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[Pension Benefit Guaranty Corporation's Proposal to Increase Premium Rate for the Single Employer Basic Benefits Insurance Program]. HRD-78-2; B-164292. October 6, 1977. 8 pp. + enclosure (1 pp.).

Report to Rep. Carl D. Perkins, Chairman, House Committee on Education and Labor; Rep. Al Ullman, Chairman, House Committee on Ways and Means; by Elmer B. Strats, Comptroller General.

Issue Area: Income Security Programs: Programs to Protect Workers' Income (1306).

Contact: Human Resources Div.

Budget Function: Income Security: General Retirement and Disability Insurance (601).

Organization Concerned: Pension Benefit Guaranty Corp.

Congressional Relevance: House Committee on Education and Labor; House Committee on Ways and Means; Senate Committee on Human Resources.

Authority: Employee Retirement Income Security Act of 1974, title IV (29 U.S.C. 1301).

Review of the Pension Benefit Guaranty Corporation's (PBGC) proposed premium rate increase for participants of a defined benefit pension plan under the single employer basic benefits insurance program indicated that the present \$1.00 per plan participant per year premium is not adequate to fully fund the program. Although PBGC took into consideration numerous factors and made assumptions which could substantially affect the adequacy of the proposed \$2.25 premium rate, there is no reason to question the methodology used by PBGC.

Findings/Conclusions: The programmatic and data trend assumptions made relating to such matters as forecast of future claims, return on investment, and collectibility of employer liability are subject to variations which could substantially affect premium rate requirements. However, in view of the limited experience of this relatively new Federal operation, there is no basis for computing a better estimate.

Recommendations: Because of the uncertainty in the assumptions and the data used to determine the premium rate, PBGC should undertake thorough annual reviews of its premium rates to ascertain whether adjustments in the rates are warranted. The results of the annual premium rate reviews should be provided to the Congress for its consideration because of its role in approving the rates. (SC)

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-164292

October 6, 1977

To the Chairmen  
Committee on Education and Labor  
Committee on Ways and Means  
House of Representatives

In response to your August 4, 1977, letter, we reviewed the methodology and assumptions the Pension Benefit Guaranty Corporation (PBGC) used to conclude that a premium rate increase from the present \$1.00 to \$2.25 per year for each participant of a defined benefit pension plan is needed. The requested increase is to apply to the single employer basic benefits insurance program under title IV of the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1301). The increased rate would be effective January 1, 1978, if, as required by ERISA, it is approved by the Congress through a concurrent resolution.

As agreed with your offices, we primarily limited our review to the following matters which would affect the premium rates:

- the apparent reasonableness of the methodology PBGC used in determining the \$2.25 premium rate,
- the pending policy decision on the extent PBGC assets will be invested in United States securities,
- the pending policy decision on how fast revolving fund assets will be transferred to the trust fund, and
- the pending court decisions on the collection from employers of liability for pension plans terminating with insufficient assets to pay guaranteed benefits.

On September 15, 1977, we briefed staff members from your offices on our work. Officials of PBGC and staff members of the Senate Committee on Human Resources and the Joint Committee on Taxation were also present at the briefing.

HRL-78-2  
(20725)

The following summarizes our observations which were discussed during the briefing. Because of the short time frame we had to provide the committees with information on the requested rate increase, our observations were based on a limited review of how PBGC estimated the premium rate increase, and not on a detailed review of the accuracy and reliability of the data on which the proposed rate increase was based.

#### ADEQUACY OF PRESENT PREMIUM RATE

According to PBGC, the single employer basic benefits program had a deficit of \$41 million as of September 30, 1976, because the current premium of \$1.00 per participant per year was not sufficient to finance estimated net claims of \$82 million resulting from plan terminations. PBGC projects that, without a premium increase, the deficit will grow to about \$60 million by January 1, 1978, and to almost \$170 million by the end of 1981.

#### METHODOLOGY

PBGC's estimate of the \$2.25 premium rate was based on the financial condition of the single employer insurance program as of September 30, 1976, and the program's expected financial condition through December 31, 1981.

In estimating the program's future financial condition, PBGC considered numerous factors including estimated future single employer pension plan terminations, amount of benefits guaranteed for payment by PBGC, plan assets available for payment of guaranteed benefits, return on PBGC investments, amounts of plan asset insufficiencies to be collected from plan sponsors, and mortality rates of plan participants.

#### PREMIUM RATES BASED ON UNCERTAIN ASSUMPTIONS

In computing the rate, PBGC made numerous programmatic and financial trend assumptions relating to such matters as future claims, return on investment, and the collectibility of employer liability. The assumptions are subject to great variation which could substantially affect premium requirements. The variability of the assumptions is discussed in the following paragraphs.

### Forecast of Future Claims

PBGC's forecast of future claims is based on the statistical relationship of projected unemployment rates to terminating pension plans which have insufficient assets to pay guaranteed benefits. The relationship assumed is that plan terminations increase as the unemployment rate increases and plan terminations decrease as the unemployment rate decreases. The \$2.25 premium rate was computed based on the Administration's forecast that the current unemployment rate of about 7 percent will decline to 4.7 percent by the end of 1981. PBGC estimated that a \$2.65 premium rate would be needed, however if the unemployment rate stays at 7 percent through 1981.

