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# Proposals to Change Pension Benefit Guaranty Corporation's (PBGC) Premium Structure: Issues for Congress

(name redacted)

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## Summary

This report provides background and analysis of the premiums charged by the Pension Benefit Guaranty Corporation (PBGC), which is a government-owned corporation that was created in 1974 to protect the retirement income of participants in private-sector, defined benefit (DB) pension plans. When a company terminates a DB pension plan that does not have enough assets to pay 100% of the promised benefits, PBGC pays, in accordance with statute and up to a maximum yearly dollar amount, the benefits to participants in the terminated plan. In FY2013, 901,000 individuals received \$5.4 billion in benefit payments from PBGC. An additional 617,000 workers will receive benefits when they retire.

PBGC consists of two insurance programs: (1) a multiemployer pension program, which protects the benefits of 10.4 million participants in collectively bargained DB pensions in which several employers make contributions, and (2) a larger single-employer pension program, which protects the benefits of 31.9 million participants in DB pensions operated by one employer for its eligible employees. Since FY2002, PBGC has ended each fiscal year with a deficit. The total deficit for the PBGC at the end of FY2013 was \$35.6 billion. Most of this deficit is attributable to the single-employer program, which ended FY2013 with a deficit of \$27.4 billion. At the end of FY2013, PBGC's single-employer program reported assets of \$83.0 billion and liabilities of \$110.6 billion. Most of PBGC's liabilities are future benefit obligations.

Although PBGC receives no congressional appropriations, its financial condition may be of interest to Congress. If PBGC's deficit persists, then cuts to benefits or U.S. government financial assistance could be necessary. PBGC is funded by a combination of insurance premiums paid by employers who sponsor DB pension plans, the assets of DB pension plans that are trusted by PBGC, and income earned on the investment of the trusted plan assets.

Some policymakers who are concerned by PBGC's financial position have renewed the calls for changes to the structure of the premiums that PBGC collects from employers. The suggested changes include increasing current premium levels or adding a premium that would better reflect a pension plan's potential liability to PBGC. PBGC collects three premiums from DB plan sponsors: (1) an annual flat-rate premium of \$49 per participant; (2) an annual variable-rate premium of \$14 per \$1,000 of underfunding; or (3) a termination premium of \$1,250 per plan participant per year for three years for pension plans that terminate under certain conditions.

Changes to PBGC's premium structure were included in the Department of Labor's FY2012 and FY2013 proposed budgets. In the 112<sup>th</sup> Congress, H.Con.Res. 34, the Concurrent Resolution of the Budget for Fiscal Year 2012, and H.Con.Res. 112, the Concurrent Resolution of the Budget for Fiscal Year 2013, recognized a need to reform PBGC but did not adopt the President's budget recommendations. In the 112<sup>th</sup> Congress, the Moving Ahead for Progress in the 21<sup>st</sup> Century Act (MAP-21; P.L. 112-141) increased the premiums levels but did not change the structure of the premiums that DB plan sponsors pay. In the 113<sup>th</sup> Congress, H.J.Res. 59 (P.L. 113-67), the vehicle for the December 2013 bipartisan budget agreement, increased PBGC premiums that the sponsors of single-employer DB pension plans pay. Proponents of changes to PBGC's premium structure argue that the current premium structure does not adequately reflect the risk to PBGC of some underfunded pension plans. Some have proposed that PBGC charge premiums based on the financial health of a DB plan sponsor. Although risk-based premiums would better allocate the risk of termination among DB plan sponsors, their implementation would raise additional concerns.

## Contents

Background on PBGC .....	1
The Financial Position of PBGC .....	2
Financing of PBGC.....	8
Revolving and Trust Funds.....	8
PBGC Premiums .....	8
Three Types of PBGC Premiums .....	9
Proposals to Adjust PBGC's Premium Structure.....	11
Analysis of PBGC Premiums and Proposed Changes.....	13

## Figures

Figure 1. Financial Position of the Single-Employer Insurance Program of the Pension Benefit Guaranty Corporation .....	3
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## Tables

Table 1. PBGC Single-Employer Program Data: FY2004 to FY2013 .....	6
Table 2. PBGC Single-Employer Program Premium Levels.....	10

## Contacts

Author Contact Information.....	16
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## Background on PBGC

The Pension Benefit Guaranty Corporation (PBGC) is a federal government agency established in 1974 by the Employee Retirement Income Security Act (ERISA; P.L. 93-406). PBGC was created to protect the pension benefits of participants and beneficiaries in private-sector, defined benefit (DB) pension plans. These pension plans provide a specified monthly benefit at retirement, usually either a percentage of salary or a flat dollar amount multiplied by years of service. PBGC does not insure the pension plans of churches, religious organizations, state and local governments, or the federal government. In addition, defined contribution (DC) plans, such as §401(k) plans, are not insured by PBGC. PBGC is headed by a director who is appointed by the President and confirmed by the Senate. The Secretary of Labor chairs PBGC's Board of Directors, with the Secretaries of Treasury and Commerce serving as board members.

PBGC runs two distinct insurance programs: one program for single-employer pension plans and a second for multiemployer plans. Single-employer plans are operated by one employer for the benefit of eligible employees of that company. Multiemployer plans are collectively bargained plans to which more than one company makes contributions. PBGC maintains separate reserve funds for each program. The single-employer program is the larger of the two programs.

