This study attempts to identify key points in the development and use of outcome information in the Pension Benefit Guaranty Corporation (PBGC), assessing its progress, its current challenges, and its planned steps. It represents a continuing effort, led by the American Society for Public Administration (ASPA) Task Force on Government Accomplishments and the National Academy of Public Administration (NAPA) Panel on Improving Government Performance, to identify "lessons learned" that may be of benefit to all agencies moving further into strategic planning and performance measurement. Because the PBGC is both an insurance and enforcement agency, the kinds of programs and agencies that may find this case study relevant include regulatory programs, safety and security programs, environmental agencies, federal insurance agencies, and private insurance agencies.

The Pension Benefit Guaranty Corporation and its Early Warning Program[1]

Context

The Pension Benefit Guaranty Corporation (PBGC) was established in 1974 by Title IV of the Employee Retirement Income Security Act (ERISA). Its mission is to protect the pensions of nearly 42 million working men and women in about 55,000 defined benefit pension plans. This mission involves encouraging the maintenance of private pension plans, protecting benefits in ongoing plans. Under the federal single-employer pension insurance program, the PBGC is liable for the payment of guaranteed benefits in the event that an underfunded plan terminates, typically because of employer insolvency. An underfunded plan could also be terminated if the PBGC found that a condition for distress termination, as defined by ERISA, has been met. If an underfunded plan terminates, the liability assumed by the PBGC is generally equal to the present value of future benefits

---

[1] This case was written by David Gullen, Antonio Iskandar, and Erwin Tiongson with guidance from Professor Sung Deuk Hahm (Georgetown University) and Professor Linda Kaboolian (Harvard University) for use in the Public Management & Budgeting Track, Graduate Public Policy Program, Georgetown University.

net of the plan’s assets. Underfunding at termination thus translates into costs to the PBGC and possibly to the workers, because not all of the promised pensions may be guaranteed by the PBGC.

PBGC operations are financed through premiums of defined benefit plans, assets assumed from terminated plans, and investment income, among other resources. The PBGC receives no funds from general tax revenues. Since its inception, the PBGC has registered an accounting deficit, that is, its liabilities have exceeded its assets. Related to this, various oversight agencies and Congressional committees have closely monitored the performance of the PBGC. As early as 1977 the General Accounting Office (GAO) found the PBGC accounting systems and operating procedures to be problematic. In 1987 the Office of Management and Budget (OMB) placed the PBGC on its list of "high risk" federal agencies with internal financial problems. PBGC has since removed itself from both high-risk lists.

The underfunding of the pension plans that PBGC insures total $31 billion, as of December 31, 1994. These underfunded pension plans cover nearly eight million workers and retirees. Most of these workers are in underfunded pension plans sponsored by the automobile, steel, industrial and commercial machinery, airline, and tire and rubber industries.

In 1990, at the time of some of the largest bankruptcies and losses in its history which included the Eastern Air Lines and Pan American World Airways cases, the PBGC changed its focus from maximizing recoveries after the plan becomes insolvent, that is, when financial conditions have completely degenerated. At this point conditions are such that corporate resources are no longer available, companies have little flexibility, and pension plans must be terminated. Recoveries in these bankruptcies were often limited and sometimes other creditors fared better than the PBGC.

Two specific corporate transactions--Crane Corporation's spinoff of CF&I Steel and White Consolidated Industries' sale of its Blaw Knox division--led to a change in the PBGC's focus from damage control to loss prevention. In 1985, Crane Corporation spun off CF&I Steel, a downsized subsidiary with unfunded pension liabilities amounting to $200 million. CF&I filed for bankruptcy in 1992 and the pension plan was terminated two years later. In 1985, White Consolidated Industries disposed of its Blaw Knox Steel division. Like CF&I, Blaw Knox had questionable prospects with unfunded pension obligations amounting to $120 million. Its pension plans were eventually terminated in 1992. In both these corporate transactions, the PBGC believed that an early warning program might have facilitated the negotiation of settlements to structure protection for pension plans which could have prevented the termination of pension plans and massive losses to workers and the PBGC before they occurred.

