Statement
for the

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"The Pension Benefit Guaranty Corporation"

By

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Written Testimony of Dallas Salisbury

Chairman Kohl, Senator Martinez, and members of the committee: My name is Dallas Salisbury. I am president and chief executive officer of the Employee Benefit Research Institute (EBRI). I am pleased to appear before you today. All views expressed are my own, and should not be attributed to EBRI, or any other individual or organization. Established in 1978, EBRI is committed exclusively to data dissemination, policy research, and education on financial security and employee benefits. EBRI does not lobby or advocate specific policy recommendations; the mission is to provide objective and reliable research and information. All of our research is available on the Internet at www.ebri.org and our savings and financial education material is at www.choosetosave.org

I have personally worked on retirement and pension issues since joining the Labor Department in 1975 as it was organizing to fulfill its responsibilities under the Employee Retirement Income Security Act of 1974 (ERISA). I was later on the staff of the Pension Benefit Guaranty Corporation, before joining EBRI in 1978 as its first employee. While at the PBGC I served as a special assistant to the Executive Director, as Acting Director of Communications, and as Director of the Congressionally mandated study of he Multiemployer Insurance System, the results of which led to drafting and enactment of the Multiemployer Pension Plan Amendments Act. While at PBGC I participated in many meetings with the "Board reps", the individuals designated by the Secretaries of Labor, Treasury and Commerce to work with PBGC executives on an ongoing basis. These individuals had most of the direct dealings on behalf of the PBGC with these cabinet members who make up the Board of Directors of the PBGC.

After leaving the PBGC I was appointed to a special PBGC task force by President Reagan to study a proposal to "privatize" the PBGC. The group concluded that privatization of the PBGC was infeasible as corporate insolvency was not seen as an insurable event under terms that would be acceptable to Congress.

A decade after leaving the PBGC, I was appointed by President George H. W. Bush to represent the general public on the PBGC Advisory Committee, and participated in that groups interviews of many investment managers during quarterly reviews, and meetings with those applying to become investment managers. That Advisory

Committee also worked with the then Executive Director James Lockhart, now the head of the agency overseeing Fannie Mae and Freddie Mac, on reform proposals that ultimately became law in 1986, 1987 and 1994, which changed the PBGC premium structure and the circumstances under which a plan sponsor could terminate a plan and pass the liabilities to the PBGC. These changes took steps towards relating premiums to the level of unfunded exposure a plan presented to the PBGC, and towards making voluntary termination contingent upon the insolvency of the plan sponsor, unless the PBGC determined that it was in the interest of PBGC to approve a termination based upon terms negotiated to protect the agency (and thus the defined benefit system and its participants and beneficiaries).

Under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) PBGC insures, subject to statutory limits, pension benefits of participants in covered private defined benefit pension plans in the United States. The Corporation's goals include safeguarding the federal pension insurance system for the benefit of participants, plan sponsors, and other stakeholders, providing exceptional service to customers and stakeholders, and exercising effective and efficient stewardship of PBGC resources. (PBGC 2008 Annual Report)

Given limited time I will respond the three sets of specific questions provided to me and then would be pleased to respond to any additional questions.

First: What are the current obligations facing the PBGC?

PBGC estimates that, measured on a termination basis, total underfunding in single-employer defined benefit plans that PBGC insures was approximately $225 billion as of December 31, 2006. A April 2009 report from Milliman estimated that the largest 100 plans were slightly overfunded as a group at year end 2006, while a total system estimate from Ryan Labs Asset Management found the total system to be 88 percent funded at year end 2006. By April of 2009 Milliman estimated that the 100 largest funds were 80 percent funded, and Ryan estimated that the entire system was just over 70 percent funded, suggesting total system underfunding of as much as $500 billion.

The PBGC protects the benefits of most private single and multi-employer pension plans in the event that the plans are terminated without sufficient assets to pay all benefits. The total obligation represented for the PBGC is highly volatile from month to month and year to year. For example, the PBGC 2008 actuarial report stated:

> For the single-employer program, the liability as of September 30, 2008 consisted of:
>
> (1) $57.32 billion for the 3,850 plans that have terminated; and
>
> (2) $12.61 billion for 27 probable terminations.
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> For the multiemployer program, the liability as of September 30, 2008 consisted of:
>
> (1) $1 million for 10 pension plans that terminated before the passage of the Multiemployer Pension Plan Amendments Act (MPPAA) and of which PBGC is trustee; and
>
> (2) $1.768 billion for probable and estimable post-MPPAA losses due to financial assistance to 90 multiemployer pension plans that were, or were expected to become, insolvent.

Today's testimony by PBGC suggests that the $12.61 billion has now increased to $23.61 billion, and the $57.32 billion to about $67 billion due to interest rate changes ($7 billion) and investment losses ($3 billion). These changes underline the volatility experienced by all defined benefit pension plans tied to both interest rates (liability swings) and investments (asset swings), and the reason plan sponsors have generally argued against mark to market accounting and for smoothing both interest rate and investment return volatility in order to smooth contributions.

How many pensions is it insuring?

The Pension Benefit Guaranty Corporation (PBGC) insures the pensions of about 33.8 million workers and retirees in about 28,000 private-sector defined benefit pension plans under its single-employer insurance program, and 10.1 million participants under its multiemployer program in about 1500 plans.

What are the basic demographics of this group?

