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Proposal will strengthen corporate DB plans

Risk-based premiums would reward, not punish, sound companies

By Joshua Gotbaum

The Pensions & Investments May 2 editorial, "A way out for the PBGC," endorsed the proposal that Pension Benefit Guaranty Corp.'s premiums be set like those of private insurance companies and other federal insurance programs. "Like any insurance carrier," P&I said, "the PBGC should price its premiums on a risk basis." P&I agreed that the proposal would help preserve the pension insurance program.

We're glad P&I has joined Business Insurance, the Washington Post and the Boston Globe — as well as the Government Accountability Office and the Congressional Budget Office — in recognizing the soundness of the PBGC proposal.

But it was disturbing to read, in the very same editorial, that running the PBGC the way P&I had just endorsed "might well further weaken the corporate defined benefit system."

We think that statement is wrong. Here's why.

Current premiums punish sound companies with defined benefit pension plans.

Most companies will never go bankrupt and never require the PBGC to assume the costs of their pension plans — more than 75% of our plan sponsors have investment-grade ratings. They should be rewarded with lower rates and less hassle.

Instead, we do the opposite: their premiums are raised because other companies went bankrupt and handed the PBGC a pension deficit. They know it — and they resent it. I've been told many times, "I don't want to pay for some irresponsible bankrupt company in another industry." But that's exactly what happens when Congress raises PBGC premiums to pay for the mistakes of others.

It's no surprise that businesses oppose higher PBGC premiums. No business wants their insurance rates to rise. But they'll like it even less if they go up because of someone else.

Would higher premiums really lead to defined benefit plan terminations? No. PBGC premiums represent only a tiny, tiny fraction of a fraction of a company's labor costs. According to the U.S. Bureau of Labor Statistics, the average employee in a private firm has a total employment cost of about $28 per hour. PBGC premiums represent about 3 cents per hour, about one-tenth of 1% of total employment cost.

Because PBGC premiums are so small, it is not surprising that there is not a single case on record of PBGC premiums causing a company to terminate its pension plan.

PBGC premiums will be raised, so why not do it right?

The PBGC's resources, like those of other federal insurance programs, come from paid premiums, not tax dollars. Unlike other federal insurance programs, Congress, not the PBGC, sets those premiums and they're too low. In order to avoid any request for taxpayer funds, Congress has repeatedly raised PBGC premiums, from $1 per person when the agency was founded, to an average of $65 per person for most plans today. Since the PBGC's deficit is now at record levels, premiums are likely to be raised again.

Based on prior history, when Congress raises premiums, it does so in ways that must discourage the sponsors of sound defined benefit plans. Legislated increases aren't phased in. The variable-rate premium hits companies hardest just when they can least afford the cost. And the "one-size-fits-all" approach forces companies that pose almost no risk to the PBGC to subsidize those that do.

Companies should be encouraged to keep defined benefit plans.

Many companies have chosen to freeze their defined benefit plans to new employees. Some are actively considering terminating their plans and eliminating the defined benefit option. Many observers believe that the greatest threat to defined benefit plans is that, as soon as those plans get back to full funding, companies will terminate them.

If we want to preserve defined benefit options for employees, we should encourage, not discourage, defined benefit offerings.

Lower premiums would be a good first step, which the PBGC could offer to sound companies and sound plans if Congress allowed. There are other possibilities. Right now, the regulatory playing field tilts sharply in favor of defined contribution plans. For example, defined benefit plans have greater disclosure and fiduciary requirements. Is that necessary? In the Pension Protection Act of 2006, Congress encouraged consideration of cash balance plans and other hybrid approaches that combine the retirement security of defined benefit plans with some of the strengths of defined contribution plans. These approaches could offer companies and employees an alternative that, for many employees, would be preferable to the "you're on your own" world of defined contribution plans.

Reformed premiums could help preserve defined benefit plans

In his budget, President Obama proposed setting PBGC premiums as it is done by the Federal Deposit Insurance Corp., by other federal insurance programs, and by essentially all private insurance companies: based on the risks that companies and plans pose to the PBGC and to their employees. This could help preserve DB plans in several ways.

For one, avoid raising premiums just when companies can least afford them. The current variable-rate premium hits companies hardest just when they can least afford to pay. The FDIC solved this problem years ago. The PBGC could, too.

Also, offer sound companies lower premiums. Rather than being forced to pay higher premiums because of the mistakes of other companies, we'd rather offer most companies the lower rates they deserve.

There are other parts of the P&I editorial with which we must respectfully disagree. We don't think creation of the PBGC was, as you put it, "a bad idea." We don't think the 1.5 million people whose pensions we're paying do, either. Or the more than 40 million others whose plans we're trying to preserve.

We agree with P&I that much more work is needed: to balance the needs of employers and employees, and to develop a range of retirement security options to meet their diverse needs.

For these challenges, I believe the PBGC has unique strengths: to carry out its mission, the PBGC must be knowledgeable both about pensions and about the realities of business within which they must fit. As a result, the agency can help both the executive branch and Congress to reconcile and to advance the goals of both economic growth and a secure retirement.

We look forward to continuing discussions with P&I and its readers in doing so.

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