reflects the economic realities, shows a cumulative **loss** of $23.3 billion. Bad accounting creates bad incentives. For example, Congress might have been more vigilant to balance premium and risk levels if the budget had reflected PBGC's true economic losses.

Many budget experts favor a form of accrual accounting for federal insurance programs, similar to the way that federal lending is handled under the Federal Credit Reform Act of 1990. Although accrual accounting opens up the possibility of certain types of gamesmanship, the history of the lending programs over the last decade suggests that accrual accounting can better align budgeting with reality than the simplistic cash accounting that is used today for insurance programs.

Thank you for the opportunity to testify. I look forward to your questions.

Mr. PLATTS. Thank you, Mr. Elliott.

We are now going to ask Mr. Walker and Mr. Belt to join you at the table.

Mr. Walker, I think we will start with what is the financial future as we can best identify right now with PBGC. Mr. Elliott talked in his written testimony in their model that perhaps in 2021 insolvency would occur. I was wondering if your office has done any modeling of that nature in naming a year in which the insolvency would happen if no changes would occur?

Mr. WALKER. I don't recall us doing an independent analysis of that or being asked to do that. I will tell you that different people might have different opinions of what the date might be, but I think the bottom line is it is only a matter of when, not a matter of if.

I might note just to put things in context that in the case of HI, the Medicare Program, the trust fund on that is supposed to run dry in 2019 and in the case of Social Security, it is 2042. Therefore, this is obviously closer to the former rather than the latter. Therefore I would say the sense of urgency for action in connection with PBGC and defined benefit system reform is somewhat greater, although I think we ought to act on all three.

Mr. PLATTS. If we use 2018 with Social Security when we actually start using bonds, when we start generating less money than we are paying, all these dates are going to fall pretty tight if we don't act. I think your opening statement that we need to look to reform each one of these individually, but understand there is the picture of how they are all interconnected.

The PBGC was put on GAO's high risk list back in 1990 and came off 5 years later. Can you give us some background on what got them on the list then and what they did to get off the list?

Mr. WALKER. In fairness, it wasn't the agency that has been put back on the high risk list, it is the Single Employer Insurance Program which is the subject of this hearing rather than the entire agency.

Basically, as our statement and probably some of the others show, if you look at the history of the financial condition of the PBGC, it has varied over the years and there were a number of reforms enacted into law spanning several periods of time. For a brief period of time, PBGC actually had significant surpluses. I might note that our country had significant surpluses due to a number of very large terminations concentrated in a couple of industries, steel and airlines, those surpluses and the accumulated surplus changed very dramatically in a very short period of time to where at September 30, 2004, the PBGC has an accumulated deficit of over $23 billion.

We saw the turn and our view was it was going to get worse absent some type of action, not just by the executive branch and the PBGC, but also by the Congress. That is why we put the PBGC Single Insurance Program back on the high risk list. It is also why we are here today.

Mr. PLATTS. You touch on the surpluses over several years in the late 1990's and I guess a question for maybe all three of you is your analysis when we look at the trend and see some small deficits increasing through the early 1990's and see significant surpluses for about 5 years and then all off the charts in the last 3 years.

What is your assessment of what started driving those surpluses or the appearance of surpluses and what came to be in 2001, 2002 where we are today. Does this tell us something about the systematic problems of the way we have structured PBGC?

Mr. BELT. If I might, I would direct your attention to an interesting study or report put out by Credit Suisse First Boston called "The Magic of Pension Accounting." Part three. Their analysts have done a very extensive study of the pension insurance program and all the issues related to moral hazard. They note beginning in 1999, the period from 1999 to 2003, with respect to the S&P 500 which covers more than half of our overall liability, the total assets over that 4-year period rose by $10 billion, less than a 1 percent compound annual growth rate per year while liabilities during that same period of time grew by $430 billion, more than a 10 percent compound annual growth rate. That was a combination of factors, not the least of which was falling asset values in the pension plans, also falling interest rates which increased the value of the liabilities and also companies were not putting much cash in the pension plans during that period of time. They had taken advantage of something called credit balances that exist in the system right now to be able to take contribution holidays.

I believe this is in charts in my written testimony. What we have seen in companies that we have taken over—like Bethlehem Steel, USAirways and United Airlines as well, for several years prior to termination, the companies were putting no money into the pension plans, notwithstanding the fact that the gap was widening between the value of the assets and liabilities. In some cases, the liabilities continued to accrue normally as well and in some cases, they were actually negotiating new benefit increases.

Mr. WALKER. Again, macro and micro, macro with regard to the overall defined benefit pension system. As you know, for much of the 1990's, the markets went up pretty healthily. In the last several years, we have seen that interest rates have gone down. As a result for a period of time in the 1990's, the overall funding for defined benefit plans was very positive but as the markets corrected and as interest rates declined it meant the asset values came down and the amount of money it took to buy out the liabilities went up significantly because interest rates went down. When interest rates go down it costs more money to be able to buy out the liability.

You had the combined effect of reducing asset values, increasing liabilities, that causes the bottom line to hemorrhage.

As Brad properly mentioned, there are flaws in the current minimum funding standards whereas you had situations where companies didn't have to make contributions under the current law because they had these credits. At the same point in time, the bottom line of their pension plan is hemorrhaging.

