PENSION BENEFIT GUARANTY CORPORATION—AMENDMENTS AFFECTING SINGLE-EMPLOYER AND MULTIEMPLOYER DEFINED BENEFIT PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 2019

A BILL TO DELAY THE EFFECTIVE DATE FOR MANDATORY COVERAGE OF MULTIEMPLOYER PLANS UNDER TITLE IV OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

S. 2125

A BILL TO AMEND TITLE IV OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 TO AUTHORIZE THE PENSION BENEFIT GUARANTY CORPORATION TO EXTEND, FOR NOT MORE THAN EIGHTEEN MONTHS, THE DATE ON WHICH THE CORPORATION FIRST BEGINS PAYING BENEFITS UNDER TERMINATED MULTIEMPLOYER PLANS

H. CON. RES. 369

TO ESTABLISH A REVISED COVERAGE SCHEDULE FOR BASIC BENEFITS GUARANTEED BY THE PENSION BENEFIT GUARANTY CORPORATION FOR EMPLOYEE PENSION BENEFIT PLANS WHICH ARE NOT MULTIEMPLOYER PLANS

OCTOBER 14, 1977

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

22-794 WASHINGTON : 1978

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S361-44

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PENSION BENEFIT GUARANTY CORPORATION—AMENDMENTS AFFECTING SINGLE-EMPLOYER AND MULTIEMPLOYER DEFINED BENEFIT PLANS

FRIDAY, OCTOBER 14, 1977

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:20 a.m. in room 1224, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senator Bentsen.

Senator BENTSEN. The subcommittee will come to order. This morning, the Private Pension Subcommittee will hold hearings on two important issues relating to the Federal termination insurance program for private pension plans.

[The committee press release and the text of the bills, S. 2019. S. 2125, and H. Con. Res. 369 follow:]

FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS SETS HEARINGS ON S. 2019, S. 2125, AND H. CON. RES. 369

The Honorable Lloyd Bentsen (D., Tex.), Chairman of the Subcommittee on Private Pension Plans and Employee Fringe Benfits, announced today that the Subcommittee will hold hearings on S. 2019, S. 2125, to delay the effective date for mandatory coverage of multiemployer plans under Title IV of the Employee Retirement Income Security Act of 1974, and H. Con. Res. 369, a proposed resolution to revise the coverage schedule for basic benefits guaranteed by the Pension Benefit Guaranty Corporation for single employer plans. No date has been set for this hearing due to the uncertain schedule of the full Committee in connection with its work on the energy tax bill. However, it is contemplated that these hearings will be held on or before October 18, 1977, in Room 2221 of the Dirksen Senate Office Building. Due to the uncertainty of the date of these hearings and the limited time available for the conduct of such hearings, the Subcommittee is tentatively scheduling Mr. Matthew M. Lind, Acting Executive Director of the Pension Benefit Guaranty Corporation, as the sole witness to present oral testimony on these matters.

To insure that the Subcommittee can obtain maximum input from all interested parties, all persons interested in these issues are requested to submit written statements outlining their views. If time permits, those persons who wish to present oral testimony as well as submit written statements should so indicate and will be notified of the date of the hearing and invited to present such oral testimony.

Senator Bentsen, in calling these hearings, noted the September 19 report of the Pension Benefit Guaranty Corporation concerning potential multiemployer plan liabilities under ERISA. He pointed out that there is a great deal of uncertainty as to the potential cost of the termination insurance program and the impact that large terminations could have on the pension benefit guarantee program and the private pension system in general.

"That study shows that about 2 percent of all multiemployer plans, covering about 5 percent of all participants in such plans, are experiencing extreme financial hardship indicating a high potential for plan termination within the next 5 years. The aggregate unfunded vested liabilities of these plans in 1977 exceed $350 million," Bentsen stated.

According to the PBGC, about 12 percent of all multiemployer plans covering 20 percent of the participants in such plans are in difficult financial straits and may need to terminate their plans. To safeguard the interests of all American workers covered under the Federal Pension Benefit Guaranty Program, legislative review of the problems faced by these plans and the danger they represent to the continued vitality of our insurance program must be thoroughly reviewed.

SUBMISSION OF STATEMENTS AND REQUESTS TO TESTIFY

Senator Bensten advised that witnesses desiring to submit statements and requesting to testify at this hearing (if scheduling permits) must submit their requests and five copies of their statements to Michael Stern, Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Friday, October 14, 1977. Witnesses will be notified as soon as possible after this out-off date if it is possible to schedule them to appear.

[S. 2019, 95th Cong., 1st sess.]

A BILL To delay the effective date for mandatory coverage of multiemployer plans under title IV of the Employee Retirement Income Security Act of 1974

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4082(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1381) is amended by—

(1) striking "1978" in paragraph (1) and substituting "1979";

(2) striking "1978" in paragraph (2) and substituting "1979";

(3) striking "1977" in subparagraph (B) of paragraph (2) and substituting "1978"; and

(4) striking "1978" in paragraph (4) and substituting "1979".

(5) striking "1977" in subparagraph (D) of paragraph 4 and substituting "1978.".

[S. 2125, 95th Cong., 1st sess.]

A BILL To amend title IV of the Employee Retirement Income Security Act of 1974 to authorize the Pension Benefit Guaranty Corporation to extend, for not more than eighteen months, the date on which the corporation first begins paying benefits under terminated multiemployer plans

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 4082(c) of the Emloyee Retirement Income Security Act of 1974 (relating to effective dates; special rules) is amended—

(1) by inserting after "January 1, 1978" each place it appears the following: ", or the date fixed by the corporation under paragraph (5), whichever is later",

(2) by inserting after "December 31, 1977" the following: ", or the day before the date fixed by the corporation under paragraph (5), whichever is later", and

(3) by adding at the end thereof the following new paragraph:

"(5) The corporation may delay the January 1, 1978, effective date for benefit payments with respect to terminations of multiemployer plans to a date not later than July 1, 1979, if it determines, before January 1, 1978, that such a delay is necessary to prevent serious financial difficulty for the corporation and to insure proper coverage for multiemployer plans terminating after such effective date".

(b) Section 4082 of such Act is amended by adding at the end thereof the following new subsection:

"(d) If, pursuant to subsection (c)(5), the corporation exercises its authority to fix a date later than January 1, 1978, the corporation shall present to the Committee on Education and Labor and the Committee on Ways and Means of the House of Representatives and the Committee on Human Resources and the Committee on Finance of the Senate a report which comprehensively addresses those matters which caused the corporation to determine to fix a date later than January 1, 1978, including a full and complete explanation of any actions taken or to be taken by the corporation to alleviate or eliminate the difficulties referred

to in subsection (c)(5), and explanations of options for other actions considered and rejected by the corporation. If the report contains recommendations for amendments to this title, such recommendations shall be fully explained, and shall be accompanied by explanations of other options for legislative change considered and rejected by the corporation. The report shall be presented by the earlier of—

"(1) July 1, 1978, or

"(2) two hundred and seventy days before the date fixed by the corporation pursuant to subsection (c)(5)."

[H. Con. Res. 369, 95th Cong., 1st sess.]

Whereas in accordance with section 4006(b)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(b)(1)), the Pension Benefit Guaranty Corporation transmitted to Congress a proposed revised coverage schedule for basic benefits guaranteed by the Corporation for employee pension benefit plans which are not multiemployer plans, together with a statement of the proposed effective date of such schedule and the reasons for the proposal: Now, therefore, be it

Resolved by the House of Representatives (the Senate concurring), That the Congress favors the proposed revised coverage schedule transmitted to Congress by the Pension Benefit Guaranty Corporation on September 23, 1977.

Senator BENTSEN. The first issue relates to the effective date for mandatory termination insurance coverage for multiemployer pension plans under the 1974 Pension Reform Act. At present termination insurance for multiemployer plans becomes effective January 1, 1978. There have been several proposals to delay the effective date of this provision for 1 year or more.

The second issue relates to the appropriate level for insurance premiums for single employer pension plans. The Pension Benefit Guaranty Corporation has suggested increasing the premium for single employer plans from $1 to $2.25 per participant, effective January 1, 1978. We are pleased to have the Acting Director of the Pension Benefit Guaranty Corporation, Mr. Matthew Lind, here this morning to discuss these issues.

