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Before the Committee on Finance

United States Senate

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Mr. Chairman, Ranking Member Baucus, and Members of the Committee: Good afternoon. I want to commend you for holding this timely and important hearing, and I appreciate the opportunity to discuss the challenges facing the defined benefit pension system and the pension insurance program, and the Administration's proposals for meeting these challenges.

My colleagues will describe the Administration's comprehensive reform plan in detail, so I would like to take this opportunity to briefly outline some of the reasons why fundamental and comprehensive reform is so urgently needed if we are to stabilize the defined benefit system, strengthen the insurance program, and protect the retirement benefits earned by millions of American workers.

Introduction

Private-sector defined benefit plans are intended to be a source of stable retirement income for more than 44 million American workers and retirees. They are one of the crowning achievements of the system of corporate benefit provision that began more than a century ago and reached its apex in the decades immediately following World War II.

That system, however, has on occasion been beset by problems that have undermined the economic security that workers and retirees have counted on. For example, the bankruptcy of the Studebaker car company in the early 1960s left thousands of workers without promised pension benefits. In such cases Congress has been called upon to safeguard the benefits workers were expecting—indeed, Studebaker was the catalyzing event that led to the passage of the Employee Retirement Income Security Act (ERISA) and the creation of the Pension Benefit Guaranty Corporation a decade later.

The defined benefit pension system is at another turning point today, and the key issues are largely the same: Will companies honor the promises they have made to their workers? The most recent snapshot taken by the PBGC finds that corporate America's single-employer pension promises are underfunded by more than $450 billion. Almost $100 billion of this underfunding is in pension plans sponsored by companies that face their own financial difficulties, and where there is a heightened risk of plan termination.

Of course, when the PBGC is forced to take over underfunded pension plans, we will provide the pension benefits earned by workers and retirees up to the maximum amounts established by Congress. Unfortunately, notwithstanding the guarantee provided by the PBGC, when plans terminate many workers and retirees are confronted with the fact that they will not receive all the benefits they have been promised by their employer, and upon which they have staked their retirement security. In an increasing number of cases, participants lose benefits that were earned but not guaranteed because of legal limits on what the pension insurance program can pay. It is not unheard of for participants to lose more than 50 percent of their promised monthly benefit.

Other companies that sponsor defined benefit plans also pay a price when underfunded plans terminate. Because the PBGC receives no federal tax dollars and its obligations are not backed by the full faith and credit of the United States, losses suffered by the insurance fund must ultimately be covered by higher premiums. Not only will healthy companies that are responsibly meeting their benefit obligations end up making transfer payments to weak companies with chronically underfunded pension plans, they may also face the prospect of having to compete against a rival firm that has shifted a significant portion of its labor costs onto the government.

In the worst case, PBGC's deficit could grow so large that the premium increase necessary to close the gap would be unbearable to responsible premium payers.[1] If this were to occur, there undoubtedly would be pressure on Congress to call upon U.S. taxpayers to pay the guaranteed benefits of retirees and workers whose plans have failed.

If we want to protect participants, premium payers and taxpayers, we must ensure that pension plans are adequately funded over a reasonable period of

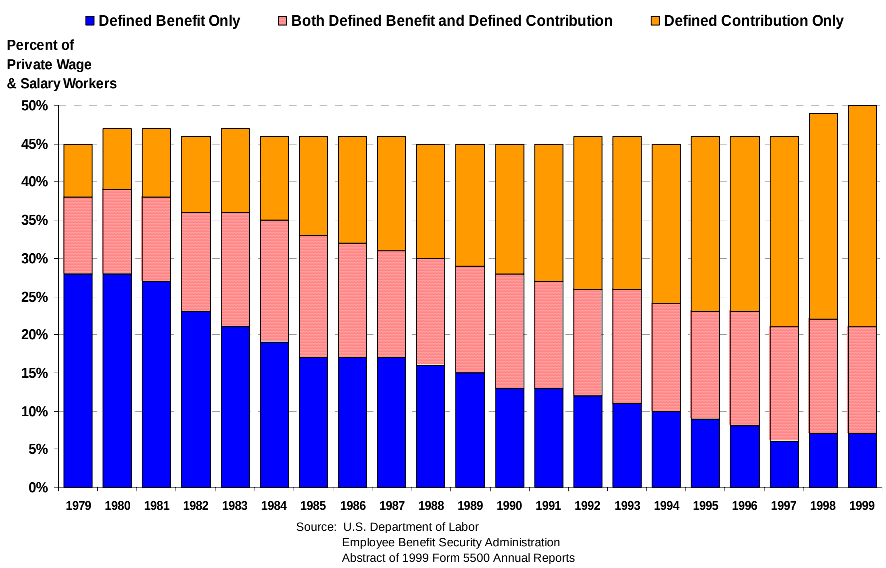
[1] See page 3, *Pension Tension*, Morgan Stanley, Aug. 27, 2004. "[I]n today's environment healthy sponsors may well decide that they don't want to foot the bill for weak plans' mistakes through increased pension insurance premiums."

time. As I will discuss in more detail, the status quo statutory and regulatory regime is inadequate to accomplish that goal. We need comprehensive reform of the rules governing defined benefit plans to protect the system's stakeholders.