Development of Indicators

Goal

The stated goal of the PBGC's Early Warning Program is to, "assure that the pension system does not experience the difficulties that plagued the banking industry in the last decade." The program focuses on corporate transactions that are considered to risk pension insolvency. PBGC has identified four goals for the program:

1. Protect pension benefits. (However, as mentioned, PBGC does not insure all the benefits promised by employers so if an underfunded plan terminates, benefits can be lost.)
2. Limit future losses incurred by PBGC to preserve the integrity of the federal pension insurance system.
3. Achieve appropriate pension protection through negotiation with employers.
4. Raise corporate awareness of the importance of sustaining pension plans during a corporate transaction.

Introduction to the Indicator

The Early Warning Program currently monitors 400 companies with pension plans underfunded by more than $25 million. Its principal performance indicator is:

The dollar value of additional pension funding that employers make as a result of negotiation with PBGC.

It should be noted that even before the Early Warning Program, employers restored some of the underfunded plans to full funding without PBGC intervention. For example, companies with profits especially sensitive to the national business cycle often funded their plans during periods of economic expansion. In time, other companies made the changes in business operations and internal finance necessary to fund their pension promises.

By and large, only if a plan terminates, and only at termination, does the plan's funding level influence: (1) whether all the promised benefits are provided and (2) PBGC's cost to provide pension benefits that it guarantees. Nevertheless, the funding level during the life of a plan is important for three reasons:

It is likely that those plans that are most seriously and persistently underfunded are the most apt to terminate while underfunded. (PBGC has not, however, disseminated any data detailing this risk.)

If an underfunded plan terminates, then the greater the underfunding, the greater the risk to promised pension benefits.

If an underfunded plan terminates, then the greater the underfunding, the greater the cost to PBGC of providing guaranteed benefits.

On this reasoning, the Early Warning Program monitors underfunding and negotiates with employers for additional plan financing.

The System

The Early Warning Program strives to accomplish these goals through an integrated system which:

1) *Targets the universe of underfunded plans and prioritizes the work of the PBGC.*

The Early Warning Program provides protocol for the identification of companies with underfunding. In addition to traditional reliance of premium filings and transaction reports, the PBGC is proactive in identifying underfunded plans. A corporate research department relies on inter-agency information sharing between the Department of Labor, Internal Revenue and Securities and Exchange Commission as well as analysis by industry experts including rating agencies and professional analysts.

As a result of this monitoring the Early Warning Program has identified 10,000 companies with underfunded plans. An analysis of underfunded plans shows that 85% of the exposure is in 400 companies. Further analysis shows that a similar percent is found in five industries: auto, steel, machinery, airlines, and tires. As a result of this analysis, the Early Warning Program allows for the prioritization of monitoring and intervention activities to those plans presenting the largest potential liability, the largest number of affected participants, and the highest probability of risk of insolvency.

The first screen used for risk assessment focuses on size on size of underfunding and of the plan: $25 million in underfunding with over 2,000 participants. Once these thresholds are met, corporate transactions that may affect the probability of termination are determined. Targeted companies are assigned to various levels of monitoring and intervention depending on this assessment. Monitoring involves ongoing scrutiny for changes in environmental conditions, leadership, status of the plans or transactions that might affect the plans. High level monitoring involves more intense research into conditions and more frequent checks. High level monitoring of targeted companies is justified in approximately 25% of cases by the size of underfunding ($500 million or more), the company's credit quality, and research that reveals troublesome operating or financial conditions.

Once the Early Warning Program staff identifies a potential transaction by one of the targeted companies, the transaction is investigated to determine whether it would jeopardize retirement benefits. Transactions that might activate this investigation occur in approximately 5% of targeted companies. If it is determined that the transaction would affect the pension plans, then the PBGC initiates contact with the company and opens active negotiations. Active negotiations are also triggered by bankruptcy filing and missed premiums. This occurs in approximately 5% of targeted companies. A company might be added to the target group at any time should conditions warrant inclusion. Therefore, an unexpected layoff might trigger active negotiations for a firm that might not have been in the original targeted group. As a result, the percentages presented here should be read as the percentage of the current targeted group rather than actual workload.

