

Q&A with Fran Hawthorne, author of “Pension Dumping: The Reasons, the Wreckage, the Stakes for Wall Street” (Bloomberg Press)

NCRO: What determines pension premiums?

HAWTHORNE: As with any insurance, the person who gets insurance coverage has to pay a premium, or a fee for the coverage. In this case, it’s basically the employees who pay the premium, because the company takes the payments out of the pension plan assets. In fairness, I have to say that seems reasonable – just as I pay my own car insurance premiums. I hope my premiums are “wasted” in that I hope I never get in a car accident, and employees hope their company will never dump their pension plan. But just in case Congress sets the amount of the premiums, and in fact, it has raised rates eight times since the passage of the pension law ERISA in 1974 – which began at just a dollar per person per year! However, rate hikes alone can’t solve the PBGC’s basic dilemma. That’s because the PBGC doesn’t operate according to either of the two standard models of insurance – car insurance and health insurance. In a “true insurance” program, like car insurance, customers who pose a bigger risk (drivers with a record of accidents, young drivers) pay a higher premium. In a “social insurance” system, like health care, the insurance company encompasses a huge, diversified pool of customers who all pay the same rate, with healthy customers essentially subsidizing those who need more care. Since that diversity may not be sufficient to keep rates reasonable, there are also incentives for members to reduce their risk, such as lower premiums for nonsmokers. To carry that same philosophy to pensions, Congress added higher, risk-related premiums for underfunded plans. But that can compound the problem: If the premiums are too low, they don’t do the job, and if they’re too high, they may be the final straw that pushes a shaky company to dump its pension plan.

NCRO: What do you think will happen to the PBGC's deficit? Will it continue to grow?

HAWTHORNE: That depends on the markets and the economy. Since the PBGC now invests part of its portfolio in stocks, its deficit – or, optimistically, surplus – will ride the waves of the stock market. But the biggest factor in determining the size of the deficit is how many companies go bankrupt and terminate their pension plans, and the size of those plans' deficits. And sadly, considering the economic conditions of the last couple of years, I think we can safely assume some increase in the PBGC's deficit over the next five to ten years.

NCRO: Will the taxpayers pick up the tab? Or will retirees see their benefits reduced further?

HAWTHORNE: Taxpayers have never funded the PBGC so far, and with the huge federal deficit and the looming shortfalls in Medicare and Social Security, I can't imagine Congress or any president adding the PBGC to that burden. Besides, as the government sees it, there's an "easy" alternative source of funding the PBGC -- raising premiums. Also, the PBGC could hope to juice its income by investing more in stocks.

While that turned out to be a poor decision in 2008, stocks do outperform fixed income over the long haul

NCRO: One interesting solution you mentioned in your book was secured creditor status for the PBGC. I know it's a moon shot, but it is a great idea. Who have been the major opponents of this?

HAWTHORNE: The main opponents are the creditors who now stand further ahead in line, such as bank lenders, bond holders, and bankruptcy lawyers. Also, any changes in status would have to be enacted via legislation, and those bills would have to go through the judiciary committees in the House and Senate – which is a nonstarter right there. Naturally, those two committees are far more sympathetic to the bankruptcy lobby -- and less sympathetic to the benefits world -- than are the committees that usually deal with pension issues (primarily the labor and aging committees).

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