State of the Defined Benefit System

Traditional defined benefit pension plans, based on years of service and either final salary or a specified benefit formula, at one time covered a significant portion of the workforce, providing a stable source of retirement income to supplement Social Security. The number of private sector defined benefit plans reached a peak of 112,000 in the mid-1980s. At that time, about one-third of American workers were covered by defined benefit plans.

Pension Participation Rates 1979 - 1999



In recent years, many employers have chosen not to adopt defined benefit plans, and others have chosen to terminate their existing defined benefit plans. From 1986 to 2004, 101,000 single-employer plans with about 7.5 million participants terminated. In about 99,000 of these terminations the plans had enough assets to purchase annuities in the private sector to cover all benefits earned by workers and retirees. In the remaining 2,000 cases companies with underfunded plans shifted their pension liabilities to the PBGC.

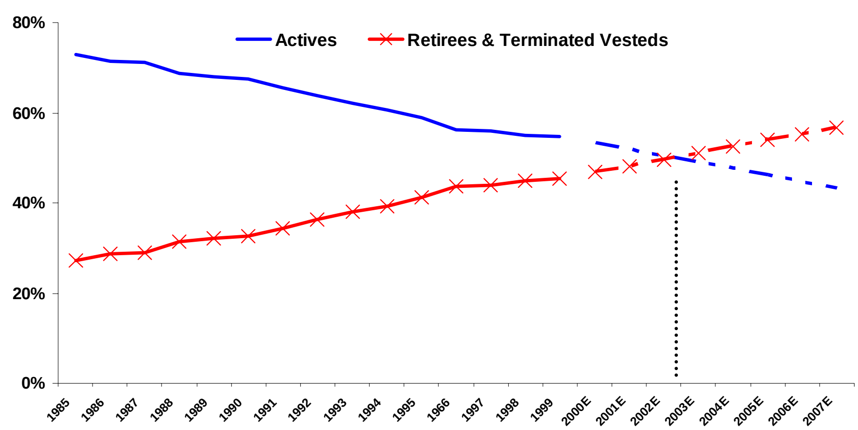
Of the roughly 30,000 defined benefit plans that exist today, many are in our oldest, most mature industries. These industries face growing benefit costs due to an increasing number of retired workers. Some of these sponsors also face challenges due to structural changes in their industries and growing competition from both domestic and foreign companies.

In contrast to the dramatic reduction in the total number of plans, the total number of participants in PBGC-insured single-employer plans has increased. In 1980, there were about 28 million covered participants, and by 2004 this number had increased to about 35 million. But these numbers mask the downward trend in the defined benefit system because they include not only active workers but also retirees, surviving spouses, and separated vested participants. The latter two categories reflect past coverage patterns in defined benefit plans. A better forward-looking measure is the trend in the number of active participants, who continue to accrue benefits. Here, the numbers continue to decline.

In 1985, there were about 22 million active participants in single-employer defined benefit plans. By 2002, the number had declined to 17 million. At the same time, the number of inactive participants has been growing. In 1985, inactive participants accounted for only 28 percent of total participants in single-employer defined benefit plans, a number that has grown to about 50 percent today. In a fully advance-funded pension system, demographics don't matter. But when $450 billion of underfunding must be spread over a declining base of active workers, the challenges become apparent.

Participants in Defined Benefit Pension Plans

[1985 - 2007 est.]



Source: U.S. Department of Labor
Pension and Welfare Benefits Administration
Abstract of 1999 Form 5500 Annual Reports Spring 2004

The decline in the number of plans offered and workers covered doesn't tell the whole story of how changes in the defined benefit system are impacting retirement income security. There are other significant factors that can undermine the goal of a stable income stream for aging workers.

