

To be insurable, a risk must encompass a large number of homogeneous risks, the incidence of loss must be spread randomly over time and probable total losses should be calculable.⁹ Although there are a large number of pension plans it is not clear that the risks associated with each are homogenous. There are distinct differences in the degree of probable loss among plans. This will cause different, although not insurmountable, problems in determining an adequate and equitable premium structure. A much more serious problem, however, is that pension losses, whether either benefits are guaranteed or plan assets are insured, are not likely to be random through time. That is losses would tend to cluster in times of economic stress.

An adequate insurance program where the risks being covered are neither homogenous nor random will almost surely have to depend on Government support. Since risks are not homogenous it will be necessary to require all plans to participate in order to avoid the problem of adverse selection. Even with a premium structure supported by low risk plans, the Government will have to be prepared to finance the plans in case of catastrophic losses.

It is generally agreed that any feasible reinsurance plan would insure liabilities and not assets. However, the question of providing protection against the contingency that assets in the pension fund will decline in value has also been raised. To insure either real or paper assets against value erosion is akin to insuring the value of the assets of all firms in the economy. To insure the assets of all productive enterprises in the economy against dynamic risk is unthinkable since no one could ever determine the potential losses.

One system of insurance based on assets might be an arrangement which discounted assets to reflect the probability of decline in value. For example, assets held in cash or Government securities might be assumed to have no discount. Corporate bonds might have a 5 percent discount, while corporate stocks or real estate might be discounted at 25 percent. The problem of setting the discount should be enough to discourage such a system. But the potential effect of such a system on the capital markets could be unwelcome. The insuring agency would be placed in the position of de facto regulation of investment policy for all pension funds. This is the very antithesis of what a free investment market demands. For this reason, section 402 of the Javits bill, "Pension and Employee Benefit Act of 1967," dealing with foreign securities is too restrictive. Since we find no way of insuring assets we would conclude that if a plan had assets equal to the vested liabilities of the fund, no insurance would be necessary.

We turn now to the question of insuring the liabilities of the plan. As we have just indicated, there is no need to reinsure liabilities which are covered by assets. Thus only unfunded liabilities need be insured. The category "unfunded liabilities" is often vague and includes liabilities which may never have to be paid. Contrast this with the deposit liabilities of commercial banks, and savings and loan associations which are always precisely determinable, and, therefore, more readily insurable. Therefore, it is suggested that the maximum insurance coverage would be confined to unfunded vested liabilities.

⁹ See Dan M. McGill, "Guaranty Fund for Private Pension Obligations," p. 199 in this compendium.