



United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-249864

December 18, 1992

The Honorable Tim Roemer
House of Representatives



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Dear Mr. Roemer:

This letter responds to your February 10, 1992, request that we study the impact of the proposed Pension Restoration Act of 1991 (PRA), H.R. 824, on the financial condition of the Pension Benefit Guaranty Corporation (PBGC). PRA would require PBGC to pay annuities to plan participants--known as pension losers--or their surviving spouses who lost pension benefits because their pension plans terminated prior to passage of the Employee Retirement Income Security Act (ERISA) in 1974. In this letter, we present (1) estimates of the number of pension losers or their surviving spouses, (2) estimates of the amount of annuity payments and administrative costs in H.R. 824, (3) the impact of these expenditures on the financial condition of PBGC, and (4) the difficulties of implementing PRA.

BACKGROUND

Before 1974, the federal government regulation of the operations of the private pension system was minimal; in particular, the government did not specify funding standards and it did not insure pension benefits. As a result, thousands of plan participants lost their benefits when the companies they worked for terminated their underfunded pension plans.¹

In response to these and other problems confronting private pension plans, the Congress passed ERISA in 1974. ERISA established vesting and funding standards as well as reporting and disclosure requirements; the Department of Labor (Labor) and the Internal Revenue Service (IRS) are responsible for oversight. ERISA also created PBGC to insure the payment of benefits for most defined

¹A plan is underfunded when it does not have sufficient assets to pay promised benefits.

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benefit pension plans.² This insurance, however, generally applied only to pension plans in existence after ERISA's passage. Consequently, participants in underfunded plans that terminated before ERISA was enacted were generally not eligible to receive pension benefits from PBGC.

Several legislative attempts have been made to have PBGC provide annuities to these pension losers. A 1991 Senate version of PRA, S. 243, was rejected primarily because of concerns that it would substantially weaken the financial condition of PBGC.

The current PBGC deficit, the present value of its liabilities minus its assets, has grown significantly in recent years, to \$2.3 billion, and is expected to increase further.³ PBGC currently insures about \$40 billion in unfunded liabilities, with \$13 billion of this in plans with financially troubled sponsors.

H.R. 824 provides that qualified participants receive an annuity of up to \$75 for each year of service and qualified spouses receive an annuity of up to \$37.50 for each year of service by the qualified participant. These annuities would be funded by PBGC. As written, H.R. 824 does not have a cap on annuities. Previous versions of PRA proposed limiting the maximum annuity for participants to \$1,500 per year and for qualified spouses to \$750 per year. As agreed with your staff, the annuity cost estimates discussed in this letter reflect these maximums.

RESULTS IN BRIEF

Enacting PRA is estimated by PBGC to cost \$466 million (\$406 million for annuities and \$60 million for administrative expenses). Funding PRA annuities from PBGC resources will further weaken the financial condition of PBGC and might have a detrimental impact on its ability to meet long-term benefit obligations.

²These plans provide a specified monthly benefit at retirement, usually based on salary and years of service. PBGC does not insure individual account plans, public pension plans, professional service employer plans with fewer than 26 active participants, and most church plans.

³Financial Condition of the Pension Benefit Guaranty Corporation (GAO/T-HRD-92-52, Aug. 11, 1992) and Improving the Financial Condition of the Pension Benefit Guaranty Corporation (GAO/T-HRD-92-60, Sept. 25, 1992).

Although the PBGC cash flow projections indicate PBGC should be able to pay PRA annuities for the remainder of this century, these payments will reduce the growth in PBGC assets. PBGC projects its 2001 deficit will increase to \$4.8 billion without PRA annuities and to \$5.7 billion with them. Furthermore, implementation of PRA will be difficult because records of pre-ERISA underfunded pension plans that were terminated, which are needed to process and verify claims, may not be available.

H.R. 824 contains unclear language that may encourage more participants and spouses than intended to apply for and receive benefits. It may also provide larger annuities than intended. Consequently, the ultimate annuity and administrative costs of H.R. 824, with the resulting impact on the financial condition of PBGC, could be greater than the estimates we present.

SCOPE AND METHODOLOGY

The information presented in this letter was obtained through interviews and documents gathered from federal agencies--Labor, IRS, PBGC, and the Social Security Administration (SSA)--and interested groups or individuals--Pension Rights Center; Pension Losers Committee; and Paul Jackson, a retired actuary who has been involved with the pension losers' issue for a number of years.

