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The Center On Federal Financial Institutions (COFFI) is a nonprofit, nonpartisan, non-ideological policy institute focused on federal insurance and lending activities.

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PBGC: White Paper Implications

An extensive numerical analysis published by PBGC supports the Administration's claims that their pension reform proposal could strongly improve pension funding and future claims on PBGC. The analysis can be found in a 20-page White Paper available at www.pbgc.gov/publications/white_papers. The analysis is very complex and interested readers are urged to consult the White Paper itself to understand the methodological choices.

The overall conclusions are directionally as expected. The tighter funding rules would lead to higher contributions, lower levels of underfunding, and lower future claims on PBGC. However, the changes in these levels are projected to be fairly dramatic and therefore bear summarizing.

It should be noted that the claims analysis relies on PBGC's PIMS model which has many strengths and is the best existing model for this type of analysis. However, it generally seems to underestimate future claims and therefore shows too rosy a view of PBGC's finances. Structurally, it does not attempt to predict the effects of the "moral hazard" problems that are known to substantially increase PBGC losses. For example, troubled firms often significantly enhance pension benefits in exchange for holding down cash compensation, with both parties knowing PBGC is there to pick up the check if the company goes under.

Annual new claims would drop by 2014 to roughly 45% of the levels projected without reform. In absolute terms, we estimate that this would be a difference of about $1.25 billion ($1.0 billion with reform compared to $2.25 billion without.) This uses a baseline that assumes current law, except that the "temporary fix" on the discount rate is assumed not to expire.

The White Paper only gives the figures as an index of claims compared to expected 2005 levels, with 100 as the base in 2005. However, we were able to combine this with public information available in PBGC's Annual Report to estimate that the 2005 base level of expected new PBGC claims averaged about $4 billion. (See technical note below.)

The $1 billion figure implies that post-reform PBGC premiums could eventually revert to levels close to their historical averages, after adjusting for future inflation. This could occur once the present $23.3 billion PBGC deficit is paid down, assuming that future claims are reduced as expected by the tighter funding rules. Premiums would need to cover $1 billion of claims and roughly $0.7 billion of PBGC expenses (on COFFI estimates.) Adjusting for a 3%

inflation rate would bring this down to $1.3 billion in today's dollars, a bit below last year's $1.5 billion but above the medium term average of about $1 billion.

Minimum pension contributions would be almost twice as high as under current law from 2009-2012, but would quickly converge with current law thereafter. 2014 levels under both reform and current law would still be almost 50% greater than the total for 2005.

Pensions would be 95% funded by 2014, compared to roughly 80% funded at that point under current law and a little over 70% funded now. All figures are on a termination basis, the manner in which PBGC calculates funding for plans which terminate and make claims on PBGC.

Technical Note

We were able to convert the claims index to absolute numbers as follows. Pages 11 and 12 of PBGC's 2004 Annual Report give the results of 5000 runs of the PIMS model assuming current law holds (with, we assume, renewal of the temporary fix that uses a corporate bond discount rate.) It seems reasonable to assume that the average of these 5000 runs would be quite close to the average of the 500 runs used for the White Paper and that standard assumptions would be used for both the White Paper and the PBGC Annual Report.

Conceptually, we made a guess as to the absolute dollar level for 2005 claims and then determined the dollar levels for the remaining years through 2014 by multiplying the 2005 number by the index percentage for each year given in the White Paper. These absolute numbers were then discounted back at 5% to see if they gave a total value for the decade in 2004 dollars equal to the $20 billion given in the Annual Report. We used a particular Excel tool to work backwards to tell us the correct "guess" that provided the right match. Once we had the match, we then knew the starting value and the values for all subsequent years.

