Another bailout? Government pension insurer could be next, expert says

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Another multi-billion-dollar taxpayer bailout could lie ahead, this time to rescue a cash-strapped government program that insures pensions of 44 million American workers and retirees, a University of Illinois finance professor warns.

Jeffrey R. Brown says the troubled Pension Benefit Guaranty Corp., which steps in when private-sector employers with under funded defined-benefit plans go bankrupt, was $14 billion short of the cash it will need to cover pensions based on the latest estimates released a year ago.

But he predicts the shortfall will soar as a sour economy shutters more businesses and a plunging stock market carves into pension fund assets, with a government fix similar to this month's $700 billion Wall Street bailout as the likely solution.

"Over the next decade, we could easily end up with another $50 billion to $100 billion or more of taxpayer money needed for a bailout – in this case the bailout of failed corporate pension plans that didn't put adequate money aside," Brown said. "One-hundred billion doesn't seem like as much as it did a few weeks ago, but it's still a tremendous amount of money."

Brown says the epic stock market tumble is a perfect storm for the already troubled PBGC, which insures workers and retirees in more than 30,000 defined-benefit pension plans.

The market collapse makes business failures more likely, and increases the odds that their pension plans will be under funded because assets are typically heavily invested in stocks, said Brown, a senior economist with the President's Council of Economic Advisors in 2001-2002.

"Those two things together are going to put more pressure on the PBGC, which is already underfunded," he said. "And the PBGC has increased the risk further by heavily investing its own assets in the stock market. So taxpayers are almost certainly going to find themselves on the hook for this some day."

The PBGC, established in 1974 to safeguard retirement accounts, was struggling long before the economy nosedived, said Brown, who wrote a paper on the program's flaws that appeared this year in the *Journal of Economic Perspectives*.

He says three fundamental problems have combined to sink the PBGC in red ink:

The program lacks incentives that encourage employers to adequately fund pension plans and may actually discourage it because companies know they can fall back on the federal safety net.

Employers pay a flat fee for insurance rather than adjusted rates based on risk. Brown says the one-price-fits-all approach encourages risky investments, and means employers who maintain solid plans ultimately subsidize those that don't.

Financial reports that the PBGC provides to workers and retirees is often lacking and outdated, which Brown says stifles any clamor for reform.

One long-term solution, he says, is PBGC reform that would mandate insurance, but require employers to buy policies through private insurers rather than the government.

"Private insurers would have an incentive to price the insurance properly, just like auto insurers charge more for a 16-year-old male who's been driving for a month than a 50-year-old woman who's never had an accident," Brown said.

He says government is reluctant to charge risk-adjusted rates because its books would reflect hefty balances until claims catch up with income, a process that could take years with pension accounts.

"It leads to a crescendo of: 'Why are you charging us so much? You're making a profit, so you should lower your premiums,' " Brown said. "It's just very hard to sustain politically."

While shifting premiums to private insurers would not eliminate the existing problem, it could greatly reduce additional losses in the future, said Brown, the director of the Center on Business and Public Policy in the U. of I. College of Business.

Risk-adjusted premiums would decrease the potential for funding problems, and using private insurers would spread coverage around rather than loading it all on the PBGC, he said.

"Even if one of the insurance companies winds up in financial distress, it's not like one insurer would be backing every single pension plan in the U.S.," Brown said. "So even if the government still had to step in and take over, the impact is going to be smaller than if they were insuring everything directly."

Brown says the PBGC faces no eminent financial crisis because most pension payouts are still years away. And he says Congress is unlikely to consider broad reform until a crisis erupts.

In the meantime, he says Congress should tweak regulations to promote healthy pension funds and acknowledge that the government will likely have to step in some day and bail out the PBGC.

Brown says the government has no formal obligation to rescue the PBGC, but predicts politics will ensure a bailout, similar to the deal that propped up mortgage lending giants Fannie Mae and Freddie Mac, which also had no formal government backing.

"I just can't imagine that a congressman is going to tell constituents their firm failed to adequately fund their pension and the government failed to make them fund it, but you're the one who's going to bear the cost of those mistakes," Brown said.

Source: University of Illinois at Urbana-Champaign