Information on the number of pension losers was derived from estimates made in a 1979 study for Labor.⁴ PBGC and Mr. Jackson used this study to estimate the number of survivors and the costs, beginning in 1993, of providing PRA benefits to them. We did not assess the methodology and results of the Labor study.

We obtained estimates of the current number of pension losers and the amount of annuity payments from PBGC officials. These estimates assume that (1) only fully vested pension losers identified in the Labor study and their surviving spouses would be eligible for annuities and (2) the annuities were capped at \$1,500 and \$750. We also obtained (1) PBGC forecasts of cash flows and financial condition, based on its 1991 published, but

⁴PRE-ERISA PLAN TERMINATION BENEFIT LOSSES, Hay Associates on contract to Labor (June 15, 1979).

unaudited, financial statements;⁵ (2) estimated costs to administer PRA if it was passed; and (3) the position of PBGC and Labor officials concerning PRA and the reasons for these positions.

With IRS and SSA officials, we explored the availability of information on employment, earnings, and employer-sponsored pension plans for participants whose underfunded pension plans terminated prior to passage of ERISA. Such information could be used to help validate the claims of individual pension losers.

From Mr. Jackson, we obtained estimates of the current number of pension losers and the amount of annuity payments. Like the PBGC estimates, his estimates were based on the Labor study and assumed the same caps on annuities for pension losers and spouses. We also obtained comments on, as well as reasons for, his support of the pension losers and passage of PRA. Our review of Mr. Jackson's calculations revealed an inconsistency that results in a slight understatement in his estimated cost of H.R. 824.

We did our work from May to September 1992. It was done in accordance with generally accepted government auditing standards.

ESTIMATED NUMBER OF PENSION LOSERS

The precise number of participants who lost pension benefits before 1974 is not known. The number who would be entitled to benefits if PRA was passed is also not known. The 1979 Labor study estimated that about 244,000 participants lost benefits when their pension plans terminated, but that only 67,000 were fully vested and survived to 1979. Using the Labor study, Mr. Jackson calculated that in 1992, there would be about 52,000 surviving pension losers and spouses, with 39,000 (25,000 pension losers and 14,000 spouses) immediately eligible for annuity payments since the pension losers were, or would have been, 65 years of age or older. PBGC officials calculated there would be about 47,000 surviving pension losers and spouses, with about 38,000 (24,000 pension losers and 14,000 surviving spouses)

⁵We have never been able to audit the PBGC financial statements. For a discussion of our most recent efforts, see Financial Audit: Pension Benefit Guaranty Corporation's 1991 and 1990 Financial Statements (GAO/AFMD-92-35, Mar. 2, 1992).

immediately eligible for annuity payments at the beginning of 1993.

ESTIMATED COST OF ANNUITIES FOR PENSION LOSERS

A 1993 implementation of PRA, Mr. Jackson estimated, would result in an annuity cost of \$305 million on a present value basis and a first year outlay of about \$42 million. He calculated these annuities using an 8 percent interest rate. He estimated that annuities would be paid well into the next century.

A 1993 implementation of PRA, PBGC officials said, would cost \$406 million for annuities on a present value basis; the first year outlay would be about \$44 million. To calculate the amount of the annuities, PBGC used a combination of interest rates grading down from 6 percent. The difference in interest rates used by Mr. Jackson and PBGC explains about half the difference in their annuity cost calculations.

Our review of the calculations showed an inconsistency in Mr. Jackson's methodology. His methodology assigned spouse benefits to spouses of living participants, and ignored surviving spouses of those who died before 1993. We could not determine if this explained the other half of the difference in the two estimates. We found no inconsistency with the PBGC methodology.

Adoption of PRA, PBGC officials expect, would require additional administrative resources to identify pension losers and surviving spouses and to process their claims. The additional administrative expenses are estimated to be about \$60 million on a present value basis, \$54 million for PBGC's administrative expenses and \$6 million to reimburse SSA in connection with earnings verification. Estimated PBGC outlays for the first year would be about \$12 million.

Annuity payments will decline steadily into the next century. Annual administrative expenses also are expected to decline in a few years after the PRA is enacted.

