The PBGC clearly is in a dangerous financial condition. It is currently insolvent and unable to pay its legally required pension claims in as little as 10 years. Its current financial difficulties are primarily the result of a poorly designed pension insurance system and are not a consequence of an underfunded private pension system.

To survive, however, it is clear that the PBGC must be recapitalized. The Reagan administration and Congress are well aware that sweeping changes are necessary in our private pension insurance system. The recapitalization of the PBGC fund could conceivably utilize many elements, including enlarging the agency’s credit line with the Treasury; setting more stringent standards for minimum funding and higher maximums on yearly funding; establishing risk-adjusted insurance premiums; reducing PBGC’s guarantee; allowing private insurers to insure more pension dollars; setting stiffer waiver standards; or, mounting a bail-out using taxpayer’s money.

How long before the PBGC runs out of cash? The exact timing will depend on future plan terminations, on interest rates, and on related factors. The result ultimately will depend on the political process and on Congress waiting before providing a solution, however, it could find itself faced with some very unpleasant and very expensive choices.

Legislative Band-Aid

In 1986, Congress enacted the first major piece of legislation to shore up the finances of the single-employer PBGC fund since passage of ERISA. This legislation, the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA), contains several provisions to improve the viability of the single-employer insurance fund, including: (1) a tripling of the annual insurance premium; (2) more restrictive termination rules; and (3) additional liability for corporations choosing to terminate a single-employer pension plan.

SEPPAA’s most sweeping provision is the $850 annual premium per employee. The PBGC had requested a premium increase to $7.50 based on a projected fund deficit in 1985 of less than $600 million, but that low estimate excluded the unusually large claims that were later paid to the Allis-Chalmers, Wheeling Pittsburgh, and LTV Corporation.

The other SEPPAA provisions make it more difficult to terminate an underfunded plan and require sponsoring companies that terminate an underfunded plan to assume more liability to cover underfunding. It is unclear at this time, however, whether SEPPAA makes any major change in bankruptcy law or in the liability of zero-net-worth corporations that terminate their underfunded pension plans.

Concluding Remarks

Forty million Americans—about one-third of the workforce—have a private, employer-sponsored pension that is insured by the Pension Benefit Guaranty Corporation (PBGC).

The PBGC is a federal, tax-supported agency that is required by law to pay guaranteed retirement benefits to insured workers who would normally lose their pension as a result of the failure or inability of an employer to meet the minimum funding requirements on employers in multi-employer pension plans. The PBGC does not guarantee benefits under the Employee Retirement Income Security Act (ERISA) to guarantee the benefits of employees who are defined-benefit plans. The PBGC was established in 1974 to guarantee the benefits of employees who are defined-benefit plans.

Providing a Safety Net

The PBGC was established in 1974 under the Employee Retirement Income Security Act (ERISA) to guarantee the benefits of employees who are defined-benefit plans in certain types of pension plans. The idea was to design a government-sponsored insurance system in which employers of defined-benefit plans would be assured that they would receive their promised benefits. A defined-benefit plan requires a corporation to contribute to a pension fund on the basis of the benefits that eventually are scheduled to be paid to pension holders. The PBGC, in contrast, has no regulatory powers; it passively insures all defined-benefit plans.

The current maximum level for individual PBGC-guaranteed payments is $1,857.96 per month. The PBGC guaranty, which was originally set at $250 in 1974, is adjusted each year in accordance with increases in the Social Security wage base. The guaranteed ceiling affects very few participants, however. In fact, the average monthly benefit check issued by the PBGC today is less than $250. The guarantee covers only “basic” benefits that, by PBGC regulation, include vested retirement benefits, plus any cost-of-living adjustments, and any death, survivor, or disability benefits a participant is on payroll status on the date of the plan termination. Although authorized to insure nonbasic benefits, such as special supplementary benefits that are offered to encourage early retirement, the agency has opted not to do so.

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The PBGC is self-financed; it does not receive any regular government funding. The pension-guarantee fund is financed from several sources: (1) from annual premiums per participant from insured pension plans; (2) from assets valued at the flat-rate premium (the latest available), the corporation had total assets of $1.44 billion and had $2.74 billion in total liabilities, leaving it with an accumulated deficit of approximately $1.3 billion at the end of 1985. This unprecedented escalation of accumulated deficit is attributed primarily to two large claims by two companies: the Allis-Chalmers Corporation and the Wheeling-Pittsburgh Corporation. Almost $600 million of the PBGC claims are of approximately $600 million. Although the agency’s negative net worth soared in 1985, it still had a positive cash flow.