For example, in lieu of outright termination, companies are increasingly "freezing" plans. Surveys by pension consulting firms show that a significant

number of their clients have or are considering instituting some form of plan freeze.[2] Freezes not only eliminate workers' ability to earn additional pension benefits but often serve as a precursor to plan termination, which further erodes the premium base of the pension insurance program.
Given the increasing mobility of the labor force, and the desire of workers to have portable pension benefits that do not lock them into a single employer, many companies have developed alternative benefit structures, such as cash balance or pension equity plans that are designed to meet these interests. The PBGC estimates that these types of hybrid structures now cover 25 percent of participants.[3] Unfortunately, as a result of a single federal court decision, the legal status of these types of plans is in question, further threatening the retirement security of millions of workers and retirees.[4]

The Role of the PBGC

The PBGC was established by ERISA to guarantee private-sector, defined benefit pension plans. Indeed, the Corporation's two separate insurance programs—for single-employer plans and multiemployer plans—are the lone backstop for hundreds of billions of dollars in promised but unfunded pension benefits. The PBGC is also the trustee of nearly 3,500 defined benefit plans that have failed since 1974. In this role, it is a vital source of retirement income and security for more than 1 million Americans whose benefits would have been lost without PBGC's protection, but who currently are receiving or are promised benefits from the PBGC.

PBGC is one of the three so-called "ERISA agencies" with jurisdiction over private pension plans. The other two agencies are the Department of the Treasury (including the Internal Revenue Service) and the Department of Labor's Employee Benefits Security Administration (EBSA). Treasury and EBSA deal with both defined benefit plans and defined contribution benefit plans, including 401(k) plans. PBGC deals only with defined benefit plans and serves as a guarantor of benefits as well as trustee for underfunded plans that terminate. PBGC is also charged with administering and enforcing compliance with the provisions of Title IV of ERISA, including monitoring of standard terminations of fully funded plans.

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[2] See, e.g., Aon Consulting, *More Than 20% of Surveyed Plan Sponsors Froze Plan Benefits or Will Do So*, Oct. 2003; Hewitt Associates, *Survey Findings: Current Retirement Plan Challenges: Employer Perspectives* (Dec. 2003).

[3] Table S-35, PBGC Pension Insurance Data Book 2004 (to be issued April 2005).

[4] *Cooper v. IBM Personal Pension Plan*, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (holding that cash balance plans violate age discrimination provisions of ERISA). Other courts, however, have disagreed. *Tootle v. ARINC, Inc.*, 222 F.R.D. 88 (D. Md. 2004); *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000).

PBGC is a wholly-owned federal government corporation with a three-member Board of Directors—the Secretary of Labor, who is the Chair, and the Secretaries of Commerce and Treasury.

Although PBGC is a government corporation, it receives no funds from general tax revenues and its obligations are not backed by the full faith and credit of the U.S. government. Operations are financed by insurance premiums, assets from pension plans trusteed by PBGC, investment income, and recoveries from the companies formerly responsible for the trusteed plans (generally only pennies on the dollar). The annual insurance premium for single-employer plans has two parts: a flat-rate charge of $19 per participant, and a variable-rate premium of 0.9 percent of the amount of a plan's unfunded vested benefits, measured on a "current liability" [5] basis.

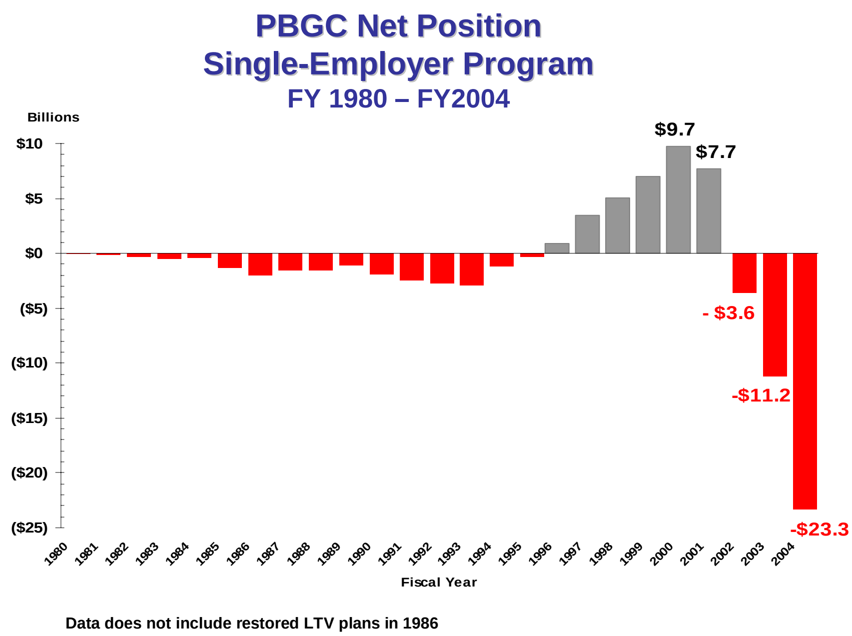
The PBGC's statutory mandates are: 1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of participants; 2) to provide for the timely and uninterrupted payment of pension benefits to participants; and 3) to maintain premiums at the lowest level consistent with carrying out the agency's statutory obligations. In addition, implicit in these duties and in the structure of the insurance program is the duty to be self-financing. *See, e.g.*, ERISA § 4002(g)(2) (the United States is not liable for PBGC's debts).