IMPACT OF PRA ON THE FINANCIAL CONDITION OF PBGC

Implementation of H.R. 824 would have an adverse impact on the financial condition of the PBGC (see enclosure I for our review of key elements in H.R. 824). The act would immediately increase PBGC's liabilities by an estimated \$406 million--the amount of the PBGC annuity estimate. This is an 18 percent increase in the 1991

PBGC deficit of \$2.3 billion. This increase would hamper PBGC's efforts to strengthen its financial condition.

In the short term, PBGC projects that even though its net cash flow is expected to decline through the rest of this century, it should be sufficient to pay PRA annuities.⁶ For example, PBGC expects to have a net cash flow of \$771 million in 1993, excluding any payment of PRA annuities. If PRA is enacted, the annuity payments would reduce this net cash flow by \$44 million, thereby reducing the growth in PBGC assets.

Over the long term, PRA will have a negative impact on the PBGC financial condition, PBGC officials stated. Without the inclusion of PRA, PBGC forecasts that its deficit will increase to \$4.8 billion by 2001.⁷ With PRA, however, the 2001 deficit will increase to an estimated \$5.7 billion.

H.R. 824 specifies that annuity payments and other expenses will be paid from the PBGC revolving and trust funds authorized by ERISA. This will cause PBGC's assets to be consumed faster than would otherwise be the case. Eventually, current and future plan sponsors will have to cover the cost of PRA through higher premium payments, or the Congress will need to supplement shortages in the PBGC funds with tax revenues.

Supporters of PRA, however, believe that PBGC has sufficient resources to pay for and administer the program. Further, many supporters believe the U. S. government has a moral obligation to the pension losers--ERISA was passed, in large part, because of the pension benefit losses suffered by pension losers when their plans terminated. Indeed, supporters argue that pension losers should have been covered by ERISA's provisions establishing the PBGC.

⁶The PBGC cash flow consists of its revenue (premium income, investment income, assets from newly terminated plans, and recoveries from plan sponsors) and its expenditures (benefit payments, as well as administrative and other expenses). Net cash flow is the difference in these two items.

⁷This is a mid-level projection by PBGC for the combined single-employer and multiemployer guaranty programs. The most pessimistic PBGC projection, which it states is not a worst case estimate, predicts its 2001 deficit could increase to \$17.9 billion for the single employer program alone.

If enacted, PRA should not be funded from premium income, PBGC officials believe, or from pension assets it holds in trust. These assets support the insurance program and are intended for pension plan participants covered by ERISA. Officials say the use of these assets for pension losers would jeopardize the insurance program. Any pre-ERISA annuities, officials believe, should be funded by a separate congressional appropriation and a separate organization should be tasked with administration of the program.

We are concerned that funding PRA annuities from PBGC resources would further weaken the PBGC financial condition. The PBGC deficit is expected to increase substantially during the next decade, as a result of probable terminations of plans with large unfunded liabilities. Requiring PBGC to pay PRA benefits would only increase its deficit and might impair its ability to pay insured benefits at some point in the future.

DIFFICULTIES OF IMPLEMENTING PRA

Implementation of PRA will be difficult. The records needed--to establish that a pension loser participated in a plan and to verify both the number of years of credited services he or she earned and the amount of benefits already received--may be unavailable from individuals, terminated plans, or others.

In order to process and verify each PRA claim, the following information would be needed: (1) earnings or employment records; (2) records of participation and vesting in an employer's pre-ERISA underfunded pension plan that was terminated; (3) record of benefits received, if any, either at plan termination or as an annuity; and (4) evidence that a spouse is entitled to pension benefits.

Once a claim has been filed, PBGC will have difficulty verifying eligible participants, obtaining information on pre-ERISA plans, and determining whether an applicant is qualified for a benefit. Currently, PBGC has no information on individual pension losers. PBGC suspects that the records of many plans that terminated before ERISA was passed may no longer exist, making it difficult to determine eligibility and correct annuity amounts. Our work indicates this suspicion may be well founded.

SSA has records that can be used to verify employment of the pension losers, SSA officials said, and to determine the number of years worked for each employer. This information can be made available on a reimbursable basis

and may cost about \$6 million for 40,000 pension losers. The cost of providing this information is high, according to SSA officials, because the data would be obtained manually since it is on microfilm. The cost would increase if substantially more people file claims and/or if SSA would need to hire additional staff to respond to this request. SSA recommended that a pilot study of 500 to 1,000 cases be done to better determine the availability of earnings information, as well as the time and cost of obtaining such data.