In FY2013, the single-employer program insured 31.9 million participants in 23,400 pension plans and the multiemployer program covered 10.4 million participants in about 1,450 pension plans.<sup>1</sup> *As there are no current proposals to change the structure of the premiums of the multiemployer program, the remainder of this report discusses only the single-employer program.* Although federal law states that the U.S. government is not liable for any of the debts incurred by PBGC,<sup>2</sup> many policymakers feel that the government would provide PBGC the necessary resources if its funds became insufficient to pay benefits to retirees.<sup>3</sup>

The financial condition of PBGC may be of interest to Congress for several reasons: (1) Congress has demonstrated a clear interest in the retirement income security of American workers, for example, by providing a variety of tax incentives to encourage employer and employee contributions to retirement plans (Congress established PBGC as a pillar of retirement income security); (2) the insolvency of PBGC could require decreases in retirees' promised benefits or U.S. financial assistance; and (3) increases in PBGC premiums are scored by the Congressional Budget Office (CBO) as increases in government revenue.

A pension plan may terminate either voluntarily in a standard or in a distress termination or in an involuntary PBGC-initiated termination.<sup>4</sup> A standard termination of a pension plan occurs when a pension plan has sufficient assets from which to pay participants' promised benefits. The pension plan sponsor guarantees benefits by purchasing an insurance annuity for each participant. PBGC's involvement in a standard termination is minimal: it confirms that the plan sponsor has met the

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<sup>1</sup> See the 2013 PBGC Annual Report available at <http://www.pbgc.gov/documents/2013-annual-report.pdf>.

<sup>2</sup> 29 U.S.C. 1302(g)(2) states that "The United States is not liable for any obligation or liability incurred by the corporation."

<sup>3</sup> See, for example, "\$34 Billion Shortfall Estimate Sparks Renewed Talk of Taxpayer Help for PBGC," *Pensions & Investments*, May 14, 2010, available at <http://www.pionline.com/article/20100514/REG/100519901>.

<sup>4</sup> More information on pension plan terminations is available in CRS Report RS22624, *The Pension Benefit Guaranty Corporation and Single-Employer Plan Terminations*, by (name redacted) and (name redacted).

requirements for conducting a standard termination. A distress termination of a pension plan occurs when a plan terminates with an insufficient amount of assets from which to pay participants' promised benefits. Employers cannot terminate an underfunded pension plan at their discretion: they must prove that they are financially unable to support the pension plan. PBGC may also initiate a termination of a pension plan. In a PBGC-initiated pension plan termination, PBGC must demonstrate one of the following: (1) the plan has not met the minimum funding requirements; (2) the plan cannot pay current benefits when due; (3) a lump sum payment has been made to a participant who is a substantial owner of the sponsoring company; or (4) the loss to PBGC is expected to increase unreasonably if the plan is not terminated.

In distress and involuntary terminations, PBGC becomes the trustee of the terminated plan and pays the participants' benefits in accordance to law and up to a statutory maximum benefit amount. PBGC guarantees the basic benefits of a pension plan, which include the pension benefits at normal retirement age, most early retirement benefits, disability benefits, and annuity benefits for survivors of plan participants. Some benefits are not fully guaranteed by PBGC.<sup>5</sup> PBGC cannot pay annual benefits to a retiree above a statutory maximum dollar amount. The annual maximum benefit depends upon the year of plan termination, the age at which the participant begins to receive benefits, and the form of the benefit payment. For example, the maximum benefit is \$59,318 for a participant in a plan that is terminated in 2014 and who receives a single-life annuity beginning at the age of 65. The maximum benefit is \$34,024 if the participant receives a joint-and-survivor annuity beginning at the age of 55 and the participant's spouse is also 55 years old.<sup>6</sup> PBGC reported in 2006 (the most recent year for which data is available) that an examination of 125 trusteed plans showed that 84% of participants received 100% of their benefits earned under the plan.<sup>7</sup>

The remainder of this report details the financial position and sources of revenue of the PBGC's single-employer pension program, describes the premiums that the sponsors of single-employer pension plans pay to PBGC, and discusses recent policy proposals to alter the structure of the premiums that single-employer pension plans pay to PBGC.

## The Financial Position of PBGC

At the end of FY2013, the single-employer program of PBGC reported total assets of \$83.2 billion of which \$77.9 billion were investments. The remaining assets consisted of cash, securities lending collateral, receivables, and capitalized assets. PBGC reported total liabilities of \$110.6 billion, of which \$105.0 billion were the present value of future benefit payments. The total deficit of the single-employer program at the end of FY2013 was \$27.4 billion.<sup>8</sup>

**Figure 1** details the amount of assets, liabilities, and the net financial position of PBGC's single-employer program from FY1980 to FY2013. From FY1980 to FY1994, PBGC had end of year deficits and from FY1995 to FY2001, PBGC finished each year with a surplus. Since FY2002, PBGC has reported yearly deficits at the end of the fiscal year. One measure of the financial

<sup>5</sup> For example, the PBGC does not guarantee benefits that were created or increased within five years prior to plan termination.

<sup>6</sup> The benefit is adjusted to be actuarially neutral. A benefit payment is actuarially neutral if it is adjusted to pay the same total dollar amount over a participant's expected lifetime.

<sup>7</sup> See Pension Insurance Data Book 2006, available at <http://www.pbgc.gov/docs/2006databook.pdf>.

