

***Forget Bedford Falls
and Jimmy Stewart.***

***It's Congress that
Clarence the Angel
has to win over to
keep Old Man Potter
from forcing out
all the residents
of Pensionville!***



Just Whose Wonder



The PBGC's Plan to Save Pensionville

By Henry C. Eickelberg

On Tuesday, March 8, 2005, the U.S. House of Representatives' Ways and Means Subcommittee on Select Revenue Measures held a public hearing on the Bush administration's proposal to change the current pension funding rules. The following article is an adaptation of my oral testimony, presenting the business community's perspective on that proposal.

PENSIONVILLE. YOU MAY HAVE HEARD OF IT. It's an old, established community, and in years past, it was a vibrant place to live. But over the past 20 years, Pensionville has fallen on hard times. It has already seen its population of pension plans fall from 62,000 to about 32,000. These days, all the growth seems to be occurring on the other side of Retirement Valley, in a new town called Defined Contributionville.

You see, operating a retirement plan in Defined Contributionville is a lot easier. It provides a lot more flexibility when it comes to controlling costs. Retirement plan owners who live there contribute only what they want to pay, so they're never confronted with the sudden financial surprises that often plague residents of Pensionville.

It's not that the Pensionville City Fathers haven't tried to bolster the town's declining population, but these efforts haven't met with much success. In fact, many former residents would argue that their previous attempts have hurt Pensionville.

ful Life Is It, Anyway?

Simply put, Pensionville isn't nearly as friendly a place to live as it once was.

Part of living in Pensionville means that you have to buy insurance through a local institution called the Pensionville Bank & Guaranty Co. (or PBGC for short). Its president is a gentleman named Henry F. (Old Man) Potter. He runs the PBGC along with a group of administrators from other governmental agencies.

Lately, the PBGC has suffered a number of costly foreclosures, primarily on Steelmaker Street and Airline Avenue. Old Man Potter and the administrators have become understandably quite concerned about the prospects of additional large foreclosures on Airline Avenue and potentially even moving over to Carmaker Court. Pensionville's mayor asked Potter and the other administrators to develop a plan to shore up Pensionville's financial condition and present it to the town council, which they did.

Potter et al. believe they have devised a plan that will save Pensionville and, if nothing else, strengthen the financial integrity of this fragile community. While generally supportive of the PBGC, some members of the town council were quietly skeptical about whether the plan would actually strengthen Pensionville or simply accelerate the existing exodus.

Mr. Potter worked up a 10-point plan to save Pensionville.

► **POINT 1.** Potter's plan calls for the town council to almost

double the cost of pension plan insurance, from \$19 for each pension plan occupant to \$30. In cases where the pension plan is financially weaker, Potter wants to strengthen it by forcing the owner to pay additional risk-based premiums, not to the plan, but to the PBGC.

Also, under Potter's proposal, the PBGC would be given the authority to set the rate of any risk-based premium. This way, no one in government would need to be bothered with having to approve an increase, in the event that the PBGC felt it needed more money.

The town council appeared favorably inclined toward this ordinance since it could keep this new money. The council could use the money to fill budget holes that appear in other areas. It's not clear how much, if any, of this new money would actually go to shore up the PBGC and its operations.

► **POINT 2.** Potter has asked the town council to limit all pension plan debt to a seven-year amortization term. This restriction would apply to all new pension plans or increases in pension plan benefits. In addition, this restriction would be imposed on all existing outstanding pension plan debt. So, for example, if an existing pension plan is amortizing its outstanding pension liabilities over more than seven years (say for 30 years), after this ordinance passes, that same debt would need to be accelerated and re-amortized over no more than seven years.

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► **POINT 3.** Potter also asked the town council to prohibit the use of a 48-month rolling interest rate in figuring pension plan debts. Instead, Old Man Potter wants pension plan owners to use something called a 90-day yield curve. The 48-month rolling interest rate provides a lower debt payment for pension owners, but Potter believes that this puts the PBGC at greater risk. Thus, even though the vast majority of pension plans have been operating for literally decades (and are not at risk of being foreclosed), Potter says the 90-day yield-curve better reflects the pension plan's true financial condition in the unlikely event he has to take over the plan.