The last thing I would mention is PBGC has received a disproportionate amount of its losses from certain industries that are subject to quite a bit of competition and in many cases, have gone through extensive deregulation, in particular, the airline industry and the steel industry. So I think some of the losses have been the result of things going on with regard to certain industries.

Mr. PLATTS. Mr. Elliott.

Mr. ELLIOTT. If I might add one thing because I think you have raised a very important question. We need to understand whether we are in an odd period or whether this is the accumulated result of a lot of problems. One thing people often don't realize who are unfamiliar with the insurance industry, PBGC is a credit insurer. Credit insurers tend to have the same characteristics as say hurricane insurance. Most years you need to make money because every so often, you are going to lose a lot of money.

It is not actually that reassuring that there were a few years when PBGC made some money, we needed to be making money most years to be ready for the really bad ones that come in the credit cycle.

Mr. PLATTS. That goes to the graph that tells us that the systematic or structural problems with the way we set up the system is because we weren't making money but for a few limited years more driven by the market valuations, that we clearly have a structural problem because we are not putting money away for these bad years that are going to come.

Mr. ELLIOTT. Absolutely. The only extended good period for PBGC financially was the fool's paradise at the end of the bubble when we all thought we were making money.

Mr. BELT. I think the more interesting chart if you look forward is the dramatic increase in our reasonably possibles, that is, the amount of underfunding in pension plans sponsored by companies now higher credit risks, that is they are not investment-grade risk companies. That is the real concern. We have seen a ramp up from about $10 billion in underfunding by junk bond-rated companies 2 or 3 years ago to now almost $100 billion. There is still a lot of risk resident in the system.

While I agree with David that the bulk of the losses thus far have come from two industry sectors, airline and steel, the majority of our exposure looking forward is actually in other industry sectors.

Mr. PLATTS. Kind of setting the stage as far as the type of problem we are facing, I wasn't here in Congress when we had the savings and loan debacle. Is this issue something that without needed reforms, we will have a similar challenge before the American taxpayer?

Mr. BELT. I actually have the dubious pleasure, I guess, of having been counsel to the Senate Banking Committee during that period of time. I was involved in drafting FIRREA and FDICIA in dealing with establishing the Resolution Trust Corp.

As I noted previously, there are some very real differences between that situation and some unfortunate similarities. I think the two principal similarities are that there is a tremendous lack of transparency in the system. Back then, it was something called regulatory accounting principles that were used to really hide the problems resident in a lot of the risk at that point, and we have the same lack of transparency problems under both the financial accounting standards as well as ERISA today.

The other problem most relevant to the S&L situation is the tremendous degree of moral hazard that exists in the system. That is what we need to address, all the perverse incentives to actually shift costs onto the Federal Government.

I do want to note there are a couple of important differences and I think both Doug and David noted this. We are not facing a liquidity crisis at this point in time. There was a liquidity crisis in the S&L situation where you were dealing with demand deposits.

The other difference is that this is more a function of a flaw in the rules themselves. At that point in time, there was a lot of malfeasance on the part of Charlie Keatings and others that I don't think you see here. It may be you can question whether people had prudently matched their pension plans, but it appears in most cases, they fully complied with applicable requirements, which is part of the problem.

Mr. PLATTS. The system allows that underfunding to occur as opposed to them circumventing the rules?

Mr. BELT. United Airlines filed an informational brief in a court. We have been dealing with them in bankruptcy right now where they potentially present a claim of $6 billion. They take some pride in noting they complied with all ERISA's rules and regulations. Notwithstanding that fact, they are $8 billion underfunded.

Mr. WALKER. It was prior to my tenure but I know my predecessor, Chuck Bowsher, spent quite a bit of time testifying before Congress before and after the meltdown of the savings and loan industry.

I think it is important we learn from the lessons of the past and that we hopefully act before we have to act when the facts are clear and compelling. In that regard, it is clear that this is not a temporary problem, there are systemic problems that need to be addressed.

I might also note, technically the PBGC is not backed by the full faith and credit of the U.S. Government. The PBGC has the authority to borrow up to $100 million and that is it. From a practical standpoint, yourself as an elected member, can imagine what type of public pressure there would be placed on the Congress to act if for some reason, the PBGC was not able to discharge its responsibilities.

Therefore, I think from a practical standpoint we shouldn't take a lot of comfort in the fact that technically the government doesn't have to step in but practically, there would be a lot of pressure to do so. That is why it is important to engage in the systematic reforms.

Mr. PLATTS. I would agree with your assessment that maybe legally it is not backed by the full faith and credit but morally, it will be and more important while we do move forward with these reforms.

The analogy with the savings and loan and the fact that it was too late, whereas we have the chance to bring these issues forward. Hopefully we do get our hands around this issue and move forward in a positive way.

You mentioned, Mr. Belt, transparency and similarities and the lack of transparency. My understanding is the Form 5500 is one of your main sources of information and your analyzing, and that is in essence almost 2 year old data. It kind of goes to the point of lack of transparency if you are making decisions today in the very fast changing marketplace for industries out there, the ability to rely on what you have before I assume that is one of the areas that we have structural changes and your thoughts on that as well, Mr. Elliott.

Mr. BELT. You make an excellent point, Mr. Chairman. Participants can't make informed decisions about their own retirement security, shareholders can't make informed investment decisions, and regulators can't make informed policy decisions when we are dealing with stale information that actually hides the true financial status of pension plans, particularly in dynamic market environments of today.

