BY THE COMPTROLLER GENERAL

Report To The Congress

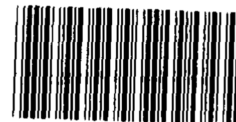
OF THE UNITED STATES

Legislative Changes Needed To Financially Strengthen Single Employer Pension Plan Insurance Program

The federal insurance program for single employer (sponsor) pension plans administered by the Pension Benefit Guaranty Corporation was created by the Employee Retirement Income Security Act of 1974. At the end of fiscal year 1982, the program reported a $333 million deficit because claims from terminating plans accumulated faster than they could be financed from premiums. The Corporation estimates that unless premiums are increased this deficit could increase to an estimated $938 million by fiscal year 1987.

Claims result primarily from bankrupt sponsors who are unable to continue funding pension plans. However, other circumstances also contribute to the increasing deficit: (1) full insurance coverage is generally provided for benefits granted retroactively for past service that have received limited sponsor funding; (2) minimum plan contributions by sponsors are deferred with Internal Revenue Service approval and remain unpaid upon plan termination; and (3) authority to recover unfunded pension liability for plans from sponsors is limited.

This report contains recommendations to the Congress to financially strengthen the program.



GAO/HRD-84-5
NOVEMBER 14, 1983

027127

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

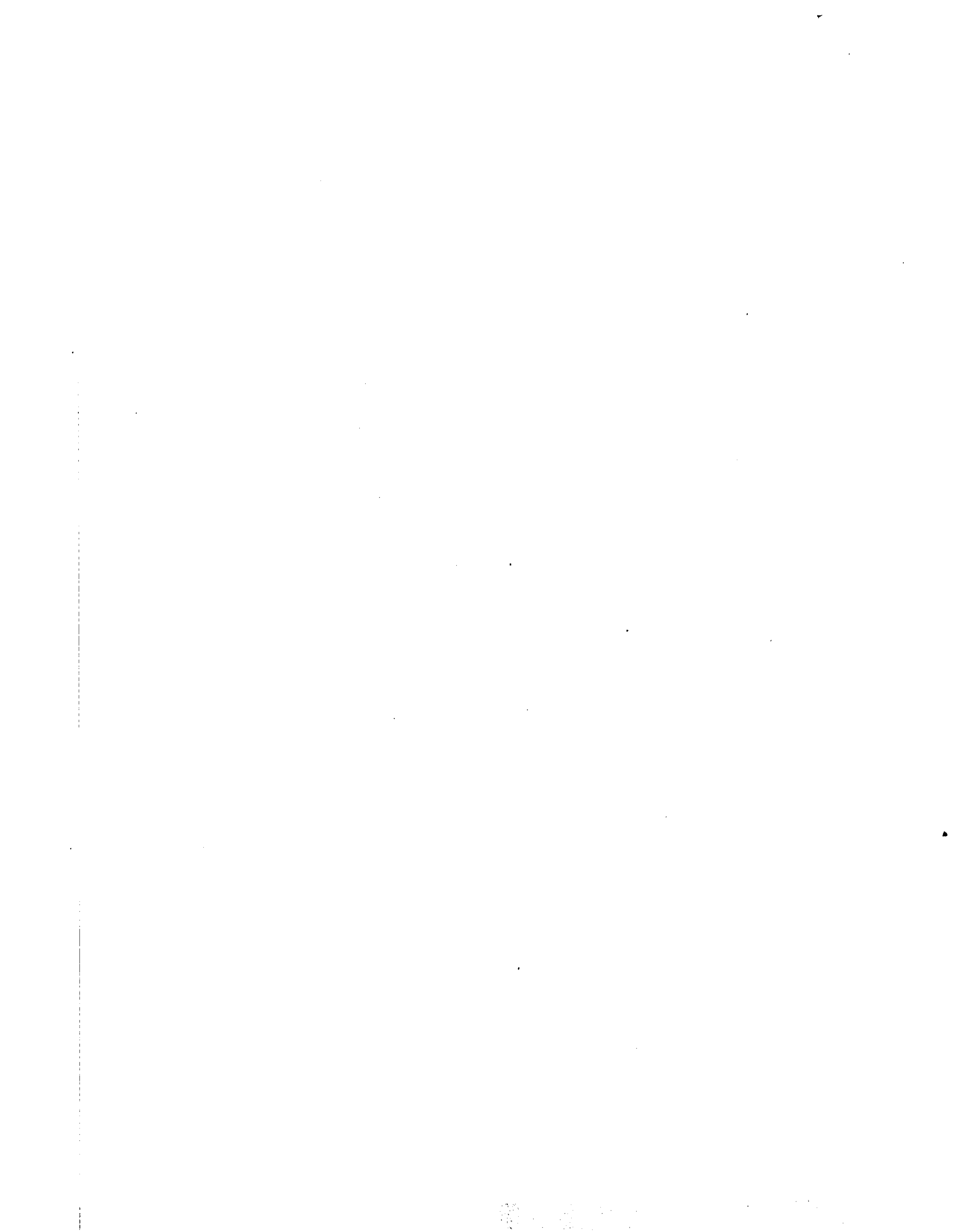
B-206935

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses legislative changes needed to financially strengthen the Pension Benefit Guaranty Corporation's insurance program for private pension plans sponsored by individual employers. We made the review because of congressional and public concern about the program's financial condition, the accelerated level of insurance claims, and the large proposed increase in the program's premium rate. In the report we are recommending that the Congress amend the Employee Retirement Income Security Act of 1974 to improve the Corporation's recovery of unfunded pension plan liabilities from employers that terminate their plans. We are also suggesting that the Congress consider strengthening the act's provisions for establishing the insurance program's premium rate, the level of benefits insured, and pension plan funding requirements.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Labor; the Commissioner of Internal Revenue; the Board of Directors and the Executive Director of the Pension Benefit Guaranty Corporation; and other interested parties.

Charles A. Bowsher
Comptroller General
of the United States



COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

LEGISLATIVE CHANGES NEEDED TO FINANCIALLY STRENGTHEN SINGLE EMPLOYER PENSION PLAN INSURANCE PROGRAM

D I G E S T

The Pension Benefit Guaranty Corporation (PBGC), established by the Employee Retirement Income Security Act of 1974 (ERISA), administers a self-financing insurance program to protect the benefits of about 29 million participants in 106,000 private pension plans. These plans are sponsored by individual employers. PBGC pays guaranteed benefits for plans that terminate with insufficient assets.

PBGC's single employer termination insurance program is financed primarily from premiums paid by ongoing plans, based on the number of plan participants. The annual premium rate, originally set at $1.00 per plan participant in 1974, was raised to $2.60 by the Congress in 1978. A further rate increase to $6.00 requested by PBGC in May 1982 is under congressional consideration.

PURPOSE OF REVIEW

GAO made its review because of growing public and congressional concern about the program's financial condition, the accelerated level of claims, and the large proposed premium rate increase. The review included examining information on 683 of 783 pension plans terminated as of September 30, 1981, that were trusteed or expected to be trusteed by PBGC. GAO also analyzed in depth 38 selected plan terminations.

FINDINGS

Since its inception, the single employer insurance program has been operating at an increasing deficit. The deficit--the difference between program liabilities for guaranteed benefits and assets necessary to pay for them--has risen because net claims for benefits owed by terminating plans accumulated in greater amounts than could be financed by premiums. Liquidity of the insurance program has not become jeopardized thus far because assets of terminated plans that PBGC has

taken over and premiums collected have been sufficient to maintain payments to participants in the short term. However, if the premium rate is not raised, this deficit could continue to grow, threatening the program's ability to pay guaranteed benefits in the long term.

The deficit is aggravated by the following circumstances: (1) full insurance coverage is generally provided for benefits granted retroactively for past service that have received limited sponsor funding, (2) sponsors' minimum plan contributions to fund benefits are deferred with Internal Revenue Service (IRS) approval and remain unpaid upon plan termination, and (3) PBGC has limited authority to recover unfunded pension liability from terminating sponsors. To alleviate these circumstances, the Congress would have to amend ERISA.

Growing deficit weakens the program's financial condition

Unless the Congress approves a premium rate increase, the program's deficit--which PBGC reported to be $41 million as of September 30, 1976, $189 million by the end of fiscal year 1981, and $333 million a year later--could grow to an estimated $938 million by the end of fiscal year 1987.

Under ERISA's self-financing provision the insurance program could operate for a number of years without a premium rate increase because terminated plans generally have sufficient assets to pay benefits for a time after termination. While a premium increase could be avoided for many years, a substantially larger increase than the $6.00 premium rate would ultimately be needed if the current rate increase request is not granted.

GAO believes that PBGC's proposed $6.00 premium rate is reasonable and necessary to reduce the deficit at this time. The $6.00 rate could retire the $333 million deficit in 8 years. Also, premiums provide the primary means to finance net claims of terminating plans, and PBGC has not acted on past premium rate studies indicating needed increases. GAO believes that PBGC should act in a more timely manner to advise the Congress of changes needed in its premium rate. (See pp. 7 to 18.)

Liabilities for unfunded past service benefits can increase claims against the program

ERISA allows sponsors 30 to 40 years to make payments (contributions) for unfunded pension obligations for participants' past service. Forty years is permitted for funding obligations that existed at the inception of ERISA and 30 years for obligations created since ERISA's enactment. ERISA provides that the insurance program must fully guarantee benefits after a 5-year phase-in period.

Claims against the insurance program can be increased because benefits are fully guaranteed after a relatively short period, as compared to the period permitted for sponsors to fund the plans. Resulting differences are financed by insurance premiums collected from ongoing plans.

One or more of the following conditions that can increase such claims were present in plans GAO reviewed.

--Contributions for unfunded past service liabilities were being made over the longest periods permitted under ERISA (30 or 40 years).

--Contributions had not been made for one or more plan years before plan termination.

--The plan was created or amended extending benefits for past service and then terminated within a few years.

The median life of 683 plans that have terminated with claims against the insurance program was 11 years. Hence, the time available under ERISA's 30- or 40-year minimum standards to fund liabilities for past service benefits was limited for many plans. (See pp. 20 to 31.)

