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PBGC YEAR IN REVIEW

BY DAVID GOLDFARB

THE PENSION BENEFIT GUARANTY CORP. (PBGC) reported a $35.6 billion gap between its assets and its liabilities in its 2013 annual report, implying that at some point it could fail to pay all the benefits it has guaranteed. The slight worsening in its financial position came entirely from increased multiemployer program liabilities. By contrast, the PBGC's single-employer program's financial position actually improved over the year.

Multiemployer Program

The record-high $8.26 billion underfunding in its multiemployer program creates a substantial risk that, without changes, the program will become insolvent. Last year, the PBGC estimated such insolvency as having a 36 percent chance of occurring by 2022 and a 91 percent chance of occurring by 2032. The program covers about 10.4 million participants in 1,435 insured plans, primarily in the trucking, retail food, construction, mining, and garment industries.

Most of the multiemployer program deficit growth stems from the addition of 22 new plans that the PBGC projects either have assets and collectible withdrawal liabilities payments that will not be able to cover benefits and expenses or will become insolvent within 10 years.

Unlike troubled single-employer plans, for which the PBGC becomes the trustee at plan termination, the PBGC steps in at plan insolvency for a multiemployer plan. Insolvency generally occurs after all contributing employers have left the plan. The program's guaranteed benefit is modest, about $12,870 yearly compared with the single-employer program's $57,500 approximated annual guarantee.

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Risk, Return, and Retirees: Measuring Pension Obligations

WHEN ACTUARIES measure pension plan obligations, they typically use two different approaches to select the discount rates that determine the obligation's present value: market-based and expected return-based methods. Depending on which method is used, plan sponsors will balance various factors that affect their contribution levels and plan rates of return. Given the current debates on the discount rate used to measure pension obligations, the Academy published the issue brief *Measuring Pension Obligations* in November. It examines and defines these two approaches for selecting discount rates and explores their potential for risks and for gains and losses when used for defined benefit pension plans.

As noted in the issue brief, "the market-based and expected return-based methods of measuring pension obligations both use a rate of return on assets to determine a present value of future pension benefits, but the assets of the portfolios differ." For the market-based method, an actuary selects the discount rate

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To further complicate matters, many Pension Protection Act of 2006 (PPA) provisions to help severely distressed multiemployer plans improve their funding status will expire at the end of 2014. These combined factors have led both the multiemployer plans community and Congress to consider potential changes to the system. This year alone the National Coordinating Committee for Multiemployer Plans (NCCMP) released a report offering a series of reforms, and a House Education and Work Force subcommittee held several hearings on the subject. The Government Accountability Office (GAO) also released a report in March recommending that Congress consider comprehensive and balanced structural reforms to the multiemployer system. These events make it probable that some legislative proposal will arrive in 2014.

Single-Employer Program

Unlike the multiemployer program, the single-employer program, although underfunded, does not risk running out of funds in the next 10 years, according to the PBGC's 2012 exposure report. In fact, the single-employer program's financial position improved by $1.76 billion, its deficit decreasing to $27.4 billion. The program's net gain came largely from a decrease in actuarial charges from changing interest factors.

Although some have questioned the reality of the PBGC's single-employer program deficit, the Academy's Pension Committee in an August issue brief concluded that the PBGC's methods and assumptions produce a reasonable representation of the single-employer program's current obligations and deficit. But the committee recognized that immediate premium increases for plan sponsors are unnecessary and potentially counterproductive and encouraged policymakers to explore new sources of income to address the deficit, an issue explored by the Pension Practice Council in an April 2012 issue brief.

Creating Lifetime Income

Part of the PBGC's mission is to encourage the continuation and maintenance of voluntary private pension plans. As part of this, the PBGC continued to educate participants on the consequences of taking a lump-sum offer. In August, PBGC Director Josh Gotbaum told the ERISA Advisory Council that "pension plan lump-sum cash-outs to retirees are like cigarettes: They are legal, many people like them, and they are bad for you." Gotbaum also shared his view at the Academy board meeting in October, praising the Academy's ***Risky Business*** discussion paper, which outlines the challenge of ensuring lifetime income for retirees and offers potential solutions that legislators, regulators, and employers can undertake.