STATEMENT OF MATTHEW M. LIND, ACTING EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY HENRY ROSE, GENERAL COUNSEL; VINCENT CICCONI AND JOHN HIRSCHMANN

Mr. LIND. Mr. Chairman, I am Matthew Lind, the Acting Executive Director of the Pension Benefit Guaranty Corporation. I have with me here today Henry Rose, our General Counsel, John Hirschmann who heads up our financial analysis and planning group, in the Office of Program Development and who was responsible for the premium request study, Vincent Cicconi of the Office of Program Development, who led the team that did the multiemployer claims study.

I am grateful for the opportunity to testify before you, first, in support of deferring the date on which the Pension Guaranty Corporation must begin mandatory termination insurance coverage for multiemployer plans, and second, in support of our request for an increase in the premium rate for the termination insurance program for single employer pension plans.

Mr. Chairman, I have a prepared statement. However, with your approval, I would like to place that statement in the record and provide a somewhat shorter summary statement.

Senator BENTSEN. Mr. Lind, looking at the length of it, I am very agreeable to that.

Mr. LIND. I hope that my short summary is, in fact, short.

Senator BENTSEN. We are faced with a time problem. The Finance Committee meets at 10 on the energy problem, and I will have to attend that meeting.

Mr. LIND. Thank you.

We have previously provided the committee with a comprehensive report and, Mr. Chairman, with your approval I would like to place a short summary of that report in the record as well.

Senator BENTSEN. That will be fine.

Mr. LIND. Thank you very much.

[The summary referred to follows:]

SECTION I.—MANAGEMENT SUMMARY

A. PURPOSE

The Corporation has received formal authorization of its Board of Directors to to request Congressional approval of an increase in the premium for the single employer basic benefits program to $2.25 per participant effective January 1, 1978. This staff document summarizes the background and basis for the Corporation's request that was formally transmitted to Congress by the Acting Executive Director on September 23, 1977.

B. BACKGROUND

ERISA initially established the premium for the single employer basic benefits program at $1.00 per participant. This rate has been continued to date because, prior to completion of the Corporation's current analysis, sufficient experience was not available to determine what premium was needed to support the program.

This analysis now indicates that at the end of the first two years of operations (September 2, 1974 to September 30, 1976) a deficit of $41 million had been incurred in the single employer program. This deficit occurred because the current premium of $1.00 was not sufficient to finance the estimated net claims of $82 million that had resulted from plan terminations. Furthermore, projections by the Corporation indicate that, if the premium is not increased, this deficit will continue to grow. By January 1, 1978 (the date on which the Corporation is requesting that the incresae be effective) the projected deficit will have increased to approximately $60 million. Without a premium increase, this deficit is expected to continue to grow at the rate of $25 to $30 million per year. Thus, by the end of 1981 (the end of the period being analyzed by the Corporation) the deficit would be almost $160 million.

C. TIMING OF PREMIUM INCREASE

It is important that the recommended increase be effective by January 1, 1978. January 1 is a critical date, since over 50% of all premium revenue is collected from plans whose plan year begins on this date. Thus, any delay beyond January 1 would result in the loss of the majority of the year's revenue derived from the increase in the premium. In order to finance the additional deficit caused by even a one-quarter delay, the future premium would have to be increased from $2.25 to $2.40.

ERISA requires Congressional approval for any premium increase in the form of a concurrent resolution and further provides that any such premium increase must receive Congressional approval at least 30 days prior to the end of the plan year to which it may apply. Thus, in order for the premium increase to be effective on January 1, Congressional action must be completed before the end of the current session.

D. BASIS FOR REQUEST

1. Forecast of future claims

The Corporation's recommendation for a premium increase to $2.25 is based upon an analysis of insufficient plans that have terminated to date, as well as

projections of the likely number and characteristics of future insufficient terminations, based upon that experience. In brief, the results of this analysis show that the rate of termination of plans with insufficient assets to pay guaranteed benefits (which are the only plans which result in a claim on the premium) does not appear to have increased since the enactment of ERISA.[1] Rather, 80 percent of the claims resulting from these insufficient terminations have occurred because of the closing of a business entity and, therefore, are the result of a business decision which was made independent of the existence of ERISA. Furthermore, the number of insufficient terminations since ERISA does not appear to have occurred at a materially different rate than can be inferred from 1972 and 1974 studies of pre-ERISA terminations. For these reasons, the Corporation feels that it already has sufficient experience to provide a valid basis for projecting future claims.

The Corporation's analysis shows that a statistically valid relationship exists between the number of insufficient terminations per quarter and the unemployment rate. The $2.25 premium requirement is based upon this relationship and the official administration forecast that the unemployment rate will decrease to 4.7 percent by the end of 1981. The sensitivity of the required premium to this latter assumption can be seen by assuming no future improvement in the current unemployment rate of 7 percent. In this latter case, the required premium would be $2.65.

2. Current Funding

The Corporation is basing its request for a premium increase on the premise that its claims should be "currently funded" when they occur.[2] This means that the Corporation shall attempt to have on hand, at any point in time, assets which, together with the return that can be achieved on their investment, will be sufficient to pay all benefits guaranteed by it at that same point in time. By requiring plans insured during a given period to bear the cost of claims incurred during that period, "current funding" avoids, to the maximum extent possible, having pension plans in the future assume the burden for financing the cost associated with current insufficient plan terminations. It also keeps future premium increases to a minimum and, thereby, minimizes their potential destabilizing influence on the continuation of private pension plans.

Under a "pay as you go" approach, the Corporation would be funding its liability in a manner completely inconsistent with the philosophy of ERISA. From a programmatic point of view, this funding policy would shift the responsibility for the claims of today's plans to future generations of plans. This, in PBGC's judgment, is not equitable. Furthermore, it would become increasingly more difficult to get the eventual premium increase approved, because the longer it is delayed the greater the ultimate increase would have to be. This in turn increases the likelihood that the Corporation would have to exercise its borrowing authority from the U.S. Treasury and/or have its liabilities financed from general tax revenues rather than premium income.

3. Other key program assumptions

The Corporation's analysis of the premium requirement is based upon the following additional assumptions concerning the future of the single employer basic benefits program:

i. The assessability of employer liability under Section 4062 will be upheld by the courts. This Section is already the subject of active litigation. The Corporation currently projects (based on terminations to date) that 40 percent of plan asset insufficiency for all terminating plans will be collected from employers. The prospect of employer liability has discouraged termination of insufficient plans by many plan sponsors. It has caused others to make their plans sufficient prior to termination. If no employer liability can be assessed, the required premium would increase to about $3.35, given the current claims rate.

More importantly, any limitation on the Corporation's ability to assess liability is likely to induce additional insufficient terminations and, therefore, to further increase the premium needs of the program.

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[1] This is in contrast to the rate of total terminations, the vast majority of which are sufficient.

[2] This is in contrast to assuming that the program should be funded on a "pay as you go" basis which would only require that assets on hand be sufficient to pay specific monthly pension benefits when they fall due.

ii. The expected deficit of $60 million by the proposed date of the premium increase will be recovered by amortizing it over a 10-year period. A significantly shorter period was not selected in order to avoid increasing the premium by a substantial amount. However, use of a longer period would not significantly reduce the premium because of the need to continue to pay interest on the unrecovered balance.

iii. The program will not be funded so as to accumulate planned reserves for contingencies such as higher than expected claims or adverse investment performance. The mandatory nature of the program makes such reserves unnecessary.

iv. The current policies of the Corporation, including the investment of trust assets and transfer of assets from the revolving fund to the trust fund, will be continued.

It should be noted that while the Corporation believes all of the above assumptions are valid, a change in any of them would cause the premium to be higher. Therefore, it is very unlikely that the Corporation's request for a premium of $2.25 per participant represents an overstatement of its actual needs.

E. SUMMARY

The $1.00 premium is not adequate to finance claims of the single employer basic benefits program on a current basis. It is the Corporation's recommendation that a premium increase to $2.25 be approved in time to become effective January 1, 1978. The sooner an increase is implemented, the lower the ultimate premium that will be required. The very large ultimate increase needed under the "pay as you go" approach presents such a great risk to the continuation of a self-financing program as to make it clearly unacceptable.

Mr. LIND. In regard to multiemployer coverage, I think just a little bit of background would be valuable, Mr. Chairman.

As you know, the mandatory coverage of multiemployer plan terminations was deferred by ERISA until 1978. At the time this issue was being considered, the Congress was advised by both union and employee representatives involved with multiemployer plans that such plans probably did not need termination insurance. In fact, it was stated that such plans do not terminate because of the risk-sharing among contributing employers which is inherent in such plans.

This perspective was supported by studies conducted by the Treasury and Labor Departments. In 1972, a Treasury-Labor study of multiemployer plan terminations from 1965 through 1971 indicated that there were very, very few multiemployer terminations. Where such plans did terminate, the losses were quite small, averaging less than $500,000 per year.