Contributions deferred for terminating plans can result in higher claims against the program

ERISA amended the Internal Revenue Code to require sponsors to meet minimum funding standards for annual contributions to pension plans and set

limits for the amount of contributions that can be deducted for federal income tax purposes.

ERISA permits IRS to approve the waiver of sponsor minimum contributions to the plan during periods of business hardship. As of April 30, 1982, IRS had reported to PBGC requests for waiver of over $400 million in contributions owed by 111 plan sponsors that IRS later approved. To the extent that these sponsors can overcome periods of financial hardship and do not terminate pension plans, PBGC benefits. However, eight sponsors who received $40.4 million in funding waivers later terminated their plans with unpaid amounts remaining to be funded by the insurance program. Because conditions imposed by IRS in granting minimum funding waivers do not effectively protect the program against later exposure to underfunding at plan termination, future claims against the program could increase.

In evaluating the effect of waivers IRS granted to 16 plan sponsors, GAO found that the program had incurred or could incur higher claims because (1) PBGC may lack authority to recover waived amounts, (2) PBGC's recoveries may be reduced because sponsor resources are low, and (3) benefits can be increased during periods when waivers are outstanding. (See pp. 33 to 41.)

PBGC authority limited in recovering unfunded liability from terminating plan sponsors

ERISA employer liability provisions limit recovery of unfunded pension obligations from sponsors terminating pension plans. For the first 7 years of operation, the insurance program expected to recover an estimated $60 million of employer liability in support of $397 million in claims for underfunded plans.

When a plan terminates, ERISA obligates the sponsor to finance any deficiency in plan assets needed to meet guaranteed levels. The sponsor's liability is, however, limited to 30 percent of the sponsor's net worth (the difference between business assets and liabilities at a particular point in time). This was expected both to deter solvent sponsors from terminating underfunded

plans and to produce a reasonable recovery of liability from ongoing sponsors. These objectives are not being met.

GAO's review of terminated pension plans showed that PBGC's recovery from plan sponsors was limited because (1) 30 percent of net worth was not sufficient to pay unfunded pension plan liability for sponsors that continued in business; (2) contingent liabilities could not be established against companies that divested portions of their business, including underfunded pension plans terminated later by financially weak sponsors; and (3) it was precluded from sharing in the distribution of insolvent sponsors' assets to unsecured creditors because many sponsors did not have positive net worth. (See pp. 42 to 53.)

MATTERS THE CONGRESS SHOULD CONSIDER

The Congress, to minimize the need for future premium rate increases beyond the proposed $6.00 increase, could amend ERISA to

--reduce the time period over which sponsors can fund liabilities for past service benefits or establish more stringent funding requirements for plans whose funding levels drop below a certain minimum, and/or

--extend the 5-year guarantee phase-in period for providing full insurance coverage of past service benefits and/or eliminate coverage during the phase-in period. (See p. 31.)

The Congress could also amend ERISA to provide for more timely adjustment of premium rates. Two mutually exclusive options are available:

--Require PBGC to provide information in its annual report to the Congress on the adequacy of the existing premium rate and to recommend changes in the rate when warranted.

--Provide a method for automatically adjusting the premium rate annually based on insurance program experience. (See p. 18.)

GAO is also making several suggestions to reduce the impact of the IRS minimum funding waiver process on the pension insurance program. (See p. 41.)

Other actions can be taken to improve the program's financial condition. GAO recommends that the Congress amend ERISA to provide that sponsors that remain in business after terminating pension plans continue to be liable for payment over time of the plan's asset insufficiencies. Collections under such authority should be made by PBGC considering the best interests of employees, employers, and the insurance program. GAO further recommends that PBGC be authorized to

--claim, as an unsecured creditor instead of claiming a portion of the sponsor's net worth, the full amount of plan asset insufficiency from a sponsor discontinuing business that terminates a plan and

--hold, for a limited time, all prior contributing sponsors secondarily liable for certain plan asset insufficiencies. (See p. 53.)

AGENCY COMMENTS

PBGC supports GAO's findings on the need for increased premiums and legislative changes. PBGC's detailed comments and its observations on the specific application of some of GAO's recommendations are discussed in the report. (See pp. 18, 32, 41, and 53.)

Labor agreed with GAO on the need for legislation to protect the financial soundness of PBGC. In Labor's view, while the recommendations of an administration Task Force on Single Employer Termination Insurance Legislation are slightly different, the goals of GAO's proposals are consistent with those of the administration. IRS stated that it did not oppose adoption of GAO's recommendations. (See p. 18.)

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Background	1
	Objectives, scope, and methodology	3
2	GROWING DEFICIT WEAKENS FINANCIAL CONDITION OF THE INSURANCE PROGRAM	7
	Size and nature of claims	8
	Recovery of unfunded liability from terminating plan sponsors	10
	Premium increase necessary to reduce deficit	13
	Conclusions	17
	Matters for consideration by the Congress	18
	Agency comments	18
3	LIABILITIES FOR UNFUNDED PAST SERVICE BENEFITS CAN INCREASE CLAIMS AGAINST THE INSURANCE PROGRAM	20
	Pension plan funding standards and insurance program guarantees	21
	Impact of liabilities for unfunded past service benefits on the insurance program	24
	Conclusions	30
	Matters for consideration by the Congress	31
	Agency comments and our evaluation	32
4	CONTRIBUTIONS DEFERRED FOR TERMINATING PLANS CAN RESULT IN HIGHER CLAIMS AGAINST THE INSURANCE PROGRAM	33
	PBGC may lack authority to recover waived contributions when plans terminate	34
	Low sponsor resources reduce PBGC recoveries	36
	Sponsors increase benefits after contributions are waived	37
	Conclusions	39
	Matters for consideration by the Congress	41
	Agency comments and our evaluation	41
5	PBGC AUTHORITY LIMITED IN RECOVERING UNFUNDED LIABILITY FROM TERMINATING PLAN SPONSORS	42
	Limitations on recovery of employer liability from ongoing sponsors	43

Page

CHAPTER

Limited increase in recovery of unfunded pension liability attainable in bankruptcy and business liquidation 44

Transfer of unfunded pension liabilities through business divestment can increase insurance program costs 47

Conclusions 52

Recommendations to the Congress 53

Agency comments and our evaluation 53

APPENDIX

I Glossary 55

II The priority order of claims in bankruptcy proceedings 59

III GAO comments on S. 1227 61

IV Letter dated September 13, 1983, from the Executive Director, PBGC 65

V Letter dated September 1, 1983, from the Commissioner of Internal Revenue 69

VI Letter dated September 21, 1983, from the Deputy Assistant Secretary for Labor Management Relations, Department of Labor 70

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act of 1974
GAO	General Accounting Office
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation

CHAPTER 1

INTRODUCTION

Private pension plans are a major factor in the security of millions of American workers and their dependents. Before the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1001 et seq.), when plans terminated without sufficient assets to pay benefits due participants, long-time employees and their beneficiaries often lost all or a portion of their earned retirement benefits.

To better protect plan participants, ERISA established, among other things, (1) the Pension Benefit Guaranty Corporation (PBGC), a new government entity, to insure certain benefits of participants in defined benefit plans[1] and (2) minimum funding standards for these plans. PBGC administers two self-financing insurance programs--a plan termination insurance program for single employer defined benefit pension plans[2] and an insolvency insurance program for multiemployer defined benefit plans.

This report focuses on the impact on the financial condition of the single employer insurance program's growing deficit resulting from terminated plans that are underfunded. This program provides insurance protection for about 29 million participants in 106,000 private defined benefit pension plans.

BACKGROUND

Sponsors often create pension plans for their employees many years after starting in business and include past years of service in computing pension benefits. In these situations, a sponsor may create a large unfunded actuarial liability before being required to make any contributions to the plan. Before enactment of ERISA, if a plan was terminated, the plan sponsor was not legally required to guarantee the payment of promised pension benefits.

----

[1]Defined benefit pension plans generally provide definitely determinable benefits to participants based on such factors as years of employment, retirement age, and compensation received. Other technical terms used throughout this report are defined in appendix I.

[2]A single employer plan is established and contributed to by one employer or employer association.

Under ERISA, PBGC's single employer insurance program is intended to encourage the continuation and maintenance of private pension plans, provide for the timely and uninterrupted payment of pension benefits, and maintain insurance premiums charged to pension plans at the lowest possible level. A board of directors consisting of the Secretaries of Labor, Commerce, and the Treasury was established under ERISA to govern PBGC. PBGC's day-to-day operations have been delegated by the board to an executive director.

PBGC finances the single employer termination insurance program from terminated plan assets, collection of liabilities owed by sponsoring employers of terminated plans, premiums collected from ongoing pension plans, and investment income. Premiums are collected annually from plans based on the number of plan participants. The annual premium rate was originally set at $1.00 per participant with the enactment of ERISA in 1974. The Congress later amended ERISA to increase the rate to $2.60 effective January 1, 1978. A rate increase to $6.00 requested by PBGC in May 1982 is under congressional consideration.

ERISA provided that the insurance program shall guarantee pension benefits, subject to certain limitations, that had vested before plan termination. ERISA also amended section 412 of the Internal Revenue Code to require plan sponsors to meet minimum funding standards for annual contributions. ERISA provided that unfunded actuarial liabilities of plans in existence on January 1, 1974, could be funded over 40 years and unfunded actuarial liabilities created for plans established or amended in the future could be funded over 30 years. Although there is generally no maximum limit on the amount that an employer may contribute to a pension plan over time, ERISA amended the Internal Revenue Code to provide that annual contributions that an employer can deduct for federal income tax purposes may not exceed the lesser of the amount required to

--fund the plan's normal cost plus unfunded actuarial liabilities in equal dollar amounts over 10 years or

--bring the plan to a full funding status.[3]

Both the level of the plan funding and the amount of guarantees were expected to play an important role in maintaining the insurance program's financial stability.

---

[3]A pension plan is in full funding status when its assets equal or exceed its actuarial liability.