It is in fact the case, the principal source of information for all pension plans is the Form 5500 which is a required to be filed by all 30,000 D-B plans, when we get that information in our hands, it is usually over 2 years old. We do have an additional source of information, more timely information, information filed under Section 4010 which is information required to be filed by companies more than $50 million underfunded for pension plans. We do get that on an annual basis, and we will have those reports coming in April 15, a little over a month from now, and they will actually speak to December 31, 2004. That is more timely information.

We actually have that. Unfortunately, in the law right now, ERISA Section 4010 says we have to keep that information confidential. We know the more timely financial status information. We believe that information should be available to the marketplace. It is not just an issue of lack of transparency in ERISA with respect to sources of information, it is the fact the information provided bearns no relation to economic reality in many cases. You have actuarial valuation of assets, you have smoothed interest rate, a whole host of mechanisms that are really designed to obfuscate current economic reality.

It is a problem not only in ERISA but also in accounting standards.

Mr. PLATTS. Are there specific proposals that BPGC has put forth regarding changing those forms to not allow there to be an intentional blurring of the reality?

Mr. BELT. That is part and parcel of the administration's reform proposal.

Mr. WALKER. I want to note that GAO currently is doing work on the Form 5500 filing requirement. We anticipate issuing a report this summer and expect there will probably be some recommendations coming as part of that report.

The other thing is my understanding is the administration is recommending the funding information be expedited, not the entire Form 5500 but that the funding information be expedited and reported quicker.

I think one of the concepts that we need to keep in mind is when we have a situation that represents a bona fide risk based upon a reasonable person, to both the PBGC and the plan participants and beneficiaries, information has to be provided quicker and there needs to be an enhanced degree of transparency as compared to what we have right now because history has shown that with a risk-based, targeted degree of transparency, it does have a positive behavioral effect. The market forces can then come together, whereby retirees, unions, and workers can say why aren't you funding my pension plan. I think it is prudent to try to help those market forces come to bear to minimize the necessity for government intervention.

I do believe the PBGC is going to need more authority to intervene quicker than it has the ability to intervene right now in addition to what it can do right now because it doesn't have a lot of flexibility at the present time. It holds the nuclear option. It can go in and terminate the plan and cause it to impose losses on the PBGC and plan participants and beneficiaries. It doesn't have enough intermediate options which I think it needs to explore more.

Mr. PLATTS. Mr. Belt, in the forms that are required, what is the ability for you to go out to companies and ask them to provide additional information and how successful are you likely to be based on the track record where you say you would like a little more information to get a clearer picture. They say we gave you what you required and that is all we are giving you.

Mr. BELT. We routinely request additional information in appropriate circumstances and we have civil subpoena authority to request information to conduct investigations. There certainly has been some resistance to that in the past given the fact that companies take this notion that with respect to pensions, leave us alone, you don't really have much business meddling in our business. By and large, I would agree with that. I don't want to be doing that.

When they are taking actions, that pose material risk of loss to the pension insurance program or they are otherwise abusing the pension insurance program in a way that may harm the interest of participants, premium payers or the taxpayers, then it is incumbent upon us to use the tools at our disposal to try to address those situations.

As David noted, the tool set is fairly limited under current law. We call it the atom bomb with a nuclear option. That is really a last resort because termination of the plan has all the harsh consequences I talked about. In some cases, termination may be necessary to avoid future or further losses down the road but we would rather get to a position where we can say, let us talk about some of these intermediate sanctions or remedies and not have to push that button.

Mr. PLATTS. As we look at structural changes, to me a fairly simple reform of the transparency that gets to the moral pressure that is brought or the marketplace pressure to have internally companies do better by their pensioners is a fairly simple step that doesn't have the risk of negatively impacting the economic viability of the company. At least it is a starting point as we get into these structural changes.

Mr. Elliott.

Mr. ELLIOTT. I would just like to reinforce some of what has already been said which is I think there is a misconception that the PBGC is an insurance company and a misconception it is a regulator. There is a little bit of truth to each, but the fact is, as an insurance company, it can't set premiums, it can't decide who it is going to take, it can't tell companies they are acting in a way that makes them lose their insurance. It has almost none of the attributes of an insurance company.

Mr. PLATTS. Or as a regulator?

Mr. ELLIOTT. Yes, and as a regulator, it isn't.

Mr. PLATTS. I would like to recognize the gentleman from Tennessee, Mr. Duncan, for a statement and then questions.

Mr. DUNCAN. Thank you, Mr. Chairman.

This is a very, very important topic and I am just so sorry that I had some other meetings and appointments and couldn't get here until now, so I will probably ask about things already covered. I want to apologize to the witnesses.

Mr. Walker seems to come here every time on mind boggling topics. A few weeks ago you were here and the Defense Department had lost $9 billion in Iraq and then there was $35-$45 billion that I think had been wrongly handled. I mentioned then that Charlie Cook, the very respected analyst, said people can comprehend $600 hammers or $900 toilet seats but they couldn't comprehend any figure over $1 billion. There is a lot of truth in that.

It just kind of scares me. We have a $8.5 trillion national debt. Everyone's eyes glaze over when you talk about that because that is such an unbelievable figure you can't comprehend that. Then we have these $400-$500 billion deficits we continue to run. I sit here and think, how in the world are we going to pay all these Civil Service pensions, pay all the military pensions, pay all the Social Security pensions, Medicare, Medicaid and then you get to the PBGC.

