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The Effect of PBGC Premium Increases on Single-Employer Defined Benefit Plan Costs

This is the second of our three-part series regarding pension costs for single-employer defined benefit plans. Our leading article detailed the impact of interest rates on rising plan costs; we will next discuss immunization strategies and then wrap up with suggestions to minimize pension plan cost and volatility.

The Pension Benefit Guaranty Corporation (PBGC) is the U.S. governmental agency which insures pensions under the private defined benefit plan system.

When a company can demonstrate that it no longer has the financial capability to provide pension benefits earned by plan participants, the PBGC may step in as the insurer and pay benefits up to certain guaranteed levels. While both single and multi-employer plans are mandatorily covered, this article focuses on single employer plans.

Operating with no general tax revenue, the PBGC relies on premiums from plan sponsors, investment gains, and the assets of PBGC-trusteed plans to fund their operations. Over time, as the PBGC has taken over an increasing number of underfunded pension plans, the excess of PBGC trusteed plan liabilities over plan assets has risen substantially, which has led to a deteriorated financial condition for the agency.

PBGC Premium Hikes

Because the premiums paid to the PBGC are seen as fees, rather than taxes, they are often an easy source of revenue for Congress to seek, even for purposes completely unrelated to the private pension system. Following the most recent government shutdown, Congress approved and President Obama signed the Bipartisan Budget Act of 2013, which included a sharp increase in PBGC premiums over the next four years. This increase was on top of significant increases already made as part of the Pension Protection Act of 2006 and was unrelated to the financial condition of the PBGC's single employer program.

Premiums for Single-Employer Plans can be broken down into two categories:

1. A flat dollar amount for every plan participant and,
2. A variable rate, which is tied to the unfunded vested benefit liabilities of a plan.

The per participant premium increased from $42 in 2013 to $49 in 2014, and eventually to $64 in 2016 with further increases tied to national average wage growth. The variable rate premium per $1,000 of underfunding increased from $9 in 2013 to $14 in 2014, and eventually to at least $29 in 2016 (likely to be higher due to wage growth adjustments) and further adjusted thereafter for wage growth.[1] There is a variable rate premium cap

[1] Bipartisan Budget Act of 2013, enacted December 26, 2013

of $400 per participant; increasing to $500 per participant in 2016 and indexed thereafter that applies to severely underfunded plans.

A plan with five hundred participants, $23 million in plan assets and $27 million in vested benefit liabilities might have the following schedule of premiums:

Effect of PBGC Premium Increases

Year	Unfunded Vested Liability	Per Participant Premium	Variable Rate Premium	Total	Total as % of Current Plan Assets
2014	$4,000,000	$24,500	$56,000	$ 80,500	0.35%
2015	3,500,000	28,500	85,000	113,500	0.49%
2016	3,000,000	32,000	90,000	122,000	0.53%
2017	2,500,000	33,000	78,000	111,000	0.48%

In the above illustration, premiums would increase substantially, even though the plan becomes better funded over the period as a result of required minimum funding rules. This illustration assumes there are no further additional increases in premiums during this period, which may not hold out given the government's tendencies to find sources of revenue from wherever they are available.

Planning ahead for these premium increases is important for plan sponsors. With a 50% increase in the fixed rate premium and the Variable Rate Premium increasing over three times its current rate, sponsors must consider ways to reduce these costs. Our next article will focus on several approaches that may reduce pension plan costs, as well as general suggestions to minimize pension costs and volatility in our current economic environment.