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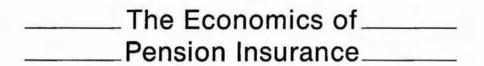
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# Richard A. Ippolito

Chief Economist Pension Benefit Guaranty Corporation

1989
Published for the
Pension Research Council
Wharton School
University of Pennsylvania
by

IRWIN

Homewood, IL 60430 Boston, MA 02116

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Project editor: Paula M. Buschman Production manager: Bette Ittersagen Compositor: TCSystems, Inc.

Typeface: 10/12 Melior

Printer: R. R. Donnelley & Sons Company

#### Library of Congress Cataloging-in-Publication Data

Ippolito, Richard A.

The economics of pension insurance / Richard A. Ippolito.

p. cm.

Bibliography: p.

Includes index.

ISBN 0-256-07474-7

Pension Benefit Guaranty Corporation 2. Insurance, Pension trust guaranty—United States. I. Title

HD7105.45.U6I615 1989

368.4-dc19

88-39853

CIP

Printed in the United States of America

1234567890 DO 65432109

To Pauline, Benedic, and Dominic

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#### PURPOSE OF THE COUNCIL

The Pension Research Council was formed in 1952 to undertake academic research into those institutional arrangements designed to provide financial resources for a secure and dignified old age. It seeks to broaden public understanding of these complex arrangements through basic research into their social, economic, legal, actuarial, and financial foundations. While generally geared to the long view of the pension institution, projects undertaken by the Council are always relevant to real-life concerns and frequently focus on issues under current debate. The Council does not speak with one voice and espouses no particular point of view. The members do share a general desire to encourage and strengthen private-sector approaches to old-age economic security, while recognizing the essential role of Social Security and other income-maintenance programs in the public sector.

The Pension Benefit Guaranty Corporation (PBGC) was created by the Employee Retirement Income Security Act of 1974. The PBGC was to insure defined benefit pension benefits in the event of termination of a pension plan with insufficient assets to pay vested liabilities when the plan sponsor was unable to make up the difference. The insurance program was started with almost no information about risk and exposure parameters in the market and little or no information about historical pension terminations. Premiums reflected neither the financial condition of the pension fund nor the plan sponsor; benefits were set at very high levels; and the potential for moral hazard was virtually unconstrained.

Insurance experts at the time predicted the so-called insurance system had the potential to grow into a large federal transfer agency. Many of their predictions came true. By 1986, the cost of the PBGC program was perhaps 50 times original estimates.

Despite this experience, relatively little has been written that evaluates the consequences of creating the new government insurance system. Like most federal programs, it is easier to start than to revamp once it becomes apparent that the cost is higher than anticipated.

This does not mean, however, that the PBGC problem has not been studied or that an understanding of its causes and consequences has not been developed. Various staff in the executive and congressional branches—and the professional staff of the PBGC, in particular—have accumulated a remarkable amount of information and understanding of "the PBGC problem."

After spending approximately one year at the PBGC, I had the urge to try to write down the information I had assimilated from the senior staff in some systematic way. The value of this exercise was not in creating new information available to public policymakers in government. Those involved in assessing the PBGC program have access to the information and expertise necessary to evaluate experience and reform ideas. Instead, my intention was to write a volume for the benefit of those outside the government process.

I hope the book is of some interest to public policy experts and those who operate insurance firms and pension plans. Most important, however, I hope the information in the volume provides a basis for study by students of insurance. The history of the PBGC provides a textbook case study of the consequences of establishing an insurance system that does not adhere to sound insurance principles, and the consequent solvency problems provide a good backdrop for discussion of various reform ideas.

I developed the outline of the book as if a well-meaning Congress created the system with the ultimate idea that, after a suitable understanding of how a pension insurance contract could be written, the insurance program could be transferred to the private sector. Thus, the book is arranged in a way that tries to use historical claims experience and various reform efforts toward developing a pension insurance policy that ultimately would work in the private sector. While I ended up trying to describe a system I thought would work, my main purpose was to provide the information necessary for readers to come to their own conclusions and to formulate their own ideas of how a pension insurance market could actually work.

#### **ACKNOWLEDGMENTS**

This book could not have been written without the support of many individuals. I must first thank Dan McGill, whose 1970 Pension Research Council volume on the same subject inspired my attempt. I wrote what might be considered a follow-up volume, which describes "what happened," in answer to McGill's volume, which warned "what will happen if." I am also indebted to my colleague Emerson Beier for patiently teaching me insurance principles, for challenging (and, in many cases, modifying) my ideas, and for his thorough critique of a previous draft. Jack VanDerhei was equally generous with his time in providing information and advice, for making his pension insurance pricing study available for extensive citation, and for a careful review of an earlier draft.

I must also thank my colleagues Vincent Cicconi and John Hirschmann for providing factual and institutional information to me during the process of writing the book and for making extensive corrections to a draft manuscript; and various individuals who were generous enough to provide comments for revision, including William Beyer, Zvi Bodie, Alicia Munnell, and Jim Pesando. This, of course, does not absolve me from any errors that may remain; nor does it implicate any of these individuals with views expressed in the volume.

Many staff members in the PBGC's research and policy office provided various data and information for the book, including Richard Freiman, John Leonard, Linda Mizzi, Gail Sevin, Larry Shirley, and, especially, Fran Morawski. Ronetta Lawson undertook the task of typing all the tables and much of the other appendix materials.

I am especially grateful to Audrey Frazier, who did the bulk of the typing for the book through its various drafts and generated all of the

figures for the volume. She did an outstanding job and kept a smile on her face through the entire project. I am also especially grateful to the Executive Director of the PBGC, Kathleen Utgoff, who generously provided me with academic freedom and institutional support for my various research activities at the corporation, particularly for this volume. I would like to emphasize that the views expressed in the book are my own, and therefore are not intended to represent the official position of the PBGC.

Richard A. Ippolito

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