I mentioned in my last newsletter, very few people even know what the PBGC is but it says in this brief, there are 30,000 plans and 34 million workers. I put in my last newsletter to 250,000 homes in my district, the New York Times had this story in January that said you have this $23.3 billion deficit. Is that going up, coming down or where do we stand?

Mr. BELT. Three years ago, the single employer program had a $7.7 billion surplus. We have had a $31 billion swing to bad in our net position over the past 3 years and it certainly is our concern that the hole will get much deeper unless we enact appropriate reforms now. The first rule of holes Secretary Chao talked about when she unveiled the administration's reform proposal was, "Stop digging."

Mr. DUNCAN. Let me ask this and I apologize because I know you have probably already covered this, but what do we have to do, what reforms are you recommending?

Mr. BELT. We have a comprehensive set of reforms that are attached to the testimony or at least we reference them. They are in three areas. One is strengthening the funding rules; make sure the companies, in contrast to the current law, are appropriately funding their pension plans and if they are underfunded, we give them a reasonable period of time to get up to fully funded. Second, address some of the moral hazard in the system particularly through rationalized premium rules. Premiums have been insufficient thus far.

Mr. DUNCAN. You have been $16–$19 a month and you want to go to $30 a month?

Mr. BELT. It is actually per year, sir, $19 per plan participant per year is what they pay so this would be an additional $11 per plan participant per year for what may be $1 million worth of pension coverage for an annuitant. A lot of people complained, the plan sponsors complained about paying higher premiums, and I understand none of us likes to pay higher premiums.

Mr. DUNCAN. That is per year. I didn't realize that.

Mr. BELT. The premiums haven't been raised since 1994, notwithstanding the fact that wages have gone up in the interim, the maximum guarantee under law has gone up on a wage index in that period of time as well. Losses have grown. A viable insurance system has to have premium levels sufficient to cover expected claims.

Historically, we have had about $1 billion annual premium revenue at PBGC. That has gone up a little more recently but just in the last 3 years, I noted we had a $30 billion swing in our net position. Clearly that premium revenue is far insufficient to cover expected claims.

Mr. DUNCAN. Is the number of plans and the number of single-employer workers covered going up or going down?

Mr. BELT. Actually, a little of both. The number of plans has fallen fairly dramatically over the past 20 years from a peak of about 112,000 20 years ago to just under 30,000 today but most of that was smaller plans. The number of workers covered in the system between both the single employer and multiemployer program has actually grown a little bit. It is about 44 million workers and retirees who are covered by the PBGC.

However, what we see is more than half of those now are retirees. Fewer than half are active workers. So there is a clear trend line away from the defined benefit plan as we have traditionally known it. A lot of companies have looked at alternative structures like cash balance plans that you are familiar with, but there has definitely been a trend line down.

Mr. DUNCAN. Several years ago when I was waiting to change a plane in Atlanta, I read a front page article in the Atlanta Constitution, that said at that time, several thousand plans a year were getting out from under the PBGC because there was too much, they thought, red tape and regulations and bureaucracy involved. Has that been eased some or are you still getting complaints like that?

Mr. BELT. Indeed and they are very valid complaints. ERISA's history is characterized by layering on, tinkering at the margins. A little tweak here and there just makes the system more complex and needlessly so. We are doing two things. The administration's reform proposal is all about substantially simplifying the current complex morass of rules and regulations. Also, at the PBGC, we are looking at our rules and regulations, strengthening where necessary, streamlining where we can. An example of that is for the first time allowing electronic filing of the Form 4010 that I talked about before which heretofore had not been in a standardized format, comes in paper forms that look like this, we hand load that in excel spreadsheets, and everybody is handwriting these documents. We are setting up an electronic environment. We are allowing participants and other practitioners to engage with the PBGC on-line, which we hadn't done before. So we are doing what we can. There is no question that statutory changes are necessary.

Mr. DUNCAN. Mr. Walker, what do you say about all this? You heard me say a few minutes ago that I don't see how in the world we are going to meet all these obligations with the Civil Service, military and all that. Do you see problems, the same problems I see? What do you think we need to do about this right now.

Mr. WALKER. First, there is a big picture and a small picture. On the big picture, I would recommend our 21st Century Challenges report. It was issued 2 weeks ago and has been sent to your office. Basically it says that we are on an unsustainable path from the financial and fiscal standpoint for the whole government and we are going to have to fundamentally restructure discretionary spending, mandatory spending, entitlement programs and tax policies.

PBGC is a subset of that overall challenge. It is on a unsustainable path. We need to step back and fundamentally reassess what its proper role and function is. It needs systemic reforms, many along the lines of what Brad talked about. While I agree with you, Mr. Duncan, that it is difficult and it might be easier to deal with $600 toilet seats than it is $1 billion, I think we can keep in mind that $1 billion is about $1.7 million $600 toiletseats, so it is unacceptable under any circumstance.

Mr. DUNCAN. Let me tell you what I think. You are really in a key position. I think this is such a serious problem that I think you almost need to be the Paul Revere of this day. You need to get out and rally, call peoples' attention to this report and these problems we are talking about and how unsustainable they are. I think right now most people don't realize how serious these problems are and how we are not going to be able to pay these.

