

# Higher PBGC Premiums Coming for 2015

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In December of 2013, large PBGC premium increases were part of the Bipartisan Budget Act of 2013. The premium increases are reflected in both flat-rate (per participant) and variable rate (per thousand dollars of unfunded vested benefits), and those increases are significant. They are significant enough that sponsors paying 2015 PBGC premiums out of general assets may want to budget ahead for the fact that premiums may be 60% larger than 2014 premiums, and more than twice as large as premiums would have been before any legislative increases. A typical well-funded plan may have premiums that approach 1% of their funding target, even if they have no contribution requirement.

## A Sample Well-Funded Plan

We can assume that a typical well-funded mid-sized plan may have \$100 million of assets, \$100 million of funding target and 2,500 participants. Such a plan may have a contribution due to accruing benefits during the year, or none if it is frozen and paid expenses out of general assets rather than plan assets.

We can assume that a typical 2015 effective rate for funding would be approximately 6.25%, and the effective rate for the 2015 PBGC liabilities would be approximately 4.25%. Our sample plan has a duration of 15, which would mean PBGC liabilities would be approximately \$132.25 million (assuming nearly all liability is fully vested), introducing an additional \$32.25 million of underfunding for a plan that is fully funded on a PPA funding basis.

If we use those same numbers for pre-legislative increase, 2014 levels after the increase, and the expected 2015 levels, we would end up with total premiums as follows:

	Before Legislative Increases	2014 PY After 2013 Legislation	2015 PY After 2013 Legislation
Participant Count	2,500	2,500	2,500
Flat Rate	\$35	\$49	\$57
<b>Flat Rate Premium</b>	<b>\$87,500</b>	<b>\$122,500</b>	<b>\$142,500</b>
Unfunded PBGC	\$32.25MM	\$32.25MM	\$32.25MM
VRP Per Thousand	\$9	\$14	\$24
<b>Variable Premium</b>	<b>\$290,250</b>	<b>\$451,500</b>	<b>\$774,000</b>
<b>Total Premium</b>	<b>\$377,750</b>	<b>\$574,000</b>	<b>\$916,500</b>
Legislative Increase Effect	N/A	+51.95%	<b>+142.62% (!)</b>

A perfect example would reflect that the spread between effective rates from year to year is not exactly the same, but for our example, it's close enough.

There is a cap on total premiums payable by a plan of \$475 per participant per year, but the sample plan is not helped by the cap. In 2016, that cap (which represents total fixed and variable rate amounts) will rise to \$564 per participant. Figuring out the maximum premium possible is an easy task.

## **What's Ahead for 2016?**

We would expect the spread between funding the target and PBGC premium liability to narrow slightly in 2016 because the effect of 2014 funding relief under HATFA is expected to wear away over time. Eventually, the funding rates and PBGC rates should be similar in an average year, but without a drastic increase in corporate bond rates before the end of the 2015 calendar year that will not occur for 2016.

For 2016, the PBGC variable rate increases yet again, this time to \$29 (possibly higher with indexing), and the flat rate premium increases to \$64. If our sample plan had the same PBGC underfunding of \$32.25 million and the same participant count, the premium would rise in 2016 to \$1,095,250, still short of any relief by the premium cap, which is slightly over \$1.4 million.

While we don't know what the end of the year holds, we can expect that the spread between PBGC and PPA funding rates may narrow slightly versus 2015, so the premium might be slightly lower, but likely still higher than 2015 premiums.

## **What's Causing This?**

The high premiums are caused by several factors. Most notably, The Bipartisan Budget Act increases passed in an environment where the funding discount rates were higher than the PBGC premium discount rates. PBGC rates were unchanged by funding rate-relief legislation. The rate spread automatically creates some underfunding when calculating premiums for all but the very best funded plans, and provides a temporary windfall for the PBGC. The rate spread is coupled with a nearly three-fold legislative increase in the premium rate per \$1,000 of underfunding and a flat rate premium that is approaching double its prior rate.

After passage of the Bipartisan Budget Act, HATFA "funding stabilization" legislation extended and increased the effect of MAP-21 funding relief, further exacerbating the deficit. If one were going to create a recipe to increase PBGC premiums, these items would be the primary ingredients.

The good news is that eventually, without additional legislation, this deficit should narrow as the HATFA legislation's effectiveness in providing contribution relief decreases with the passage of time. The bad news is that if corporate bond rates don't rise significantly, it will take a while for that to happen.

In addition, 2017 will likely see the IRS require a mortality assumption update for single employer plans, which could increase PBGC premium liabilities by a percentage in the high single digits. Every \$1 million of increase will subject almost all plans to at least another \$29,000 in variable rate premiums. Our well-funded sample plan could get close to hitting the premium cap.

## **What Can Sponsors Do?**

Sponsors can increase cash contributions to plans, especially poorly funded plans. The borrowing environment and the ability to deduct both contributions and interest expense may make borrowing-to-fund more attractive than paying PBGC premiums. There is, however, some danger in getting too aggressive with accelerated funding. A plan that has very favorable investment experience may find that they become overfunded on a plan termination basis. Having excess assets in a plan is probably the last thing a for-profit plan sponsor would ever want to do due to excise taxes on any monies that return to a

plan sponsor in a termination. For an ongoing plan sponsor with a typical 60-65% equity allocation, there is no easy scenario that doesn't involve significant risk or have the sponsor resigning themselves to forgoing asset return potential.

A sponsor has less of this risk if it holds a conservative investment philosophy that tracks the corporate bond market more closely, as would a sponsor intending to terminate in the near future.

We would encourage plan sponsors to work with their actuary to do a thorough analysis of the benefits and risks of any scenarios they wish to pursue to reduce their PBGC premiums.

**A Recent History and Near Future Look at PBGC Premium Rates**

Lastly, we are providing a recent history and near future look at the flat rate premium, variable rate premium and per-participant variable rate premium cap. It's important to note that the cap shown here is applicable for the variable rate premium only, and in our examples earlier, we have added the flat rate premium to get the total maximum premium that any plan sponsor would pay per participant.

Year	Flat Rate Premium	Variable Premium Rate	Per Participant Premium Cap
2012	\$35	\$9	N/A
2013	\$42	\$9	\$400
2014	\$49	\$14	\$412
2015	\$57	\$24	\$418
2016	\$64 (est)	\$29 (est)	\$500

The 2016 amounts shown are estimated, and will be indexed in subsequent years. One may wonder why a premium *rate* per thousand dollars of underfunding would be indexed in the future. We wonder why, too.

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