Forecasts of unemployment rates vary significantly. For example, one econometric forecasting firm forecasted that the unemployment rate would decline to 5.8 percent by 1981 whereas another forecasted the rate would decline to 5.9 percent by 1980. Still another econometric forecasting firm estimated that the unemployment rate would increase to 8.5 percent by 1979.

Further, PBGC computed the \$2.25 premium rate on the projected magnitude of insufficient terminations based on the 27 month period July 1974 through September 1976. The PBGC recognized, however, that terminations of large insufficient plans (of at least 250 participants) and the number of participants in them can not be predicted with certainty using this short-term trend. For example, according to PBGC, one large pension plan which terminated in the first quarter of fiscal year 1977 is expected to account for slightly over half of the dollar amount of claims expected for all plan terminations during the fiscal year. PBGC projects that if a termination of this magnitude occurs in each of the next 5 years, the premium rate required would be \$3.38.

### Return on Investments

To administer the single employer insurance program, PBGC maintains a trust fund and a revolving fund. Presently, the assets of terminated pension plans under PBGC trusteeship are commingled in the trust fund and managed by private investment concerns. The trust fund assets are held by a nationally chartered bank in Boston, Massachusetts, and managed by three money managers under contract with PBGC. The money managers

are located in Chicago, Illinois; San Francisco, California; and Boston, Massachusetts. Trust fund assets are invested in diversified portfolios which consist primarily of corporate stocks and bonds.

Presently, premiums and employer liability collections are deposited in the revolving fund. Revolving Fund assets in excess of current needs are invested in United States securities.

In computing the \$2.25 premium rate, PBGC assumed that the present investment policy would continue and that revolving fund assets would earn a 5 percent rate of return and the trust fund would earn a 8 percent rate of return resulting in a rate differential of 3 percent between the two funds. PBGC also assumed that revolving fund assets will be transferred to the higher rate of return trust fund to finance asset insufficiencies of terminated plans and that such insufficiencies will be amortized from such transfers over a 7-1/2-year period. As pointed out below, these assumptions are subject to a high degree of uncertainty.

#### Investment Policy

The authority to set PBGC policy is vested in a board of directors. The board of directors consists of the Secretaries of Labor (Chairman), Commerce, and Treasury. In August 1976, the Secretary of the Treasury took the position that all PBGC assets--both revolving and trust funds--should be invested in United States securities. According to PBGC, the Secretaries of Commerce and Labor support the current investment policy of investing trust fund assets primarily in corporate stocks and bonds. At the time of our review, this policy question had not been resolved and the Office of Management and Budget had been asked to help resolve the issue.

According to PBGC, a "Government-only" investment policy would increase the premium rate estimate from \$2.25 to \$3.85 if the projected 5 percent rate of return on United States securities is actually experienced. In computing the \$3.85 rate, PBGC took into account its estimate that the number of insufficient plans would increase by about 50 percent and employer liability would increase by about 100 percent because the projected interest from assets of terminated plans would be reduced and thus less income would be earned for the payment of benefits.

### Transfer Policy

In computing the \$2.25 rate, PBGC assumed that available revolving fund assets would be transferred to the trust fund using a 7-1/2-year amortization period. According to PBGC, however, no transfers and no final decision on the transfer policy had been made as of September 30, 1977. If an alternate policy is adopted, it could have an impact on the premium rate. For example, PBGC estimates that a policy providing for immediate transfer of all available revolving fund assets to the trust fund would reduce the premium by about five cents. Conversely, PBGC estimates that delaying any transfer of funds until all assets of the trust fund are exhausted would be equivalent to a "Government only" investment policy and increase the premium to about \$3.85.

### Rates of Return

PBGC's anticipated rates of return of 8 percent for private sector securities and 5 percent for United States securities are within a reasonable range of what future expectations might be. It can be argued, however, that both the rates and the differential between them--3 percent in this instance--are either high or low because differences of opinion exist in the investment community concerning the exact rates of return which can be derived from different investment policies.

One updated study used by PBGC in making its interest rate assumptions projected the annualized rate of return for the 25-year period 1976 through 2001 to be

--10.6 percent for a private sector portfolio invested 50 percent in equities and 50 percent in long-term corporate bonds, and

--7.2 percent for a United States securities portfolio invested 90 percent in bonds and 10 percent in bills.

For the 15-year period 1961 through 1975, however, the annualized rate of return experienced for the same portfolio mixes was 5.1 percent for a private securities portfolio and 3.6 percent for a United States securities portfolio. For the 15-year period 1960 through 1974, considering the same investment portfolios, the annualized rate of return experienced was 3.8 percent for a private securities portfolio and 3.7 percent for a United States securities portfolio.

Also, during the 19-month period January 1976 through July 1977, the average market yield of all marketable interest bearing United States securities not due until the end of 4 years was about 7 percent or about 2 percent higher than the rate used by PBGC.