These mandates are not always easy to reconcile. For example, the PBGC is instructed to keep premiums as low as possible to encourage the continuation of pension plans, but also to remain self-financing with no recourse to general tax revenue. Similarly, the program should be administered to protect plan participants, but without letting the insurance fund suffer unreasonable increases in liability, which can pit the interests of participants in a particular plan against the interests of those in all plans the PBGC must insure. The PBGC strives to achieve the appropriate balance among these competing considerations, but it is inevitably the case that one set of stakeholder interests is adversely affected whenever the PBGC takes action. The principal manifestation of this conflict is when PBGC determines that it must involuntarily terminate a pension plan to protect the interests of the insurance program as a whole and the 44 million participants we cover, notwithstanding the fact that such an action is likely to adversely affect the interests of participants in the plan being terminated.

The pension insurance programs administered by the PBGC have come under severe pressure in recent years due to an unprecedented wave of pension plan

[5] Current liability is a measure with no obvious relationship to the amount of money needed to pay all benefit liabilities if a plan terminates.

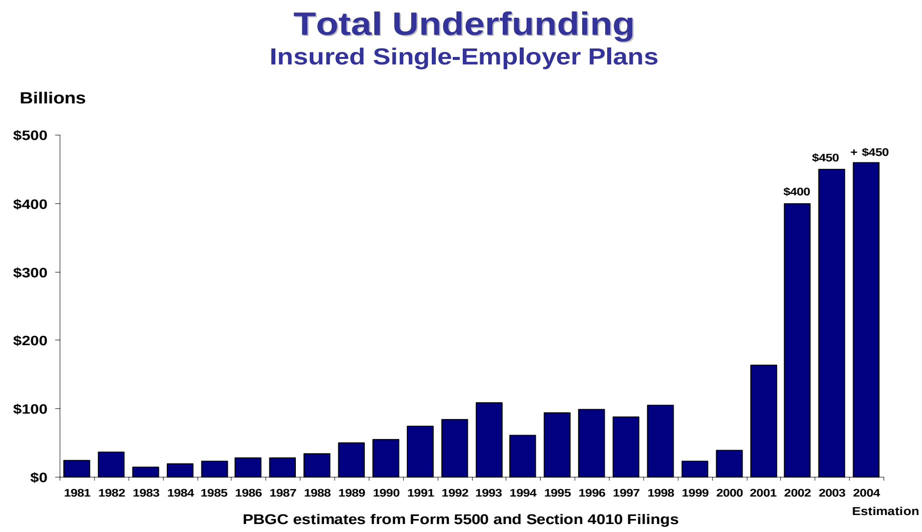
terminations with substantial levels of underfunding. This was starkly evident in 2004, as the PBGC's single-employer insurance program posted its largest year-end shortfall in the agency's 30-year history. Losses from completed and probable pension plan terminations totaled $14.7 billion for the year, and the program ended the year with a deficit of $23.3 billion. That is why the Government Accountability Office has once again placed the PBGC's single employer insurance program on its list of "high risk" government programs in need of urgent attention.



Notwithstanding our record deficit, I want to make clear that the PBGC has sufficient assets on hand to continue paying benefits for a number of years. However, with $62 billion in liabilities and only $39 billion in assets as of the end of the past fiscal year, the single-employer program lacks the resources to fully satisfy its benefit obligations.

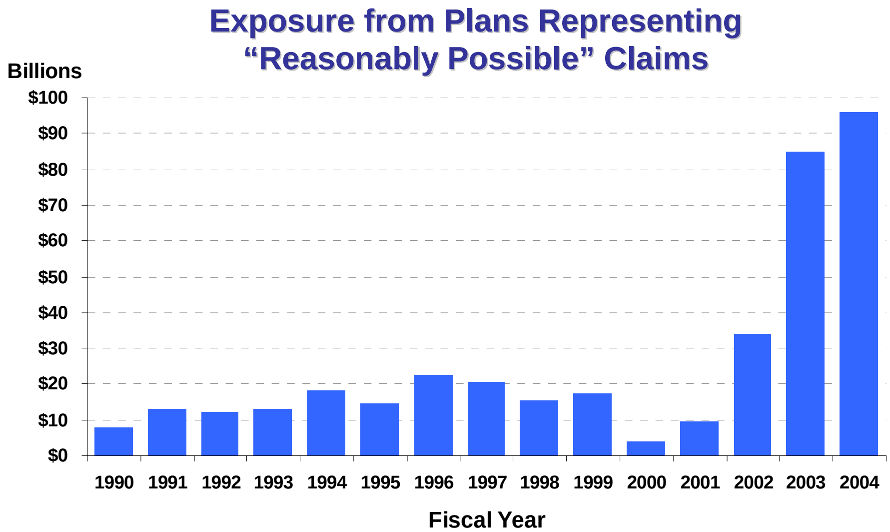
Mounting Pressures on the Pension Safety Net