So I think it is indeed understandable that the Congress, and we, too, at the Corporation, started this program with the expectation that we were not going to have large problems in the multiemployer area.

Nevertheless, during the interim between enactment of ERISA and mandatory coverage of multiemployer plans, Congress granted PBGC limited discretion to cover multiemployer plans in the unlikely event a significant termination occurred. In order to finance discretionary coverage of those terminations, the initial premium for multiemployer plans was set at 50 cents.

What has been our emerging experience? Last May in a ceremony at the Labor Department, the Corporation entered into a trusteeship agreement with three multiemployer plans operating in the millinery industry in New York City. The participants in these plans were involved in the manufacture of hats.

The history of these plans is worth noting because I think it is indicative of what is happening in a number of other industries. The three plans were started in the 1950's. At that time, they had 10,000 participants and the cost of the pension amounted to 2 percent of payroll.

As you know, changing fashion styles, which accelerated in the 1960's, had the effect of producing precipitous decline in this industry as people stopped wearing hats. Thus we found on the day of termination, that was last December 31, that the participation in this plan had declined from 10,000 to 4,000 and that the cost of the pension plan had gone to 11 percent of payroll in a low-wage industry.

To make matters worse, we found that of the 4,000 participants, 2,700 were either retired or eligible for retirement. In other words, the ratio——

Senator BENTSEN. Give me those numbers again?

Mr. LIND. 2,700 participants were either retired or eligible for retirement out of 4,000.

To be more precise, the plan had 2,400 retirees and, I believe, another 300 workers who were eligible for retirement but who had continued working.

In other words, the ratio of retirees to active workers in the plan was almost two-to-one. As a consequence the active workers were faced with the prospect of seeing a substantial portion of what could have been their wages going to pay for the immediate retirement benefits of retirees.

We are facing a similar situation with a plan covering the milk drivers of northern New Jersey. Here, too, we see an industry which is on the verge of extinction; that is, the home delivery of milk. Again, we have a very large proportion of retirees in relation to the active workers. Again, we see a situation where the interest of active workers is pitted against the interest of retirees in a relatively low-wage industry with very high pension costs. We feel that this plan, as in the case of millinery, has had no alternative but to terminate and seek assistance from the Corporation.

In the case of the millinery plans, the cost of that termination will be between $5 million and $6 million net for the Corporation, net of an anticipated $1 million collection from the current employers as payment of employer liability.

In the milk plan, the net unfunded liability is $20 million. Our tentative agreement with the employer calls for $4 million payment for employer liability under a special group arrangement.

The net effect, however, of both of these plans is a $20 million to $22 million cost to the Corporation.

Senator BENTSEN. What kind of funding levels have you seen? Have they been fairly unrealistic in funding?

Mr. LIND. Well Senator Bentsen, it seems to us that where we have declining industries, the actuarial assumptions invariably tend to be optimistic, because they frequently assume continuation of current employment levels. I am not certain whether this is true in these two specific plans, but I am aware of other such situations. In the longshoremen's plan on the west coast, for example, in the late 1960's there was a tremendous amount of shipping going out of the west

coast as a result of the war. The plan actuaries at the time assumed that current employment levels would continue, and benefits were increased substantially. And, of course, when the war wound down, there was a very sharp drop in shipping and a precipitous decline in employment. That decline has continued as a result of further mechanization of cargo handling.

What you see in situations like the millinery plans are changing technology and economic conditions, and many actuaries involved with these plans do not take these longer term possibilities into account in their forecasts. So you wind up with a situation where the actual contributions invariably fall short of the estimate.

Senator BENTSEN. What kind of vesting levels have you seen in these plans?

Mr. LIND. In the case of the millinery workers, no vesting.

Senator BENTSEN. Until when?

Mr. LIND. Until age 65.

Senator BENTSEN. Until they reach the full age of 65?

Mr. LIND. Yes, Senator Bentsen, that is right.

In fact, it is kind of sad. There were many workers with long service in that industry at ages 63 or 64, who on termination were left with no vested benefit at all. This is one of the reasons why these plans and the employers in these industries feel an almost moral obligation, if not a business necessity, to establish new plans for the active workers.

Those new plans frequently try to recognize past service of those employees who, by virtue of the initial termination, were left with no benefits. It is a very unfortunate situation.

Senator BENTSEN. Are you familiar with the vesting in the milk plan?

Mr. CICCONI. Not specifically. We can provide it.

Mr. LIND. We can provide you with that. I think there was little vesting there as well.

[The following was subsequently supplied for the record:]

PENSION BENEFIT GUARANTY CORPORATION,
Washington, D.C., October 18, 1977.

Hon. LLOYD BENSTEN,
Chairman, Subcommittee on Private Pension Plans and Employee Fringe Benefits, U.S. Senate, Washington, D.C.

DEAR CHAIRMAN BENTSEN: I appreciate this opportunity to respond further to several questions that you raised at the October 14, 1977 hearing before the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance.

1. *Vesting Provisions in Multiemployer Plans.*—Sections 211 and 1017 of ERISA prescribe the effective dates for the vesting requirements of Titles I and II of ERISA. It is our understanding that, in general, all plans in existence on January 1, 1974 (including multiemployer plans) must meet one of ERISA's minimum vesting schedules as of the plan year that begins on or after January 1, 1976. The Internal Revenue Service's minimum vesting regulation, Treas. Reg. §1.411(a)-2 (1977), discusses the effective date provisions of Title II of ERISA in greater detail.

As we discussed, the PBGC expects to exercise its discretion to guarantee basic benefits under the Milk Industry-Local 680 Pension Plan. The agreed-upon termination date for that Plan will be November 30, 1975, the expiration date of the industry-wide collective agreement purusant to which the Plan operated. That Plan contains no vesting schedule as such. Participants who have completed at least 25 years of covered service are entitled to a flat monthly benefit; the, benefit is greater for those who have completed 30 or 35 years of service. In

addition, certain participants who had completed at least 15 years of service and met specified age requirements by the Plan's termination date are entitled to reduced or early retirement pensions.

2. *Investment of PBGC Premium Funds.*—Subsection 4005(b)(1)(B) of ERISA requires that premiums collected by PBGC be credited to the appropriate revolving fund established on the books of the United States Treasury, pursuant to subsection 4005(a).

Separate funds have been established for guaranteeing basic benefits under multiemployer and non-multiemployer plans, and the premiums paid by those plans have been invested in Treasury special issues. The average annual return on those investments has been approximately 6.5%. As you know, the assets of the terminated plans for which PBGC becomes trustee are invested in private-sector securities.

I hope this is of assistance.

Sincerely,

MATTHEW M. LIND,
Acting Executive Director.

Mr. LIND. In general, Mr. Chairman, it appears to us that there are a number of declining industries, labor-intensive industries——

Senator BENTSEN. Educate me a little bit more. I do not remember the details, but what are the obligations now of the Pension Corporation in that kind of a situation where you obviously had very poor vesting provisions and an employee departs and you have had inadequate funding?

I remember the options we gave for vesting and funding, but how are they applied? Are they retroactive? Give me the details of how it works; I have forgotten.

Mr. LIND. In these particular plans——

Senator BENTSEN. I am asking an elementary question.

Mr. LIND. I believe the vesting provisions apply, in the case of these plans, for plan years beginning after December 31, 1975.

Senator BENTSEN. What?

Mr. LIND. I believe the new vesting provisions became operable for plan years beginning after December 31, 1975. In the case of multiemployee plans, I am not certain.

Senator BENTSEN. If you are fuzzy on it, I do not feel so bad. You will give me the details?

Mr. LIND. Yes, Mr. Chairman.

In any event, in these plans, ERISA's vesting provisions had not taken hold, and I might add that, even if they had, under the current provisions of title IV and the Corporation's regulations, new benefit entitlements which arose as a result of those vesting provisions would have been subject to phase-in rules and little protection would have been initially afforded.

In general, therefore, Mr. Chairman, it appears to us that plans in a number of declining, labor-intensive industries across the country pose significant potential for claims against our program. I will try to describe the dynamics of what I think is happening here. I think it is worth while to point out that when we have a declining industry that involves single employer plans, what we see as the industry declines—as the employers leave the industry or go out of business—are terminations of individual plans at that point. In other words, as the industry declines, you would expect to see a number of terminations occurring along the way.