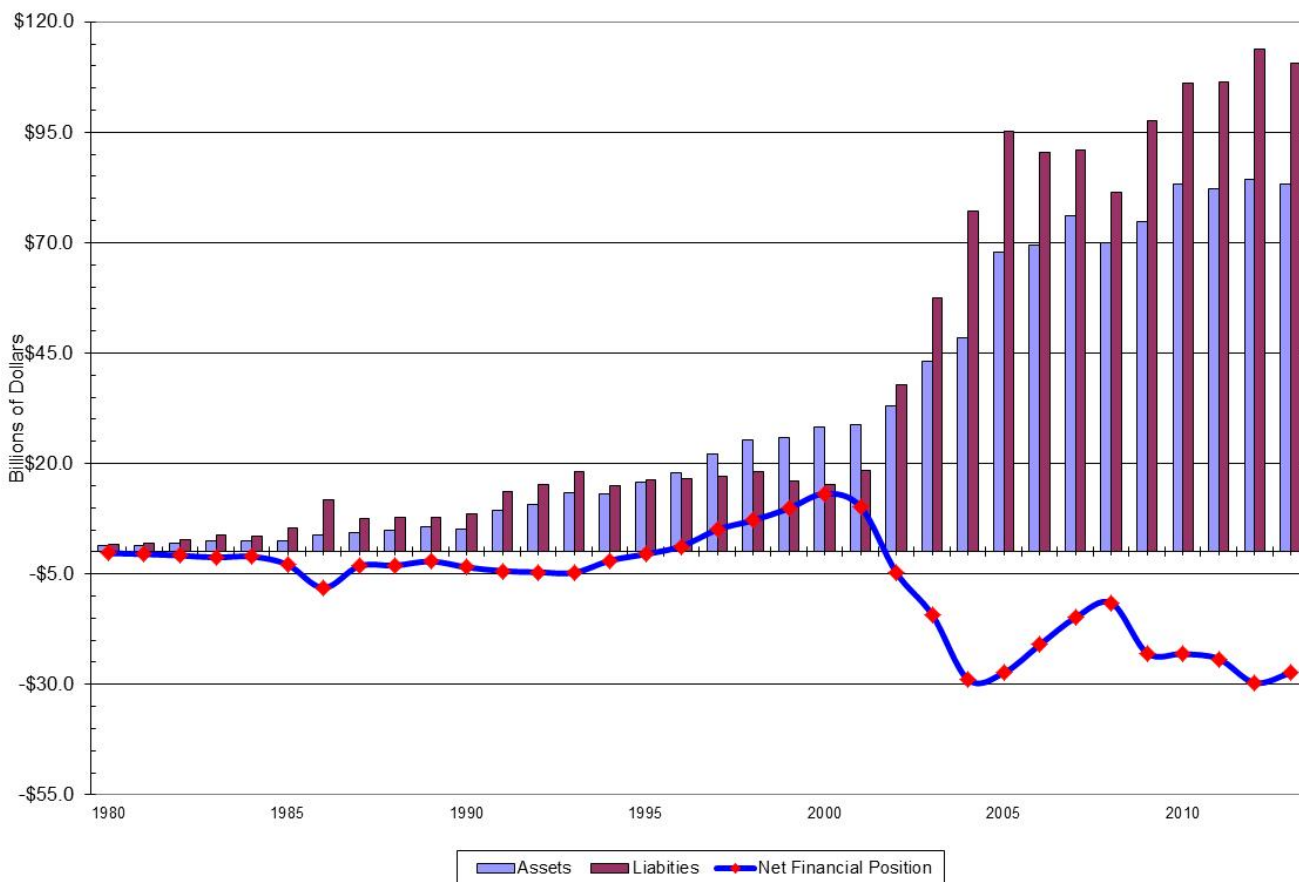
<sup>8</sup> See the 2012 PBGC Annual Report available at <http://www.pbgc.gov/documents/2012-annual-report.pdf>.

health of a pension plan is the “funding ratio,” which is the ratio of pension plan assets to liabilities. The ratio of assets to liabilities for PBGC was 75.2% at the end of FY2013, which means that currently PBGC has insufficient assets from which to fund all of its future benefit obligations.

Because the benefit obligations are paid out over several decades, retirees’ benefits are not at immediate risk and PBGC has indicated that it “has enough funds to meet its obligations for years.”<sup>9</sup> At the end of FY2013, PBGC had \$83.2 billion in assets in its single-employer program and had paid \$5.4 billion in benefits during FY2013. However, the deficit cannot persist indefinitely without an increase in PBGC revenues, a decrease in benefit outlays, or both.

**Figure 1. Financial Position of the Single-Employer Insurance Program of the Pension Benefit Guaranty Corporation**

End of Fiscal Year: FY1980 to FY2013



**Source:** PBGC Pension Insurance Data Books and FY2013 Annual Report.

**Notes:** CRS adjusted the dollar amounts for inflation using the fiscal year (October to September) monthly averages for the Consumer Price Index, All Urban Consumers (CPI-U).

<sup>9</sup> See Message from Director Josh Gotbaum in PBGC 2012 Annual Report, available at [http://www.pbgc.gov/Documents/2012\\_annual\\_report.pdf](http://www.pbgc.gov/Documents/2012_annual_report.pdf).

The funding ratios of private-sector DB pension plans have been below 100% in recent years and continued weakness in the economy could result in increases in pension plan terminations. Greater pension plan underfunding implies that, on average, plans that end in distress terminations would impose a greater financial burden on PBGC. A study of the 100 largest corporate DB plans indicated that the funding ratios of these plans were 93.9% as of November 30, 2013, an increase from the November 30, 2012 ratio of 74.0%.<sup>10</sup> The funded status of these plans was 105.4% in 2007, dropped to 79.3% in 2008, was 81.7% in 2009, 83.9% in 2010, and declined from 86.8% in February 2011 to 75.5% in February 2012. The decline in funding ratios from 2007 to 2012 was the result of several factors: (1) new pension plan funding requirements authorized by the Pension Protection Act of 2006 (PPA; P.L. 109-280); (2) decrease in prices on the stock market, which reflected lower expectations for corporate profits due to the recession that began in December 2007 and ended in June 2009; and (3) lower interest rates, which reflected Federal Reserve efforts to influence the economic recovery. The improvement from 2012 to 2013 was the result of improved investment performance and increases in interest rates.<sup>11</sup>