Everybody is counting on these military pensions and Civil Service pensions. I think people have to demand that the Federal Government become much more fiscally conservative if they want to draw a check that is going to mean anything. What we will start doing I guess is printing more money and that won't work for very long. You have a key position being the Comptroller General now and so forth.

Mr. WALKER. I can assure you that I am dedicated to doing my part and I think that is about the 10th time in the last 2 weeks I heard somebody call me a Paul Revere. I take that as a positive. I am going to do my part but it is going to take a lot more people working together to get out the message.

Mr. DUNCAN. It is going to take all of us. That is why I said I am pleased that Chairman Platts called this hearing today because we need to do more of this. I know Todd is doing as much as he can but I just shake my head about it. I know one of our fellow Republicans was quoted the other day as saying something about we didn't need to worry about it because we wouldn't be in office a few years from now when all this is going to hit but we have some big problems.

Mr. PLATTS. When we talk about 2020 or 2042 or 2052, I say my son will be eligible to retire from Social Security in 2063 and my daughter in 2066 which sounds like a long time off until you put it in the perspective of those are my children, so whether it is Social Security or PBGC, you are right, these are issues that we either need to be serious in our approach to solving them or else future generations will suffer tremendously.

Mr. DUNCAN. I think it is going to hit us a lot sooner than 2042.

Mr. WALKER. I think you both make a good point. Two quick comments. One, I think when you talk about numbers, billions, trillions, whatever, it is almost mindboggling so you are trying to convert it to terms that people can understand. I think there are two things people have to keep in mind. Whether it is the PBGC or whether the government as a whole, it is about values, fiscal responsibility, stewardship and prudence being three examples.

The other thing is it is about people. It is about our kids, our grand kids and future generations. So it is about values and it is about people. It is just prudent to act sooner rather than later because time is working against us. The longer we wait, the tougher it is going to be, the more dramatic the changes will have to be, and the less transition time there will be.

Mr. DUNCAN. Thank you.

Mr. PLATTS. Tom Brokaw describes our seniors today as the greatest generation, saved the world in World War II and the importance of them being engaged in these debates, especially as it relates to Social Security which is setting the stage. If we can do this, then we can take on the real challenge, Medicare, which is more staggering and seniors can play such a critical role and show their great strength as they did in the 1940's in defending the world by saving the financial security long term for our Nation and our citizens, to be engaged in a responsible and active way as opposed to here in Washington, it is just so politicized. It is Republicans versus Democrats, not good policy.

It looks like we are going to have a first vote in about 10–15 minutes. Mr. Walker, I know you need to leave by 3:30 p.m., so let us get in a few more questions.

Mr. Belt, as far as when we look at structural changes, some entities, specifically FDIC, if that provides a model we should be looking at for the type of structural changes we should give you and PBGC to address your challenges?

Mr. BELT. I certainly think that is a useful analog to look at, a reasonably successful financial regulator and Federal insurer. Ultimately it depends upon the policy decisions made by Congress as to the appropriate role of the Pension Benefit Guaranty Corp. Both Dave and Doug alluded to this at the outset.

Right now, PBGC has to be several things. We are charged with the statutory responsibility of looking out for plan participants in a given situation, United Airlines, Bethlehem Steel, what have you. We are also charged with the responsibility of looking out for the interest of the 44 million plan participants that we insure. We are also charged with making sure we have resources to pay the benefits of the 1 million people that we are now wards for. They have come in and are in trusteed plans. We will be cutting checks for them for the next 40 or 50 years.

We are also specifically charged with keeping premiums as low as possible, protecting the interest of premium payers. As noted, we are explicitly not backed by the full faith and credit of the U.S. Government. We are supposed to be self financing. Those are often very difficult to reconcile. In fact, they are usually butting heads.

Every time I have to make a business or policy decision at PBGC, I am inevitably goring somebody's ox. If we have to make the decision to terminate a pension plan because it is going to present a long-term loss or risk to the insurance program as a whole, that is going to hurt the interest of the participants in that particular plan because they stop accruing benefits, and they may have benefits cut back.

I also can't just write checks willy-nilly and also protect the interest of premium payers and the taxpayer as well. We are this odd hybrid as Doug noted of being both a traditional insurer in some respects, and also a social insurer.

Mr. PLATTS. I think Mr. Elliott's first point was Congress deciding which is it, social program, insurer, to clearly define you are one or the other so you can move forward and know what is expected and given the tools within the defined mission that you have whereas now we are wanting to be everything to everybody, especially when we talk about keeping premiums as low as possible, $9 per year for that $1 million in potential coverage, yet we know we are not funding it long term satisfactorily. You are just competing with yourself.

Mr. BELT. On the premium, to put it in perspective in another case, United Airlines, as an example and they are just illustrative, I don't want to pick on United Airlines, but they pay about $2 million a year in premiums to the pension insurance program but they may present a claim of over $6 billion to us. The increase in the flat rate premium from $19 per capita per year to $30 a year, that additional $11 increase would be about another $1 million they would have to pay in. That would be $1 million additional versus a claim of $6 billion and they are spending that much litigating in Bankruptcy Court mostly against us each and every month.

Mr. PLATTS. The example gives a point for us to look at. What are your best options as you are watching a company and based on review of information that a company is in trouble and is going to come in. We talked about you going in and involuntarily terminating it. What can you do within the responsibilities you currently have?