When we are dealing with industries that involve multiemployer plans, as the industry declines, rather than seeing plan terminations

we see withdrawals of contributing employers. When those withdrawals occur, the added financial burden due to the loss of contributions formerly provided by those employers is shifted to the continuing employers. This process will continue until this burden becomes unbearable, and the only choice is to terminate. The net effect is to defer the inevitable plan termination until some time down the road, 10 or 20 years, depending on how rapid the decline in the industry is. I think, therefore, it is little wonder that we did not see too many terminations in the 1960's because, after all, many of the multiemployer plans in this country are post-World War II creations.

Senator BENTSEN. We had Vietnam going about that time.

Mr. LIND. Yes.

Because of this concern and our perceptions of what may be happening out there, the Corporation initiated an in-house study of potential multiemployer plan terminations.

Let me summarize the result of that study, which we have submitted to the Congress. That study indicated that 2 percent of multiemployer plans, involving 5 percent of the participants in such plans, were experiencing severe economic hardship and had a high potential for termination within the next 5 years. The unfunded liabilities in these plans were estimated to be $350 million. That does not include, however, any potential for recovery of employer liability. We have not had the time or the information to get a sense of what employer net worth is behind those liabilities. But if the millinery plans are indicative, and recognizing that we are generally dealing with low capitalized industries in most cases, we do not expect substantial collections of employer liability to offset the $350 million.

Perhpas more alarming, Mr. Chairman, is the second result of the study indicating that an additional 10 percent of plans, covering almost 15 percent of participants in multiemployer plans, were experiencing significant financial hardship and had a significant potential for termination. The unfunded liabilities of these plans, which may terminate some time over the next decade or 15 years, barring some unforeseen turnaround, is estimated at $3.5 billion.

Senator BENTSEN. How would the cash build up for that potential liability? How would the pay-out occur by the Pension Corporation? The cash flow liability of the Pensions Guaranty Corporation would extend over a substantial period of time, would it not?

Mr. LIND. That is right. Each of these terminations, depending on the age composition of the participants, might result in a cash flow requirement extending over a 30-year period. That is why, even if they all terminated today—both groups of plans and almost $4 billion in liabilities—there might not be an immediate cash flow problem. The initial cash flow requirements for the Corporation may be 5 to 10 percent of that aggregate liability, something on the order of $200 to $400 million in benefit payments. Even that would not, in our judgment, create an immediate cash burden for the Corporation, because in general, even the most poorly funded plans, with certain exceptions, have sufficient assets to meet 1, 2, or 3 years worth of benefit obligations.

Senator BENTSEN. What options do you have insofar as taking these plans in? We get to a mandatory date, as I recall, but is that

mandatory, then, for all multiemployer plans or do you have some options as to what you can take and what you do not take?

Mr. LIND. Under current law, once mandatory coverage goes into effect, we must guarantee benefits.

Senator BENTSEN. You lose your options at that point?

Mr. LIND. That is correct, Mr. Chairman.

It is conceivable that remedial legislation after that date might change the picture, but our counsel advises us that significnat legal questions could arise if there was any attempt to change provisions of coverage at a subsequent date retroactively.

Senator BENTSEN. Do you think there are significant legal problems if the mandatory requirement is taken off? Is that what you are saying?

Mr. ROSE. No, Mr. Chairman. What Mr. Lind was referring to is the possible scenario of not deferring the mandatory coverage date and then subsequent legislation retroactively changing the rules.

Senator BENTSEN. I would agree.

Mr. LIND. Do you have any further questions on this particular point?

Senator BENTSEN. What if the postponement is agreeable? Is there any protection, then, for participants of multiemployer plans that would terminate before that mandatory coverage date?

Mr. LIND. Yes, there is, Mr. Chairman. There is still discretion to guarantee benefits in plans that terminate.

Senator BENTSEN. How do you decide?

Mr. LIND. I think the policy that we have had in the past is to provide protection within the financial limits that we have in place today.

Senator BENTSEN. Do you have some really serious guidelines, or is it whoever puts the pressure on you for coverage?

Mr. LIND. The guidelines that we have really look toward, whether, in our judgment, the facts and circumstances warrant coverage. We do not like being in a judgmental situation. That is always difficult.

Senator BENTSEN. You are subjected to an awful lot of political pressure.

Mr. LIND. Yes, we are. I think what we ask ourselves in these cases is whether or not there is any reasonable alternative to termination.

I might point out, Mr. Chairman, that, at a minimum, if termination occurs—and I am speaking personally now—I feel that it is incumbent upon us to at least provide protection up to the level which can be recovered through employer liability. In doing that, we become a link, without necessarily dipping into premiums, between the pension promise made by the employer and the employer's net worth.

If we were to deny coverage and then just walk away from it, that link would be broken even if there were substantial employer assets.

So we think that there is protection. We also think that if there are terminations during an extended deferral period, subsequent legislation, which may address a myriad of problems in the multiemployer area, could be made retroactive because, under the present statutory provisions, the plans which terminate during the discretionary period would not have firm guarantees from the Corporation.

Indeed, it seems to me that conditions of coverage that we have already entered into make it fairly clear that there may be subsequent adjustments in benefit levels. I think it would be much easier for us to cover those plans and when we have a revised program, to make the program retroactive as regards to those discretionary guarantees.

Senator BENTSEN. Would you concur in that?

Mr. ROSE. Yes. I do not think there would be any serious problem with retroactively making the benefits stronger. It is another question, when you are taking them away.

Senator BENTSEN. I am sure that is right.

What do you think the premium would be? Do you have any idea what the premium would be? Do you have any projections, or have your studies gone far enough where you have some feel for what the premium would be in multiemployer plans? Obviously, 50 cents is not enough.

Mr. LIND. Mr. Chairman, the study that we have submitted indicates the range. We have identified certain situations which we feel have a high probability of termination. The study speaks about a rock bottom of $350 million over some indefinite period, let us say within the next 5 years and extends all the way to the $4 billion level.

Senator BENTSEN. What?

Mr. LIND. $4 billion. Those are the plans which today appear to be experiencing significant hardship or problems.

Senator BENTSEN. What was your first number? I must have misunderstood you. You said your rock bottom was what?

Mr. LIND. $350 million. We think that 2 percent of the plans are experiencing severe economic hardship. There are 10 percent more plans experiencing significant hardship that we think also have significant potential for termination. It is hard to pinpoint the time frame, this year, or sometime in the next 10 years, those plans would pose an additional $3.5 billion worth of liabilities. You have a very wide range, and the premium level would depend not only on the absolute amount, but on the period over which the liabilities would occur.

For example, take the $350 million. Our study indicates that that amount could very likely occur over a 5-year period. If those were the only terminations, that would be $70 million a year, plus administrative expenses. That would bring it up to $75 million a year and I think that that would be about a $15 premium.

Senator BENTSEN. When do you anticipate that you would have solid enough projections to make a recommendation? You have one problem of cost. If you get these premiums too high it is counterproductive; you would get all kinds of terminations. When do you expect to come out with projections?

Mr. LIND. By the way, staff has just told me that this $350 million would result in a $9 premium. My Ph. D. in mathematics has been depreciating over the years, but I was a theoretician. I would like that for the record.

Senator BENTSEN. We have had nothing but theoreticians for the last 2 weeks in the Finance Committee.

Mr. LIND. I am not particularly optimistic that even by next July, when we would be committed to bring to the Congress a set of com-

prehensive proposals, I am not particularly optimistic that at that time that we will have a firm fix on what a likely premium requirement will be.

I think that there are so many aspects of economic life that will affect whether some of these plans terminate, that at best we will have a range at that time that is somewhat narrower than we have today. I do hope that we will have, at that time, a sense of what premium levels are intolerable, and it may be necessary for us to then impose restrictions that would avoid letting premiums get to levels where the premiums themselves become a causal factor in encouraging termination.

Senator BENTSEN. I saw in the morning paper that the President said we may have a tax cut proposed next year, but it will be an integral part of the tax reform package. That means to me that the Finance Committee is going to be pretty busy next year.

Again, if you do not come up with your proposals until the end of the summer, there will be very little chance that the Finance Committee would be able to act on them. So I think the pressure is going to be on you to do something before then.

Mr. LIND. I can assure you, Mr. Chairman, that we feel it. We can live up to the commitments that we have in this area.

Senator BENTSEN. As you study this thing, you know we have such misinformation as we arrive at our decision, and you have done your best to extricate those people who made those forecasts from the bad counsel that we got, and I think you have some justification for your statements, but in reviewing this—and at the same time, the multiemployer people leave us out. I suppose at least the employees have very much changed their opinions.