2) *Active negotiations with companies*

Active negotiations build on the foundation provided by the Early Warning Program. PBGC negotiators use the analysis provided by the research staff of the Early Warning Program in face-to-face meetings with corporate representatives. The purpose of the meeting is to introduce the PBGC's intention to be proactive, review the corporation's legal responsibility to its pension plans, and express the PBGC's analysis of and concern about a proposed transaction.

The PBGC attempts to set the terms for bargaining by demonstrating its knowledge of the situation and by reviewing the various options for ameliorative action by the company as well as the PBGC's enforcement tools under ERISA. It is the PBGC's goal to achieve a negotiated settlement that will support existing plans. Toward that end it will include in the negotiations the various parties to a pension fund including unions, creditors, and others with legal standing.

3) *Ongoing compliance monitoring of negotiated settlements*

Negotiated settlements result in a compliance agreement which provides to the PBGC financial and transactional information that companies are otherwise not required to provide, thereby making legal enforcement of the settlement, when needed, more timely. In addition, the PBGC maintains a dialogue with parties to the agreement after settlement.

The agency also uses the monitoring system to compile an annual top 50 list of underfunded pensions, a list already in use even prior to the Early Warning Program. Combined with ancillary reproving mechanisms such as published reports and conferences, this list informs the public and provides an incentive for companies to comply with pension funding requirements.

The PBGC shares information with other agencies. The PBGC gives its list of companies with underfunded pensions to the Securities and Exchange Commission. The SEC, in turn, advises the PBGC when the said companies file registration statements describing a restructuring. The PBGC's ability to weigh in with the SEC on registration statements is intended to improve its negotiating leverage with employers.

The agency has also developed a working relationship with the Internal Revenue Service which is responsible for pension funding and funding waivers, an exception granted by the IRS to companies which temporarily free them from enforcing tax laws on meeting legally required funding levels. As Martin Slate notes,

> "A missed contribution or request [for funding waiver] is often the first signal that a larger restructuring is needed. The IRS and PBGC work together, making the negotiation of security arrangements a condition of granting a funding waiver."

The collective action between the PBGC and these agencies establishes negotiations which begin a dialogue with a company that is potentially useful if the company's financial position continues to decline.

Challenges

The PBGC's development of Early Warning Program indicators presented fundamental challenges: establishing credibility with the corporate community, assimilating the myriad transactions into the Early Warning Program, and developing the right performance measures.

The PBGC did not possess clear negotiating authority. As the PBGC's Executive Director, Martin Slate, observed:

> ”The extent of the PBGC’s authority in negotiating with companies was untested, and the statutory basis for PBGC’s ability to influence transactions had been largely unenforced. Some companies felt that they were being singled out and resisted PBGC’s overtures to negotiate."

In response, the PBGC has been willing to use its strong sanction of termination to reinforce negotiations. In order to dispel its perception by some as an intrusion into normal business practices, the organization has sought to allow the timely procession of corporate transactions while negotiating for acceptable levels of pension protection. The tactic underlined the PBGC’s principle that, as one analyst put it, ”Regulation shouldn’t be for its own sake, but rather to develop a partnership which procures what you need." The PBGC has used its partnership with the business community to obtain its compliance with acceptable levels of pension underfunding.