**Table 1** provides information about the operations of PBGC's single-employer program since FY2004. Since its creation in 1974, PBGC has become the trustee of 4,557 single-employer pension plans and in FY2013 paid \$5.4 billion in benefits to 799,210 end-of-FY2013 participants in these plans.<sup>12</sup> Over the past 10 years PBGC has become larger: it paid benefits to 1.7 times more participants in FY2013 than in FY2004 and paid 1.7 times more in inflation-adjusted benefit amounts in FY2013 than in FY2004. PBGC's deficit increases with each pension plan that PBGC becomes trustee of, while the base from which PBGC collects premiums continues to decrease as a result of the increasing number of terminations of fully funded pension plans.<sup>13</sup>

Some policy analysts feel that certain PBGC accounting policies overstate its deficit.<sup>14</sup> For example, PBGC currently discounts its future benefits obligations using an interest rate that approximates the discount rate used in the private-sector annuity market. The rates used by PBGC were approximately 3.25% in FY2013. Some have suggested that PBGC should value its benefit obligations using discount rates similar to the rates used by private-sector DB pension plans, which, in general, are higher than the insurance company rates that PBGC currently uses. Although the value of PBGC's benefit obligations would decrease if it used higher discount rates,

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<sup>10</sup> These studies cover the 100 U.S. public companies with the largest defined benefit pension assets. For data through the end of 2009 see Milliman 2010 Pension Funding Study available at <http://www.milliman.com/expertise/employee-benefits/products-tools/pension-funding-study/pdfs/pension-funding-study.pdf>. For data from 2010 and 2011 see the Milliman 100 Pension Funding Index available at <http://publications.milliman.com/publications/eb-published/pdfs/milliman-100-pension-funding-01-06-12.pdf>. For 2012 data see the Milliman 100 Pension Funding Index, available at <http://milliman.com/expertise/employee-benefits/products-tools/pension-funding-index/pdfs/pfi-january-2013.pdf>. For 2013 data see <http://us.milliman.com/pfi/>.

<sup>11</sup> The S&P 500 stock market index declined 38% in 2008 and reached that level again on March 26, 2013. One-year Treasury note yields were 5.0% on January 2, 2007, and had fallen to 0.12% on January 3, 2012.

<sup>12</sup> PBGC reported 781,160 benefits' recipients as of the end of FY2012. Some participants received a one-time, lump-sum benefit or died before the end of the fiscal year and so were not included in the end-of-year number.

<sup>13</sup> Although the number of participants who receive benefits and the number of plans trustee by PBGC has increased since 2002, the number of participants in PBGC insured plans decreased from 34.2 million in FY2002 to 33.4 million in FY2011 and the number of plans covered decreased from 31,229 to 25,607 over the same period. See Tables S-30 and S-31 of the Pension Insurance Data Book 2009 for the number of PBGC-insured plans and the number of plan participants from 1980 to 2009. See the 2011 PBGC Annual Report for the number of PBGC-insured plans and the number of plan participants in 2010 and 2011, available at <http://www.pbgc.gov/documents/2011-annual-report.pdf>.

<sup>14</sup> See American Benefits Council, "Ten Reasons to Doubt PBGC's Reported Deficit," press release, November 15, 2011, available at <http://www.appwp.org/newsroom/2011/pr11-18.cfm>.

PBGC's director indicated that he felt that current accounting practices should be maintained. He also indicated in February 2012 that discounting future benefit obligations using corporate bond rates would have lowered PBGC deficit to about \$20 billion.<sup>15</sup> Policy analysts have differences of opinion with regard to the appropriate rate for discounting pension plan liabilities.<sup>16</sup>

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<sup>15</sup> Testimony of PBGC Director Joshua Gotbaum, in U.S. Congress, House Education and the Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Examining the Challenges Facing PBGC and Defined Benefit Pension Plans*, Hearings, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., February 2, 2012.

<sup>16</sup> In general, financial economists tend to say that pension plans should use discounts rates that reflect the probability that a payment will not be made in the future while actuaries tend to say that pension plans should use discount rates that equal the expected rate of return on plan assets. PBGC's use of discount rates that insurance companies use are lower than the discount rates used by private pension plans and much lower than those used by state and local government pension plans.



**Table I. PBGC Single-Employer Program Data: FY2004 to FY2013**

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	Percentage Change, 2004 - 2013
Benefits Paid (millions of 2013 dollars)	\$3,726	\$4,423	\$4,725	\$4,825	\$4,648	\$4,865	\$5,841	\$5,558	\$5,472	\$5,489	47.3%
Participants Receiving Monthly Benefits <sup>a</sup>	517,900	682,540	612,630	631,130	640,070	743,610	747,530	775,300	781,160	799,210	54.3%
Number of Plans Trusteed and Pending Trusteeship	3469	3585	3673	3783	3850	3993	4140	4292	4447	4557	31.4%
Premium Income (millions of 2013 dollars)	\$1,807	\$1,741	\$1,669	\$1,669	\$1,451	\$1,980	\$2,384	\$2,157	\$2,685	\$2,943	62.8%
Investment Income (millions of 2013 dollars)	\$3,963	\$4,677	\$2,528	\$5,358	-\$4,509	\$6,877	\$8,114	\$3,587	\$8,935	\$2,741	-30.8%
Total Assets (millions of 2013 dollars)	\$48,337	\$67,775	\$69,422	\$76,053	\$69,970	\$74,678	\$82,765	\$82,184	\$84,324	\$83,227	72.2%
Present Value of Future Benefits (millions of 2013 dollars)	\$75,415	\$83,698	\$80,038	\$78,308	\$64,971	\$90,213	\$96,183	\$96,748	\$107,355	\$105,018	39.3%
Net Position: Assets – Liabilities <sup>0</sup> (millions of 2013 dollars)	-\$28,890	-\$27,336	-\$21,001	-\$14,829	-\$11,563	-\$22,899	-\$23,072	-\$24,216	-\$29,616	-\$27,381	-5.2%
Ratio of Assets to Liabilities	62.6%	71.3%	76.8%	83.7%	85.8%	76.5%	78.2%	77.2%	74.0%	75.2%	-

**Source:** FY2013 Annual Management Report.

**Notes:** CRS adjusted the dollar amounts for inflation using the FY (October to September) monthly averages for the Consumer Price Index, All Urban Consumers (CPI-U).