SSA does not have any information on pre-ERISA pension plans. Because of this, SSA will be unable to verify whether a person's claiming to be a pension loser either participated in or was vested in a pension plan at its termination.

IRS does not maintain information on pension plans that terminated before 1974, IRS officials said. At our request, they checked the federal records center for the availability of files on four pre-ERISA terminated plans and found that no records for these four plans were available. The center policy, IRS officials said, is to destroy records over 10 years old.

Labor information on pre-ERISA terminated pension plans had also been destroyed, according to Labor officials.

It will be difficult for many pension losers or their surviving spouses to prove they are eligible for a PRA annuity because requisite plan records are not available from federal sources and because the plans, and perhaps the sponsors, have been out of existence 20 years or more. If rigid entitlement standards are applied, many eligible pension losers may never receive their annuities because they will be unable to provide the necessary support for their claims. Unqualified persons could be declared eligible, however, if entitlement standards are relaxed.

CONCLUSION

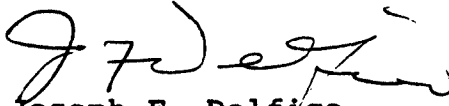
Enactment of PRA with a start date of 1993 is estimated to cost \$406 million for annuities and an additional \$60 million for administrative expenses in present value terms. These estimates assume that only those who lost benefits when their underfunded pension plans terminated will receive annuities. PBGC estimates it will have sufficient funds in the near future to pay initial PRA expenditures--annuities estimated, in 1993, to be \$44 million and administrative expenses estimated to be over \$12 million. Having PBGC fund PRA would increase the

Corporation's deficit immediately. PBGC expects that its deficit, without PRA, will increase from \$2.3 billion in 1991 to \$4.8 billion by 2001. The PBGC deficit already raises concerns about its ability to meet its long-term benefit obligations.

For some time, we have been concerned with the financial condition of PBGC and with the looming potential claims from underfunded plans of financially troubled sponsors that PBGC expects to receive. Enactment of H.R. 824, with the requirement that funding come from PBGC resources, will further weaken the financial condition of PBGC and might threaten its ability to pay benefits in the future.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this letter for 30 days. At that time, it will be made available on request. If you have any questions, please call me on (202) 512-7215.

Sincerely yours,



Joseph F. Delfico
Director, Income Security Issues

KEY ELEMENTS AND REVIEW OF H.R. 824

Under H.R. 824, qualified participants, those whose pension plans terminated before ERISA was passed in 1974, would receive an annual payment of \$75 for each year of service under a plan. This amount could be reduced under specific circumstances. Under the plan, qualified spouses (widows and widowers of qualified participants) would receive an annual payment of \$37.50 for each year of service by the qualified participant. This amount could also be reduced under specific circumstances. To qualify for these annuities, pension losers must be at least 65 years old and must have been vested in the pension plan at its termination.

The annuity cost estimates in this letter were made using two assumptions not specified in H.R. 824--first, a \$1,500 cap on annuities for participants and a \$750 cap for surviving spouses and, second, that annuities would only go to those who lost some or all their benefits when their underfunded plans were terminated. These assumptions may lead to an underestimate of the true costs to PBGC of H.R. 824 for the following reasons.

First, the absence of a cap on annuity amounts (or, equivalently, the absence of a 20-year cap on years of creditable service) means long-service participants, and their surviving spouses, would be eligible for larger annuities than those upon which the reported cost estimates were based.

Second, H.R. 824 specifies that, to be qualified, a vested participant had to be in a pension plan that terminated before ERISA was enacted, not that the plan had to be underfunded or that the participant had to lose some or all of his or her benefits. Thus, vested participants of any plan that terminated before September 1, 1974, and their surviving spouses, could be eligible for annuities under PRA. In addition, the H.R. 824 provisions concerning reductions in annuity amounts are ambiguous and could be interpreted to allow the payment of annuities to participants who had received, or were receiving, all pension benefits to which they were entitled. Further, H.R. 824 would only reduce surviving spouse annuities for plan payments made to the surviving spouse and not for plan payments to the participant. Thus, all widows and widowers of participants who did not select a joint and survivor benefit option could be eligible for annuities, even if the participant had

received all pension benefits to which he or she was entitled. These features of H.R. 824 could result in a larger population of eligible participants and larger potential costs to PBGC than reported in our letter.

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