What these acceptable levels of underfunding are, however, remains controversial. The Early Warning Program outcome indicators try to capture both the quantitative and qualitative aspects of the job. According to the PBGC staff, the agency identifies risky levels of underfunding and reports its performance as the dollar value of the reduction in the level of underfunding pursuant to a negotiated settlement. The indicators are based on traditional measures of creditworthiness and analysis of corporate transactions. Given the dynamic character of financial markets, the measures must incorporate an ever-growing catalog of corporate transactions. If they do not, the indicators will systematically misdiagnose the significance of a particular transaction. The unique character of each corporation must also be considered. Underfunding may not necessarily lead to insolvency. Requiring a struggling company to put scarce investment dollars into its underfunded plan may also increase the risk of bankruptcy. By the same token, profits put in pension funding cannot go for worker training or new equipment. Meanwhile, cyclical manufacturing companies can have fluctuating levels of underfunding. The refinement of indicators, therefore, is a never-ending process. The PBGC recruits private sector experts and establishes a public/private sector partnership to enhance its monitoring efforts, its understanding of corporate activities, and, ultimately, the Early Warning Program’s set of indicators.

Performance Indicators

The actions of the PBGC are circumscribed by the complexity of the interests of the various parties represented in pension plans. For example, the interests of currently working employees and retirees may not be the same, as in the case when a termination threatens the viability of an employer.

Similarly, narrowing the PBGC's deficit may conflict with protecting participants in a given plan. Regulation may also increase the chances of bankruptcy rather than decrease it. Thus, there is no one full outcome measure that sufficiently serves the PBGC's purpose.

Traditionally, the PBGC has dealt with this complexity by organizing PBGC operations around the goal of eliminating its own accounting deficit. PBGC treats likely insolvencies by including their expected costs in its accounting. Improving plan health thus is immediately beneficial to PBGC's accounting. This performance measurement represents the reduction of "rework" in the production/operations vernacular. Involuntary terminations represent failures and improving the collection of premium revenues and assets from the estates of bankrupt firms represent "scrap salvage." While some progress was made during the late 1980's in stabilizing the PBGC, significant improvements in the deficit and proper balancing of complex interests required that the PBGC refocus its enforcement efforts to avoid "rework."

The PBGC measures the performance of the Early Warning Program by the number of participants protected and the dollar value of protections negotiated. The organization also tracks the number of transactions reviewed for which no action was necessary. The Early Warning Program's performance, therefore, is typically measured as the reduction in underfunding. Though there is no one sufficient performance measurement, this indicator nonetheless provides a clear-cut target, underfunding, requiring a clear-cut solution, namely, increased funding for underfunded pension plans. Its meaning is also relatively straightforward: at termination, underfunding creates costs for both the PBGC and workers. It is therefore appropriate for both the PBGC and a particular company to focus on the problem of underfunding.

The Use and Impact of Information on Outcomes/Results

PBGC says that its Early Warning Program has led to the negotiation of 30 major settlements in the last three years, generating $13.5 billion in new pension contributions and protections and contributing to the general decline in underfunding from $71 billion to about $31 billion.

Monitoring involves ongoing scrutiny for changes in environmental conditions and intervention depending on the screening tools described in the Development of Indicators section. Low level monitoring involves regular checks on conditions, contact with senior financial officers, and monitoring for potentially harmful transactions. High level monitoring involves more intense research into conditions and more frequent checks.

Analysts also contact those companies on the top fifty list before it is published for public consumption. (In a way this paper reports on the combination of the Top 50 list with the Early Warning Program.) This strategy is meant to give companies the chance to increase pension funding and, thus, remove themselves from this list. Additionally, it is intended to help the agency develop inroads into the business community. The PBGC analysts cited several episodes in which companies, fearing that they would be on the list, contacted the agency to confirm its status and to negotiate remedial measures.

To promote the efficient use of its resources, the PBGC allocates them so that they yield, as one analyst calls it, "the most bang for the buck." Consequently, the agency focuses on high level monitoring cases in which pensions are underfunded by more than $25 million. The number of such funds represents 80% of all cases monitored. Additionally, the PBGC uses its Early Warning Program to enforce the following legal requirements:

1. Privately held companies with underfunding of $50 million must notify the PBGC of certain transactions at least 30 days in advance.
2. All companies with over $50 million in underfunding will be required to file actuarial and financial information annually.