In addition to the $23 billion shortfall already reflected on the PBGC's balance sheet, the insurance program remains exposed to record levels of underfunding in covered defined benefit plans. As recently as December 31, 2000, total underfunding in the single-employer defined benefit system came to less than $50 billion. Two years later, as a result of a combination of factors, including declining interest rates and equity values, ongoing benefit payment obligations and accrual of liabilities, and minimal cash contributions into plans, total underfunding exceeded $400 billion.[6] As of September 30, 2004, we estimate that total underfunding exceeds $450 billion, the largest number ever recorded.



Not all of this underfunding poses a major risk to participants and the pension insurance program. On the contrary, most companies that sponsor defined benefit plans are financially healthy and should be capable of meeting their pension obligations to their workers. At the same time, the amount of underfunding in pension plans sponsored by financially weaker employers has never been higher. As of the end of fiscal year 2004, the PBGC estimated that non-investment-grade companies sponsored pension plans with $96 billion in underfunding, almost three times as large as the amount recorded at the end of fiscal year 2002.

[6] See page 14, *The Magic of Pension Accounting, Part III*, David Zion and Bill Carcache, Credit Suisse First Boston (Feb. 4, 2005). "[F]rom 1999 to 2003 the pension plan assets grew by $10 billion, a compound annual growth rate of less than 1%, while the pension obligations grew by $430 billion, a compound annual growth rate of roughly 10%." See also page 2, *Pension Tension*, Morgan Stanley (Aug. 27, 2004). "DB sponsors were lulled into complacency by inappropriate and opaque accounting rules, misleading advice from their actuaries causing unrealistic return and mortality assumptions, and mismatched funding of the liabilities, and the two decades of bull equity markets through the 1990s veiled true funding needs."



The most immediate threat to the pension insurance program stems from the airline industry. Just last month, the PBGC became statutory trustee for the remaining pension plans of US Airways, after assuming the pilots' plan in March 2003. The $3 billion total claim against the insurance program is the second largest in the history of the PBGC, after Bethlehem Steel at $3.7 billion.

In addition, United Airlines is now in its 27th month of bankruptcy and has argued in bankruptcy court that it must shed all four of its pension plans to successfully reorganize. The PBGC estimates that United's plans are underfunded by more than $8 billion, more than $6 billion of which would be guaranteed and a loss to the pension insurance program.

Apart from the significant financial impact to the fund, if United Airlines is able to emerge from bankruptcy free of its unfunded pension liability, serious questions arise as to whether this would create a domino effect with other so-called "legacy" carriers, similar to what we experienced in the steel industry. Indeed, several industry analysts have indicated that these remaining legacy carriers could not compete effectively in such a case and several airlines executives have publicly stated that they would feel competitive pressure to shift their pension liabilities onto the government if United is successful in doing so. Of course, these companies would first have to meet the statutory criteria for distress terminations of their pension obligations.

While the losses incurred by the pension insurance program to date have been heavily concentrated in the steel and airline industries, it is important to note that these two industries have not been the only source of claims, nor are they the only industries posing future risk of losses to the program.

The PBGC's best estimate of the total underfunding in plans sponsored by companies with below-investment-grade credit ratings and classified by the PBGC as "reasonably possible" of termination is $96 billion at the end of fiscal 2004, up from $35 billion just two years earlier. The current exposure spans a range of industries, from manufacturing, transportation and communications to utilities and wholesale and retail trade.[7] Some of the largest claims in the history of the pension insurance program involved companies in supposedly safe industries such as insurance ($529 million for the parent of Kemper Insurance) and technology ($324 million for Polaroid).