- a. This number refers to the number of participants receiving monthly benefits at the end of the fiscal year. Participants who received one-time, lump-sum payments or who died during the year are not counted.
- b. Besides the present value of future benefits, PBGC Annual Report includes the following payables as liabilities: derivative contracts, amounts due for purchases of securities, amounts payable upon return of securities loaned, unearned premiums, and accounts payable and accrued expenses. See the 2013 PBGC Annual Report available at <http://www.pbgc.gov/documents/2013-annual-report.pdf>.

## Financing of PBGC

PBGC is entirely self-financing and does not receive any federal appropriations. PBGC is funded by cash flows from the premiums that pension plan sponsors pay, the assets of pension plans that are trusted by PBGC, and dividends and interest from investments.

## Revolving and Trust Funds

PBGC maintains three funds for the single-employer program: two on-budget revolving funds and a nonbudgetary trust fund.<sup>17</sup> The on-budget funds appear on the balance sheet of the federal government and changes to the revolving funds affect the federal budget deficit. The nonbudgetary trust fund does not appear on the balance sheet of the federal government and changes to the trust fund do not affect the federal budget deficit.

The revolving funds are on-budget accounts that receive the premiums that plan sponsors pay, earn interest income from investments in government securities, and receive transfers from the off-budget trust fund. Benefit payments are paid from the revolving funds. The assets of the revolving funds must be invested in U.S. government securities.

The nonbudgetary trust fund receives the assets of pension plans that are trusted by PBGC. The assets in this trust fund are invested according to an investment policy approved by PBGC Board of Governors and are currently invested 30% in equities and 70% in fixed-income securities. The investment income earned by the trust fund is not counted as part of the federal budget. PBGC periodically transfers assets from the trust fund to the revolving fund to reimburse the payment of participant benefits.

PBGC premium income, interest on federal securities in PBGC's revolving funds, and transfers from PBGC's trust fund to PBGC's revolving fund are recorded as offsetting collections in the federal budget. Increases in these offsetting collections are recorded as increases in federal revenues.

## PBGC Premiums

Each sponsor of a pension plan that is insured by PBGC pays annual premiums. Total premium income in FY2013 was approximately \$2.9 billion, which was 53.6% of the amount of benefits paid.<sup>18</sup> For FY2004 to FY2013, premium income averaged 41.37% of benefits paid.

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<sup>17</sup> ERISA Section 4005 (29 U.S.C. 1305) established seven revolving funds to carry out PBGC's activities. One of these funds supports activities in the multiemployer program and three of these funds are not used because PBGC currently does not carry out activities supported by these trust funds. Further information on the trust funds is available in U.S. General Accounting Office, *Pension Benefit Guaranty Corporation: Statutory Limitation on Administrative Expenses Does Not Provide Meaningful Control*, GAO-03-301, February 2003, <http://www.gao.gov/new.items/d03301.pdf>.

<sup>18</sup> Benefit payments are made from premium income, investment income from the revolving and trust funds, and transfers from the trust fund.

## Three Types of PBGC Premiums

PBGC collects three types of premiums: (1) a flat-rate, per-participant premium, (2) a variable-rate premium based on the dollar amount of a plan's underfunding, and (3) a per-participant premium payable for three years after a DB pension plan terminates. The premium amounts are authorized in 29 U.S.C. 1306. Changes in PBGC's premium structure and changes to premium amounts have been authorized by Congress in statute, although previous Administrations have proposed giving PBGC's Board of Directors the authority to set premium levels.<sup>19</sup>

- **Flat-rate premium.** The sponsors of DB pension plans pay annual premiums of \$49 per participant. The premium amount is indexed to increases in the national average wage index, as determined by the Social Security Administration. In FY2013, PBGC collected \$1.4 billion in flat-rate premiums. This premium was authorized by ERISA and was initially set at \$1.00 per participant.
- **Variable-rate premium.** Plans that do not have enough assets set aside to pay 100% of the promised benefits are considered underfunded. The sponsors of underfunded DB plans pay an annual premium of \$14 per \$1,000 of underfunding.<sup>20</sup> Beginning in 2014, the variable-rate premium will be indexed to increases in the average wage index. In FY2013, PBGC collected \$1.6 billion in variable rate premiums. In FY2010, the most recent year for which PBGC has published data, 41.7% of insured pension plans paid the variable-rate premium and 48.9% of participants in insured plans were in plans paying the variable-rate premium.<sup>21</sup> This premium was authorized in the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203).
- **Termination premium.** Plans that terminate under certain distress terminations or in a PBGC initiated termination are liable for a termination premium of \$1,250 per plan participant per year for three years. This premium was authorized in the Deficit Reduction Act of 2005 (P.L. 109-171) and was scheduled to expire December 31, 2010; however, the Pension Protection Act of 2006 (PPA; P.L. 109-280) made this premium permanent. In FY2013, PBGC recorded \$137 million in termination premiums. PBGC indicated that it does not expect to collect termination premiums and indicated that "the termination premium is reserved at 100% since no significant collection has yet been achieved."<sup>22</sup>

PBGC premium revenue in FY2013 was offset by \$94 million in write-offs of interest, penalties, and termination premiums.

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<sup>19</sup> For example, the FY2008 Department of Labor budget indicated that the administration would introduce legislation to authorize PBGC's Board of Directors to set the variable premium rate. See Department of Labor FY2008 Budget, available at <http://www.gpo.gov/fdsys/pkg/BUDGET-2008-APP/pdf/BUDGET-2008-APP-1-15.pdf>. Legislation was not introduced in the 110<sup>th</sup> Congress.