The PBGC will expend a significant amount of resources on lower level cases when justified by special circumstances. Often times, the analysts are encouraged to "gestalt" the appropriate strategies, tasks, and initial course of action. Given the high volume of information monitored, managers do not allow themselves to get bogged down in the details but rather encourage, "everyone to do their own thing toward a common goal."

In terms of the most unexpected impact of their use, the indicators have established a dialogue between the business community and the PBGC. Analysts frequently field phone calls from companies who are considering a merger but want to address pension fund issues in order to achieve a smooth process and efficacious outcome. Analysts have encouraged this trend by visiting the companies to explain the impact of a given merger proposal on the company's pension funds. Companies have reportedly been positively affected not only by the agency's effort to protect pensions but also its interest in developing constructive relationships with the business community.

Meanwhile, a number of stakeholders in the PBGC's mission provided support for the program. Specifically, groups representing workers and retirees participated in the development process of the Early Warning Program. The President of the United Automobile Workers, Owen Bieber, commended the PBGC for, "the outstanding job they have done in working with GM to draft an agreement." Namely, the PBGC negotiated with GM to contribute $10 billion to its largest and most underfunded pension plan covering 600,000 workers and retirees. In the New Valley (formerly Western Union) bankruptcy case, the PBGC's readiness to take legal action may have led to the turnaround of the country's tenth most underfunded pension plan. Since New Valley's purchase by another corporation, contributions have exceeded the mandatory minimum funding requirements. Grateful for the firm action taken by the PBGC, a retiree of Western Union wrote to the agency:

> "Thank goodness with the brilliant negotiations and legal maneuvering, the PBGC was there providing representation in the best interest of the retirement plan. It worked out well for us, largely because of PBGC's effort."

Costs

At the onset of the implementation of the Early Warning Program, the PBGC encountered some obstacles in fulfilling its mission. In general, companies did not understand the mission of the program, the extent of the PBGC's authority was untested, and the PBGC's ability to influence transactions had been largely unenforced. Since the program may be viewed as an intrusion into normal business practices that would stop transactions, some companies were disinclined to negotiate settlements of underfunded pension plans. However, the PBGC partially overcame these obstacles by using its involuntary termination power to reinforce negotiations. In 1992, a court victory in the case of FEL, a defense contractor that was about to be separated from its corporate group, placing the pension plan in danger, established that the agency could terminate a pension plan when its "possible long-run loss may reasonably be expected to increase unreasonably unless the plan is terminated." Simultaneously, the effectiveness of the program has depended on the ability of the PBGC to properly identify risky transactions before funds suffer too greatly.

The new approach required the PBGC to reconsider its structure. The PBGC had to bring as much new financial expertise as possible to its activities. It hired financial analysts, industry experts, and developed a network of Wall Street equity and credit analysts. The PBGC set an internal flow of communication among its staff and updated the use of modern technology, to help it accomplish its goal.

Not without controversy, Congress passed reforms to the Retirement Protection Act (RPA) in 1994 with support of both parties. The reforms enhanced the agency's ability to identify and respond to corporate transactions making a strong Early Warning Program possible. Detailed Technical Updates provided broad guidance on the agency's enforcement of the new requirements until specific rules were developed. Another update informed companies of the assumptions the PBGC would use to calculate unfunded benefits. This gave companies more time to make additional contributions to reduce underfunding.

Lessons learned

The PBGC Early Warning Program must be viewed in context. Employers set up pension plans voluntarily. Since the early 1980s there have been fewer and fewer of the traditional pension plans that PBGC insures. Some of the companies that have retained traditional pensions spend more to set up and administer these plans than they pay in retirement benefits. Most analysts believe that regulatory burdens and the fear of legal entanglement have discouraged some companies from establishing and continuing pension plans, especially traditional ones.

In the Early Warning Program, the PBGC has had to tread carefully with a program that: (1) monitors company financial transactions and (2) goads companies (often financially hard-pressed companies) to put additional money to pension plans for the sake of retirement payments in the future rather than current demands. The 1994 Retirement Protection Act requires businesses to submit pertinent financial information to PBGC but this was a controversial provision that was cut back when Congress considered it.