The two 15-year periods discussed above also indicate how the differential between the private securities and the United States securities rate of return can vary. For the period 1961 through 1975 the differential was 1.5 percent. For the period 1960 through 1974, however, the differential was one-tenth of 1 percent.

Higher than anticipated rates of return would have a downward influence on premium rate requirements, and lower than anticipated rates of return would have an upward influence. In addition, the potential effect of changes in the investment and transfer of funds policies on premium rate requirements would be diminished or heightened depending on the differential in rates of return between private sector securities and United States securities. For example, a difference between rates of return smaller than the anticipated 3 percent would diminish the effect of a decision to invest only in United States securities.

#### Collectibility of Employer Liability

Under section 4062 of ERISA, a defined benefit plan sponsor is liable to PBGC for up to 30 percent of its net worth for the amount which plan assets are insufficient to pay guaranteed benefits. PBGC estimates plan asset insufficiency at \$343 million for plans terminating during the period September 1974 through December 1981. In computing the \$2.25 rate, PBGC assumed that 40 percent or \$137 million of the \$343 million would be collected from plan sponsors.

Several pending court cases have raised legal questions as to the extent employer liability is collectible in certain situations. In one case involving a parent and subsidiary relationship, a bankruptcy judge ruled that liability was limited to that of the subsidiary directly responsible for the insufficiency of assets in the terminated plan. PBGC appealed the ruling.

In several other pending court cases, plan sponsors contend that plans--terminating before the effective date of ERISA's vesting provision and having a specific plan provision limiting the sponsor's liability for benefits to the extent of plan assets are not subject to the employer liability provisions. Since ERISA's vesting provisions became effective with a plan's first plan year beginning after December 31, 1975, an adverse ruling could affect the collection of employer liability for plans terminating before the provisions' effective date. Further, although not specifically addressed in a court case, a bankruptcy judge has indicated that the collection of employer liability accruing before ERISA vesting and funding requirements became effective may be unconstitutional.

PBGC has not identified the specific potential impact adverse rulings in the various court cases could have on the collectibility of employer liability. However, PBGC estimates, if no employer liability could be collected, that a \$3.33 premium rate would be required. Further, according to PBGC officials, without employer liability as a deterrent to terminations, many more underfunded plans might terminate and the premium required to finance benefits for such underfunded plans could be much higher.

### CONCLUSIONS

Based on the indicated present and future financial condition of the single employer insurance program, we concur with PBGC that the present \$1.00 per plan participant per year premium rate is not adequate to fully fund the program. Also, although PBGC took into consideration numerous factors and made assumptions which could substantially impact on the adequacy of the proposed \$2.25 premium rate, we have no reason at this time to question the methodology used by PBGC.

However, the programmatic and data trend assumptions made relating to such matters as forecast of future claims, return on investment, and collectibility of employer liability, are subject to great variation which could substantially affect premium rate requirements. Nevertheless, in view of the limited experience of this relatively new Federal operation, we have no basis for computing a better estimate.




Because of the uncertainty in the assumptions and data used to determine the premium rate, we believe that PBGC should undertake thorough annual reviews of its premium rates to ascertain whether adjustments in the rates are warranted. We also believe that the results of the annual premium rate reviews should be provided to the Congress for its consideration because of the role it has reserved for itself in approving the rates.

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During the September 15, 1977. briefing, we provided the committees' staffs with a schedule showing the potential impact of the \$2.25 premium rate on insured single employer pension plans by size of plan. A copy of the schedule is enclosed.

As arranged with your offices, unless the report's content is publicly announced earlier, we plan no further distribution until 10 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

We hope the information provided is responsive to your needs.



Comptroller General  
of the United States

Enclosure

**IMPACT OF PREMIUM ON SINGLE EMPLOYERS**  
 (Based on data from premium year 9/2/75 - 9/1/76)

Plan size (number of participants)	Number of plans	Number of participants	Average number of participants per plan 1/	Annual cost per average plan 1/			
				\$	10 \$	11 \$	15 \$
1 - 10	23,875	119,192	5		10 \$	11 \$	15 \$
11 - 25	11,897	197,205	17		34	38	51
26 - 50	7,458	272,104	36		72	81	108
51 - 100	6,221	450,440	72		144	162	216
101 - 200	5,124	737,377	144		288	324	432
201 - 500	5,055	1,609,686	318		636	716	954
501 - 1,000	2,403	1,698,827	707		1,414	1,591	2,121
1,001 - 5,000	2,297	4,821,242	2,096		4,198	4,723	6,297
5,001 - 10,000	325	2,268,807	6,981		13,962	15,707	20,943
10,001 - 50,000	298	5,942,743	19,942		39,884	44,870	59,826
50,001 - 100,000	24	1,674,653	69,777		139,554	156,998	209,331
100,001 - 250,000	11	1,943,599	176,691		353,382	397,555	530,073
250,001 - 582,651	2	977,651	488,826		977,652	1,099,859	1,466,478
<b>Total</b>	<b>64,990</b>	<b>22,713,526</b>					<b>1,955,304</b>

1/ Rounded to nearest whole number