<sup>20</sup> Prior to 2008, underfunded DB plans that made a contribution to their pension plan equal to their full funding limit were not required to pay the variable premium. The full funding limit was the maximum tax deduction allowed by a plan for pension plan contributions.

<sup>21</sup> See 2010 pension insurance data tables available from PBGC at <http://www.pbgc.gov/Documents/pension-insurance-data-tables-2010.pdf>.

<sup>22</sup> The PBGC income statement records a bad debt expense equal to 100% of the termination premium, plus an amount for uncollectable interest and penalties, because it does not expect to collect termination premiums from plan sponsors. See PBGC FY2011 Annual Report, p. 75.

ERISA established the initial flat-rate premium of \$1.00 per participant and the \$2.60 flat-rate premium beginning in 1978. The variable rate premium was first collected in 1988 and the termination premium was first collected in 2006. Since 2007, the flat-rate premium has been adjusted annually for increases in the national average wage index, as determined by the Social Security Administration. Beginning in 2014 the variable-rate premium will also be adjusted for increases in the national wage index. The changes to the index were insufficient for an increase in the flat-rate premium in 2011 or 2012. MAP-21 set the premium rate for 2013 and 2014 and P.L. 113-67 increased PBGC premiums that the sponsors of single-employer DB pension plans will pay in 2015 and 2016.

Some policymakers have suggested that PBGC premiums are lower than those that would be charged in a private market. For example, a research paper in 2002 estimated that private insurance premiums would be twice the amount charged by the PBGC at the time.<sup>23</sup> A 2005 report by CBO indicated that premiums would need to be increased by a factor of 6.5 to be comparable to premiums charged in a private insurance market.<sup>24</sup>

**Table 2** provides historical data on the single-employer program premium levels.

**Table 2. PBGC Single-Employer Program Premium Levels**

	Authorizing Statute	Flat-Rate Premium	Variable-rate Premium	Termination Premium
September 2, 1974-1977	Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406)	\$1.00	-	-
1978-1985		\$2.60 <sup>a</sup>	-	-
1986-1987	Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272)	\$8.50	-	-
1988-1990	Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203)	\$16.00	\$6.00	-
1991-2005	Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508)	\$19.00	\$9.00	-
2006	Deficit Reduction Act of 2005 (P.L. 109-171)	\$30.00	\$9.00	\$1,250.00
2007		\$31.00 <sup>b</sup>	\$9.00	\$1,250.00 <sup>c</sup>
2008		\$33.00	\$9.00	\$1,250.00
2009		\$34.00	\$9.00	\$1,250.00
2010-2012		\$35.00	\$9.00	\$1,250.00
2013	MAP-21 (P.L. 112-141)	\$42.00	\$9.00	\$1,250.00
2014		\$49.00	\$14.00	\$1,250.00

<sup>23</sup> See Steven Boyce and Richard A. Ippolito, "The Cost of Pension Insurance," *Journal of Risk and Insurance*, vol. 69, no. 2 (June 2002).

<sup>24</sup> See Congressional Budget Office, *The Risk Exposure of the Pension Benefit Guaranty Corporation*, September 2005.

	Authorizing Statute	Flat-Rate Premium	Variable-rate Premium	Termination Premium
2015	H.J.Res. 59 (P.L. 113-67)	\$57.00	<sup>d</sup>	\$1,250.00
2016		\$64.00		\$1,250.00
2017		<sup>e</sup>		\$1,250.00

**Source:** Congressional Research Service (CRS).

- a. The Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406) established the initial premium rate of \$1.00 per participant. ERISA authorized the increase in the flat-rate premium to \$2.60 beginning in 1978.
- b. The Deficit Reduction Act of 2005 (P.L. 109-171) adjusted the flat-rate premium annually for increases in the national wage index beginning in 2007.
- c. The Pension Protection Act of 2006 (PPA; P.L. 109-280) provided for a special termination premium of \$2,500 per participant for pension plans of commercial airlines that terminated within a five-year period that began with the year that a commercial airline plan adopted funding rules made available to commercial airlines in the PPA.
- d. MAP-21 increased the variable-rate premium by \$4 (after the 2013 level is adjusted for changes in the national wage index) per \$1,000 of unfunded benefits in 2014, and by another \$5 (after the 2014 level is adjusted for changes in the national wage index) per \$1,000 of unfunded vested benefits in 2015. H.J.Res. 59 increased the variable rate premium in 2015 by \$10 (after the 2014 level is adjusted for changes in the national wage index) per \$1,000 of unfunded benefit and by another \$5 in 2016 (after the 2015 premium is adjusted for changes in the national wage index).
- e. The flat-rate premium in 2017 will be adjusted for changes in the national wage index in 2016.

## Proposals to Adjust PBGC's Premium Structure

Since 2002, PBGC has reported end of fiscal year deficits. Recently, some policymakers have suggested changes to PBGC premiums to eliminate the deficit and minimize the likelihood that PBGC would exhaust its resources. If the PBGC were unable to make benefits payments, it might need to implement changes to participants' benefits or request financial assistance.

In the 112<sup>th</sup> Congress, The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (MAP-21; P.L. 112-141) increased flat-rate and variable-rate premiums that DB plan sponsors pay. MAP-21 did not alter the structure of the premiums. In the 113<sup>th</sup> Congress, H.J.Res. 59, which became P.L. 113-67 and was the vehicle for the December 2013 bipartisan budget agreement, increased PBGC premiums that the sponsors of single-employer DB pension plans pay but did not alter the structure of premiums.