Under ERISA the administrator of a terminating pension plan must notify PBGC at least 10 days before the proposed date of termination and give PBGC information so it can determine whether plan assets are sufficient to pay the guaranteed benefits. When assets are sufficient, PBGC authorizes distribution of them to eligible participants based on plan provisions and applicable requirements of ERISA. As of September 30, 1981, PBGC had received about 37,400 plan terminations, of which 36,700 (98 percent) had sufficient assets to pay guaranteed benefits.

For the approximately 700 terminating plans that did not have sufficient assets, PBGC initiated action to become the plans' trustee. As trustee, PBGC has a role similar to that of a plan administrator, in that it has complete responsibility for the plan's management--including assuring that benefits are paid to participants when due and plan assets are adequately invested. As trustee PBGC or its agents maintain plan records, process applications for retirement, issue checks, and answer participants' and beneficiaries' questions. PBGC can collect up to 30 percent of the sponsoring employer's net worth[4] to make up part or all of the plan asset insufficiency. PBGC generally audits the plan assets and sponsoring employer's net worth to determine the extent of the insurance program's liability to participants for guaranteed benefits. ERISA provides two general ceilings, the lower of which limits participants' monthly benefits guaranteed by PBGC. (See p. 23.)

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was undertaken because of growing public and congressional concern over the financial condition of the insurance program for single employer pension plans, the accelerated level of claims, and the substantial proposed increase in premiums.

To identify alternatives for maintaining premium rates at the lowest possible level and improving the insurance program's financial condition, we initiated a study of ERISA program provisions and PBGC procedures and policies. Our study was

---

[4]Employer net worth is generally the difference between the value of business assets and liabilities accumulated at a point in time. For the insurance program, PBGC determines net worth on a basis that best reflects, in its judgment, the economic value of the sponsor's assets and liabilities.

designed to analyze the impact of past and prospective claims[5] on the program's financial condition under ERISA provisions governing the level of

--assets available in private pension plans that terminate,

--plan sponsor liability that can be recovered, and

--benefits guaranteed to plan participants.

We also assessed PBGC's request for a premium rate increase and analyzed several congressional bills that were designed to amend the insurance program. Our work was performed in accordance with generally accepted government auditing standards.

We obtained a wide range of information during 1982 from PBGC's records on 683 of the 783 pension plans terminated as of September 30, 1981, that were trusteed or expected to be trusteed by PBGC.[6] We divided the universe of 683 plans into strata representing (1) four sponsor financial conditions (ongoing, out-of-business, bankruptcy liquidation,[7] and bankruptcy reorganization),[8] (2) funding level at termination, (3) plan age, and (4) level of net claims against the insurance program. From these strata, we selected 36 plans terminated by 23 sponsoring employers: plans of 17 sponsors were judgmentally selected and plans of 6 other sponsors were randomly selected to complete plan review coverage. Although not designed to obtain statistically projectable results, the selection process used, in our opinion, replicates known conditions of the terminated plans that resulted in claims aggravating the insurance program's deficit.

---

[5]The term "claim," as used in this report and defined in the glossary, has the same meaning as plan asset insufficiency.

[6]In our review we excluded 88 plans trusteed by PBGC to ensure continuity of benefits even though plans were sufficiently funded and 12 insufficient plans trusteed during a pre-ERISA period.

[7]Bankruptcy liquidation refers to provisions of chapter 7 of the Bankruptcy Code in which the assets of a business are liquidated to pay the debts of the business.

[8]Bankruptcy reorganization refers to chapter 11 of the Bankruptcy Code, which allows a debtor business to restructure its finances so that it may continue to operate, provide its employees with jobs, and pay its creditors.

Using these data updated for 1982 experience, we analyzed the level and composition of PBGC claims experience and identified conditions affecting the level of claims. To assess special circumstances surrounding the collection of employer liability, we added two plans of two other sponsors that were proposed for termination before September 30, 1981, but not accepted for termination and trusteed by PBGC until 1982. We reviewed the 38 plan terminations to analyze, in more depth, conditions having a major impact on the level of net claims[9] against the insurance program. Our analyses of the two plans accepted for termination in 1982 were limited to issues relating to employer liability.

To review the impact of minimum pension plan funding standards on the termination insurance program, we evaluated how these standards were applied by the 23 sponsors of 36 plans we selected from PBGC's termination inventory as of September 30, 1981. We also obtained information from the Internal Revenue Service (IRS) and PBGC concerning the processing of employer requests for waiver (deferral) of contributions otherwise required by ERISA's minimum funding standards. As of April 30, 1982, IRS had reported to PBGC requests for waivers of over $400 million in contributions owed by 111 plan sponsors which it later approved.

To analyze the impact of such waivers on claims against the insurance program, we reviewed requests by 16 of the 111 sponsors included in this universe. These waivers were selected based on the size of the actual or potential impact on the trust fund. Eight of the 16 sponsors had terminated pension plans as of September 30, 1982, that were trusteed or expected to be trusteed by PBGC. Two of the eight sponsors were also included in our review of minimum pension plan funding standards. The other eight had not terminated plans but were being monitored by PBGC because of the financial condition of their businesses and the magnitude of pension plan asset insufficiency that could potentially fall on the insurance program.

In analyzing PBGC's May 1982 request for a premium rate increase, GAO actuaries used PBGC's methodology, making certain adjustments to past experience to put the data on a uniform, projectable basis. The actuaries then calculated the rate based on two experience bases--all 7 years of PBGC experience under ERISA and the last 4 years of experience based on the premise

---

[9]Net claims refers to the remaining claim against the insurance program after the amount of employer liability recoverable from the terminating sponsor is deducted.

that the first 3 years of experience after ERISA may be considered atypical. The actuaries' analyses of the premium rate increase request were limited to conditions in effect when PBGC's May 1982 rate study was performed and were based on a limited review of how PBGC estimated the premium rate increase, and not on a detailed review of the reliability and accuracy of the data on which the rate increase was based. Except for the proposed $6.00 premium rate increase, the impact on the program's deficit of pending legislation amending the single employer provisions of ERISA governing PBGC pension plan liability assumptions was not in the scope of our study.

CHAPTER 2

GROWING DEFICIT WEAKENS FINANCIAL

CONDITION OF THE INSURANCE PROGRAM

Since its inception the single employer insurance program has been operated by PBGC at a deficit because net claims for insufficient terminating plans have accumulated in greater amounts than could be financed through premium collections.[1] At the end of PBGC's first 25 months of operation on September 30, 1976, its financial statements reported that the program had accumulated a $41 million funding deficit. PBGC's reported deficit had increased to $189 million by fiscal year 1981 and to $333 million a year later.[2] PBGC estimates that the deficit could increase to $938 million by the end of fiscal year 1987 if its requested annual premium rate increase from $2.60 to $6.00 per participant is not granted by the Congress. Based on our assessment we believe that the $6.00 rate is the lowest level that should be provided.

Liquidity of the insurance program has not become jeopardized thus far because the assets of terminated plans that PBGC has trusteed and premiums collected have been sufficient to pay

---

[1]The deficit, which is instrumental in establishing the premium rate required by PBGC to meet its obligations, reflects the difference between the present value of guaranteed benefits of insufficient terminated plans ($1.138 billion) and PBGC's total assets ($834.8 million). Our most recent evaluation of PBGC's financial statements disclosed material accounting and estimating problems, internal control weaknesses, and major uncertainties that significantly reduce the reliability of important account balances. Accordingly, we were unable to determine the reasonableness of PBGC's reported deficit. (See our report, "Disclaimer of Opinion on the Financial Statements of the Pension Benefit Guaranty Corporation for the Fiscal Year Ended September 30, 1980," GAO/AFMD-82-42, June 23, 1982.) However, while uncertainty may exist as to the precision of the deficit for financial statement reporting purposes, the unfunded guaranteed benefits attributable to plans terminated at the time of PBGC's premium study and the additional guarantees resulting from subsequently terminated plans show the need for additional funds to pay guaranteed benefits.

[2]Although final data were not available on PBGC's claims and deficit, PBGC officials told us in October 1983 that the program's deficit was expected to exceed $333 million as of September 30, 1983.

benefits and the program's administrative costs in the short term. However, because of the existing and anticipated increases in the program's deficit, the present premium together with terminated plans' assets are not expected to produce sufficient revenues to meet PBGC's long-term liabilities. The following sections describe the level of claims, plan insufficiency recovery experienced by the program, and our assessment of PBGC's premium rate increase request.

SIZE AND NATURE OF CLAIMS

During the insurance program's first 7 years of operation, $397 million in claims resulted from the termination of 683 plans that lacked sufficient assets to pay guaranteed benefits. Sixty-seven of these plans each had claims of $1 million or more that accounted for about $321 million (or 81 percent) of the program's $397 million total claims and $288 million (or 85 percent) of the $337 million of net claims (see table 1).

The net claims that will be financed from premiums totaled about half of the present value of benefits guaranteed by the insurance program. Premiums will be used to finance 65 percent of guaranteed benefits for the 67 plans with a claim greater than $1 million, compared to 24 percent for the 616 plans with a claim less than $1 million.

In addition to a low recovery of employer liability, assets were sufficient to pay only 39 percent of the guaranteed benefits. The assets available to pay guaranteed benefits were only 28 percent for plans with a claim exceeding $1 million, but were 62 percent for plans with a claim less than $1 million, as shown in table 1 below.

Table 1

PBGC Exposure by Size of Claim as of September 30, 1981

	Claim of $1 million or more		Claim less than $1 million		Total	
	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits
	(67 plans)		(616 plans)		(683 plans)	
Present value of guaranteed benefits	$446	100	$202	100	$648	100
Less: Plan assets at termination	125	28	126	62	251	39
Equals: Claims against insurance program	$321	72	$ 76	38	$397	61
Less: Employer liability recovered or expected to be recovered	33	7	27	14	60	9
Equals: Net claims against insurance program	$288	65	$ 49	24	$337	52

From fiscal year 1979 to 1981 the number of claims exceeding $1 million increased (due primarily to bankruptcy), as shown in table 2. The 67 claims averaged about $4.8 million, and the largest from one plan was about $34.8 million. In contrast, the average claim less than $1 million was about $123,000.