Looking at workers with a defined benefit plan, they are predominately union, and older. About 13 percent of all private workers are in a single employer defined benefit plan and 4 percent in a multiemployer plan. About half the insured participants are active, about one quarter retired, and about one quarter separated and vested but not yet retired.

Second: How prepared is the PBGC in paying out existing pensions and what

limitations does PBGC face in securing revenue for this (i.e. inability to raise premiums, etc.).

The current assets of PBGC exceeded the liabilities attributable to plans that had already terminated at the end of FY 2007, but today's testimony suggests that is no longer the case. However, annual net negative cash flow is about $2.5 billion, providing for nearly two decades of payments at current asset levels.

The longer term issue relates to what one expects for the future in terms of terminations and net liabilities related to them.

The PBGC has the ability to return to the Congress at any time with a request to raise premiums on insured defined benefit plans. The issue is not the ability to do so, but rather the implications in the longer term future of defined benefit plans and their ability to pay premiums. The total number of participants has continued to increase slowly on whom premiums are paid, even as the number of plans decreases.

Third: What are the future challenges facing the PBGC?

The major future issue for PBGC is what happens to defined benefit plans. As long as an employer or group of employers maintains the plan until it is pays its last benefit, PBGC is fine. The risk is underfunded terminations due to business failures or reorganizations. The revised figures discussed today by PBGC suggest that this is a major challenge should the current economic crisis continue for some time, including their estimate of potential auto industry net exposure of $42 billion dollars were all plans to end up with the PBGC.

Fourth: What does the current DB pension system environment look like?

The current system environment is mixed to bad. Plan terminations have accelerated. Plan freezes have accelerated. And, the current economic crisis holds the potential for more plans to shift liabilities to the PBGC.

Fifth: What plans may default to the PBGC in the future (i.e. auto companies)?

The PBGC provides estimates of probable terminations in multiple industries. Their 2008 reports suggested significant exposure in transportation, retail, financial services and health care. Their testimony today underlines the dramatic erosion in the economy since the end of September, and the possible consequences for PBGC. The longer the economic recession continues, the higher unemployment goes, and the longer the Federal

Reserve holds down interest rates, the worse the situation for defined benefit plans and the PBGC will become. Low interest rates cause pension liabilities to rise, and that in turn requires much larger pension contributions when rates are smoothed over 3 to 5 years instead of 20, 30 or 40. Provisions in the Pension Protection Act of 2006, combined with current interest rate policy, will likely combine to cause harm to the defined benefit system and the PBGC in the years immediately ahead. That does not speak to the merits of the policies, just the results.

Sixth: What are the future liabilities (unhealthy DB plans) for the PBGC?

PBGC annually reports numbers on a broader set of possible terminations by industry, without naming firms. At year-end 2008, PBGC estimated its exposure from underfunding by plan sponsors whose credit ratings were below investment grade or who met one or more financial distress criteria at approximately $47 billion in 2008, down from $66 billion in 2007. Given current conditions, as reported by PBGC today, this number is moving back up. As they note, dropping interest rates added an estimated $7 billion to PBGC liabilities since the end of September.

Seventh: How will this affect the PBGC moving forward?

Were both Chrysler and GM plans to move to the PBGC, which may not happen, total assets of the agency would move towards 200 billion dollars. Liabilities would grow large as well, but cash flow on those plans would be easily covered for many years. The ongoing risk for PBGC also relates to premium payments, as terminations move participants onto the books of the PBGC. Thus, the PBGC has strong motivation to have firms that survive bankruptcy to keep their pension plans, even if then frozen.

Eight: Are companies with healthy DB plans likely to retain their plans and remain paying premiums into the future?

Companies and unions that continue to believe that the plan helps them achieve workforce and retirement objectives at a justifiable cost will do so. But, recent years have seen many companies that are healthy and have healthy DB plans make the decision to freeze them, and in some cases terminate them. The level of volatility that mark to market accounting / funding introduces, particularly in recent years when market volatility has been significant, serves to decrease the incentives for many sponsors to continue their defined benefit plans. Recent consulting firm surveys suggest that the movement away from open defined benefit plans by strong companies will continue. And, the affect that the rules of the Pension Protection Act of 2006 are already having on many seemingly health DB plans is not encouraging, as committed plan sponsors have taken action to freeze their plans at least temporarily due to large contributions being required due to extraordinary investment and interest rate volatility.

Conclusion

Defined benefit plans in the private sector currently provide annuity income to about 23 percent of those over age 65. For those between 65 and 69, 18.8 percent report such income, with average payments of $2,491 and median payments of $9,180. These are important additions to Social Security.

The average pension paid by PBGC in 2006 was $6,372. While there is much focus on the fact that PBGC pays a maximum benefit of about $54,000, it is important to note that for most defined benefit plan participants that limit represents a dream, not a problem.

There has been a great deal of discussion about the advent of 401(k) plans and what that may mean for workers. Data on current IRA and 401(k) account balances from the Federal Reserve that individuals near retirement age have sufficient balances to provide median annual income of between $7,000 and $9,000 for married individuals, and $3,000 and $5,000 for single individuals.

Defined benefit plans are important for many, as they were to my father throughout his 93 years, as well as to my sister in law since my brother passed away at the age of 64 and left a joint and survivor pension. Defined contribution plans are as well, as individuals like me depend only on a 401(k) account balance and 30 years of contributions and investment earnings.

In all cases, the objective should be to keep all promises that are kept, and to help individuals spend and save and invest on an informed basis. Or as we say so often, choose to save if you do not want to work forever!

Thank you for the invitation to be with you today.