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OUTLOOK 2009

PBGC Hangs Hat on Investment Policy as Strategy to Survive Market Turmoil

The Pension Benefit Guaranty Corporation said its investment policy would protect the agency from losses as employers terminate underfunded plans, although practitioners question whether that is the case.

The PBGC's investment policy that was adopted in 2008 was intended to diversify asset investments to improve their returns, Charles E.F. Millard, told BNA Dec. 16. He said he considers the policy the agency's "best opportunity" to meet its financial obligations without a congressional bailout.

"In light of the deteriorating economy, PBGC will face major financial and operational challenges over the next few years," Jim Keightley, a partner with Keightley & Ashner LLP and PBGC's former general counsel, told BNA Dec. 24. "Given the uncertainty in the financial markets, its investment policy will continue to be an area of controversy," he said.

Harold J. Ashner, also a partner with Keightley & Ashner and former assistant general counsel for legislation and regulations at PBGC, told BNA Dec. 24 that he questions the efficacy of the policy in the future given the current economic turmoil. He called for a review of the policy because of the economic changes since the policy was created.

"A great deal of attention will be focused on how PBGC can minimize the likelihood that a taxpayer bailout will be needed, and on the role of its investment policy as part of that effort," Ashner said.

There have been dramatic changes in the economy since the time PBGC decided on its new investment policy, Ashner said. It is important to determine, in light of current economic circumstances, what the right policy is, he said.

Modest Risk Seen for Policy. According to Millard, the policy takes a level of risk that is modest among institutional investors while tripling the chance to get to full funding over the next 10 years.

The new investment policy announced by the agency in 2008 was intended to address the agency's long-term time horizon and to diversify the asset mix (33 PBD, 2/20/08; 35 BPR 447, 2/26/08). The policy allocates 45 percent of PBGC assets to a diversified set of fixed-income investments, 45 percent to diversified equity investments, and 10 percent to alternative investment classes.

At the time of the announcement, Millard said this strategy of increased diversification would generate better returns, while providing superior protection against ultimate downside risks over time. The previous policy was not diversified, and therefore carried greater risk (42 PBD, 3/4/08; 35 BPR 539, 3/4/08).

This new investment policy was a dramatic shift after decades of following a policy aimed at limiting the probability of losses, Dallas Salisbury, president of the Employee Benefit Research Institute, had said when the policy was announced (33 PBD, 2/20/08; 35 BPR 447, 2/26/08).

Millard also discussed funding, including auto industry pensions, the agency's ability to meet its obligations,

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and getting off the Government Accountability Office's watch list.

Funding Pensions and the Auto Industry. ''When the president signed the Pension Protection Act, he made a very succinct statement that I think summarizes how the pension insurance system needs to function,'' Millard said. ''That is, promises made have to be promises kept,'' he said.

The system has to recognize that the more leeway given to employers to not fully fund their pension plans, the more pressure is put on the system, and the greater the risk that some of those promises will ultimately not be kept, Millard said.

''I don't think that the foregoing necessarily leads to a one size fits all, 100 percent funding at all times as a standard, but, it means employers made the commitment, it is their obligation to live up to it,'' Millard said.

Referring to the current financial difficulties of General Motors Corp., Ford Motor Co., and Chrysler LLC, Millard said that whatever government financial assistance is provided to the auto companies, pension funding should be a condition of government financial assistance.

President Bush approved a plan Dec. 19 to provide GM and Chrysler with a combined $17.4 billion in loans from the Treasury Department's bailout fund, provided the companies prove by March 31, 2009, that they are on a path to profitability (245 PBD, 12/23/08; 35 BPR 2889, 12/30/08). Ford Motor Co. was not seeking a short-term loan.

One practitioner noted that funding relief is not a panacea. ''The problem is that by granting relief on the funding rules you're not necessarily doing anyone any favors,'' Andrew Oringer, a partner in the New York office of White & Case, told BNA Dec. 17. ''If the funding deficit is allowed to bulge, you may simply be putting an albatross around the company that it will never be able to shake,'' he said.

Auto companies need to be required to fund their pension benefits, Millard said. They have used their pension plan to fund attrition benefits, buyout packages and early retirement offers, and as an exchange for cuts in health care benefits, he said.

Those health care benefits were not pension promises, according to Millard. So when they used the pension plan to reimburse cuts in health care, they used their pension plan to fund their business plan, he said.

''Keep in mind, each of these companies has credit balances that carry over from prior years that allows them to say they are 'overfunded,' '' Millard said. Overfunded in ''pension speak'' is not what most people think overfunded means, he said.

None of these plans have more assets than they do liabilities, Millard said. When they got those credit balances, it was with a certain set of liabilities in mind, he said. That set of liabilities did not include attrition benefits, he said. So they widened their gap by adding liabilities and decreasing their assets more quickly, putting the pension system, PBGC, and their current workers at greater risk, he said.

''I don't want to see Bethlehem Steel all over again,'' Millard said. When Bethlehem Steel filed for bankruptcy, everybody questioned why, when it went bankrupt, it was only 45 percent funded, he said.

''In two or three years, should the auto companies come to PBGC, I don't want it to be said that nobody ever sounded that alarm,'' Millard said.

Agency Financial Challenges. In the near term, one to five years, PBGC has a net annual outflow of approximately $2.5 billion per year (payout: $4 billion a year; take-in $1.5 billion a year), Millard said. The agency has approximately $60 billion in assets, he said.

In the longer term, 10 to 20 years, PBGC will continue to inherit underfunded plans, Millard said. When the agency takes over an underfunded plan, the liabilities exceed the assets for such plans, he said.

''At some point, there is concern,'' Millard said. However, he said he believes the agency will be better able to meet its longer term obligations than would have been the case a year ago because of the new investment policy that is designed to give the PBGC a far better chance to meet those obligations over time.

Getting off the Watch List. There is little opportunity to get off the GAO's high risk watch list because the business model upon which PBGC is based is ''nearly designed never to get the agency fully funded,'' Millard said. ''PBGC's hands are tied. All plans pay the same regardless of their risk status,'' he said.

GAO's 2009 congressional and presidential transition Web page designated PBGC's single-employer pension insurance program as high risk due to the financial dangers it faces.

As one example, Millard said that Congress has refused to give PBGC the ability to set risk-based premiums similar to a life insurance company, which charges lower premiums to good risks and higher premiums to poor ones.

However, there is opposition to risk-based premiums. ''The ERISA Industry Committee is opposed to risk-based premiums,'' Mark Ugoretz, president of ERIC, told BNA Dec. 19.

Risk-based premiums would require PBGC to rely on credit agency determinations of the credit worthiness of the plan sponsor, which has no connection to the funded status of a pension plan, Ugoretz said. There are examples where the credit worthiness of a plan sponsor is troublesome, while the pension plan may be fully funded, he said.

For those companies that do not have credit ratings, the government would be required to determine the financial condition of the company on an ongoing basis, Ugoretz said. The federal government should not be in the business of determining the viability of private sector businesses, he said.

By Michael W. Wyand

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