The Early Warning Program’s greatest strength is its simplicity. In focusing on the level of underfunding as the key performance measurement, it provides clear-cut targets as well as clear-cut solutions. Compared to other indicators, the Early Warning Program provides a measure-- reversal of underfunding-- that is easily understood and, consequently, easily justified.

The risk caused by underfunding is also easily understood. If a pension plan were to terminate while underfunded, the company might not be able to make good on its pension promises to its employees. By the same token, a company’s putting money into an underfunded plan is also clear-cut: They are acting to make good on their pension promise. Apparently, one reason the Top 50 list of underfunded plans to gets so much attention by business is that CEO are ashamed to be running a company with an underfunded plan.

Opponents of regulation often criticize government enforcement of obscure and technical legal provisions. By contrast, the concern about pension default is not a mere technicality. Unlike the use of unproven pollution-control technology for example, there is no doubt about whether company actions can be effective in improving the performance indicator of underfunding.

The program's performance also underscores the importance of developing specialized financial expertise and information sharing among government agencies to enhance its data resources to meet the business industry on its own terms. The probability of risk represented by a company must be based on thorough research about the company both in absolute terms and contextually in light of its industry, region and the general economy. As such, the PBGC may also need to develop further a more sophisticated calculus of risk, other than just the targeting of the universe of underfunded plans. The PBGC needs to take into account a cyclical production company's capital flow when evaluating its level of pension funding at one point in time.

In addition, the last three years emphasize the value of legal authority to facilitate enforcement while demonstrating the viability of constructive relationships between the government and the business community. ERISA gave the PBGC a powerful enforcement tool for involuntarily terminating a pension plan. Furthermore, the Retirement Protection Act stipulates new reporting requirements for underfunded companies. Thus, it gave the PBGC a clear legal precedent for initiating negotiations as well as information to use. Although it is willing to terminate a plan voluntarily, the PBGC is aware that this course of action could drive a company to bankruptcy, a situation in which all parties lose. The PBGC favors developing a constructive relationship with the business community. During the negotiations, the PBGC's negotiators try to tailor a settlement with which the corporation could comply, while attempting to consider the interest of all the parties involved: employees, retirees, the corporation, and the government.

However, the idea of legally permitting the PBGC to negotiate a settlement, and thus alter an ongoing corporate transaction, remains an issue. Corporations may resent the intrusion and question the PBGC's ability to determine risk to pension plans. Meanwhile, the PBGC has found that it is helpful to adopt a proactive, preventative stance to address potential problems, limit risks, and minimize actual losses.

Next Steps

Although there are plenty of reasons to be optimistic about the actual outcomes obtained with the Early Warning Program, underfunding may continue to jeopardize retirement security in the future. The PBGC's financial forecasts are uncertain since there are many external events that can affect pensions, including future economic conditions, investment results, and the legal environment such as court decisions and new laws. These mutable events can: influence current underfunding among insured plans, erode funding, induce bankruptcies among plan sponsors, and affect recoveries from these bankrupt sponsors.

However, as a regulatory agency, the PBGC's biggest challenge remains that of determining the appropriate level risk, i.e., levels of underfunding which represent a significant threat to a company's solvency. The Early Warning Program provides a straightforward performance indicator bu, as cited in the previous section, may fail to capture the more dynamic aspects of corporate transactions as well as the unique character of individual firms.

The PBGC believes that it needs to make the business community more sensitive to pension funding. It will always be easier to face controversial and changing environments when the program is institutionalized, they maintain. For this reason, the PBGC continues to publicize its successes in order to seek greater acceptance from the business community, leading more companies to approach the PBGC when restructuring business transactions. In this respect Martin Slate says:

> "Our challenge is to institutionalize our program. We haven't taken this thing through a full financial cycle, and pension situations can become much more difficult when there is a scarcity of resources. So it is important for us to make sure that the pension matters are part of the culture. That's the biggest challenge."