Table 2

Claims Experience of the Single Employer Pension Plan Insurance Program

Fiscal year	Claim of $1 million or more: Number	Claim of $1 million or more: Amount in millions	Claim less than $1 million: Number	Claim less than $1 million: Amount in millions	Total claims: Number	Total claims: Amount in millions
1975	6	$ 24	95	$12	101	$ 36
1976	7	26	111	15	118	41
1977	5	21	105	11	110	32
1978	15	71	81	10	96	81
1979	8	48	68	5	76	53
1980	12	62	72	10	84	72
1981	14	69	84	13	98	82
Total	67	$ 321	616	$76	683	$397

RECOVERY OF UNFUNDED LIABILITY FROM TERMINATING PLAN SPONSORS

The financial operating condition of the sponsors of the 683 terminated plans can generally be classified as ongoing-in-business, out-of-business outside of federal bankruptcy law, or liquidation or reorganization within federal bankruptcy law. Our analysis of PBGC's records of data in table 3 for the 683 plans shows that about 82 percent of the net claims result from plans terminated by sponsors involved in federal bankruptcy proceedings as contrasted with about 18 percent for all other sponsors. For the 224 plans whose sponsors were in bankruptcy liquidation or reorganization proceedings, PBGC's insurance program must finance 60 and 68 percent, respectively, of the benefits the program guarantees, as contrasted with 16 and 37 percent, respectively, for plan terminations by ongoing sponsors and sponsors discontinuing business outside the federal bankruptcy court. The low level of recovery for employer liability after plan termination results in heavy reliance on premium revenue to pay guaranteed benefits for these plans, as shown in table 3.

PBGC has recovered or expects to recover $60 million in employer liability, or 15 percent of the $397 million in claims against the insurance program at September 30, 1981. PBGC's recovery rate for plans with a claim less than $1 million was 36 percent ($27 million of $76 million as shown in table 1), compared to 10 percent ($33 million of $321 million) for plans

Table 3

PBGC Claims Exposure by Sponsor Financial Condition at Pension Plan Termination

	Ongoing-in-business		Out-of-business		Federal Bankruptcy Code: Chapter 7 business liquidation		Federal Bankruptcy Code: Chapter 11 business reorganizations		Total	
	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits	Amount in millions	Percent of guaranteed benefits
	(217 plans)		(242 plans)		(120 plans)		(104 plans)		(683 plans)	
Present value of guaranteed benefits	$104	100	$123	100	$133	100	$288	100	$648	100
Less : Plan assets at termination	49	47	63	51	51	38	88	31	251	39
Equals: Claims against insurance program	$ 55	53	$ 60	49	$ 82	62	$200	69	$397	61
Less : Employer liability recovered or expected to be recovered	38	37	15	12	3	2	4	1	60	9
Equals: Net claims against insurance program	$ 17	16	$ 45	37	$ 79	60	$196	68	$337	52
Net claims as a percent of total net claims	5		13.4		23.4		58.2		100	

with a claim exceeding $1 million. Table 4 below shows PBGC's estimated recovery of employer liability by the sponsor's financial condition at termination for the 67 plans with a claim exceeding $1 million.

Table 4
Recovery of Employer Liability by
Sponsor Financial Condition for 67 Plans
With a Claim of $1 Million or More

Sponsor financial operating condition	Number of plans	Claim against insurance program (guaranteed benefits less plan assets)		Employer liability recovered or expected to be recovered		Employer liability as a percent of claim
		Amount in millions	Percent	Amount in millions	Percent	
Ongoing-in-business	12	$ 36	11	$25	76	69
Out-of-business	12	36	11	5	15	14
Bankruptcy:						
Business liquidation	20	62	19	1	3	2
Business reorganization	23	187	59	2	6	1
Total	67	$321	100	$33	100	10

- - - -

When we initiated our review, fiscal year 1981 was the most recent fiscal period for which data were available. Thus, this report is based on cumulative data through September 30, 1981. The data now available for fiscal year 1982 termination activities, however, show that the financial trend experienced by PBGC during its first 7 years of operation is continuing.

The insurance program's estimated deficit grew from $189 to $333 million during fiscal year 1982. Twenty-three plans were terminated during the year with a claim of $1 million or more, which resulted in a total of $229 million in claims against the program. These claims represented a substantial dollar value increase over similar claims from prior years. However, the recovery rates for employer liability (5 percent), plan assets (29 percent), and the net claim paid from premium revenue (65 percent) for these plans in fiscal year 1982 were comparable to the program's prior experience (see table 1 on p. 9).

Claims from sponsors in bankruptcy liquidation or reorganization accounted for 54 percent of the value of claims during fiscal year 1982 as compared to 78 percent for all prior years. Claims for plans terminated by ongoing sponsors during the year accounted for 43 percent of the program's total claims compared to 11 percent for all prior years. This increase resulted from the termination of five plans with claims totaling about $99 million, of which PBGC expects to recover only $17 million from the sponsors.

PREMIUM INCREASE NECESSARY TO REDUCE DEFICIT

Premiums provide the primary means under the insurance program to finance net claims of terminating pension plans and PBGC administrative costs. When insurance program costs exceed premium revenue, PBGC should act in a timely manner to request that the Congress provide a premium rate increase or the insurance program deficit will escalate. The premium rate increase to $6.00 now before the Congress is needed to reduce its deficit under present provisions of ERISA.

PBGC's premium rate increase request represents a significant increase over its present rate of $2.60. However, the Congress can minimize the need for sizable future increases in the premium rate by providing for more timely adjustment of the rate based on the results of annual PBGC studies of premium rate requirements.

Assessment of premium rate request

PBGC's requested rate was computed by dividing the estimated annual insurance claims and administrative costs during 1983 to 1987 and the cost to retire the deficit in 5 years by the estimated number of participants in insured plans for the same period. The relationship of each element to the requested premium rate of $6.00 is summarized in table 5 below.

Table 5

Cost Elements in PBGC's Premium Requirements

Cost element	Estimated annual cost	Estimated annual participants in covered plans	Cost per participant
	(millions)		
Future net claims	$ 96.8	32.1	$3.02
Administrative expenses	31.2	32.1	.97
Deficit retirement	62.7	32.1	1.95
Total	$190.7		$5.94[a]

[a]Rounded up to $6.00 by PBGC.

According to PBGC's May 1982 premium study, a $6.00 rate would eliminate the program's projected deficit of $236 million at January 1, 1983, within 5 years. Based on later PBGC studies the program's deficit is expected to reach $938 million by the end of 1987 without an increase.

In addition to retiring the program's deficit by the end of 1987, the $6.00 premium rate must generate sufficient revenue to cover the program's net claims and administrative costs during the period. In computing the $6.00 rate, PBGC used a linear projection of its past experience with 783 plans terminated at September 30, 1981, and estimated that future net claims would increase from $84.4 million in 1983 to $109.2 million in 1986, for an average annual claims rate over that period of $96.8 million.

Using PBGC's premium methodology we made adjustments to the data to test the sensitivity of PBGC's methodology. These adjustments included the addition of prospective claims of certain terminated plans not included in PBGC's analysis, more current termination experience, and other technical refinements. We did not consider the impact of proposed revisions to ERISA or any changes to the 5-year period selected for amortizing the deficit. After these adjustments, we calculated premium rates using all 7 years of experience under ERISA ($6.87) and the last 4 years based on the assumption that the number of plan terminations in the years just after ERISA was unusually high and not likely to occur again ($7.25). Because both rates exceeded PBGC's requested $6.00 rate, we believe that the $6.00 rate is both reasonable and necessary.

The sensitivity of PBGC's projection of future net claims to the termination of plans with a net claim over $1 million provides a major source of uncertainty. For fiscal years 1978-81, 49 plans with a claim over $1 million terminated with net claims averaging $60.1 million. Analysis of PBGC's preliminary data on program operations for fiscal year 1982 shows that net claims from 23 such plans were about $212 million--almost 3 times higher than the average for the prior 4-year period. By contrast, PBGC's rate study projected net claims for fiscal year 1982 to be $74 million. The higher than expected claims in 1982 resulted in a deficit of $333 million at September 30, 1982. The $6.00 rate would retire this deficit in 8 years, and a $6.80 rate would be needed to retire this deficit in 5 years, assuming that PBGC's May 1982 claims projections were realized in fiscal years 1983-87.

PBGC assumed that a similar level of net claims would occur once every 8 years (the length of time PBGC has operated) and, on this basis, projected that average net claims for the next 5 years would increase from $96.8 million to $118 million a year. Thus, about $3.75 of the $6.00 premium rate would be needed to cover the projected future claims (compared to $3.02 shown in table 5 on p. 14). In addition, $2.75 would be needed to retire the $333 million deficit over a 5-year period, as planned in the May 1982 premium request. Assuming the $0.97 administrative cost remains valid, a premium rate of $7.47 would be needed to cover future claims and administrative costs and retire the deficit in 5 years.

The $6.00 rate would retire the $333 million deficit in 15 years and cover the increased net claim projection ($118 million a year) and administrative costs. These projections are based on a $6.00 premium rate being effective for plan years beginning on or after January 1, 1983.

Timely adjustment of premium rate necessary

Under ERISA's self-financing provision the insurance program could operate for a number of years without a premium rate increase because terminated plans generally have sufficient assets to pay benefits for a time after termination. For example, in fiscal year 1982 PBGC's benefit payments were $94.2 million, and about $834.8 million in assets was available to pay benefits. While a premium increase could be avoided under this pay-as-you-go approach for many years, a substantially larger increase than the $6.00 premium rate would ultimately be needed if the current rate increase request is not granted.

In a 1977 study of the program's premium requirements,[3] PBGC concluded that its insurance program should attempt to have on hand at any point in time assets which, together with investment return, are sufficient to pay all guaranteed benefits. Thus the full cost of each year's plan terminations is to be borne by the plans subject to the risk of termination in that year. Requiring plans to pay premiums on this basis avoids, to the maximum extent possible, having pension plans in the future assume the burden of financing the costs associated with past insufficient plan terminations. It also keeps future premium increases to a minimum.

