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Premium hikes raise questions of motives, PBGC's future

Shortfall in pension fund failsafe smaller even without new fees

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Deborah Forbes was stunned when she learned that a budget deal congressional leaders and the Obama administration hammered out included provisions that again boost insurance premiums employers must pay the Pension Benefit Guaranty Corp.

“Those increases come on top of $17 billion in PBGC premium hikes approved by Congress in 2012 and 2013, and at a time when the PBGC, by its own estimates, is getting healthier every year,” said Ms. Forbes, executive director of the Bethesda, Maryland-based Committee on Investment of Employee Benefit Assets, which represents large pension plan sponsors.

Other business groups say the third PBGC premium hike since 2012 is a budget gimmick, saying the additional funds were sought as a way to help offset the federal budget deficit rather than meet a new revenue need of the PBGC, which recently projected that its deficit will sharply decline from $19.3 billion in 2014 to $4.9 billion in 2024.

However, the PBGC last week reported that its deficit jumped nearly 24% in fiscal 2015, to a record high of $76.4 billion, an increase driven largely by interest rates.

“Increasing PBGC premiums is considered by policymakers as an easy way to raise money. It was revenue-, not policy-driven, as there was no call by the PBGC for increased premiums,” said Annette Guarisco Fildes, president and CEO of the ERISA Industry Committee in Washington.

Some also say the higher charges will result in more employers de-risking their pension plan obligations or accelerate the move of employers to freeze or terminate their pension plans.

“This was a heedless action,” said Lynn Dudley, senior vice president of global retirement and compensation policy at the American Benefits Council in Washington. “It is heedless because it was done without regard to the potential negative consequences. Premium increases are unnecessary and threaten the long-term viability of both the defined benefit pension system and the PBGC's plan termination insurance program by further driving away employers concerned about the unpredictability of premium increases.”

Whether needed or not, the legislation President Barack Obama signed into law earlier this month mandates a several-

step increase in PBGC premiums paid by employers that sponsor the more than 22,000 defined benefit plans covered by the PBGC's insurance program. That program protects participants' benefits in underfunded pension plans the PBGC takes over from financially troubled or failed employers.

The current flat rate, a $57-per-participant premium that all plan sponsors pay, was to increase to $64 in 2016. Under the recent change, it will increase incrementally over a three-year period until it hits $80 in 2019 — a 40% jump from the current rate.

In addition, the variable-rate premium paid only by employers with underfunded plans will increase from $24 per $1,000 of plan underfunding now to $41 in 2019 — a 71% jump from the current rate.

According to the Congressional Budget Office, the higher charges will result in employers paying more than $4 billion in additional PBGC premiums from 2016 through 2025. Last year, employers paid the PBGC about $3.8 billion in premiums.

Whether the PBGC, in fact, collects that $4 billion in additional premium that the new law is supposed to generate is, experts say, far from certain. There is little doubt, they add, that the latest premium increases will add fuel to the biggest pension plan trend of the past several years: de-risking.

Under the most common de-risking approach, employers typically offer to convert a future annuity into a cash lump sum, often for former employees who have vested but are not collecting a benefit.

Hundreds of employers have done so in recent years, including Ford Motor Co., Archer Daniels Midland Co. and Hartford Financial Services Group Inc.

In another de-risking approach, employers shift the liability of paying benefits to insurers by purchasing a group annuity — a step more than two dozen major employers have taken in recent years — that transfers billions of dollars in plan benefits to insurers.

Through either approach, an employer's pension plan gets smaller, as does the employer's PBGC premium tab. For example, reducing a pension plan to 10,000 participants from 30,000 would reduce an employer's cost by $1.6 million in 2019 just for the flat-rate premium.

The cost increases are “adding fuel to employers' drive to de-risk their pension plans,” said Alan Glickstein, a senior retirement consultant at Towers Watson & Co. in Dallas.

That may cause employers to “rethink” whether the pension plans are worth the cost, said Stuart Schulman, a principal at Buck Consultants at Xerox in New York.

Matt McDaniel, a partner at Mercer L.L.C. in Philadelphia, said this could result in a “vicious circle” with the PBGC needing higher rates to compensate for lower premium revenue, triggering more employers to de-risk their plans.

That is a potential “death spiral” for the PBGC insurance program, said Rick Jones, a senior partner at Aon Hewitt in Lincolnshire, Illinois.

That could “force plan sponsors to once again ask themselves if this whole DB thing is really such a good idea at all,” Bob Collie, chief research strategist of Americas institutional at Russell Investments, said about defined benefits in a blog post.

Still, some employers will stick with their defined benefit plans.

“There is a core of employers who have the plans and remain committed to the plans,” said Brad Smith, an Atlanta-based partner at investment consultant NEPC L.L.C., adding that some employers continue to believe that defined benefit plans aid in attracting and retaining employees.