The following are some recent policy proposals that would affect PBGC premiums:

- **President's FY2012 and FY2013 Budgets.** The Administration's FY2012 and FY2013 budgets for the Department of Labor proposed that PBGC Board receive authority to adjust premiums and to take into account the risks that different sponsors pose to PBGC. Specifically, the FY2013 Budget proposed giving PBGC Board the authority to set premiums beginning in 2014. The budget also called for a one-year study and public comment period to assist with implementation and a gradual phase-in of premium increases. The Administration estimates that

this proposal would save \$16 billion over 10 years.<sup>25</sup> PBGC's director indicated that premiums average about 3.5 cents per hour for an industrial worker and that increases in the premiums would be a small percentage of hourly wages.<sup>26</sup>

- **House FY2012 and FY2013 Budget Proposals.** The reports to H.Con.Res. 34, the Concurrent Resolution of the Budget for Fiscal Year 2012, which was passed by the House on April 15, 2011, and H.Con.Res. 112, the Concurrent Resolution of the Budget for Fiscal Year 2013, which was passed by the House on March 29, 2012, contained identical language that stated they did not assume the President's proposal but "recognized the need to reform PBGC to ensure that a future taxpayer funded bailout does not occur." The budget resolutions estimated potential savings over 10 years of \$2.7 billion (in the FY2012 budget resolution) and \$8.34 billion (in the FY2013 budget resolution) but did not identify the source of the savings.<sup>27</sup>
- **The President's Plan for Economic Growth and Deficit Reduction.** In September 2011, the President's proposal to the Joint Select Committee on Deficit Reduction was released and contained legislative language that would have increased the flat-rate premium from the current rate of \$35 per participant per year to \$44 per participant in 2014. The flat-rate premium would have increased each year until 2020 to \$66 per participant per year. The proposal would have replaced the variable-rate premium that is based on the amount of plan underfunding with a risk-based premium that would have been determined by the following factors: the risk of losses to PBGC; a plan's assets and liabilities; the financial condition of the plan's sponsor; PBGC estimated investment income; and any other factor PBGC's Board would have determined to be appropriate. The proposal also recommended that increases in the premiums would have been minimized when the economy or financial markets were weak. In addition, the proposal would have prohibited reliance on credit agency ratings to set premiums, although publically available measures of risk or exposure could have been used. The proposal also would have prohibited premium increases that resulted in premiums more than four times as large as a plan sponsor's 2010 premium.<sup>28</sup>

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<sup>25</sup> There have been previous calls for a change to risk-based premiums. For example, a 2005 proposal from the George W. Bush Administration to reform the defined benefit pension system included PBGC premiums based on the level of risk for financially troubled companies. See "Pension Reform: 'More Honey Than Vinegar' in President's Proposal, Official Says," *Pension and Benefits Daily, The Bureau of National Affairs*, January 18, 2005.

<sup>26</sup> Testimony of PBGC Director Joshua Gotbaum, in U.S. Congress, House Education and the Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Examining the Challenges Facing PBGC and Defined Benefit Pension Plans*, hearings, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., February 2, 2012. In FY2011, PBGC reported revenues of \$2.0 billion and that the single-employer program covered about 33.0 million defined benefit pension plan participants. The premium per worker in FY2011 was, on average, approximately \$60 per year, although considerable variation likely exists in the per-person premiums. Plans that were 100% funded paid the \$35 flat-rate premium, while underfunded plans paid the \$35 flat-rate premium plus the variable-rate premium.

<sup>27</sup> See U.S. Congress, House Committee on the Budget, *Concurrent Resolution on the Budget—Fiscal Year 2012*, report to accompany H.Con.Res. 34, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., H.Rept. 112-58 (Washington, DC: GPO, 2011), p. 108 and U.S. Congress, House Committee on the Budget, *Concurrent Resolution on the Budget—Fiscal Year 2013*, report to accompany H.Con.Res. 112, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., H.Rept. 112-421 (Washington, DC: GPO, 2011), p. 101.

<sup>28</sup> The recommendation is available at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf>.

- **The National Commission on Fiscal Responsibility and Reform.** The report from the National Commission on Fiscal Responsibility and Reform, co-chaired by former Senator Alan Simpson and Erskine Bowles and released in December 2010, contained a recommendation that PBGC's board be given authority to increase the flat-rate and variable-rate premiums.<sup>29</sup>
- **The Debt Reduction Task Force.** The Debt Reduction Task Force, co-chaired by former Senator Pete Domenici and Alice Rivlin and released in November 2010, recommended that the flat-rate premium increase by 15% (which would increase the premium from \$35 to \$40.25) and that the variable-rate premium increase from \$9 to \$12 per \$1,000 of underfunding.<sup>30</sup> The task force also recommended that the variable rate premium be based partly on the riskiness of a pension plan's investment allocation. Pension plans that have a greater allocation in equities would pay higher variable rate premiums.<sup>31</sup>

## Analysis of PBGC Premiums and Proposed Changes

The yearly deficits in PBGC's single-employer program have renewed focus on the financing of PBGC and the premiums that Congress has authorized PBGC to collect. Changes to PBGC's premium structure were also discussed as part of pension plan funding reforms prompted by the termination of several large pension plans in the early 2000s. Of the top 10 largest companies that have presented claims to PBGC, the termination of the pension plans of nine of these occurred from 2001 to 2005.

Although the current structure of both flat-rate and variable-rate premiums has advantages and disadvantages, premium changes would not be without potential challenges. This section discusses these issues and challenges, including the counter-cyclical nature of pension plan insurance, the challenges for PBGC in determining private-sector companies' financial health, and comparisons with other government insurance programs.

In response to higher pension insurance premiums, some pension plan sponsors might choose to freeze or terminate their DB pension plans. In a pension plan freeze, the pension plan is closed to new participants. In addition, a pension plan may opt to prohibit existing participants from earning pension benefits in the future. In a terminated pension plan, the plan sponsor closes the pension plan, but must guarantee participants' benefits through the purchase of an insurance annuity for each of the participants.