Going Forward

On Dec. 13 the House approved PBGC premium increases as part of *The Bipartisan Budget Act of 2013*, H.J.R. 59, the resulting legislation from the two-year budget deal negotiated between Senate Budget Committee Chairperson Patty Murray (D-Wash.) and House Budget Committee Chairperson Paul Ryan (R-Wis.). The Senate has yet to vote on the bill at the time this article went to press. The budget bill increases flat-rate premiums to $57 per participant for plan year 2015 and $64 for plan year 2016, indexed to wage growth thereafter. Variable-rate premiums would rise by $5 per $1,000 in underfunding in plan year 2015 and an additional $5 in plan year 2016, indexed to wage growth thereafter. The agreement also calls for increasing the variable-rate premium cap to $500 for plan years beginning after 2015.

Even if the budget bill becomes law, focus on the PBGC will continue. The GAO listed the PBGC in 2003 as a "high risk" agency because it controls neither the benefits it pays nor the premiums it charges. The president's fiscal year 2014 budget called for giving the PBGC board the authority to adjust premiums, taking into account the risks different plan sponsors pose to their retirees and the PBGC. Given this issue and the structural problems facing multiemployer pension plans, it is likely policymakers will continue to propose potential changes to the pension insurance system going forward.

DAVID GOLDFARB *is the Academy's pension policy analyst.*

Updated Social Security and IRS Amounts for 2014

These four tables list updated figures for IRS pension limits, Social Security amounts, covered compensation, and PBGC premiums for 2014.

Andrew Eisner of Buck Consultants Knowledge Resource Center compiled the tables.

Covered Compensation, 2014

2014 WAGE BASE $117,000

(Advance calculation—pending IRS release of amounts)

YEAR OF BIRTH	AGE IN 2014	SSRA	YEAR OF SSRA	COVERED COMPENSATION ROUNDED TO			
				$1*	$12	$600**	$3,000
1947	67	66	2013	67,309	67,308	67,200	66,000
1948	66	66	2014	69,997	69,996	70,200	69,000
1949	65	66	2015	72,600	72,600	72,600	72,000
1950	64	66	2016	75,094	75,084	75,000	75,000
1951	63	66	2017	77,511	77,508	77,400	78,000
1952	62	66	2018	79,834	79,824	79,800	81,000
1953	61	66	2019	82,097	82,092	82,200	81,000
1954	60	66	2020	84,309	84,300	84,600	84,000
1955	59	67	2022	88,543	88,536	88,800	90,000
1956	58	67	2023	90,600	90,600	90,600	90,000
1957	57	67	2024	92,571	92,568	92,400	93,000
1958	56	67	2025	94,449	94,440	94,200	93,000
1959	55	67	2026	96,266	96,264	96,000	96,000
1960	54	67	2027	98,023	98,016	97,800	99,000
1961	53	67	2028	99,720	99,720	99,600	99,000
1962	52	67	2029	101,331	101,328	101,400	102,000
1963	51	67	2030	102,926	102,924	103,200	102,000
1964	50	67	2031	104,477	104,472	104,400	105,000
1965	49	67	2032	105,951	105,948	106,200	105,000
1966	48	67	2033	107,340	107,340	107,400	108,000
1967	47	67	2034	108,609	108,600	108,600	108,000
1968	46	67	2035	109,774	109,764	109,800	111,000
1969	45	67	2036	110,820	110,820	111,000	111,000
1970	44	67	2037	111,737	111,732	111,600	111,000
1971	43	67	2038	112,594	112,584	112,800	114,000
1972	42	67	2039	113,426	113,424	113,400	114,000
1973	41	67	2040	114,197	114,192	114,000	114,000
1974	40	67	2041	114,849	114,840	114,600	114,000
1975	39	67	2042	115,406	115,404	115,200	114,000
1976	38	67	2043	115,834	115,824	115,800	117,000
1977	37	67	2044	116,126	116,124	116,400	117,000
1978	36	67	2045	116,417	116,412	116,400	117,000
1979	35	67	2046	116,709	116,700	117,000	117,000
1980	34	67	2047	116,906	116,904	117,000	117,000
1981	33	67	2048	117,000	117,000	117,000	117,000
1982	32	67	2049	117,000	117,000	117,000	117,000

Advance calculation by Buck Consultants, October 2013.