Reasonably Possible Exposure

(Dollars in Billions)

Principal Industry Categories	FY 2004	FY 2003
Manufacturing	$ 48.4	$ 39.5
Transportation, Communication & Utilities	30.5	32.9
Services & Other	7.9	2.5
Wholesale and Retail Trade	5.8	4.3
Agriculture, Mining & Construction	1.9	1.8
Finance, Insurance & Real Estate	1.2	1.1
Total	$95.7	$82.1

Some have argued that current pension problems are cyclical and will disappear on the assumption that equity returns and interest rates will revert to historical norms. Perhaps this will happen, perhaps not. The simple truth is that we cannot predict the future path of either equity values or interest rates. It is not reasonable public policy to base pension funding on the expectation that the unprecedented stock market gains of the 1990s will repeat themselves. Similarly, it is not reasonable public policy to base pension funding on the expectation that interest rates will increase dramatically.[8] The consensus forecast predicted that

[7] In a recent report, Credit Suisse First Boston finds that the auto component and auto industry groups have the most exposure to their defined benefit plans (even more so than airlines). The report notes that "these two industry groups stand out because, compared to others, the degree of their pension plan underfunding is significant relative to market capitalization." See page 60, The Magic of Pension Accounting, Part III, David Zion and Bill Carcache, Credit Suisse First Boston (Feb. 4, 2005).

[8] See page 1, *Pension Update: Treading Water Against Currents of Change*, James F. Moore, PIMCO (Feb. 2005). "Unfortunately things are likely to get worse before they get better. . . As of the beginning of February, the Moody's AA long term corporate index was below 5.50% and 30-year Treasuries were below 4.5%."

long-term interest rates would have risen sharply by now, yet they remain near 40-year lows.[9] And, a recent analysis by the investment management firm PIMCO finds that the interest-rate exposure of defined benefit plans is at an all-time high, with more than 90 percent of the exposure unhedged.[10]

More importantly, while rising equity values and interest rates would certainly mitigate the substantial amount of current underfunding, this would not address the underlying structural flaws in the pension insurance system.

Structural Flaws in the Defined Benefit Pension System

The defined benefit pension system is beset with a series of structural flaws that undermine benefit security for workers and retirees and leave premium payers and taxpayers at risk of inheriting the unfunded pension promises of failed companies. Only if these flaws are addressed will safety and soundness be restored to defined benefit plans.

Weaknesses in Funding Rules

The first structural flaw is a set of funding rules that are needlessly complex and fail to ensure that pension plans are adequately funded. Simply stated, the current funding rules do not require sufficient pension contributions for those plans that are chronically underfunded. Rather than encouraging strong funding and dampening volatility as some have argued, aspects of current law such as smoothing and credit balances have been primary contributors to the substantial systemic underfunding we are experiencing. The unfortunate fact is that companies that have complied with all of the funding requirements of ERISA and the Internal Revenue Code still end up with plans that are less than 50 percent funded when they are terminated. Some of the problems with the funding rules include:

- The funding rules set funding targets too low. Employers are not subject to the deficit reduction contribution rules when a plan is funded at 90 percent of "current liability," a measure with no obvious relationship to the amount of money needed to pay all benefit liabilities if the plan terminates. In addition, in some cases employers can stop making contributions entirely because of the "full funding limitation." As a result, some companies say they are fully

[9] Long-term rates have declined in Japan and Europe – to 2.5 percent and 4.0 percent, respectively – two economies facing the same structural and demographic challenges as the United States. See page 1, *Pension Update: Treading Water Against Currents of Change*, James F. Moore, PIMCO (Feb. 2005).

[10] See page 1, *Defined Benefit Pension Plans' Interest Rate Exposure at Record High*, Seth Ruthen, PIMCO (Feb. 2005).

funded when in fact they are substantially underfunded.[11] Bethlehem Steel's plan was 84 percent funded on a current liability basis, but the plan turned out to be only 45 percent funded on a termination basis, with a total shortfall of $4.3 billion. US Airways' pilots' plan was 94 percent funded on a current liability basis, but the plan was only 33 percent funded on a termination basis, with a $2.5 billion shortfall. No wonder US Airways pilots were shocked to learn just how much of their promised benefits would be lost.

Bethlehem Steel

Termination Benefit Liability Funded Ratio 45%

Unfunded Benefit Liabilities $4.3 billion

	1996	1997	1998	1999	2000	2001	2002
Current Liability Ratio	78%	91%	99%	96%	86%	84%	NR
Was the company required to make a deficit reduction contribution?	Y	N	N	N	N	NR	NR
Was the company obligated to send out a participant notice?	Y	Y	N	N	N	N	N
Did the company pay a Variable Rate Premium?	$15 million	$17 million	N	N	N	N	N
Actual Contributions	$354 million	$32.3 million	$30.9 million	$ 8.1 million	$0	$0	$0
Debt Rating	B+	B+	BB-	BB-	B+	D	Withdrawn

[11] Generally, a plan's actuarial assumptions and methods can be chosen so that the plan can meet the "full-funding limitation" if its assets are at least 90 percent of current liability. Being at the full-funding limitation, however, is not the same as being "fully funded" for either current liability or termination liability. As a result, companies may say they are fully funded when in fact they are substantially underfunded. This weakness in the current funding rules is exacerbated by premium rules that exempt plans from paying the Variable Rate Premium (VRP) if they are at the full funding limit. As a result a plan can be substantially underfunded and still pay no VRP. Despite substantial underfunding, in 2003 only about 17 percent of participants were in plans that paid the VRP.

