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PBGC

Investment Policy on PBGC's Agenda; Practitioners Call for More Aggressive Mix

The Pension Benefit Guaranty Corporation has contracted with an outside investment adviser to review the agency's assets and liabilities in light of the best investment practices and asset allocations of similar institutions, John H. Hanley, director of PBGC's Legislative and Regulatory Department, said in discussing issues the agency will be dealing with in 2008.

Responding in writing Dec. 20 to questions asked by BNA, Hanley said there are no constraints on that review other than those imposed by current law related to the investment of the PBGC's revolving fund. Because the review is now underway, there are no results to report at this time, and no conclusions have been reached, he added.

''We look forward to a comprehensive review of the PBGC's investment strategy that would result in a more aggressive mix of investments,'' S. Michael Chittenden, director for legislation and regulations at the ERISA Industry Committee, told BNA Dec. 26.

The central point of debate at the PBGC concerning investment policy has always been whether the agency should invest more like a pension fund, with heavy equity exposure, or like an insurance company, with a reliance on fixed income portfolios, Dallas Salisbury, president of the Employee Benefit Research Institute, told BNA Dec. 26. Past reviews have always ended at the insurance company fixed income model, he said.

''I am glad to see the PBGC looking at their investment practices,'' Lynn D. Dudley, vice president, retirement policy for the American Benefits Council, told BNA Dec. 27. ''I think it is overdue,'' she said.

Board of Directors Makes Final Decision. According to Hanley, PBGC's board of directors will make the final decision about any change to the agency's investment policy. The agency operates under the guidance of the board of directors, which consists of the Secretaries of Labor (Chair), Commerce, and Treasury.

According to PBGC's 2006 annual report, under the provisions of the Pension Protection Act of 2006, the agency is required to estimate the effect of an asset allocation structure that currently is not employed by the agency. This suggested structure has higher interest rate and financial market risks: a 60 percent allocation to Standard & Poor's 500 equity index and a 40 percent allocation to the Lehman Brothers Aggregate fixed income index, the annual report said.

The annual report estimated that for 2006, an investment structure of 60 percent in equities and 40 percent fixed income would have generated a return on total investment funds of 7.9 percent, compared to the 4.2 percent produced by PBGC's program. This, in turn, would have increased the assets of the corporation by approximately $1.8 billion and reduced the deficit by a comparable amount, it added.

Other issues on the agency's 2008 agenda include plan asset data, the missing participant program, premium overpayments, and various rules under development.

Missed Opportunity. ''ERIC believes that the PBGC has missed the first sailing as equity markets recovered from the last bear market,'' Chittenden said.

According to Chittenden, large pension plans have largely seen most, if not all, underfunding erased by market gains over the last couple of years. ''What was presented as a crisis by some only a few years ago, now looks much better because of changing interest rates and improved equity markets,'' he said.

''Had the PBGC's assets been invested in a manner similar to those held by pension plans, their so-called deficit would likely have been reduced much further than it has been,'' Chittenden said.

According to Salisbury, PBGC believed that a period of low equity prices would most likely be a period of high terminations and high exposure from underfunded plans, and, as a result, the agency should not put itself in a position where it suffers large equity investment declines just as it gets hit with pension plan exposure.

''In short, invest in a way opposite to the pension funds that you are supposed to protect,'' Salisbury said.

''It will be interesting to see if the Bush administration changes that position as one of its last actions in office,'' he added.

''The Democrats have generally appointed public policy oriented pension experts to run the PBGC,'' Salisbury said. ''The Republicans have generally appointed individuals with an investment background more than a pension background,'' he said.

''Should a Democrat be elected president in 2008, it could mean a change in focus for PBGC, suggesting that it might be a bad time to make a major change in PBGC investment policy,'' Salisbury said.

''I remain concerned that PBGC does not recognize the long-term ongoing nature of pension plans, and I think that fundamental view hurts the system because it discourages employers from making the commitment to maintain a defined benefit plan,'' Dudley said.

Key Issue at Senate Hearing. The PBGC's investment policy was the key issue raised at a Sept. 6 Senate Health, Education, Labor, and Pensions Committee hearing on the nomination of Charles E. F. Millard to be director of the agency (173 PBD, 9/7/07; 34 BPR 2089, 9/11/07). Sen. Barbara A. Mikulski (D-Md.) chaired the nomination hearing on behalf of the committee chairman, Sen. Edward M. Kennedy (D-Mass.). Mikulski chairs the committee's Subcommittee on Retirement and Aging.

The Senate Dec. 14 approved Millard's nomination to be PBGC director (241 PBD, 12/18/07; 35 BPR 24, 1/1/08). President Bush had appointed Millard to work as interim director of the agency on May 23 pending his confirmation by the Senate as director.

At the Sept. 6 hearing, Mikulski said she wanted Congress ''actively involved'' in any investment policy decisions made by the agency. Any change of investment policy by PBGC is ''a major policy issue,'' she said.

''Before the asset allocation is changed, share [what you are doing] with Congress,'' Mikulski told Millard, adding that she ''gets the sense ... you will really work with Congress.''