To meet state regulatory requirements, private insurers must maintain sufficient assets to pay liabilities, a financial objective proposed by PBGC for itself in its 1977 study. Private insurers periodically compare premium income with claims experience and are required to report on their financial condition at least annually to state insurance departments. When a private insurer experiences losses in a particular policy line, it must decide whether to increase premium rates for new issues or to discontinue issuance of that coverage. If its response is not timely and financial reserves fall below state statutory minimums, the state will take whatever action it deems necessary to protect policyholders, including possible revocation of the insurer's operating rights.

Based on PBGC's 1977 study, the Congress approved an increase in the premium rate from $1.00 to $2.60 effective January 1, 1978. PBGC's study stated that a $2.60 rate would eliminate the program's projected deficit of $59.4 million by the end of 1981. However, net claims exceeded PBGC's projections, resulting in a program deficit of $95 million at September 30, 1977. By the end of fiscal year 1979, the program's deficit increased to $146 million primarily because claims continued to exceed PBGC's projections. As the deficit increased, the program's finances moved toward a pay-as-you-go basis. By the end of fiscal year 1981, PBGC reported that the program's deficit was $189 million and administrative costs and benefit payments exceeded annual premium revenue for the first time.

The need to increase the premium rate for higher claims experience was studied on a preliminary basis by PBGC in December 1980, when it was estimated that a premium rate of $4.66 would be needed to eliminate the program's projected deficit at December 31, 1980, of $157 million within 5 years. Later PBGC

---

[3]Pension Benefit Guaranty Corporation, Premium Requirements for the Single Employer Basic Benefits Insurance Program, Part 1, September 1977.

studies from March to June 1981 yielded similar results. PBGC did not act on these studies, but reevaluated program needs in a May 1982 study which now forms the basis for its requested congressional approval of an increase in the premium rate from $2.60 to $6.00 per plan participant.

Our analysis of PBGC's premium requirement shows that, if the $4.66 premium rate had been passed on January 1, 1981, in accordance with PBGC's 1980 study, a more equitable allocation of the program's costs between existing and new plans would have resulted. The additional revenue generated from this earlier increase would have reduced the PBGC January 1, 1983, projected deficit from $236 million to $105 million, thereby lowering PBGC's 1983 premium request from $6.00 to $4.86. This lower rate could have reduced the burden placed on new plans to retire the higher deficit.

According to PBGC's records, an average of 15,807 plans made premium payments for the first time during each of the fiscal years 1980 and 1981. The number of participants in these plans averaged about 76. Assuming the same number of new starts between 1983 and 1986, over 63,000 new plan sponsors could pay about $13.7 million more in premiums at the $6.00 rate than at the $4.86 rate. This additional cost represents to some extent premium revenue foregone for plans that terminated during the time the higher deficit arose.

Plans that were insured and terminated in fiscal years 1981 and 1982 were paying premiums at a rate of $2.60, which was too low based on the program's actual claims and administrative costs. PBGC's records show that 9,934 plans involving over 421,000 participants terminated during 1981 and 1982. If the premium rate had been increased to $4.66, effective January 1, 1981, these plans could have paid an estimated $868,000 in additional premiums.

- - - -

S. 1227, introduced on May 5, 1983, provides for increasing PBGC's premium rate from $2.60 to $6.00 for each plan year beginning after December 1982. H.R. 3930, introduced on September 20, 1983, also provides for this increase.

CONCLUSIONS

Based on the prospective needs of the PBGC insurance program to meet future claims and administrative costs and to retire its accumulated deficit, we believe that PBGC's $6.00 premium rate request is reasonable and necessary even if ERISA is amended to resolve problems of the insurance program discussed

in this report (see chs. 3 to 5). We further believe that the deficit should be reduced in as close to a 5-year period as possible to minimize the burden on future plan sponsors and that an approach (full funding) should be adopted for setting future premium rates that maintains the insurance program's assets at or near the total benefits guaranteed. A reassessment of the premium rate will be required in the future following any changes by the Congress to the single employer provisions of ERISA or if the period over which the deficit is to be amortized is changed.

Conditions affecting the claims experience may vary widely from 1 year to next, and if the insurance program is to be maintained on a full funding basis, more frequent adjustments of premium rate requirements will be necessary. It should be possible for PBGC to determine its needs and obtain a change in the premium rate more frequently than the 5-year time frame used in submitting the present premium rate increase request.

The Congress could amend ERISA to require PBGC to provide in its annual report the results of PBGC's analyses of insurance program experience and to recommend that the Congress raise or lower the rate whenever significant changes in insurance program needs are identified. Alternatively, the Congress could amend ERISA to provide for an automatic annual adjustment to the premium rate using PBGC's May 1982 premium methodology.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress may wish to amend ERISA to provide for more timely adjustment of premium rates for the single employer pension plan insurance program. These options are available:

--Require the Executive Director of PBGC to provide information in its annual report to the Congress on the adequacy of the existing premium rate and recommend changes to the premium rate when warranted.

--Provide an automatic annual adjustment to the premium rate using PBGC's May 1982 premium rate methodology.

AGENCY COMMENTS

PBGC agreed that the premium rate should be increased as soon as possible in order to assure that the program remains financially sound. It advised us that automatic adjustments (1) may provide greater assurance that the program would remain on a sound financial basis, (2) would help avoid large increases in premiums, and (3) may help assure that claims are financed by

plans in the years claims are incurred rather than new plans at a later date. PBGC also stated, however, that it could not definitively comment on our proposals without further study. (See app. IV.)

Labor stated that the administration strongly agrees with us on the need for legislation protecting PBGC's financial soundness. Labor also stated that, while the recommendations of the administration's Task Force on Single Employer Termination Insurance Legislation are slightly different, the goals of our proposals are consistent with those of the administration. (See app. VI.)

IRS stated that it did not oppose adoption of the recommendations in this report. (See app. V.)

CHAPTER 3

LIABILITIES FOR UNFUNDED PAST SERVICE BENEFITS CAN INCREASE CLAIMS AGAINST THE INSURANCE PROGRAM

Claims against the pension insurance program can increase because ERISA permits unfunded actuarial liabilities[1] existing at the inception of ERISA to be funded over not more than 40 years and those created after ERISA to be funded over not more than 30 years. Much of the existing unfunded actuarial liabilities result from benefit increases applicable to past service.[2] For plans that terminate, the insurance program must guarantee these benefits fully following a 5-year phase-in period. The difference between the extent to which benefits are funded and the level at which they are guaranteed at termination must be financed by insurance premiums collected from other ongoing plans when recovery cannot be obtained from the terminating plan sponsors.

Since the median life of 683 plans that have terminated with claims against the insurance program has been 11 years, the time available under ERISA's 30- or 40-year minimum standards to fund the liabilities for past service benefits[3] was limited for many plans. We reviewed 36 plans terminated by 23 sponsors that

---

[1]This report uses the term unfunded actuarial liability in places where ERISA uses the expression unfunded past service liability (see definition in app. I). Unfunded actuarial liabilities are common in defined benefit pension plans. They can arise in a number of ways. Participants are often given credit for years of service before the establishment of the plan. Similarly, benefit increases are often made retroactive. A change in actuarial assumptions can create an unfunded actuarial liability or increase the existing unfunded actuarial liability. Certain actuarial cost methods, used in a small percentage of plans, develop no unfunded actuarial liability and as such are unaffected by ERISA amortization requirements.

[2]Other portions of unfunded actuarial liability arise when a plan's actuarial experience is less favorable than that assumed in the actuarial valuation. These amounts, called actuarial experience losses, may be funded over 15 years.

[3]Past service benefits are attributable to service before the date of an actuarial valuation, including but not limited to benefits for service before the plan's inception.

resulted in claims against the insurance program. One or more of the following conditions that can increase such claims were present in 34 of the 36 plans reviewed (sufficient data were not available on contributions to make a similar determination for two plans).

--Contributions for unfunded actuarial liability were being made over the longest periods permitted under ERISA (30 or 40 years).

--Contributions had not been made for one or more plan years before plan termination.

--The plan was created or amended granting past service benefits credit and then terminated within a few years.

The following sections describe the impact of unfunded past service benefits on the insurance program under current pension plan funding standards and insurance program guarantees.

PENSION PLAN FUNDING STANDARDS AND INSURANCE PROGRAM GUARANTEES

Before ERISA's enactment, if a plan was terminated, the plan sponsor was not legally required to guarantee the payment of promised pension benefits. ERISA provided that the insurance program shall guarantee pension benefits, subject to certain limitations, that had vested before plan termination. ERISA also amended section 412 of the Internal Revenue Code to require plan sponsors to meet minimum funding standards for annual contributions. Both the level of the plan funding and the amount of guarantees were expected to play an important role in maintaining the insurance program's financial stability.

ERISA funding standards

The minimum funding standards incorporated in the Internal Revenue Code by ERISA require defined benefit plan sponsors to fund all plan normal costs and to make equal annual contributions to amortize unfunded actuarial liabilities[4] over the following specified periods:

---

[4]ERISA minimum funding requirements for single employer defined benefit pension plans were generally made effective the first plan year beginning after passage of ERISA on September 2, 1974, or, in the case of plans in effect on January 1, 1974, plan years beginning 1976 and later.

--30 years for plans established after January 1, 1974.

--30 years for all benefits created by future plan amendments regardless of the date of plan establishment.

--40 years for all unfunded actuarial liabilities by plans in existence on January 1, 1974.

Although there is generally no maximum limit on the amount that an employer may contribute to a pension plan over time, ERISA amended the Internal Revenue Code to provide that annual contributions that an employer can deduct for federal income tax purposes may not exceed the lesser of the amount required to

--fund the plan's normal cost plus unfunded actuarial liabilities in equal dollar amounts over 10 years or

--bring the plan to a full-funding status.

Any amounts contributed by an employer in excess of the amount deductible for a given year can be deducted in future tax years as long as the maximum deductible amount is not exceeded. Thus, a sponsor may make one contribution for the total amount of unfunded benefits and spread the tax deductions over not less than 10 years.