US Airways Pilots

Termination Benefit Liability Funded Ratio 33%

Unfunded Benefit Liabilities $2.5 billion

	1996	1997	1998	1999	2000	2001	2002
Current Liability Ratio	97%	100%	91%	85%	104%	94%	NR
Was the company required to make a deficit reduction contribution?	N	N	N	N	N	N	NR
Was the company obligated to send out a participant notice?	N	N	N	N	N	N	N
Did the company pay a variable rate premium?	$4 million	N	N	N	$2 million	N	N
Actual Contributions	$112.3 million	$0	$45 million	$0	$0	$0	$0

- The funding rules allow contribution holidays even for seriously underfunded plans. Bethlehem Steel made no cash contributions to its plan for three years prior to termination, and US Airways made no cash contributions to its pilots' plan for four years before termination. One reason for contribution holidays is that companies build up a "credit balance" for contributions above the minimum required amount. They can then treat the credit balance as a payment of future required contributions, even if the assets in which the extra contributions were invested have lost much of their value. Indeed, some companies have avoided making cash contributions for several years through the use of credit balances, heedlessly ignoring the substantial contributions that may be required when the balances are used up.

- The funding rules rely on the actuarial value of plan assets to smooth plan contribution requirements. However, the actuarial value may differ significantly from the fair market value. Actuarial value is determined under a formula that "smooths" fluctuations in market value by averaging the value over a number of years. The use of a smoothed actuarial value of assets distorts the funded status of a plan.[12] Masking current market conditions is neither a good nor a necessary way to avoid volatility in funding contributions. Using fair market value of assets would provide a more

[12] Page 72, *The Magic of Pension Accounting, Part III*, David Zion and Bill Carcache, Credit Suisse First Boston (Feb. 7, 2005). "Volatility is not necessarily a bad thing, unless it's hidden. . . . Volatility is a fact of doing business; financial statements that don't reflect that volatility are misleading."

accurate view of a plan's funded status. I would also note that the smoothing mechanisms in ERISA and financial accounting standards are anomalies – airlines are not allowed to smooth fuel costs; auto companies are not allowed to smooth steel prices; global financial firms are not allowed to smooth currency fluctuations.

- The funding rules do not reflect the risk of loss to participants and premium payers. The same funding rules apply regardless of a company's financial health, but a PBGC analysis found that nearly 90 percent of the companies representing large claims against the insurance system had junk-bond credit ratings for 10 years prior to termination.

- The funding rules set maximum deductible contributions too low. As a result, it can be difficult for companies to build up an adequate surplus in good economic times to provide a cushion for bad times. (However, this was not a significant issue in the 1990s—a PBGC analysis found that 70 percent of plan sponsors contributed less than the maximum deductible amount.)

Moral Hazard
A second structural flaw is what economists refer to as "moral hazard." A properly designed insurance system has various mechanisms for encouraging responsible behavior that will lessen the likelihood of incurring a loss and discouraging risky behavior that heightens the prospects of claims. That is why banks have risk-based capital standards, why drivers with poor driving records face higher premiums, why smokers pay more for life insurance than non-smokers, and why homeowners with smoke detectors get lower rates than those without.

However, a poorly designed system can be gamed. A weak company will have incentives to make generous but unfunded pension promises rather than increase wages. Plan sponsors must not make pension promises that they cannot or will not keep. For example, under current law benefits can be increased as long as the plan is at least 60 percent funded. In too many cases, management and workers in financially troubled companies may agree to increase pensions in lieu of larger wage increases. The cost of wage increases is immediate, while the cost of pension increases can be deferred for up to 30 years.

Or, labor may choose to bargain for wages or other benefits rather than for full funding of a plan because of the federal backstop.[13] If the company recovers, it may be able to afford the increased benefits. If not, the costs of the insured

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[13] See page 3, *The Most Glorious Story of Failure in the Business*, James A. Wooten, 49 Buffalo Law Rev. 683 (Spring/Summer 2001). "Termination insurance would shift default risk away from union members and make it unnecessary for the UAW to bargain for full funding."

portion of the increased benefits are shifted to other companies through the insurance fund. Similarly, a company with an underfunded plan may increase asset risk to try to make up the gap, with much of the upside gain benefiting shareholders and much of the downside risk being shifted to other premium payers.