* Represents exact average of wage bases, as permitted by law and regulations.

** After 1993, IRS does not authorize the use of covered compensation tables rounded to $600 multiples under 401(l). Thus, integrated plans using this table are not safe-harbor plans.

PBGC Premiums

PBGC Premiums	2014	2013
Single-Employer Plans:		
Flat-rate premium (per participant)	$42	$35
Variable-rate premium	$9 per $1,000 of unfunded vested benefits Maximum of $412 per participant	$9 per $1,000 of unfunded vested benefits Maximum of $400 per participant
Multiemployer Plans:		
Flat-rate premium (per participant)	$12	$9

Social Security—2014 Factors

The Social Security Administration announced updated factors for 2014.

Wage Base The maximum amount of earnings taxable in 2014 is $117,000 for Social Security purposes.

COLA The cost-of-living increase in benefits is 1.5 percent, first applicable to December 2013 benefits, payable in January 2014.

Wage Index The Average Annual Wage figure of $44,321.67 will be used in computing benefits for workers who become eligible in 2014. This figure is based on data for the last complete year (2012) and was used to determine other wage-indexed numbers given in the table below.

FACTOR		2014	2013
Wage base:			
	for Social Security	$ 117,000	$ 113,700
	for Medicare	No limit	No limit
	old-law wage base, for indexing PBGC maximum, etc.	$ 87,000	$ 84,300
Cost-of-living increase (applies to December benefits, payable in January)		1.5%	1.7%
Average annual wage (based on data two years earlier)		$44,321.67	$42,979.61
PIA formula, first bend point		$ 816	$ 791
PIA formula, second bend point		$ 4,917	$ 4,768
Maximum family benefit, first bend point		$ 1,042	$ 1,011
Maximum family benefit, second bend point		$ 1,505	$ 1,459
Maximum family benefit, third bend point		$ 1,962	$ 1,903
Retirement test exempt amount (annual)			
	below SSNRA	$ 15,480	$ 15,120
	year of SSNRA	$ 41,400	$ 40,080
Wages needed for one quarter of coverage		$ 1,200	$ 1,160
FICA (employee) tax rate:			
	Social Security (OASDI)	6.20%	6.20%
	Medicare (HI)	1.45%	1.45%
	Total	7.65%	7.65%
SECA (self-employed) tax rate, total		15.30%	15.30%

* The Medicare hospital insurance tax is two-tiered for employees - 1.45 percent applies to wages up to and including $200,000 for single taxpayers and $250,000 for married taxpayers filing jointly, and 2.35% applies to wages above those amounts.

IRS Qualified Plan Limits for 2014

Principal Limits

IRC	LIMIT	2014 ROUNDED	2013 ROUNDED	2014 UNROUNDED	NEXT INCREMENT	% INCREASE NEEDED
415(b)(1)	Defined benefit plan limit	$210,000	$205,000	$210,496	$215,000	2.2%
415(c)(1)	Defined contribution plan limit	52,000	51,000	52,624	53,000	0.8%
401(a)(17)	Limit on includible compensation *	260,000	255,000	263,120	265,000	0.8%
402(g)(1)	Limit on 401(k)/403(b) elective deferrals	17,500	17,500	17,820	18,000	1.1%
414(q)	HCE definition	115,000	115,000	118,896	120,000	1.0%
414(v)(2)	401(k)/403(b)/457(b) catch-up deferral limit	5,500	5,500	5,940	6,000	1.1%

Other Limits

IRC	LIMIT	2014 ROUNDED	2013 ROUNDED	2014 UNROUNDED	NEXT INCREMENT	% INCREASE NEEDED
457(b)	Limit on deferrals	$ 17,500	$ 17,500	$ 17,820	$ 18,000	1.1%
416(i)	Top-heavy key employee definition	170,000	165,000	171,028	175,000	2.4%
409(o)(1)(C)	ESOP payouts, five-year limit	1,050,000	1,035,000	1,052,480	1,055,000	0.3%
409(o)(1)(C)	ESOP payouts, additional one-year limit	210,000	205,000	210,496	215,000	2.2%
408(k)(2)(C)	SEP pay threshold	550	550	592	600	1.4%
132(f)(2)(A)	Commuter/transit limit (monthly)	130	245	132	135	2.3%
132(f)(2)(B)	Parking limit (monthly)	250	245	250	255	2.0%

* Governmental plans have special rules for eligible participants as defined in OBRA '93.