Mr. BELT. That is an excellent question. I would break it down to pre-bankruptcy and post-bankruptcy because once we are in the bankruptcy environment, Chapter 11, our hands are really tied by the Bankruptcy Code. Prior to that time, we monitor any number of risks to the pension insurance program, and while the vast majority of companies act very responsibly, every once in a while you come across transactions and maybe they are not intended this way or maybe they are, that pose a risk of loss. You may be spinning off an underfunded pension plan into a weak subsidiary or the other way around. You actually leave behind an underfunded pension plan where there is no ability to make good on those obligations. There may be a transaction to break up a controlled group and we have joint and several liability against members of a controlled group.

In those cases, we would ideally like to be able to go in and say, wait a second, what is your plan of action and we need to have some protection. You can't abuse the pension insurance program that way, just shift the risk to the pension insurance program.

Mr. PLATTS. What is your ability to say you can't do that? How do you say you can't do that?

Mr. BELT. We say we have concerns and can we talk about those concerns and what we might do to address them. Ultimately our only real, clearly articulated tool in the statute is to say if you don't do anything, we will terminate the pension plan. That means we take the liability, the participants are hurt.

Mr. PLATTS. The company itself may say.

Mr. BELT. If they are in bankruptcy, they may actually say go ahead and take it. Prior to that point in time, it does have some adverse consequences for them because it matures the debt obligation, may cause problems for them in the credit markets and with their other creditors, so they are not necessarily going to want to go down that path. Nonetheless it is a high level game of brinksmanship and you can imagine with a large manufacturing company in a particular sector, going in to say I am going to push that button, the kind of pressure we would get from this body and across the Hill if it were employees in their districts and their States.

Mr. PLATTS. Mr. Walker, you were involved in the first involuntary termination of a plan. Can you give an example of what decisions were made?

Mr. WALKER. I believe I made the decision to terminate the first plan involuntarily. I don't know how many have been done since then but it had never been done before. That was in the mid to late 1980's. It was clear to me that it was a circumstance in which it wasn't a matter of whether the plan was going to terminate, it was only a matter of when the plan was going to terminate and what the degree of underfunding would be. Basically, it also dealt with the steel industry and the steel industry as I said previously has gone through a lot of restructuring. It has a tremendous amount of global competition and there are certain features in the steel industry plans whereby if a plant shuts down, then very lucrative, early retirement benefits can end up popping up overnight. It was pretty clear to me that one or more plants were likely to shut down and if we waited to take action after that happened, then the fact was the liabilities were going to increase significantly. We weren't going to get more recovery because the company was worth whatever it was worth. So I made the decision to go ahead and involuntarily terminate.

I negotiated with the labor union, I negotiated with management and others to try to achieve an equitable result but again, that is the nuclear option. You need to have intermediate sanctions that are credible and viable. Let me give you an analogy.

The Internal Revenue Service has the authority to disqualify a pension plan due to abuse. They have very rarely done so because there are a lot of innocent parties that are harmed when you disqualify a pension plan. That is why it is important to have credible and meaningful, intermediate sanctions.

I will say this, there is no question you are going to have to make some changes in the insurance program, make some changes in the funding rules and make some other changes in addition to giving the PBGC some additional authority. I think you have to deal with several structural changes. It is not a matter of whether they need additional revenues, yes, they do, but I think we have to debate how much of it should be through fixed premiums versus variable or risk related premiums. While obviously the weakest companies aren't going to be able to carry the full burden, you want to minimize the amount of increases you impose on those who ultimately may not ever represent a real risk or you may encourage them to leave the system. That is one of those balancing of interests you always try to achieve. It is difficult.

Mr. PLATTS. Mr. Elliott.

Mr. ELLIOTT. If I could followup on comments about sanctions. I would agree it would be helpful for the PBGC to have additional sanctions less severe than the so called nuclear option but we should also give them carrots. They should have the ability to do things that plan sponsors would like and may need such as the ability to spread out their payments over a longer period of time, for example.

One reason I say that is that would also give them the ability to bargain to some extent with how the pension plan is being run, if there is too much equity risk in a particular plan, for example. It is hard with a sanction to make them not do that but it is easier to say there is this other thing you are asking us for, we would give you permission to do it if you could show us you will do some things to help us.

Mr. PLATTS. We have the incentives for them, kind of perverse incentives to shift the burden to the PBGC, give them incentives with a positive approach to not do that, and do right by their pensioners and ultimately the taxpayers or PBGC.

Mr. Duncan.

Mr. DUNCAN. First of all, I have a report from the GAO that says the PBGC covers 34 million workers and in your testimony, Mr. Belt, it says 44 million.

Mr. BELT. There are two different programs, the single employer program which is 34 million and about another 10 million in the multiemployer program.

Mr. DUNCAN. You also have a chart here that says there is $450 billion in underfunding estimated for 2004?

Mr. BELT. Correct.

Mr. DUNCAN. You also say, which we all realize, and I chaired the Aviation Subcommittee for 6 years, the most immediate threat is the airline industry. How much of that underfunding comes from the airline industry and how much is other industries?

Mr. BELT. We have about a total of exposure to the airline industry of about $31 billion, actually somewhat less than that now because we have taken over the USAirways plans.

Mr. DUNCAN. By far, the great majority of that comes from other industries?

Mr. BELT. That is right.