Are you going to review the possibility that it is not viable for multiemployers? Are you going to go that far in studying this?

Mr. LIND. Recently, Mr. Chairman, I spoke——

Senator BENTSEN. Is that question still open? Will you be examining that?

Mr. LIND. Yes, I think it is, Mr. Chairman.

I would like to report to you a conversation that I had with a number of employers and union representatives recently in California in a rather informal rap session held by the international foundation following the formal sessions. I found out what rap sessions were; I was the rap-ee. The question came up concerning the Connolly case, which, as you know, concerned whether or not typical cents-per-hour type plans are covered. When we talked about that, I found that what most people in that room, the employers, were really upset with was employer liability. They felt that it was unfair, because many of them had no say in collective bargaining in setting benefit and contribution levels. They thought that it was disruptive to their business operations and had severe financial ramifications for them.

When we started to speak about——

Senator BENTSEN. You have that section 4063 requiring cash or bond in case of withdrawal.

Mr. LIND. Yes, 4063. In the construction industry, for example, a national contractor might enter an area temporarily for a job. When they leave they may have to post a huge bond. If they are operating

across the country, that 5-year bond can eat into their bonding capacity and limit their ability to take on new business.

In addition, they have no say in setting benefits, so it is understandable how upset they are. Of course, many local contractors are faced with the same sort of situation.

There was not a person in that room, however, who felt that workers who had put a lifetime into an industry, should be left bereft of protection.

So there we have the dilemma. On the one hand, there was no one in that room, even the most devoted Calvinists, who felt that people who had worked their whole life should not have protection.

On the other hand, the employees did not want employer liability. They thought the cure was worse than the disease.

Senator BENTSEN. You either have to face up to paying for that thing. We have put it all under social security and take it that way, you know? They cannot have it both ways. If they do not face up to the responsibility or the liability, how can we treat it separately?

Mr. LIND. I think it is a question of how it is financed. I pointed out to these people that if there were no employee liability, premiums would rise. More important, there might be no controls over irresponsible setting of benefits.

Senator BENTSEN. That is right.

Mr. LIND. The people in that room, much to my surprise, employer and union representatives alike, started speaking about additional controls. It was not I who was suggesting that, but their concern that there be different funding that there be some limitations on increases in benefits, and things of that nature.

I can only say that, from our standpoint, I think that a consideration of this area is not only an exercise in amending title IV, but is an exercise that must address all aspects of regulation of multiemployer pension plans and must, I think, as you suggest, address the fundamental question of whether protection can be provided here without, in the long run, being detrimental to the growth of multiemployer plans and nonprofit pension protection.

Senator BENTSEN. If you want to go ahead on the single employer?

Mr. LIND. Last July, Mr. Chairman, we issued our annual report covering the fiscal year ending last September 30. That report showed that the single employer program was in a net deficit position of $41 million. That $41 million is arrived at by computing the actuarial value of all of the benefits that we must pay in the insufficient plans that terminated during that period and offsetting that liability with the assets available to pay those benefits of which there are three types: plan assets that we inherit; the employers liability collectible; and the premium dollars we have available to allocate for paying benefits to single employer plan participants.

Senator BENTSEN. Do you want to tell me why there is such a deficit there? I can remember very well the statements that all we need is 50 cents per employee, that that was fully adequate. I'm the one that said, all right, let's raise it to $1 because I sure do not want to come back and say we have to raise it later on. Let's be sure we have more than enough. And here we are.

Mr. LIND. To put it rather simply, Mr. Chairman, the claims rate itself exceeds $1. The forecast for the future claims is roughly $1.25 a year, just to pay the unfunded guarantee benefits.

Senator BENTSEN. I understand that. Why did we get such bad forecasting, such bad information? It is like putting an agency director in charge of the actuarial department in an insurance company. They make all of the assumptions on their side so they can beat the competition on the rates.

Somebody had a bias, it looks like to me, to give us that kind of bad numbers.

Mr. LIND. Mr Chairman, I am not familiar with what analysis was involved at that time, I think that there is one possible explanation, and it is that a very substantial portion of our claims arise from a fairly small number of situations. It is quite possible that the studies that were underlying the initial premium just did not cover periods where we had those types of losses.

Senator BENTSEN. I fought very hard to get this thing through the Finance Committee and it had been killed year after year by the Finance Committee. It is a difficult thing to go back to the Finance Committee and say that we were wrong in our projections. We were given bad information. Are we going to face this kind of thing every 2 or 3 years, coming back for an increase in these premiums? How do you know these figures that you give us are any more reliable than what we had 2 or 3 years ago?

Mr. LIND. Mr. Chairman, I hope that we are not going to be coming back. In all candor, however, I think that our forecasting tools in this area are kind of rudimentary at this time.

We have used aggregate forecasting tools which project prior experience into the future. I think that before we can speak with confidence here we are going to need tools that look at specific industries and look at the economic conditions in those industries rather than the overall economy.

As an example, take the steel industry. Now, we are experiencing economic growth in the country as a whole. At the same time, however, the steel industry is experiencing a decline. The steel industry has about the richest pension plans available in this country and that kind of decline could give rise to very significant claims. That is why I do not want to overpromise, Mr. Chairman, and say that I think that the $2.25 is the end.

Senator BENTSEN. Maybe we are overpromising. On the other side, maybe we have to rethink pension plan termination insurance.

Mr. LIND. Mr. Chairman, if, underlying your question—I do not know whether you are speaking about the feasibility of the program as a whole, or whether you are talking about——

Senator BENTSEN. It may be overambitious.

Mr. LIND. If you are talking about the current level of benefit protection, maybe we are promising too much and as a consequence the cost of the program itself is going to reach levels that become detrimental to longer term objectives.

This is something that we are certainly concerned with. I think yesterday Senator Javits made a comment from his perspective on the multiemployer situation that we should be looking very closely at what we are promising. I think the same may apply to the single

employer program as well, although candidly, the $2.25 premium is still a very, very small price to pay for the protection that is being provided.

Senator BENTSEN. Have you discussed the price?

Mr. LIND. $2.25. It is a loss leader.

Senator BENTSEN. It sure is. We will make it up on volume, though. Did you have anything further?

Let me ask you what you have invested your premiums in? What kind of result—do you expect any change in your investment?

Mr. LIND. To date, Mr. Chairman, the premium dollars have remained in our revolving fund and have been invested solely in Treasury securities.

Senator BENTSEN. That has been a fortunate choice for the last 2 years, looking at what the Dow was this morning, at a 2-year low.

Mr. LIND. Yes, it was.

However, I might add that there were investment opportunities 2 years ago, even annuities, which were significantly better than what Treasury was offering at that time. The current policy of the Corporation is to transfer, or to be able to transfer premium dollars from the revolving fund—where they are restricted to treasuries—to our trust funds, where we put plan assets and employer liability payments, so that the trust funds are fully funded with respect to the actuarial liabilities we have assumed.

In transferring those premium dollars to the trust fund, they would then become available for more diversified investment, in private as well as public securities. That transfer policy is now under review. It has not yet been utilized and, as you suggest, perhaps it has been fortunate that those moneys were where they are.

Senator BENTSEN. How about these assumptions upon which you have based your $2.25? What is the backup for that?

Mr. LIND. John, would you like to handle that?

Mr. HIRSCHMANN. There are four critical assumptions that entered into our analysis. The first is the evidence that since enactment of ERISA, the rate of terminations has not changed from what it was prior to enactment. We foresee a moderate decline in the rate of terminations because we assume economic conditions will improve in the country.

Senator BENTSEN. What do you know that I do not know? You see economic conditions improving?

Mr. HIRSCHMANN. That particular assumption is not carrying a heavy weight in the particular model that we use to project our claims. If we had assumed no improvement in economic conditions, we would be here asking for $2.65 rather than $2.25.

Senator BENTSEN. I think you should make the safer assumption. I do not want to see you coming back every year. I think you ought to be making some pretty conservative assumptions. I would say to my friend, Mr. Lind, that the $2.25 is not a serious liability per employee, but do not nibble them to death. The old adage about cutting a little off of the dog's tail instead of all at one time so it will not hurt so much. Make your safe assumption, and I would also say to you that on multiemployer, if you want to get ahead of this pack, the problems we are going to have legislativewise next year, you should be back to us by January 15 or February 1.

Mr. LIND. Mr. Chairman, there was certainly a range of assumptions that we could use. The assumptions we have used regarding unemployment are the administration's assumptions. We studied all the private forecasting assumptions. They did not really differ materially. We felt, in light of the statutory requirement, to keep the premiums as low as possible, that in this case the administration's assumptions were as credible as others.

