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Statement of the Shadow Financial Regulatory Committee

on

**Taxpayer Risks in the Pension Benefit
Guarantee System**

March 1, 1993

Weaknesses in the Pension Benefit Guarantee Corporation (PBGC) have been the subject of recent studies by the Congressional Budget Office (CBO) and the General Accounting Office (GAO) and testimony of several witnesses on February 2, 1993 before Subcommittee on Labor-Management Relations of the House Committee on Education and Labor. The evidence presented suggests that the PBGC is insolvent on a book value basis by about \$2.5 billion and is probably insolvent on a current value basis by as much as \$35 billion. Its exposure in the largest 50 underfunded plans alone amounts to nearly \$30 billion.

GAO indicates that the internal reporting, control and monitoring systems of the PBGC are so deficient that its operations have been seriously impaired. This means that reliable estimation of taxpayers' loss exposure in the PBGC is not possible.

Many of the incentive and design defects that plagued the FSLIC and FDIC also appear to be at work in the PBGC and threaten the taxpayer with large losses. These include inadequate minimum funding rules for plans (analogous to inadequate capital requirements), low premiums not reliably related to risk, and an implicit taxpayer guarantee of PBGC

liabilities. These defects have led to risk shifting behavior that threatens to undermine the system.

Shifting of risks to the PBGC has been observed in many ways and has been initiated by companies with underfunded plans, by labor unions, by creditors, and by the bankruptcy courts. Many companies view their pension funds as cheap sources of debt and have failed to accumulate a "rainy day reserve" for benefits triggered by plant closings and early retirements. Many firms experiencing financial difficulties, including some of the airlines, have successfully pressured their unions for wage concessions which have been partially offset by promised increases in pension benefits. Since many of these pension plans were underfunded, this shifted the pension obligations from the companies to the PBGC. Some companies have depleted their pension reserves while still meeting the minimum ERISA funding standards. Other firms in bankruptcy have stopped making required contributions with the judge's approval. Finally, creditors rarely put pressure on financially troubled companies to fund their plans, relying on optimistic funding assumptions and the expectation that pension claims will have no priority in bankruptcy anyway. Creditors sometimes pressure distressed companies to terminate plans rather than fund them.

Clearly, the problems with the PBGC merit immediate attention by the new administration and the Congress before a significant commitment of taxpayer funds is required. The Committee has not yet developed a detailed set of reforms, but the broad dimensions of reforms necessary to protect taxpayers are clear.

- ° First, the defects in the structure of the insurance system must be corrected.
- ° Second, PBGC risk monitoring, accounting and reporting systems need to be put in place that accurately reflect the present value of its insurance liabilities. Moreover, the taxpayers' share of this liability should be recognized on the federal budget.
- ° Third, the priority of claims of the PBGC against companies in bankruptcy with underfunded plans needs to be modified to

prevent the courts from shifting risks to the PBGC.

° Fourth, firms experiencing financial distress or in bankruptcy with underfunded plans must not be permitted to extend additional benefits to plan participants.

Going forward, consideration should be given to requiring that any additional benefits extended by insured plans be fully funded at the time the benefits are made. Finally, all companies with underfunded plans should be placed on a tight timetable to fund their plans fully.