Unfortunately, the pension insurance program lacks basic checks and balances. PBGC provides mandatory insurance of catastrophic risk. Unlike most private insurers, the PBGC cannot apply traditional risk-based insurance underwriting methods. Plan sponsors face no penalties regardless of the risk they impose on the system. As a result, there has been a tremendous amount of cost shifting from financially troubled companies with underfunded plans to healthy companies with well-funded plans.

Consider: Bethlehem Steel presented a claim of $3.7 billion after having paid roughly $60 million in premiums over the 10-year period 1994 to 2003, despite the fact that the company was a deteriorating credit risk and its plans were substantially underfunded for several years prior to the time the PBGC had to step in. Similarly, while United's credit rating has been junk bond status and its pensions underfunded by more than $5 billion on a termination basis since at least 2000, it has paid just $75 million in premiums to the insurance program over the 10-year period 1995 to 2004. Yet the termination of United's plans would result in a loss to the fund of more than $6 billion.

PBGC cannot control its revenues and cannot control most of its expenses. Congress sets PBGC's premiums, ERISA mandates mandatory coverage for all defined benefit plans whether they pay premiums or not, and companies sponsoring insured pension plans can transfer their unfunded liability to PBGC as long as they meet the statutory criteria.

Not surprisingly, PBGC's premiums have not kept pace with the growth in claims or pension underfunding. The flat rate premium has not been increased in 14 years. And as long as plans are at the "full funding limit," which generally means 90 percent of current liability, they do not have to pay the variable-rate premium. That is why some of the companies that saddled the insurance fund with its largest claims ever paid no variable-rate premium for years prior to termination. In fact, less than 20 percent of participants are in plans that pay a VRP.

Transparency
A third flaw is the lack of information available to stakeholders in the system. The funding and disclosure rules seem intended to obfuscate economic reality. That is certainly their effect—to shield relevant information regarding the

funding status of plans from participants, investors and even regulators. This results from the combination of stale, contradictory, and often misleading information required under ERISA. For example, the principal governmental source of information about the 30,000 private sector single-employer defined benefit plans is the Form 5500. Because ERISA provides for a significant lapse of time between the end of a plan year and the time when the Form 5500 must be filed, when PBGC receives the complete documents the information is typically two and a half years old. It is exceedingly difficult to make informed business and policy decisions based on such dated information, given the dynamic and volatile nature of markets.

The PBGC does receive more timely information regarding a limited number of underfunded plans that pose the greatest threat to the system, but the statute requires that this information not be made publicly available. This makes no sense. Basic data regarding the funded status of a pension plan, changes in assets and liabilities, and the amount that participants would stand to lose at termination are vitally important to participants. Investors in companies that sponsor the plans also need relevant and timely information about the funded status of its pensions on a firm's earnings capacity and capital structure. While recent accounting changes are a step in the right direction, more can and should be done to provide better information to regulatory bodies and the other stakeholders in the defined benefit system.

Congress added new requirements in 1994 expanding disclosure to participants in certain limited circumstances, but our experience tells us these disclosures are not adequate. The notices to participants do not provide sufficient funding information to inform workers of the consequences of plan termination. Currently, only participants in plans below a certain funding threshold receive annual notices of the funding status of their plans, and the information provided does not reflect what the underfunding likely would be if the plan terminated. Workers in many of the plans we trustee are surprised when they learn that their plans are underfunded. They are also surprised to find that PBGC's guarantee does not cover certain benefits, including certain early retirement benefits.

Finally, the Corporation's ability to protect the interests of plan participants and premium payers is extremely limited, especially when a plan sponsor enters bankruptcy. Currently, the agency has few tools at its disposal other than plan termination. While PBGC has successfully used the threat of plan termination to prevent instances of abuse of the pension insurance program, it is a very blunt instrument. Plan termination should be a last resort, as it means that participants will no longer accrue benefits (and may lose benefits that have been promised) and the insurance programs takes on losses that might have been avoidable.

Conclusion

Companies that sponsor pension plans have a responsibility to live up to the promises they have made to their workers and retirees. Yet under current law, financially troubled companies have shortchanged their pension promises by nearly $100 billion, putting workers, responsible companies and taxpayers at risk. As United Airlines noted in a recent bankruptcy court filing, "the Company has done everything required by law"[14] to fund its pension plans, which are underfunded by more than $8 billion.

That, Mr. Chairman, is precisely why the rules governing defined benefit plans are in need of reform. At stake is the viability of one of the principal means of predictable retirement income for millions of Americans. The time to act is now. Thank you for inviting me to testify. I will be pleased to answer any questions.

[14] Page 26, United Air Lines' Informational Brief Regarding Its Pension Plans, in the US Bankruptcy Court for the Northern District of Illinois, Eastern Division (Sept. 23, 2004).