The funding flexibility was intended to give sponsors the option to vary plan contributions from year to year depending on the availability of company resources. As shown in the following table, a sponsor may contribute between $75,314 and $133,063 annually to satisfy ERISA minimum and maximum funding standards for a plan that created $1 million in unfunded actuarial liability after ERISA.

Table 6

Comparison of Annual Contributions Required to Fund $1 Million Unfunded Actuarial Liability for Certain Amortization Periods[a]

Amortization schedule in years	Annual contribution
40	$ 70,102
30	75,314
25	80,197
20	88,218
15	102,612
10	133,063

[a]A 7-percent interest rate was used because it approximates the rate generally used by actuaries to compute funding levels for ongoing plans.

Under Canadian law, most provinces require private employers to fund increases in unfunded actuarial liabilities created by plans within 15 years. Plan sponsors may obtain termination coverage from private insurers. A Canadian government official stated that a 15-year funding period is used because private insurers will not absorb the risk of funding benefit promises over a longer time frame.

Insurance program guarantees

ERISA imposes limitations on (1) the amount of insured monthly benefits an individual can receive and (2) the length of time that plan benefits must be in effect before the plan and its participants are fully insured. These limitations were designed to balance the need to protect the insurance program against early plan terminations and excessive benefit promises with the need for employees to receive a meaningful portion of plan benefits.

ERISA provides two general ceilings, the lower of which limits participants' monthly benefits guaranteed by PBGC. The first limits a participant's benefits to the average monthly salary for the highest 5 consecutive years' earnings. The second establishes a maximum guaranteed level, which is adjusted annually by PBGC. The second limit was originally set by ERISA at $750 a month and was later increased by PBGC to $1,517.05 a

month for 1983.[5] This benefit ceiling for participants in a terminating plan is the rate in effect when the plan terminates. The same ceiling rate is applied to all participants in the plan regardless of whether they are eligible to receive immediate or deferred benefits.

In addition to the general ceilings, insurance coverage for new or recently amended plans[6] is phased in over a 5-year period. Only 20 percent of newly created benefits can be guaranteed by the end of the first year, subject to a floor of $20 a month and a ceiling of 20 percent of the maximum guaranteed level. The coverage increases an additional 20 percent each year until, at the end of 5 years, full coverage is available. This phasing in was intended to protect the program against plans that terminate shortly after granting large benefit increases.

IMPACT OF LIABILITIES FOR UNFUNDED PAST SERVICE BENEFITS ON THE INSURANCE PROGRAM

The granting of past service credits to plan participants creates an unfunded actuarial liability which is amortized slowly. This can result in large unfunded guaranteed benefits upon plan termination. In the first 7 years of PBGC operation, unfunded guaranteed benefits amounted to $397 million.

At the time ERISA was enacted, the 36 plans in our review had already accumulated significant unfunded actuarial liabilities that could be funded over 40 years, and many were later amended within 5 years of termination, resulting in substantial amounts of benefits that had to be guaranteed by the insurance program. Eleven of the 36 plans were started and then terminated within 10 years. Fifteen of the other 25 plans were amended within 5 years of plan termination. The average funding level for plans in our review, with claims above and below $1 million, is shown in the following table.

---

[5]The maximum benefit amount is calculated according to a formula prescribed by ERISA based partly on the contributions and benefit base figures supplied by the Social Security Administration.

[6]Any increase in the value of a plan's benefits, including such changes as a liberalization of the vesting requirements or a reduction in the normal retirement age, is subject to ERISA's phase-in provisions.

Table 7

Funding Levels for 36
Terminated Plans GAO Reviewed

	Number of plans	Present value of guaranteed benefits	Plan assets	Total claim	Assets as a percent of guaranteed benefits
	(1)	(2)	(3)	(4)	(3)-(2)
Claim above $1 million	13	$171.6	$52.2	$119.2	.30
Claim below $1 million	23	14.6	7.7	6.7	.53
Total	36	$186.2	$60.2	$125.8	.32

Initial unfunded actuarial liability
created when plans are established can
result in claims against insurance program

Sponsors often create pension plans for their employees many years after starting in business and include past years of service in computing pension benefits. In these situations, a sponsor may create a large amount of unfunded actuarial liability before being required to make any contributions to the plan. Amortization of unfunded actuarial liabilities is accomplished gradually, considering the time value of money (the expected rate of return on an investment), and each payment includes interest and principal. A substantial portion of the payments in early years is attributable to interest just as in a home mortgage. ERISA provided that unfunded actuarial liabilities of plans in existence on January 1, 1974, could be funded over 40 years. The following table illustrates the percentage of unfunded actuarial liabilities funded after certain elapsed time periods when amortizing those liabilities over selected periods.

Table 8

Comparison of Unfunded Actuarial Liability Funding Levels Achieved After Certain Elapsed Periods Using Selected Amortization Schedules

(assuming a 7-percent interest rate)

Payment years elapsed	Amortization schedule in years			
	10	20	30	40
	(percent)			
5	42	14	6	3
10	100	34	15	7
15		61	27	13
20		100	43	21
30			100	47
40				100

As table 8 shows, the unfunded actuarial liability does not decrease significantly over the first 5 years under amortization schedules of 20, 30, or 40 years. These percentages, however, may vary if the underlying actuarial assumptions change, and the level of funding in early years is lower when a higher interest rate is assumed.

According to a 1982 private research study,[7] most single employer plans have adequately funded their vested liabilities. Based on a sample of 2,091 large defined benefit plans, each with more than 1,000 participants, the study found that about half of the plans had assets sufficient to cover liabilities completely and 70 percent of the plans covered at least 75 percent of their vested liabilities,[8] as shown in table 9 on the following page.

---

[7]Employee Benefit Research Institute, Retirement Income Opportunities in an Aging America: Pension and the Economy, (Washington, D.C.: 1982), pp. 25-27.

[8]Vested liabilities are the present value of vested benefits. For IRS reporting purposes, this liability is commonly computed based on a plan's continued operation. Vested liabilities at termination have generally been smaller than those reported because of the higher interest rates used to compute them.

Table 9

Ratio of Plan Assets to Vested Liabilities for Large Single-Employer Defined Benefit Plans[a]

Funding ratio[b]	Percent of plans[c]
25 percent or more	98
50 percent or more	88
75 percent or more	70
100 percent or more	47

[a]Developed by research study tabulations of IRS disclosure data for 1977. Plan classification by type is that used by the Department of Labor.

[b]Ratio of plan assets to vested liabilities. Asset value is actuarial value, which adjusts for short-term fluctuation.

[c]Data do not include plans filing late. About 25 percent of respondents filed late in 1977.

Of a sample of 834 small and medium-sized plans, the study reported that about two-thirds had assets greater than vested liabilities.

That most plans are adequately funded to pay guaranteed benefits[9] is indicated by PBGC's inventory of terminated plans as of September 30, 1981. PBGC had received about 37,400 plan terminations, of which 36,700 (98 percent) had sufficient assets to pay guaranteed benefits.

---

[9]Sufficient assets to pay guaranteed benefits is no assurance that an unfunded actuarial liability does not exist. Unfunded guaranteed benefits (excess of present value of guaranteed benefits over fund assets) is calculated differently from the unfunded actuarial liability in the following ways: (1) all plan benefits may not be guaranteed by PBGC; (2) unfunded actuarial liability includes the benefits to be earned by active employees in the future and anticipated salary increases that affect their pensions, while guaranteed benefits are calculated as if the plan terminated at the valuation date; and (3) unfunded actuarial liability is reduced by the present value of future normal cost payments for the current roster of active employees.

A slow rate of funding of the unfunded actuarial liability for ongoing sponsors who make contributions close to ERISA's 30- or 40-year minimum requirements is generally not a major concern as long as sufficient assets are available to pay benefits when due. However, when a plan terminates, the rate at which the unfunded actuarial liability was being funded can be a critical factor in the level of claim incurred by the insurance program.

The insurance program's claims exposure could remain high for many years under ERISA's 40-year minimum funding standard for unfunded actuarial liability. The following example from our review illustrates the impact on the program of amortizing unfunded actuarial liability at ERISA's 40-year maximum.

--A recreation equipment manufacturer experiencing financial difficulties closed one of its plants in February 1977 and terminated a pension plan that had covered employees for over 21 years on December 9, 1977. According to the plan's most current actuarial valuation, about $1,328,991 in unfunded actuarial liability existed on October 31, 1976, that could be funded over a 40-year period with an annual payment of $83,327. The net claim against the insurance program at termination was $1.3 million, after a recovery of less than $41,000 in employer liability.

Not all of the plans that were established and granted past service benefits before ERISA and terminated with claims against the insurance program after enactment of ERISA were of long duration. During the first 7 years of operation, the insurance program incurred about $41.7 million in claims from 300 plans that had operated for less than 10 years. Assets available in the 300 plans were sufficient to pay only 46 percent of the guaranteed benefits. Our review of 11 of these plans showed that a substantial amount of their insufficiency at termination related to the granting of past service benefits at plan inception. Also, 9 plans that were in existence for 7 years or less accounted for 85 percent of the claims for these 11 plans.

The following example illustrates the impact on the insurance program of the granting of past service benefits created by plans that terminate within 10 years of their establishment and fund their plans at ERISA minimum levels.

--A department store chain established a pension plan for its union employees effective February 1, 1970. Credit was provided to employees for all years of service with the company. Actuarial reports and plan financial statements stated that funding periods ranging from 30 to 39 years were used. The company filed for bankruptcy

reorganization on September 27, 1974, and on January 31, 1977, the company was adjudicated as a bankruptcy liquidation and the plan was terminated. Plan assets accounted for less than 16 percent of the $1,442,000 in guaranteed benefits. Since the plan had operated for over 6 years, the guaranteed benefits were not phased in and a claim of about $1.2 million was made against the insurance program.

