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STATEMENT OF

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BEFORE THE

HOUSE COMMITTEE ON WAYS AND MEANS

ON THE

PREMIUM REQUIREMENTS OF THE

SINGLE EMPLOYER PENSION INSURANCE PROGRAM

Mr. Chairman and Members of the Committee, we are pleased to be here today to discuss the need for an increase in the single employer pension insurance program's premium rate. As you know, the Employee Retirement Income Security Act of 1974 established the Pension Benefit Guaranty Corporation to administer the self-financing program, which now insures about 30 million participants' benefits. When a plan terminates, the program finances insurance claims for guaranteed benefits not funded by sponsoring employers.

Since its inception, the program has operated at a deficit because claims have exceeded premiums paid by plans. The premium, originally $1, was increased to $2.60 in 1978. Other increases were requested in 1982 and 1984 to retire the deficit and finance program costs. In a November 1983 report (GAO/HRD-84-5) and March 1984 testimony before the Subcommittee on Oversight, we concluded that a rate increase was needed.

I will now discuss our current views on the program's financial condition and the President's budget request that the current rate for each participant be increased to $7.50, retroactive to January 1, 1985. Our testimony is based on a review of the Corporation's estimates of the program's financial condition and premium needs. We also tested the sensitivity of these estimates to more optimistic and pessimistic projections of future program costs and revenues to show how critical assumptions about key future events can cause major variations in estimates of premium needs.

FUTURE EVENTS AFFECTING THE PROGRAM'S FINANCIAL CONDITION AND PREMIUM NEEDS ARE DIFFICULT TO PROJECT

The program's future financial condition and its premium needs depend primarily on the amount of future claims and the number of participants for whom premiums are paid (participant base). The Corporation's expected claims and participant base are difficult to predict because of uncertainties about the relationship between future events and the program's past experience. For example, annual claims have varied widely in recent years--ranging from $36 million to $264 million during fiscal years 1982 to 1984. Usually, the program's actual claims have substantially exceeded the amounts that the Corporation had used to estimate the premium rate needed. By contrast, the growth in the program's participant base has slowed in recent years. However, not enough time has passed to determine the effect of this change on the size of the program's future participant base.

The Corporation's data raise another uncertainty about the program's premium needs. We have not been able to express an opinion on whether the program's financial statements are presented fairly because of major accounting and internal control weaknesses. However, Corporation data would have to be inaccurate by a substantial amount to affect the validity of the Corporation's request.

PROGRAM'S FINANCIAL CONDITION

Although the program's reported deficit was $462 million at the end of fiscal year 1984, its solvency is not in jeopardy in the short term because program assets are still available to pay benefits. However, the program's financial condition is expected to weaken unless the premium rate is increased. The Corporation estimates that the deficit will grow to over $5 billion in the next 15 years if the $2.60 rate is retained. Our estimates indicate that the deficit could be from $3 to $8 billion in 15 years.

Such deficits are avoided in the private sector because states require insurance companies to maintain assets at least equal to their liabilities and we believe this should be the case for PBGC's pension insurance program. Further, operating the program at a deficit inequitably shifts the burden of financing program costs to future premium payers. This shift occurs when premiums are not adequate to finance costs as they are incurred. For example, the program had total claims and administrative expenses of about $750 million during the last 5 years. A $5 premium rate was needed to pay these costs during the period. However, about half of the costs must be paid by future premium payers because the rate was only $2.60.

ESTIMATED PREMIUM RATE

The Corporation estimates that a $7.50 premium will cover annual costs and retire the program's deficit over the next 15 years. The annual costs include $61 million to retire the deficit, $185 million for claims, and $37 million for administrative expenses. The $7.50 rate was determined by dividing these costs by a projected annual average of 37 million participants.

The Corporation's past estimates of future claims have usually underestimated actual experience, and their estimates of the future participant base are, in our view, optimistic. Because of the uncertainties about expected claims and the participant base, we made optimistic and pessimistic assumptions about future events to determine how the rate could change. We found that it varied significantly. By assuming higher annual claims of $255 million and a lower participant base of about 33 million participants (pessimistic), we estimate that the rate would be about $11. By assuming lower annual claims of $102 million and the Corporation's participant base (optimistic), we estimate a rate of about $5.50 would be needed. We used the Corporation's participant base in making our optimistic estimate because of the recent slowdown in participant growth.

The Corporation based its 1982 request on a 5-year deficit retirement period and its 1984 request on a 15-year period. In our 1983 report, we concluded that the deficit should be retired in as close to 5 years as possible to minimize the transfer of past costs to future premium payers. Using the Corporation's assumptions about future events, we estimate that a $9 rate would be needed to retire the deficit over 5 rather than 15 years.

CONCLUSIONS

We believe that a premium increase is needed to put the insurance program on a sounder financial footing. In view of the uncertainties in determining a premium, we believe the Corporation's approach is reasonable if the insurance program's deficit is to be paid over 15 years. We continue to believe, however, that the deficit should be retired sooner. This would better insure that premium payers finance program costs when they are incurred rather than shifting such costs to future payers. We conclude, therefore, that the requested $7.50 premium is the lowest that should be provided.

This concludes my testimony Mr. Chairman. We would be glad to answer any questions you or other Members of the Committee might have.