Mr. DUNCAN. When you find a plan that is underfunded, what do you do? Do you send a letter, a notice or warning?

Mr. BELT. Current law allows them to be underfunded and allows them to continue to be underfunded. In many cases, they can take actions to not put any money into the pension plan, and they can take actions to increase benefits. Those are all proposed changes in the administration's reform proposal to address those flaws.

Mr. DUNCAN. Current law allows that. So you are saying so far you don't do anything, you don't even say a letter saying we feel your plan is underfunded or anything like that?

Mr. BELT. We have no authority to do that because they are able to say they are complying fully with the minimum funding requirements established under ERISA and Title I and Title IV right now, and the Internal Revenue Code.

Mr. DUNCAN. One of the reforms you are recommending is that you be given some authority to do something about that?

Mr. BELT. The administration's reform proposal that Dave and Doug alluded to is focused first and foremost on strengthening the funding rules so that we understand what the current financial status of the pension plan is at given point in time and then we make sure we take away a lot of these mechanisms like smoothing and like credit balances that have been used by plan sponsors under current law to allow the hole to get deeper and deeper and deeper and say you have to fund up that deficit over a reasonable period of time, 7 years.

We also put in place benefit limitations so that in fact as you get further underfunded, more benefit limitations kick in so we don't want companies in the position of not honoring the promises they have already made, and we want them to stop making new promises which are ultimately going to be hollow. There are many elements like that embedded in the administration's reform proposal.

Mr. DUNCAN. A few minutes ago we talked about the $23.3 billion and how that has been generated in the last 3 years but you have 3,500 failed plans that are under your mound?

Mr. BELT. That is correct.

Mr. DUNCAN. I assume that has speeded up in the last few years?

Mr. BELT. Actually, no. The number of plans we take over that are either voluntarily terminated or distressed terminations or abandoned, those 3,500, the number per year has not significantly increased. The amount of underfunding in the pension plans we have taken over has dramatically increased. Using the catastrophic or hurricane insurance analogy, we have been hit by the Hurricane Andrew and several others in succession over the last 2 or 3 years.

While in the past there were a lot of companies that had $100 million of underfunding, we now have had Bethlehem Steel with $3.7 billion, $3 billion in USAir, potentially United Airlines of $6 billion and many others in the multiple hundreds of millions of dollars, that were over $1 billion worth of underfunding.

Mr. DUNCAN. Thank you. We had a hearing a few weeks ago about the Defense Department and how we weren't taking any action against these companies that have ripped off the Government, but this is another important area that we ought to take some action on.

Mr. PLATTS. We are working with our witnesses and trying to help raise that awareness because your statement earlier that when you take all the issues together, each one is pretty challenging, when you take them all together, it is overwhelming. The sooner we get to working on the solutions, the better. I assure you as a subcommittee we want to continue to help raise awareness. As a non-authorizing committee, part of our role from a subcommittee standpoint is being a Paul Revere within the Congress to help raise the awareness among our own colleagues.

Mr. DUNCAN. I appreciate the three of you coming here today to talk about this. I think it is a very important problem we need to do something about.

Mr. PLATTS. Mr. Belt, can you decline to take over a plan if it will impact the solvency of PBGC? What are your rights to say no, we aren't going to do it for x, y and z?

Mr. BELT. As was noted, we can't decline or deny insurance no matter how high a risk the sponsor of the plan poses and even if they fail to pay premiums or make contributions to their plans. That is the social insurance aspect. Then there is a mechanism under current law where companies can seek to transfer their pension obligations to the pension insurance program, to the Federal Government insurance program if they meet certain statutory criteria established by Congress, the distress termination application. That is not a decision for better or worse the PBGC makes. That is in the hands of the Bankruptcy Court and a bankruptcy judge.

Unfortunately from my standpoint, the bankruptcy judge's interests are not aligned with those of the other premium payers or the participants, they are aligned with those of the debtor. Their sole responsibility is to ensure that the company is able to successfully emerge from bankruptcy and be very healthy in doing so, so they have tended to buy into the argument that they can't afford these pension plans and would not be able to emerge without them.

We do present detailed financial analysis to the bankruptcy courts but we have no control.

Mr. PLATTS. Do you have the right to appeal? No. So you can make your case but you accept what the bankruptcy judge rules?

Mr. BELT. Correct.

Mr. PLATTS. You don't have the ability to prevent a plan.

Mr. BELT. I stand corrected. We can appeal outside the bankruptcy court to the district court on that decision.

Mr. PLATTS. If a plan wants to in anticipation of turning over the plan, if they plus up their benefits, you have to accept that?

Mr. BELT. No. There is kind of a fail-safe mechanism in current law that guanantees of benefits granted within the previous 5 years are phased in over a period of time and that is to avoid exactly that situation. That also implicates issues like shutdown benefits which are not pre-funded. There are mechanisms to require phase-in of guarantees of benefits granted over the prior 5-year period.

Mr. PLATTS. We talked about structural changes but we didn't touch on personnel. Do you have the manpower to meet the challenges you are facing especially if we give you more authority and have structural changes achieved? Do you have the people you need?