Unfunded actuarial liability created by amendment of plans can result in claims against insurance program

Claims against the insurance program have increased because sponsors amended plans to provide additional past service benefits before termination. Our analysis of the 13 plans in our review with a claim exceeding $1 million showed that amendments increasing past service benefits were made once and, in some cases, twice during the 5 years before termination for each plan. Past service benefits created within 5 years before termination were in certain cases fully insured because of the $20 a month phase-in floor. (See p. 24.)

PBGC estimated that between 85 and 90 percent of participants in terminated plans received benefit increases within 5 years of plan termination that PBGC fully or partially insured. Amendments increasing benefits for past service immediately escalate a plan's unfunded actuarial liability. This occurs because participants are eligible to receive the higher benefits provided by the amendments and sponsors have not yet begun to pay for the benefit increases.

Our review of PBGC's case records for 13 plans with a claim exceeding $1 million disclosed that no plan had sufficient time under ERISA funding standards to pay for past service benefit increases occurring before plan termination. This resulted in the insurance program absorbing the unfunded guaranteed benefits related to the increases. The following examples illustrate the impact of such plan amendments on the program.

--A steel manufacturer established a pension plan for its union employees effective June 30, 1950. The plan was amended many times, increasing the unfunded actuarial liability, before it was terminated in November 1977. The last amendment increasing benefits became effective on August 1, 1975, at which time the plan's unfunded actuarial liability was increased by about $20 million. Although PBGC did not directly insure the unfunded actuarial liability, the benefit increase was 40 percent

phased in for insurance purposes when the plan terminated a little over 2 years later (20 percent phase-in per year) with an estimated 1,900 covered participants. Between the 1975 amendment and the plan's termination, the sponsor made only $1.4 million in contributions. At plan termination, plan assets accounted for about 17 percent of the present value of guaranteed benefits, resulting in a claim of almost $35 million, based in part on the plan amendments, against the insurance program.

--On November 1, 1976, another steel company's pension plan had an unfunded actuarial liability of $15.9 million that could be funded over 40 years. A November 1977 actuarial report showed that an annual contribution of $942,357 would fund this liability over the 40-year limits of ERISA. Plan amendments in November 1977 and 1978 created about $328,000 and $352,283, respectively, in additional unfunded actuarial liability that was to be funded over not more than 30 years at a total of $40,538 annually. In June 1979, the steel company, involved in a liquidation outside bankruptcy law, terminated the pension plan after almost 29 years of operation. At termination, plan assets accounted for only 9 percent of the benefits guaranteed by the insurance program, and the net claim against the program was $12.6 million.

CONCLUSIONS

The financial burden on the insurance program has been high, as evidenced by the program's increasing deficit. Under ERISA, plan assets constitute the primary source for assuring that promised benefits can be paid to covered participants. The program acts, in effect, as a reinsurer of pension benefits by providing excess coverage over available assets when a plan terminates. ERISA's standards for funding of unfunded actuarial liabilities created before and after ERISA (40 and 30 years) do not assure that adequate assets are accumulated to fund guaranteed benefits for pension plans that terminate.

As discussed in chapters 4 and 5 of this report, actions can be taken to increase recoveries from sponsors of underfunded terminating plans. The effectiveness of such actions is limited, however, because the major portion of claims against the insurance program arises as a result of plan sponsors in bankruptcy. Thus, the termination of underfunded plans will continue to place a financial burden on the program.

Any action to improve the funding of unfunded actuarial liabilities by requiring increased annual contributions over shorter periods than ERISA's 40- and 30-year standards would improve the financial health of underfunded pension plans and reduce the demands on premium payers for support of terminating sponsor claims on the insurance program. PBGC's termination experience and independent research studies indicate, furthermore, that most plans are able to meet guaranteed benefits at termination and that accelerated funding, if properly defined, would not materially affect most sponsors' financial commitments.

Another option would be to limit further insurance coverage for unfunded guaranteed benefits taking into consideration the length of time the plan operated. According to PBGC records, the median life of all insufficient plans terminated was 11 years. Under present ERISA phase-in rules, full insurance coverage is provided in the fifth year (and earlier if the phase-in amount is below ERISA's $20 per month benefit floor) for past service benefits promised.

One option for balancing insurance coverage with termination experience would be to lengthen the waiting period for full insurance coverage of past service benefits beyond the present 5-year period and to either extend or eliminate the related phase-in coverage. Such action would provide greater balance by reducing insurance coverage of recently granted past service benefits. A decision would have to be made whether changes to ERISA phase-in rules would apply only to plans newly created or amended after such changes were enacted, and language to that effect added to ERISA. This approach would preclude application of the new standard to past service benefits promised before enactment of the new provisions and would leave existing rules in place for these benefits.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress may wish to consider minimizing premium increases needed to fund the insurance program's increasing deficit by amending ERISA to

--reduce the period over which sponsors of pension plans can amortize unfunded actuarial liabilities and/or

--extend the 5-year phase-in period for providing full insurance coverage of past service benefits and/or eliminate coverage during the phase-in period.

In lieu of reducing the period for all sponsors whose plans have unfunded actuarial liability, a more stringent funding standard requiring unfunded vested liabilities to be amortized over a period of years less than the current statutory minimum could be established in order to provide more stringent funding for poorly funded plans without affecting well-funded plans. Under this approach, each sponsor could be required to contribute an amount equal to the greater of the current funding standard based on unfunded actuarial liabilities or the newly created funding standard based on unfunded vested liabilities.

AGENCY COMMENTS AND OUR EVALUATION

The concept of separate funding standards for plans based on the level of unfunded benefits included in the above "Matters for Consideration by the Congress" section was proposed by PBGC in its comments on a draft of this report. We added it to the report because we believe it is a viable option to increase pension plan funding and reduce claims exposure of the insurance program without detracting from continued use of defined benefit plans. PBGC indicated that (1) if stringent funding requirements were adopted for poorly funded plans, there probably would have to be transition rules so as not to impose unreasonably high contributions on those plans in the early years and (2) any change in the funding standards must be designed so that it does not discourage establishment or continuation of defined benefit plans.

CHAPTER 4

CONTRIBUTIONS DEFERRED FOR TERMINATING PLANS CAN RESULT IN HIGHER CLAIMS AGAINST THE INSURANCE PROGRAM

ERISA permits IRS to approve the waiver of minimum plan contributions by plan sponsors during periods of business hardship. As of April 30, 1982, IRS had reported to PBGC requests for waivers of over $400 million in contributions owed by 111 plan sponsors which it later approved. To the extent these sponsors can overcome periods of business hardship and do not terminate pension plans, PBGC benefits. Eight of the 111 sponsors, receiving $40.4 million in funding waivers, later terminated their plans with unpaid amounts remaining to be funded by the insurance program. Because conditions now being incorporated by IRS in minimum funding waivers do not give the program effective protection against later exposure to underfunding at plan termination, future claims against the program could increase.

We evaluated the effect on the insurance program of minimum plan funding waivers granted by IRS to 16 plan sponsors--including 2 that came from the 23 sponsors of terminated plans in our general review, 6 others that had also terminated plans, and 8 that had not terminated plans as of September 30, 1982, but were being monitored by PBGC because of their potential impact on the program. Our evaluation disclosed that the program had incurred or could incur higher claims because (1) PBGC may lack authority to recover waived amounts; (2) PBGC's recoveries, when allowed, may be reduced because sponsor resources are low; and (3) benefits can be increased even though contributions are waived and not collected.

ERISA amended the Internal Revenue Code to give IRS authority to defer annual minimum funding contributions for pension plan sponsors requesting a waiver. Under ERISA, all or part of the contributions owed for a plan year for normal costs and past service may be waived if the plan sponsor demonstrates to IRS that it cannot make the required payments without (1) experiencing substantial business hardship and (2) adversely affecting the interests of plan participants in the aggregate. However, IRS may not approve more than five waivers in 15 consecutive plan years. When a request is approved, IRS establishes a period not exceeding 15 years during which the sponsor must annually repay the waived contributions to the pension plan.

PBGC has no direct authority to act with IRS in approving a waiver to minimize the insurance program's exposure. However, under a January 1981 agreement, IRS gives PBGC data on requests where the amount exceeds $50,000, the plan sponsor is bankrupt, or IRS thinks PBGC would have an interest. PBGC gives IRS its views of waiver approval impact on the insurance program. As of April 30, 1982, PBGC was maintaining records on 227 waiver requests. IRS had reached a decision on 136 of these requests, 111 of which were granted minimum funding waivers for one or more plan years.

PBGC MAY LACK AUTHORITY TO RECOVER WAIVED CONTRIBUTIONS WHEN PLANS TERMINATE

PBGC's insurance program can benefit if a waiver allows a sponsor to survive and its plan to eventually become sufficient. On the other hand, the program's claims can be increased if plans for which sponsors received waivers terminate before fully repaying the waived contributions. Many recent IRS waivers have been made on the condition that the remaining contributions become due if the sponsor terminates the plan before repayment. PBGC's authority to recover when IRS excludes this condition has not been tested in the courts.

When a plan terminates before a waiver is fully repaid, PBGC attempts to recover the unpaid portion through negotiation with the plan sponsor. PBGC has recovered unpaid contributions due for periods before a plan terminates. However, ERISA and the Internal Revenue Code do not explicitly address whether a waiver relieves a plan sponsor of its obligation to repay the remaining contributions waived by IRS but not yet reimbursed by the sponsor after the plan terminates. Both IRS and PBGC general counsel officials believe that without a condition in the waiver that outstanding waived contributions become due upon plan termination, the courts could preclude PBGC from recovering contributions waived before a plan terminates. The following cases from our sample illustrate the conditions under which PBGC negotiates its claims for contributions waived by IRS.

--A plan sponsor filed for bankruptcy reorganization in July 1976. Between December 1976 and December 1978, IRS approved $2.4 million in waivers for contributions owed by the sponsor to two pension plans for 1976 through 1979 with repayment to be amortized over 15 years. IRS approval was based on the prospect that the plans would continue under the reorganized company. However, the sponsor terminated the plans on October 1, 1979, closed its business in 1981, and repaid only $77,683 of the $2.4 million in waivers. About $285,000 of scheduled amortization payments for the waivers were outstanding at the time of plan termination.