Advance Informational Copies of Form 5500 Released

ADVANCE INFORMATIONAL COPIES of the 2013 Form 5500 annual report/return have been released by the U.S. Department of Labor's (DOL) Employee Benefits Security Administration, the Internal Revenue Service, and the Pension Benefit Guaranty Corp. (PBGC). Modifications to the Form 5500 and Form 5500-SF and their schedules and instructions for plan year 2013 are described under "Changes to Note" in the 2013 instructions.

The changes include:

- DOL Form M-1 compliance information, which covers DOL final rules published earlier this year relating to Affordable Care Act provisions that protect workers and employers whose health benefits are provided through multiple employer welfare arrangements.
- Schedules H and I—PBGC coverage question information, which includes the addition of 5c to Line 5 of Schedules H and I. This question 5c asks defined benefit pension plan filers whether the plan is covered under the PBGC insurance program and replaces Plan Characteristic Code 1G previously used on line 8a of the Form 5500 to identify plans covered by the PBGC insurance program.
- Schedule SB instructions updates now reflect provisions of the Moving Ahead for Progress in the 21st Century Act (MAP-21), including clarifications to instructions for line 11b for plans where the valuation date for the prior plan year was not the first day of the plan year.

Informational copies of the forms, schedules, and instructions are available online at **www.dol.gov/ebsa/5500main.html**. Filers should monitor the EFAST website for the availability of the official electronic versions for filing using EFAST-approved software or directly through the EFAST website. Assistance with the EFAST2 system is available at **www.dol.gov/ebsa/form5500tips.html** or by calling 1-866-463-3278.

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through observable data in financial markets and uses fixed-income yield data based on a hypothetical portfolio. An actuary using the expected return-based method would select the discount rate by looking at investment allocations and estimating the returns expected from the actual portfolio.

Both approaches can achieve the same results if invested in the same type and duration of fixed-income securities. However, that seldom happens, because plans often seek to generate greater returns than those using default or risk-free securities, such as Treasury bonds.

Larger-than-anticipated returns mean that plan sponsors can invest less money to fund the debt initially. However, if investments do not perform as expected, plan sponsors would need to make up the difference to meet their obligations to retirees. The market-based method requires more upfront investment, but it creates a plan that is more stable and able to meet its obligations, should the company be unable to continue funding the plan.

Understanding these methods allows stakeholders to better evaluate the sometimes conflicting measurement of pension obligations reported. The solvency value, a market-based measurement, tells stakeholders how much the plan needs to invest in default- or risk-free securities to ensure future benefits. The budget value, an expected return-based measurement, tells stakeholders the amount the plan needs to fund obligations based on the expected returns of the plan's assets.

When plan sponsors fund their pensions based on these values, they are contributing based on different levels of certainty. A plan sponsor that uses the solvency value will need to contribute more money to the plan upfront and will have a plan that almost certainly meets all future obligations to retirees without further contributions. However, they could contribute less money initially using a budget value and investing in a diversified portfolio that has greater expected returns than default- or risk-free securities. The greater risk in this second scenario, though, means that plan sponsors may not see the expected returns and would then have a funding shortfall to make up. This is further complicated if the company is faltering and does not have the resources to make up the difference.

When plan sponsors navigate how best to measure and structure their defined benefit plans, they must take into account their ability to fund these obligations initially or if returns do not meet expectations, as well as how much certainty or risk the plan and future retirees can tolerate. As the issue brief notes, "despite these uncertainties, several elements remain constant when risk is added to the portfolio—the benefit payments owed to the pension plan's participants and the sponsor's obligation to provide those benefits remain unchanged."