PBGC's investment policy is adopted by its board, not by statute, Millard responded to Mikulski. The agency's investment policy is ''conservative in the extreme,'' he added.

Seventy percent of the agency's current allocation is in fixed income investments, largely Treasury bills, Millard said. PBGC controls assets worth approximately $61 billion and faces liabilities of approximately $80 billion, he said.

''The PBGC board has a great deal of discretion in setting the PBGC's investment policy,'' Jim Keightley, former PBGC general counsel who now is a partner with Keightley & Ashner LLP, told BNA Dec. 28.

''Such a decision requires some real balancing,'' Keightley said. ''On the one hand, there's the expectation, based on historical results, that equities will outperform bonds. On the other hand, there's the risk that too much equity exposure will result in PBGC's assets going down just when its liabilities go up because of the correlation between a down market and the failure of companies with underfunded defined benefit plans,'' he said.

Plan Asset Data. The allocation of a plan's assets is a major risk factor that needs to be taken into account when determining the potential exposure to PBGC from a particular plan, Hanley said.

He said two new questions added to the Form 5500 cover the percentage breakdown of plan assets into asset classes and the duration of the plan's bond portfolio.

The Department of Labor's Employee Benefits Security Administration, jointly with Treasury, Internal Revenue Service, and PBGC, published Nov. 16 its final rule regarding Form 5500 Annual Return/Report of Employee Benefit Plan and its notice of the adoption of revisions to the form (212 PBD, 11/16/07; 34 BPR 2702, 11/20/07; 72 Fed. Reg. 64,710 and 64,731, 11/16/07).

According to Hanley, this new data will be used in PBGC's early warning program to identify plans whose risk is increasing. The agency's risk is not simply a matter of whether plan assets equal or exceed plan liabilities, he said.

PBGC Technical Update 00-3 describes the early warning program (143 PBD, 7/25/00; 27 BPR 1740, 7/25/00), in which PBGC monitors companies with defined benefit plans that are underfunded by at least $5 million and negotiates agreements with plan sponsors contemplating a corporate transaction that the agency thinks could jeopardize the benefits owed to plan participants.

''The PBGC's announced use of the investment mix of a pension plan as part of its early warning program may create one more incentive for employers to move to a more conservative investment strategy,'' Keightley said.

Other Issues. Hanley also identified other issues to be addressed in 2008:

- *Missing Participant Program*: A draft of the regulations on the expanded missing participant program is nearing completion and proposed regulations are expected by mid-2008. The missing participants program was expanded by the PPA to cover multiemployer plans and plans not otherwise covered by PBGC's termination insurance program. At issue is what a plan must do to conduct ''diligent search'' to locate missing participants (58 PBD, 3/27/07; 34 BPR 784, 4/3/07).

■ *Premium Overpayment Interest*: A draft of the regulations on premium overpayment interest is nearing completion and proposed regulations are expected by mid-2008. The PPA amended the Employee Retirement Income Security Act to allow PBGC to pay interest on overpayments made by premium payers. Interest paid on overpayments are calculated at the same rate and in the same manner as interest charged on premium underpayments.

■ *Other Pending Proposed Rules*: Awaiting action by the Office of Management and Budget are two proposed rules on annual reporting to the agency by certain underfunded plans and multiemployer withdrawal liability, as well as one final rule on the variable rate premium. Other proposed rules will address bankruptcy terminations, cash balance plan termination, and reportable events. According to PBGC, reportable events include such things as failure to make required contributions and inability to pay benefits when due. Shutdown benefits are triggered by plant closings or permanent layoffs and can provide an unreduced early retirement benefit as early as age 42.

■ *Rules Under Development*: Rules under development that would implement provisions of the PPA include limiting the guarantee of shutdown benefits, determining benefit guarantees as of the plan sponsor's bankruptcy date, and implementing revision of multiemployer withdrawal liability.

Annual Reporting Regulation Significant. ''In the post-PPA context, the annual PBGC employer reporting regulation will be of significant interest not just primarily to large employers, but to smaller ones as well,'' Harold Ashner, former PBGC general counsel for legislation and regulations, now a partner with Keightley & Ashner LLP, told BNA Dec. 28.

According to Ashner, this is because the new PPA reporting threshold, based on any one plan in the controlled group being less than 80 percent funded, could sweep in even the smallest employers.

''Clearly, PBGC will be providing some size-based reporting relief,'' Ashner said. ''The key question is the nature and scope of that relief.''

Cautionary Note. ''I raise a cautionary note with respect to rules relating to bankrupt employers who have defined benefit plans,'' Dudley said. ''I worry a lot about the promulgation of rules that seek to try to keep employers paying premiums beyond the plan's existence or 'surcharges' for getting out,'' she said.

''I know these ideas have crept up in legislation in the past and I think they work against the system because healthy employers do not want to expose their companies to those kinds of risks and so may choose to leave rather than risk surcharges in the event a business or a business line goes bankrupt,'' Dudley said.

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