It is not our intention to be coming back every year.

Senator BENTSEN. You are destroying confidence in your forecast if you keep coming back. I would counsel you very strongly, if you are talking about something between $2.25, $2.65, if you are going to make a jump for $1 you are not going much further if you go up to $2.65 instead of having to come back 2 years later—we made a mistake, we want $2.75.

Mr. LIND. I appreciate your comments, Mr. Chairman.

Senator BENTSEN. Go ahead.

Mr. HIRSCHMANN. There are three other basic assumptions that we would like to highlight. One, the analysis assumes that there will be no unusually large claims. Such claims are, by nature, random and hard to predict. The largest claim we have incurred to date was close to $15 million. The request also assumes that we will be able to achieve the investment performance that we have assumed for the funds that we have in the revolving fund and in the trust fund.

Senator BENTSEN. What kind of investment return have you had in Treasury? What have you averaged out in the last 2 years?

Mr. HIRSCHMANN. I do not have a specific number. We can certainly provide that for the record.[1]

Mr. LIND. Mr. Chairman, we can provide you with that data. There has been good performance in the Treasury portfolio.

Senator BENTSEN. You have had high interest rates.

Mr. LIND. Yes, around 7 percent.

Senator BENTSEN. I do not know if those are valid assumptions.

Mr. LIND. Those are not assumptions that are built in to the premium forecast. It is a longer range set of assumptions. I believe if you look at the total portfolio, the assumed average rate of return is in the 6 to 6.5 percent range.

Senator BENTSEN. That is a pretty healthy rate of return if you are talking about the next 30 years.

Mr. LIND. That is true, Mr. Chairman. However, virtually all forecasts that we have seen are calling for much higher long-term rates of inflation and correspondingly higher rates of return.

Mr. HIRSCHMANN. Also, the consequence of assuming a lower rate of return is that we will have a higher rate of liabilities and participants could lose benefits. We are anxious in this particular case to be as objective as we can and not make our assumptions either too high or too low. If we err on either side, different parties will be hurt.

Senator BENTSEN. You said it was a forced assumption, the legal right to assess employer liabilities to sustain. Is that in question?

Mr. ROSE. Yes, Mr. Chairman. We are being challenged in the courts in several cases, and we are hopeful that our right will be

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[1] See p. 9.

sustained. We have had a couple of adverse decisions already. One would have only a transitory effect because it would affect only terminations that occurred before the effective date of ERISA's minimum vesting provisions.

Senator BENTSEN. Is that on single employer plans?

Mr. ROSE. Single employer plans, yes, sir.

Mr. LIND. Mr. Chairman, the cost to the Corporation of losing these cases goes far beyond what is contained in our analysis submitted to the Congress. I believe that our analysis indicates that if employer liability were not collectible, our premium would go up, I think, to about $3.30. However, the real cost, if employer liability is not collectible, is that the disincentive to terminate is removed, and we might then experience a rash of induced terminations.

Senator BENTSEN. Is the question the clarity of the statute, or the lack of clarity? What is the problem?

Mr. ROSE. There are a number of problems. Clarity is one of them.

For example, there is one case in which a master held and recommended to the U.S. district court that the parent is not liable for the employer liability of a subsidiary. It is our interpretation that it is, but I think the statute could be much clearer.

I would hope that when the Congress amends the statute that that will be done.

In other cases, employer liability is being challenged as a matter of statutory interpretation. In one case, for example, it was held that employer liability could not be assessed for accruals that took place prior to the effective date under the vesting requirements of the statute.

There are a number of cases where the constitutional issue has been raised, but it has not been squarely ruled upon by any court yet.

Senator BENTSEN. I can see where you have some serious legal questions on both of those.

Mr. ROSE. We certainly do.

Mr. LIND. Mr. Chairman, the liability of parent corporations for the termination of pension plans by a subsidiary, or other member of a control group has, we believe, been a very important factor in encouraging employers to seek alternatives to termination. We have many plans in-house involving the liquidation or shutdown of a subsidiary, where a parent company has sought to continue the pension plan.

In part, that decision reflected an awareness of employer liability. All things considered, it is easier and to the advantage of the employer to continue the present pension plan rather than terminate it.

Senator BENTSEN. Obviously, you will be coming up with a recommendation as to what you think should be done to clarify, to tighten up, those requirements?

Mr. ROSE. We are hopeful that we will have such recommendations for you next year.

Senator BENTSEN. If you have anything further, Mr. Lind, I suggest you try to summarize it in the next 5 minutes. I really have to go to the Finance Committee.

Mr. LIND. In summary, Mr. Chairman, our objective of this premium increase is to try to put the Corporation on a sound, long-term financial footing; that is, to have the premium receipts in each year be equal to the expected claims to be received in that year. This is the

same approach to funding that we find in private pension plans, and we would hope to be able to achieve that at this time.

At the same time, Mr. Chairman, I think we are mindful of the potential deleterious effects that anything we do with our program might have on new plan formation and the expansion of benefits. We are only too aware of the large number of terminations which have resulted since the enactment of ERISA. We, more than any organization, feel the brunt of those terminations.

In considering this, I would just like to point out that the increase that we are asking for amounts to somewhere between a 0.1-percent and 0.5-percent increase in pension cost. Viewed from the standpoint of payroll costs, it is on the order of 0.01 percent or one-fifteenth-of-1-cent-per-hour increase in payroll costs. We have ascertained to our own satisfaction that our premium has not been a factor in plan terminations.

Particularly now, we feel secure in the knowledge that this increase will not encourage small plans to terminate. As I mentioned to you at an earlier meeting, we discussed this matter with the American Society of Pension Actuaries, which predominantly services small plans. Their executive director has given me permission to testify here today that in fact, in their judgment, this increase will have no material effect on the behavior of small plans.

Senator BENTSEN. Mr. Lind, I would certainly concur in that, if you are talking about $30 per small plan. That is why I would also strongly urge you to be conservative in your estimate of what this premium is. If you think there is serious question at $2.25, do not hesitate to go to $2.75 or $3. Just do not come back to us again asking for another increase, that you made a mistake, and tell me why you made the mistake.

Mr. LIND. Yes, Mr. Chairman. I wish that I could assure you that I will not be sitting here again in the near future.

Senator BENTSEN. If you are going to err on this one, err on the high side.

Thank you, gentlemen.

Mr. LIND. Thank you, Mr. Chairman.

[The prepared statement of Mr. Lind follows:]

TESTIMONY OF MATTHEW M. LIND, ACTING EXECUTIVE DIRECTOR OF THE PENSION BENEFIT GUARANTY CORP.

Mr. Chairman: I am Matthew Lind, the Acting Executive Director of the Pension Benefit Guaranty Corporation. I have with me today Henry Rose, General Counsel of PBGC, and John Hirschmann and Vincent Cicconi of the Office of Program Development.

I am grateful for this opportunity to testify before you, first, in support of PBGC's request for a needed increase in the premium rate for termination insurance of single employer pension plans, and, secondly, in support of a deferral of the date when the Pension Benefit Guaranty Corporation must begin mandatory termination insurance coverage of multiemployer pension plans.

PREMIUM RATE

When Congress enacted ERISA, it provided a premium of $1.00 per participant in single employer plans to finance benefits guaranteed by the PBGC. The premium rate had to be established based on limited knowledge of pre-ERISA experience. There was no directly relevant data on which to rely when this insurance program was created. We have now had three years of actual experience. This has been documented in the PBGC staff study entitled "Premium Requirements for the Single Employer Basic Benefits Insurance Program", which we provided

Congress in support of our official request. The study shows that a one dollar premium is not producing enough revenue to finance future benefit payments which PBGC must guarantee. As a result, the single-employer basic benefits program was in a deficit position of $41 million at the end of FY 76. By the end of 1977, the indicated deficit is likely to be at least $60 million. Without a premium increase, we anticipate that this deficit will be at least $160 million by the end of 1981.

Before discussing our proposal to deal with this shortfall, I want to assure the Committee that these large and growing deficits create no present danger for plan participants. Our experience has shown that when underfunded plans terminate, most of them have enough assets to pay benefits for at least several years. Therefore, the immediate cash flow situation of the Corporation will remain manageable, and it will have sufficient assets available to make benefits payments as they become due.

The long-term prospects are different. In order to put the program on a sound on-going financial footing, and to avoid the need for precipitous increases later on, the PBGC submitted a request to the Congress to approve an increase of the premium to $2.25 per participant in single-employer plans, effective January 1, 1978. If the premium is increased to this level, we estimate that it will return enough revenue to eliminate the current deficit by the end of 1987.