► **POINT 4.** All pension plans should be reappraised annually. Potter has a fancy term for this. It's called "Mark to Market." But it's really a simple idea. Each year, if the pension plan's assets appraise for less than what the owner owes to the plan, the owner would have the option to pay off the difference over the next seven years, provided the difference is related to the pension plan's normal ongoing costs. If it is, then the pension plan owner would need to pay that piece off immediately, without being able to use loans.

► **POINT 5.** Potter knows how interest rates can affect debt payments, so he wants to recalculate pension obligations with a little twist. The twist is called the "I Win/You Lose" interest rate program.

Each year, the pension plan owner's debt would be recalculated using the PBGC's proposed 90-day yield curve. If the recalculation produces a higher payment, the owner would need to pay the new higher amount. But if the recalculation produces a new lower payment, the pension plan owner would still need to keep making the old higher amount ... for the good of the neighborhood.

► **POINT 6.** Sometimes, according to Old Man Potter, when the PBGC repossesses a pension plan, it finds that plan's financial condition is far worse than the owner has been telling anyone. It appears to the PBGC that this happens when the owner's credit has been bad for quite some time. Potter says this issue can be avoided by requiring pension plan owners who are or who become bad credit risks to make even bigger pension payments from their available cash to avoid sticking the PBGC with more liabilities.

It's Potter's opinion that pension plan owners are deliberately ignoring their pension obligations under the guise of trying to save their businesses. Potter believes that addressing the PBGC's financial risk should come before any other obligations, even saving the jobs of the pension plan occupants.

► **POINT 7.** Potter is also concerned about owners' improving their pension plans if they're already in debt. Under his proposal, if a pension plan owner already owes 20 percent more than he has in pension assets, any further pension improvements would need to be paid off in full immediately.

► **POINT 8.** Potter's plan calls for the elimination of something called the "credit balance account." This is also a pretty simple concept. It's a kind of rainy-day fund that pension plan owners can use if they run a little short on cash. If a pension plan owner kicks more money into his pension plan than is otherwise

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required, this extra cash payment gets recorded in the pension plan's credit balance account. Later, if the owner runs a little short on cash, he can simply draw on this overpayment as credit against having to make that year's required cash payment.

Potter sees this as a huge loophole. Potter and the other administrators are adamant that they're not against pre-funding pension plan costs. In fact, they really like the idea of pre-funding pension plans. They're simply against allowing pension plan owners to actually use any pre-funded amounts to offset future required contributions.

► **POINT 9.** In the past, some owners avoided paying what they owed by declaring bankruptcy and dumping the pension on Potter. Now if that happens, Potter wants to be able to put a lien on the owner's assets. In this way, he can use the proceeds from the sale of the assets to satisfy the unpaid contributions. He's not interested in being a creditor just like everybody else.

► **POINT 10.** The last part of Potter's plan to save pensions would require owners to post a large sign on their front lawns. The purpose is to warn occupants and potential occupants that the resident pension plan's financial condition has deteriorated and that the plan is at risk of being condemned by the PBGC. Potter and the administrators hope this ordinance will cause pension plan occupants to force the owner to put more cash into the pension plan rather than spend it in other ways, like on occupant salaries and maintaining jobs.

A couple of town council members questioned Mr. Potter and the administrators about whether they really believed their proposal wouldn't hurt Pensionville. Potter and the administrators scoffed at their concern. When pressed to explain why they felt that way, they all replied that it was really quite simple. Pensionville residents had nowhere else to go. In addition, Potter said that about 50 percent of the remaining pension plans were legally required to stay by union contract, so they wouldn't be going anywhere else anytime soon.

After Potter and the administrators finished their remarks, a representative of the Pensionville residents, one George Bailey, came forward and asked to address the town council. He posed three simple questions:

First, could any member of the town council honestly imagine a new owner wanting to move into Pensionville with conditions as they are today, never mind if the PBGC's plan was approved?

Second, did the town council really think pension owners would stay in Pensionville if these ordinances became law?

Third, did the town council really believe that the PBGC's plan would save Pensionville? Or would it save the PBGC at the expense of the very people it was legally obligated to protect? ●

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