Mr. BELT. We have extraordinarily dedicated and capable staff at the PBGC but it is also true we are facing an extraordinary operational and financial pressure that the organization has faced previous to this time. Those are going to continue and likely to exacerbate so it is incumbent upon us to make sure we have the best and brightest talent and that is particularly so in the area of risk management. The numbers we are talking about not are only the on-balance-sheet risks we face, we are managing $40 billion plus in assets, about $70 billion in liabilities but also these contingent liabilities and trying to monitor the risks out there with limited resources requires that we have extraordinarily capable people who understand the capital markets, who understand risk and can really bring these tools to the Government.

We are going out with a national search for a chief financial officer right now, trying to bring in the best and the brightest. I am looking at people from within government but also outside in the private sector, same with the General Counsel and new head of the Office of Risk Assessment. As you know, we are somewhat constrained in attracting the best and brightest to government as we all are.

Mr. PLATTS. I imagine in comparison to the SEC and some of the new ability they have been given under Sarbanes-Oxley to go after the key personnel. You don't have that same level of flexibility?

Mr. BELT. We do not have the same kinds of flexibilities as the FDIC and the other banking regulators, the SEC and others.

Mr. PLATTS. Mr. Elliott, the proposed reforms put forth thus far, your opinion on how far they would go to restoring long term solvency to PBGC?

Mr. ELLIOTT. The administration has put forth a very bold proposal to my surprise because obviously any bold proposal distributes a lot of pain. I think if passed it probably would solve the PBGC's problem. The issue is it would also put severe stress on the defined benefit system. There are a myriad of details I won't go into but that is the pro and the con.

Mr. PLATTS. And the risk of plans being terminated because of the cost of continuing them?

Mr. ELLIOTT. Or frozen in any event. I think it will push a number of plans toward freezing.

Mr. BELT. We respectfully disagree with that conclusion because as a policy matter, the last thing the administration and the President want to do is further impair the retirement security of millions of Americans and as a business matter, the last thing I want to do is drive out my principal revenue base, have all the good actors and premium payers leave the system and leave the bad apples behind. We think we have struck an appropriate balance but there is no question this issue has been raised as to whether we have pushed too hard and people will look to exit the system.

I would note that under current law, we have had a trend line downwards. No one is establishing new defined benefit plans except the United Methodist Church over the last several years. We would like to arrest that. We think we need to clean up the rules and our balance sheet before we can do that.

Mr. PLATTS. Based on the testimony I saw summaries from Senator Grassley's hearing yesterday, the business community and the labor community would share Mr. Elliott's concern. They see it as being too extreme and the economic impact. Is that a fair read?

Mr. BELT. The business community certainly complained about a number of aspects of the proposal. They don't want to pay higher premiums. They have made that very clear. They want to maintain the mechanisms that I talked about before, the smoothing mechanisms that kind of hide the current state of economic reality, and they want to maintain the ability to not pay in using credit balances notwithstanding the fact they may still be underfunded.

I understand their desire to retain those things. They want to have the free put to the government, I understand their desire to retain that but we don't want that poses an unacceptable risk to the taxpayer, that is not appropriate. Also with respect to labor unions, I think a lot of unions actually support many aspects of the administration's proposal. But you heard the United Auto Workers who have been on record saying they want taxpayer moneys, they want this to be a taxpayer bale out. That has been true since United Auto Workers pushed for the original creation of the pension insurance program prior to establishment of ERISA in the 1960's.

Mr. PLATTS. An important perspective on what I read from yesterday and the history in that issue.

Mr. ELLIOTT. So nobody misunderstands, I am neither advocating nor opposing the administration's proposal. I merely mean to say there are serious cons as well as pros.

Mr. PLATTS. But it is substantive and truly seeking to address the challenges before you?

Mr. ELLIOTT. Absolutely. I highly commend them for that. It is a plan that if followed through I think really would take care of the PBGC deficit.

Mr. PLATTS. Mr. Walker, your thoughts on what has been put forth thus far by the administration and your sentiments on how successful it would be versus the risk associated with moving forward?

Mr. WALKER. First, there are a lot of details contained in my testimony that I would commend to you and the subcommittee. I am willing to meet separately on this issue. I would say bottom line is there is absolutely no question in my mind that Congress needs to act and should act in this Congress, preferably in this session of this Congress.

I also believe the administration is putting forth a comprehensive proposal that deals with transparency, with funding, with certain insurance reforms. The scope of the package I believe is good. I believe there are a few elements of the package that need further examination but I think it is definitely a positive step forward and I believe that Congress needs to act on comprehensive legislation hopefully in this session of this Congress.

Mr. PLATTS. Has there been much response to the greater transparency or do they still want to keep everything secret and confidential?

Mr. BELT. That is difficult to discern. If you read some of the testimony in the second panel from yesterday's Finance Committee hearing, there are indications of why support even stronger disclosure. If that is true, I am delighted and would embrace and let us sign on the dotted line.

Mr. PLATTS. That would help and the marketplace pressure going to work.

I apologize in having to run over for votes. Try to keep close to the 3:30 p.m. commitment, Mr. Walker and safe travels. I appreciate your insights, helping to educate me as one who is probably going to be called to vote on some significant proposals in the coming year. It really has helped me and hopefully helped to broaden the exposure of what the risk is out there and if we don't act. All three of you, your knowledge base is tremendous and I am sure as a body, we will continue to call on all three of you as we move forward.

We will keep the testimony open for 2 weeks and the record open for additional information you want to submit.

I appreciate both staff for their work on this hearing.

The hearing stands adjourned.

[Whereupon, at 3:33 p.m., the subcommittee was adjourned.]

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