Our analysis of experience to date shows that, of the terminations in which plan assets were not sufficient to pay guaranteed benefits—with possible liability for PBGC—80 percent were caused by the close of a business entity. These terminations apparently are related mainly to economic conditions. Such terminations are projected to decline somewhat in the future, as economic conditions improve.

The premium increase would only require most plan sponsors to increase their annual payroll costs by about 0.01 percent, or one fifteenth of one cent per hour, per employee. Their annual pension contributions would rise by only 0.1 percent to 0.5 percent. Thus, the increase (which is very small in the perspective of other pension and payroll costs) will fall equally on small and large plans. I am confident that this premium will not be the cause of any additional terminations. For half the covered plans, the annual premium increase will be $30 or less.

Independent of the premium increase request, the Corporation has already taken steps to reduce significantly the administrative burden to employers of paying their premiums. These include modifying the definition of a participant for whom a premium must be paid, eliminating the need for a reconciliation based on an earlier estimate of the participant count, and transferring the annual reporting requirement to the DOL/IRS Form 5500.

Our request for an increase in the premium to $2.25 is based on an anlaysis which assumes that no further revision in the premium would be needed before January 1, 1982. In other words, the rate will not need to be changed unless our experience in the interim deviates substantially from the assumptions upon which the proposed premium is based. The premium does not provide for the establishment of any reserve against the possibility of higher than expected claims or adverse investment performance.

The $2.25 request assumes that the Corporation will invest its trust fund assets in the private sector, when prudent, and transfer premium revenues to the trust fund under an amortization schedule that is anticipated to make the trust fund actuarially sound on an on-going basis. These policies are still under reconsideration by our Board of Directors.

The other assumptions have been explained in detail in the staff study which we provided, and to which I have already made reference. I would like permission to insert for the record the management summary of that report.

Approval of the concurrent resolution (which is now before this Committee, the Committee on Human Resources and the appropriate House Committees) at this session will allow the premium increase to become effective on January 1, 1978. January 1 is a critical date, because the majority of plan years start on that date. Any additional delay in approval has the practical impact of delaying an increase for another year for most plans. During that year our actuarial deficit would increase by about $25 million, so that the new premium, when it would ultimately be authorized, would have to be higher.

The PBGC believes the premium increase is well considered and thoroughly justified. Approval of the premium increase will enable us to continue doing what we were created to do—protecting plan participants—on a financially sound basis.

MULTIEMPLOYER PLAN COVERAGE

Another pressing problem involves mandatory coverage of multiemployer plan terminations. I would like to discuss the interrelation of Title IV and multiemployer plans, and then turn to the legislative proposals for deferring mandatory PBGC coverage of these plans until there has been an opportunity to deal with problems inherent in the current termination insurance scheme.

When Title IV of ERISA was drafted and enacted, multiemployer plans were viewed in a perspective that suggested that there would be relatively few terminations, compared to single employer plans. The record before Congress showed a more favorable situation for multiemployer plans not only as to the number of plans, but also as to covered participants who would be affected by terminations. Much of the thinking of the Congress was influenced by a Study on Pension Plan Terminations by the Departments of Treasury and Labor which showed a low incidence of such multiemployer plan terminations during the 1965–1971 study period. Moreover, the study reported that approximately 80 percent of such terminations were attributable to mergers of such plans into other plans. Only 3 percent of the terminations arose from financial reasons. The legislative history of the Act discloses that this hopeful perspective motivated, at least in part, the initial lesser premium charged to multiemployer plans and the delayed coverage date.

However, since then, changing economic conditions in certain industries and a growing realization, both in the pension community and within PBGC, of the complexities and unforeseen problems involved in applying ERISA to multiemployer plans have changed that perspective considerably.

In the interim we have also had some actual experience in administering coverage of multiemployer plan terminations, as the Committee is aware. Exercising our discretion under Section 4082 of the Act, we recently took into trusteeship and assumed coverage of guaranteed benefits for three such plans in the millinery industry in New York at a ceremony attended by the chairman and ranking minority member of this Committee. We have tentatively committed the Corporation to extend coverage to a milk industry multiemployer plan located in New Jersey.

We believe that in both cases we have exercised our discretion to cover such multiemployer plan terminations in conformity with the statutory guidelines and in response to the needs and problems of the employers, employees and unions connected with those particular industries and the localities involved.[1]

Our assumption of coverage of those plans has spotlighted some areas of concern with respect to our present statutorily mandated coverage of *all* terminating multiemployer plans as of January 1, 1978. The millinery and milk plans are typical case examples of what occurs to multiemployer plans in a declining industry. Whether due to trends in dress fashion (as in the millinery industry), foreign competition, technology changes, economic pressures or any number of other reasons, there are a number of industries in this country that have declined over a period of time, and will very likely continue to do so.

Multiemployer plans in such industries face the combination of a falling contribution base and rising benefit costs as former participants retire.

The drafters of ERISA did not have the benefit of this experience. As I pointed out earlier, the data before Congress dealt with the years 1965–1971, generally a period of economic strength and one which began soon after a period of enormous growth in the multiemployer field. We are now seeing plans at more mature stages of development. In some cases, such as Millinery and Milk, this has meant that weaknesses discernable even at an earlier time have now become the cause of termination.

Our experience, and the possibilities of future problems that such experience suggested, led the Corporation to conduct a study of potential multiemployer plan cost that might be incurred by the PBGC termination insurance program at the time coverage of such plans will become mandatory.

The PBGC study showed:

About 2 percent of all multiemployer plans, covering about 5 percent of all participants in such plans, are experiencing extreme financial hardship, indicating a high potential for plan termination within the next 5 years. The aggregate unfunded vested liabilities of these plans in 1977 exceed $350 million.

Another 10 percent of all multiemployer plans, covering about 15 percent of all participants in such plans, are experiencing significant financial hardship which may result in plan termination, although not necessarily in the near future (within 5 years). These plans currently have aggregate unfunded vested liabilities of about $3.5 billion.

In summary, approximately one-eighth of all multiemployer plans, covering one-fifth of all participants in such plans, are experiencing significant financial hardship which may result in plan termination. The extent to which such plans will actually terminate depends in part on future economic developments in their industries, the possibility of merger into another plan, union organizing efforts, and future legislative developments relating to multiemployer plans.

The staff survey was confined to potential terminations due to financial hardship only. We felt that it would have been speculative to estimate the incidence of terminations for other reasons. However, the possibility of additional potential terminations for other reasons cannot be dismissed. In that regard, we need information about possible effects of ERISA itself on plans, as a potential factor affecting the Title IV program.

We solicited comments and suggestions from the public concerning multiemployer termination insurance both formally (through the Federal Register) and informally. In their responses, commentators stressed the conviction that it is unfair to impose additional termination liability upon participants beyond their required contributions to the ongoing plan. They pointed out that in many cases individual employer contributors to multiemployer plans have little, if any, control over a decision to terminate such plans. In the construction industry, for example, an employer may become, in effect, a captive contributor to a collectively bargained plan when he undertakes a project in a particular geographical area for a limited number of years. His required contributions during his participating years in the plan may make him a substantial employer under Section 4063 of the Act. His withdrawal from the plan when the project ends would trigger the necessity of escrowing cash or posting a bond or indemnity for a period of 5 years if the plan is insufficient at the time of his withdrawal. If the plan should terminate within 5 years after his withdrawal and the plan is underfunded, the withdrawing employer shares the employer liability.

Concern over employer liability may encourage some employers to bargain out of the plan; still others, wishing to avoid substantial employer status, may seek to reduce their participation in the plan through such measures as operating open shops. The net effect would be to reduce the contribution base of the plans, thereby increasing the burden on current employees and employers. Conceivably, such added costs and the added exposure to employer liability could precipitate termination of the plan, even where there is no significant industry decline. Ironically, instead of acting as a disincentive to plan termination, employer liability may in the case of multiemployer plans be a cause of termination.

We now possess knowledge and insights about providing termination insurance for multiemployer plans that were not available earlier. We feel strongly that the next step is to develop—in close coordination with those who will be affected by them—proposals to deal with the potential problems we have identified. By following this course, the transition to mandatory coverage will be a positive step, as it should be, and not a source of disruption and uncertainty for multiemployer plans.

We are already at work at the task of identifying and testing possible alternative proposals for multiemployer plans, and we intend to carry it through to completion whether or not the Congress defers the date for mandatory coverage of multiemployer plans.

