Risks to government pension insurer worse than thought, research finds

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A study co-written by a University of Illinois pension policy expert warns that the financial risks facing the government-sponsored corporation that insures all private-sector pension plans in the U.S. are much greater than commonly thought.

University of Illinois finance professor Jeffrey R. Brown says that the Pension Benefit Guaranty Corp. is facing a very large financial shortfall and ultimately may need to be bailed out by taxpayers.

"Our in-depth review of the PBGC's models indicates that they are likely to underestimate how bad things can get when the economy is weak," said Brown, the William G. Karnes Professor of Finance and the director of the Center for Business and Public Policy in the U. of I. College of Business. "The implication is that the financial risks facing the system are much greater than widely believed."

Brown co-wrote the paper with Douglas J. Elliott, Tracy Gordon and Ross Hammond, all of The Brookings Institution. The team of researchers conducted an independent review of the Pension Insurance Modeling System, the complex simulation model that is used for assessing the long-term health of the financially troubled PBGC insurance program.

"There is a lot of debate in the plan sponsor and policy community about whether PBGC's long-term financial projections are excessively optimistic or pessimistic," he said. "This is important because these projections frame the discussion about what steps, if any, Congress should take to strengthen the pension insurance program. Some interest groups believe that PBGC's models overstate the program's exposure, whereas many economists are concerned that the problem may be worse than it appears."

Brown, a former member of the bipartisan Social Security Advisory Board and a senior economist with the President's Council of Economic Advisers in 2001-2002, says that the federal pension insurance agency's model is "likely to substantially understate the degree of fiscal risk to PBGC's insurance programs."

"During a financial crisis or recession, you tend to have clusters of corporate bankruptcies," he said.

According to Brown, these clusters also tend to happen around the same time that the typical plan's funding status is worsening as a result of investment losses that accompany an economic downturn.

"The PBGC's model does not adequately account for these macroeconomic shocks that lead to correlated losses," he said.

Brown says the PBGC is supposed to be self-financing and not receive taxpayer funding – but notes that the same was once true of beleaguered mortgage giants Fannie Mae and Freddie Mac.

"Taxpayers are probably going to have to foot the bill in the same way we bailed out savings and loans in the 1980s and the mortgage agencies during the 2008 financial crisis," he said. "Nearly everyone believes that Congress is ultimately going to have to backstop the PBGC because it's insuring the pensions of tens of millions of people. No one believes they're going to just let it fail."

The paper is titled "A Review of the Pension Benefit Guaranty Corporation Pension Insurance Modeling System."

More information: papers.ssrn.com/abstract=2329987

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