The decision of Allis-Chalmers Corporation to terminate 11 of its pension plans in a non-bankruptcy action, the bankruptcy of Wheeling-Pittsburgh Corporation, and the recent bankruptcy petition by LTV Corporation could be justified on the basis that the companies had no other financial choice. However, it is equally plausible for corporations to voluntarily terminate large pension plans by paying the PBGC to choose bankruptcy because a court may permit a restructuring of the collective bargaining agreements and a reduction of long-term pension and insurance liabilities. To the extent that PBGC’s terminations confirm reorganization plans based on limiting long-term exposures to such outlays, bankruptcy will be an attractive alternative for debt-burdened corporations and a threat to the PBGC.

The PBGC realized that it was exposed to substantial risk of future losses through terminating plans and began policies to mitigate this risk. Congress last granted the agency a power to reject the PBGC’s request for a new premium prior to the single-employer fund, in August 1978. The PBGC’s repeated requests for a premium increase since then were fruitless until April 1990. Congress finally raised the premium to $8.50. The $8.50 premium was enacted without consideration of the LTV situation, which developed in July 1986.

LTV Spins Off Unfunded Pension Liabilities Onto the PBGC

LTV Corporation’s pension plans are underfunded by $2.5 billion. Its hourly pension plans are more severely underfunded than its salaried plans (see chart 2). In September 1986, the Dallas-based corporation transferred one of its two salaried plans to the PBGC and, on January 13, 1987, a federal court allowed the agency’s termination of the other pension plans. Assumption of the four LTV plans will triple the agency’s already burgeoning cumulative deficit.

While it is clear that the agency is already insolvent, the assumption of LTV’s unfunded liabilities is pushing the cash outflows of the PBGC above its cash inflows. As a consequence, the agency is now forced to reduce its reserves by selling investment assets so that it can pay its legally mandated claims. This is a no-lose situation. Thus, for the next few years, the PBGC will have to deal with the PBGC’s large financial problems.

The PBGC’s Potential Future Liabilities

Alicia H. Munnell investigated the prospective financial condition of the PBGC in 1982, and she observed that the business of guaranteeing private pension plans was not profitable. Munnell’s investigation found that the PBGC was financially vulnerable in 1982 to the termination of major pension plans, despite the apparent financial soundness of the overall pension system.

Munnell’s study revealed that the majority of terminated plans with insufficient assets were terminated because of adverse business conditions, such as poor economic conditions, business liquidations, or plant closings. The PBGC’s cash inflows were insufficient assets were terminated as a result of bankruptcy—an unpredictably event. Although those terminations were relatively small, she found that the worst underfunded plans are typically the largest plans. Thus, it is not surprising that the PBGC today is facing insolvency and liquidity problems in the wake of the pension-plan terminations of Allis-Chalmers, and the bankruptcy of Wheeling-Pittsburgh and of LTV, all of which Munnell identified in 1982 as companies with a high likelihood of pension-plan termination. A second, but minor, phenomenon affecting the solvency of the PBGC is the growing number of corporations that are voluntarily terminating their underfunded plans. When a pension fund is over-funded, a corporation’s management has an incentive to voluntarily terminate the fund in order to reversion. In a reversion, the PBGC is forced to reduce its reserves by selling investment assets. However, the PBGC’s financial troubles.

The Tax Reform Act of 1986 will partially blunt the incentive to terminate unfunded pension plans because it requires corporations to pay an additional tax of 10 percent on pension assets. However, there are other ways in which corporations can obtain access to surplus pension assets without terminating their pension funds. For example, Cleveland-based Sherwin-Williams Company recently received approval from the U.S. Department of Labor to terminate its plan.


3. LTV was precluded under the terms of its col- lective bargaining agreements from initiating the termination of the two plans covering hourly workers. Thus, the PBGC legally had to seek a court ruling to terminate LTV’s hourly plans. See Cathy Trout and Cynthia F. Mitchell, “U.S. Pen- sion Lit Set to Take Over Three LTV Plans,” Wall Street Journal, January 13, 1987, p. 20.