We recognize that preparing such proposals is a major undertaking. No one could appreciate the complexities involved more than this Committee, which labored long and hard to create an entire termination insurance program with little guidance from the past. This effort can be no theoretical exercise. Every suggestion and proposal must be tested, not only by hard analysis but by exposure to the comments of everyone in the pension community that must live by these rules. Unavoidably, this will take time. Consequently, we agree that a deferral of multiemployer plan coverage is in order. Under S. 2125, mandatory coverage could, at the discretion of PBGC, be postponed to July 1, 1979. S. 2019 provides deferral to January 1, 1979. A similar bill (H.R. 9378), which would extend the effective date to January 1, 1980, has been introduced in the House. In the meantime, PBGC would still have discretionary authority to cover interim terminations of multiemployer plans. We have shown in the past three years that we can exercise such authority responsibly. The timing and flexibility of such deferral should therefore not prejudice participants who might be involved in multiemployer plan terminations during a postponement of mandatory coverage.

A deferral of the length contemplated in pending bills is feasible; our studies show that even a large number of discretionary assumptions of coverage—which

we do not expect—would not be beyond the Corporation's ability to make current benefit payments.

In requesting time to prepare better ways to meet these complex problems, we recognize that there must also be sufficient time for legislative consideration of such proposals.

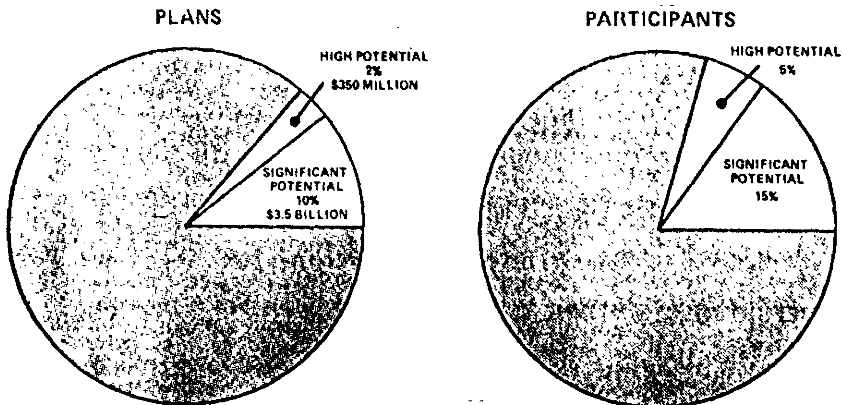
In view of the many steps involved in generating the kind of legislative proposal we are talking about, we hope that the Congress will allocate enough time for us to bring back a program that represents not only our own best thinking but also the comments and ideas of the pension community. We sincerely believe that a better, and more generally acceptable, proposal will result.

Thank you, gentlemen, for according me the courtesy of addressing you on behalf of the PBGC.

PENSION BENEFIT GUARANTY CORPORATION

DEFERRAL OF MULTIEMPLOYER COVERAGE

POTENTIAL MULTIEMPLOYER TERMINATIONS



PROBLEMS

- HIGH POTENTIAL CLAIMS IN PROBLEM PLANS/INDUSTRIES
  - POTENTIAL TERMINATIONS ($3.85 BILLIONS)-DWARF PBGC
  - INCREASED MULTIEMPLOYER PREMIUMS COULD PRECIPITATE FURTHER WITHDRAWALS/ TERMINATIONS
- EMPLOYER LIABILITY/WITHDRAWAL PROVISIONS ARE HAVING DISRUPTIVE EFFECTS ON MULTIEMPLOYER PLANS/COLLECTIVE BARGAINING
  - EMPLOYERS SEE INCENTIVE TO WITHDRAW ("BARGAIN-OUT") FROM PLANS
  - BARRIER TO ENTRY OF NEW EMPLOYERS
  - EMPLOYERS HAVE INCENTIVE TO OPERATE NON-UNION SHOPS, I.E. "DOUBLE-BREASTED" OPERATIONS
  - ABOVE EFFECTS INCREASE THE LIKELIHOOD OF TERMINATION

DEFERRAL OF MANDATORY COVERAGE FOR MULTIEMPLOYER PLANS

CON

- DELAY COULD HURT ANY PLANS WHICH MUST TERMINATE IN 1978, BECAUSE THE BENEFITS MAY NOT BE GUARANTEED, OR MAY BE REDUCED IN FUTURE.
- DELAY WOULD SOMEWHAT INCREASE PBGC'S ULTIMATE LIABILITIES.

PRO

- DELAY GIVES TIME TO DEVELOP A PROGRAM ~~RESPONSIVE TO~~ THE UNIQUE NEEDS OF MULTI-EMPLOYER PLANS.
  - THAT PROGRAM WOULD HELP MULTI-EMPLOYER PLANS TO CONTINUE AND TO GROW.
  - SUCH CONTINUANCE WOULD HELP PARTICIPANTS.
- DELAY DECREASES INCENTIVES FOR TROUBLED PLANS TO TERMINATE UP-FRONT SO AS TO ASSURE BROAD PROTECTION.
- DELAY DECREASES RISK OF CASH-FLOW PROBLEMS IF MANY PLANS TERMINATE IN JANUARY.

PENSION BENEFIT GUARANTY CORPORATION

PREMIUM REQUIREMENTS

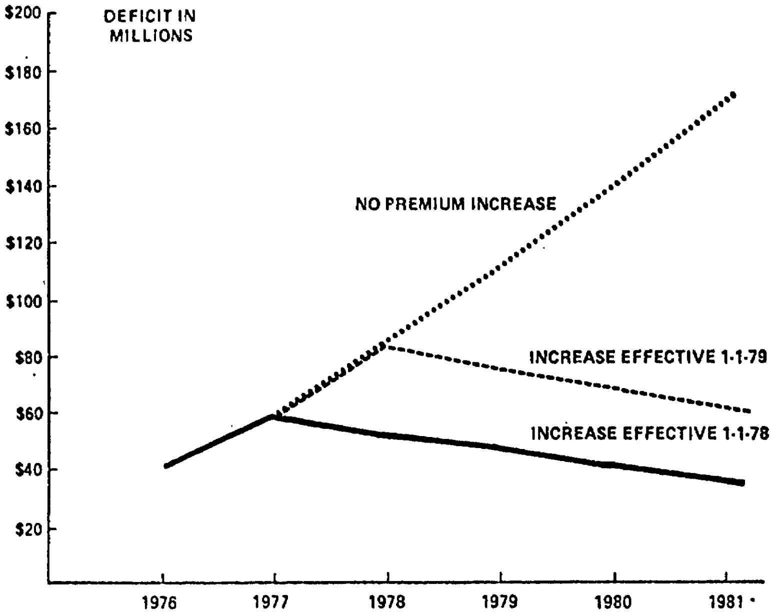
NEED FOR INCREASE

- PROGRAM HAD DEFICIT OF $41 MILLION AT THE END OF FY 1976.
- DEFICIT IS EXPECTED TO BE AT LEAST $60 MILLION AT THE END OF 1977.
- DEFICIT WILL CONTINUE TO GROW WITHOUT A PREMIUM INCREASE.

KEY ASSUMPTIONS

- CLAIMS RATE HAS NOT BEEN AFFECTED BY ERISA. FUTURE CLAIMS RATE WILL DECLINE SOMEWHAT AS ECONOMY IMPROVES.
- NO ESTABLISHMENT OF RESERVES FOR LARGE CLAIMS OR ADVERSE INVESTMENT PERFORMANCE.
- CONTINUATION OF CURRENT INVESTMENT POLICY.
- LEGAL RIGHT TO ASSESS EMPLOYER LIABILITY SUSTAINED.

PROGRAM FUNDING
ANALYSIS OF ALTERNATIVES – PROGRAM DEFICIT



EFFECTS OF PREMIUM INCREASE

- INCREASE IN ANNUAL PENSION CONTRIBUTION OF ONLY 0.1% TO 0.5%.
- INCREASE IN ANNUAL PAYROLL COSTS OF ONLY 0.01%, OR ABOUT 1/15 CENT PER HOUR.
- PREMIUM HAS NOT BEEN A FACTOR IN PLAN TERMINATIONS.
- SMALL PLANS NOT UNDULY BURDENED.
  – INCREASE IN PREMIUM FOR TYPICAL SMALL PLAN ONLY $30 PER YEAR.

Senator BENTSEN. The subcommittee will stand in recess.

[Thereupon, at 10:10 a.m., the subcommittee recessed to reconvene at the call of the Chair.]