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<sup>29</sup> See *The Moment of Truth*, available at [http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12\\_1\\_2010.pdf](http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf).

<sup>30</sup> The report is available at <http://www.bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf>.

<sup>31</sup> Pension plans that have greater allocations in equities would be more likely to experience variation in their funding ratios because the value of equities (like stocks) tends to be more variable than the price of debt instruments (like bonds).



### ***Flat-Rate Premiums***

The flat-rate premium under current law has the advantage of being simple to calculate. This advantage was recognized by the Ford administration in 1974, which said that this type of premium would be

the easiest approach to administer for both plan administrators and the insurance Corporation.... These aspects—simple calculation, prompt collection, and a fairly accurate estimate of how much money will be raised—will be very important for a sound and effective inauguration of the insurance program....

While the head tax does very little to reflect insurance risk with regard to any given plan, it does not create serious inequities because it is virtually a nominal rate and will be in effect for only a few years. Any inequities in the early years will be smoothed out over the long run when the program operates under a more risk-based premium structure.<sup>32</sup>

The flat-rate premium is a disadvantage to plans that offer smaller per-participant benefits. Plan sponsors pay this premium regardless of the size of benefits an individual would receive. This structure favors plans that offer greater per-participant benefits, which pay a lower premium per dollar of benefits covered. For example, one of the factors in a typical DB pension formula is the number of years of service a participant has with an employer. Pension plans with participants that have longer job tenure would tend to have larger benefit obligations than pension plans with workers with shorter job tenure.

### ***Variable-Rate Premiums and Proposed Risk-Based Premiums***

The variable rate premium, which is calculated on the dollar amount of pension plan underfunding, takes into account the fact that plans terminated with larger amounts of underfunding would increase PBGC's deficit more than plans with smaller amounts of underfunding. However, two pension plans with equal amounts of underfunding could pose different risks to PBGC depending on the financial health of the plan sponsor. For example, two pension plans could have an equal number of participants, pay equal benefits, and have an equal amount of underfunding but could pose different risks to the PBGC based on the financial condition of the plan sponsors: plan sponsors in weak financial condition are more likely to be terminated and trustee by PBGC compared with the pension plans of plan sponsors in good financial condition.

### **PBGC Determinations of Financial Health of Companies in Risk-based Premium Structure**

Premiums based on the financial health of a plan sponsor would require PBGC to make determinations regarding the risk of individual companies. It might be difficult to measure the financial health of some smaller firms. Large companies likely have public debt or publicly available financial statements. However smaller firms are less likely to have publicly available information or could find compiling required information administratively burdensome. Of the

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<sup>32</sup> Administration Recommendations to the House and Senate Conferees on H.R. 2 to Provide for Pension Reform, April 1974, available in U.S. Congress, Senate Committee on Labor, Subcommittee on Labor, and Public Welfare, *Legislative History of the Employee Retirement Income Security Act of 1974*: vol. III, committee print, 94<sup>th</sup> Cong., 2<sup>nd</sup> sess., April 1976, pp. 5116 - 5117.

27,647 single-employer pension plans insured by PBGC in FY2010, 16,695 (63.9%) had fewer than 100 participants.<sup>33</sup>

### **Countercyclical Nature of Variable-Rate and Risk-Based Premiums**

A drawback of the variable-rate premium, and a potential drawback of risk-based premiums, is the amount of premiums that companies pay increases during economic downturns. The amount of variable-rate premiums would increase as a result of possible increases in pension plan underfunding, caused by declines in asset values and interest rates. If risk-based premiums are based on the financial health of a company, then these might also increase during economic downturns as firms are more likely to face financial difficulties during recessions. However, companies are more likely to need cash during economic downturns. Some could find paying higher pension insurance premiums during economic downturns burdensome. The President's Plan for Economic Growth and Deficit Reduction recommended that premium increases be minimized during economic downturns.

### **Comparison with Other Government Insurance Programs**

PBGC is one of several government-run insurance programs, including federal crop insurance, federal flood insurance, and insurance for banking deposits. The Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA) insure deposits in covered banks and credit unions. Some of these federal insurance programs have risk-based premiums.<sup>34</sup> For example, FDIC charges premiums based on the riskiness of a bank's assets. Generally, the riskier a bank's assets are then the more likely the bank is to fail, which suggests a greater likelihood that FDIC would be required to cover deposits of that bank.

However, FDIC's insurance model may not be fully applicable to pension insurance. The riskiness of a bank's financial condition may be easier to determine than the riskiness of non-financial companies. For example, the riskiness of a bank is determined by an examination of the kinds of financial assets that the bank owns, which tend to have standard measures of risk. It may be difficult to determine the riskiness of non-financial companies or to establish uniform standard for all companies across many different industries. For example, the ratio of a firm's debts to assets is a common financial indicator to measure a company's financial health: a firm with a large amount of debt may be more likely to default on its debt. However, the typical debt-to-assets ratio tends vary across industries. Firms in capital intensive industries (such as airlines) tend to have higher debt-to-assets ratios than firms in less capital intensive industries. Although many indicators of a company's financial health are potentially available, some amount of judgment by PBGC might be needed to make final determinations.

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<sup>33</sup> See Pension Benefit Guaranty Corporation, *Pension Insurance Data Tables 2010*, Table S-31. As of April 25, 2012, PBGC had not released the Pension Insurance Data Books for 2011.

<sup>34</sup> More information on these programs is available in the following CRS reports: CRS Report R40532, *Federal Crop Insurance: Background*, by (name redacted); CRS Report R40650, *National Flood Insurance Program: Background, Challenges, and Financial Status*, by (name redacted); and CRS Report R41718 *Federal Deposit Insurance for Banks and Credit Unions*, by (name redacted).

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