In a claim PBGC filed in the bankruptcy court for those two plans, about $2.3 million was included for all remaining waived contributions. The sponsor filed an objection to PBGC's claim, on the basis that IRS had ruled that funding waivers are no longer payable after plan termination. IRS Revenue Ruling 79-237 states that plan funding standards, including amortization of outstanding waived contribution amounts, were required to be maintained up through the year a plan terminates and do not apply to the plan in later plan years. PBGC negotiated a settlement with the sponsor for $814,522, plus interest, before the bankruptcy court ruled on the validity of PBGC's claim for $2.3 million in waived contributions.

--IRS approved a sponsor's request for waiver of about $720,000 in contributions owed for plan years 1978-80 in September 1979. The sponsor, which had been in bankruptcy reorganization since December 1978, terminated the pension plan in March 1980. When the plan terminated, the sponsor had repaid none of the waived contributions. Although PBGC filed claims covering the full amount of the waivers, it ultimately settled for $50,000 because it believed it could not sustain a claim for unpaid waivers due after the plan terminated.

To minimize the impact of plan terminations before waived contributions are fully repaid, IRS has granted waivers that are conditional on a plan continuing for a certain period after the waiver is approved--if the plan terminates, the unpaid balance becomes due. In other instances, IRS includes a condition that requires that any part of the waived contribution as yet unpaid is due when the plan terminates, regardless of when the waiver was granted. Since the primary purpose of the conditional clauses is to protect the insurance program when plans terminate, IRS includes them only when it determines that PBGC is at substantial risk. An IRS official told us that if the Congress had wanted such conditions included in all waivers, it would have amended the Internal Revenue Code. Since the Congress has not done this, IRS officials use their judgment in each case.

Twelve of the 16 requests for minimum funding waivers approved by IRS that we reviewed contained such conditional clauses. Four of the 12 plans were terminated as of September 30, 1982, and 8 others remain in business. For the four terminated plans, PBGC will have a basis to file claims for the full amount of IRS funding waivers that remain unamortized. However, PBGC is unlikely to recover a substantial portion of the waived contributions because the sponsors do not have sufficient resources.

LOW SPONSOR RESOURCES REDUCE PBGC RECOVERIES

To receive a waiver of the minimum funding standards, an employer must demonstrate that paying the required contribution would represent a substantial business hardship. According to ERISA, IRS should consider whether

--the employer is operating at an economic loss,

--the business or industry concerned is experiencing substantial unemployment or underemployment, or

--the industry's sales and profits are depressed or declining.

IRS grants the waiver if it determines that it is reasonable to expect the business to survive and the plan to continue only if a waiver is granted. IRS officials told us that assessing the survivability of a sponsor is not an exact process, and the judgment they make is based on financial information supplied by the sponsor.

When an employer terminates its plan, PBGC attempts to recover the amount of waived contributions not paid to the plan if IRS' waiver contains a provision requiring payment of the amount waived. We reviewed IRS and PBGC records for eight employers that terminated their pension plans shortly after receiving waivers. Waivers for four of these sponsors amounting to about $35.5 million included special conditions requiring repayment of the unpaid waiver amounts upon plan termination. PBGC has completed collection of waived amounts from one of these sponsors and received only 31 percent of the amount owed. PBGC expects collections from the remaining plan sponsors to be nominal because the pension claims will be grouped with the claims of other general unsecured creditors and PBGC will have to compete for limited remaining assets.

The full impact on the insurance program of not recovering the unpaid amount of contributions is not yet clear because few plans that received waivers have terminated. However, given the large number of waivers granted as of April 1982, the potential impact is great. The following table shows the 227 waiver requests, by dollar value, that IRS reported to PBGC as of April 30, 1982, and the IRS disposition status. Of the 227 waiver requests, IRS had acted on 136 and granted 111 waivers.

Table 10

Status of Waiver Requests[a]
IRS Reported to PBGC
at April 30, 1982

Waiver amount requested	Number[b] Requested	Approved	Amount approved in millions
$50,000-100,000	71	26	$ 1.9
100,001-500,000	73	33	7.4
500,001-1,000,000	15	7	5.1
1,000,001-5,000,000	17	10	20.1
Over 5,000,000	11	9	393.9
Amount unrecorded	40	26	(c)
Total	227	111	$428.4

[a]Requests are counted by sponsor. A single request could be for more than one plan and/or year.

[b]25 requests were disapproved or closed administratively without waivers by IRS; 91 others were pending IRS action.

[c]Amount requested not included in PBGC's records.

As the above table shows, PBGC's insurance program may incur large unfunded pension liabilities as a result of the waiver process if only a few of the larger plans terminate during the next few years without adequate recovery of unpaid contributions by PBGC.

SPONSORS INCREASE BENEFITS AFTER CONTRIBUTIONS ARE WAIVED

ERISA and the Internal Revenue Code state that a plan amendment which increases the benefits, the rate of benefit accruals, or the rate at which participants become vested may not be adopted if a waiver is in effect. They further state, however, that this restriction will not apply in cases in which the amendment is determined to be reasonable and provide for only minimal increases in the plan's liabilities. IRS applies the reasonableness and minimal basis to all plan amendments that would increase benefits before the waived amounts are fully repaid regardless of when the amendment was adopted. Our analysis of waivers granted to 16 plan sponsors showed that IRS decided in four cases that the restriction on benefit increases would not apply. Two of these plans have since terminated.

The restriction on amendments increasing benefits was designed to insure that a plan's future liabilities are not increased at a time when the sponsor is unable to meet its current funding requirements. According to an IRS official the exception to this provision allows IRS to use its discretion in deciding when the increases are both reasonable and minimal and, therefore, should not affect the status of the plan's waiver. The official explained to us that the test of reasonableness can be met if other companies in the same industry are increasing their employees' benefits by a comparable amount. The effect of these benefit increases is minimal if they do not increase the unfunded actuarial liability to an amount that the sponsor could not afford when the amendment was adopted. If IRS determines that both of these criteria have been met, it informs the plan sponsor that the restriction against such an amendment will not apply.

According to an IRS official, IRS has decided that the restriction would not apply in some instances where the amendment was adopted after the waiver was approved. To illustrate, the official cited the following example which was not in our sample:

--A company was granted waivers for plan years 1976 and 1977. After the waivers were granted the company proposed adopting an amendment that would increase plan benefits by 25 cents per month per year of service for each of the next 3 years. The plan's benefits had not been increased since 1973 and were substantially below those offered by other companies in the industry. Further, the plan's actuary determined that the proposed amendment would increase the yearly cost of the plan by less than 1.5 percent. Based on this information, IRS decided in June 1980 that the proposed amendment was reasonable and, upon adoption, would result in only a minimal increase in plan liabilities.

Of eight plans in our sample that terminated after IRS granted a waiver, we identified two that received IRS permission to increase benefits. The following example illustrates the impact that benefit increases can have on the insurance program.

--A plan was established in 1962 by a manufacturer for its union employees. After suffering substantial losses the sponsor requested waivers for plan years 1977-79. In granting a waiver for 1977 and 1978, IRS stated that ERISA's prohibition regarding benefit increases would not apply to benefits already promised under the current collective bargaining agreement signed in mid-1977. IRS

based approval of the 1979 waiver, in part, on an agreement between the sponsor and bargaining representatives that benefits would not be increased during the 3-year period of the next collective bargaining agreement. Unfunded actuarial liability was increased about $883,000 for benefit increases in plan years 1977-79. When the plan terminated on February 16, 1981, PBGC recovered only $230,000 in unpaid contributions from this sponsor and incurred a net claim of about $1.5 million, resulting in part from benefit increases permitted after the waivers were granted.

In one waiver request we reviewed, IRS also recognized that funding waivers alone would be inadequate to deal with the company's hardship and, therefore, approved retroactive amendments which would reduce the plan participants' accrued benefits. In another case, IRS granted a waiver on the condition that the agreement into which the company had entered with its union to cease the accrual of benefits would continue to be in effect.

- - - -

On May 5, 1983, legislation (S. 1227) was introduced amending ERISA to improve the single employer termination insurance program. Among other things, the bill would authorize PBGC to place conditions on the payment and collection of funding waivers approved by IRS, including security in favor of the plan. It also would provide that when a waiver is granted, a lien arises on behalf of the plan for the waived amount and that in a bankruptcy or insolvency proceeding the lien is treated as a tax due and owing the United States.

CONCLUSIONS

The minimum funding waiver process is a useful method of temporarily relieving plan sponsors of the burden of plan contributions during periods of business hardship. However, the insurance program will likely have to fund all or a substantial part of the plan asset insufficiency resulting from a waiver if the sponsor terminates the plan within a few years.

The impact of the waiver process on the insurance program to date has been limited, but the potential impact could be substantial. Because PBGC could be precluded in the courts from recovering contributions waived by IRS in instances when a waiver is granted without a specific condition requiring contributions to become due upon plan termination, we believe consideration should be given to changing ERISA and the Internal Revenue Code to clearly provide that a sponsor is obligated for the remaining waived contributions which are not repaid when the plan terminates.

This condition is essential to improve the standing of PBGC claims for unpaid contributions waived in the event of subsequent plan termination. However, without further change to ERISA, it would afford only limited protection because few assets are available in relation to liabilities when sponsor businesses fail and plans must be terminated. The proposal in S. 1227 to provide a formal role for PBGC in imposing terms and conditions for the waiver of contributions, including obtaining security in favor of the plan, is a positive step in improving PBGC's involvement in the minimum funding waiver process (see app. III). However, most sponsors requiring a funding waiver are already in financial difficulty, and it may not always be possible to secure sponsor assets.

An alternative the Congress may wish to consider is placing limitations on the level of benefits guaranteed by the insurance program should the plan terminate with waived contributions unpaid. Under this alternative, recovery would not depend on the availability of sponsor assets that could be collateralized, and pretermination conditioning of funding waivers could be avoided for plans that may never terminate. Also, plan sponsors would still be primarily liable to the pension plan for unpaid waivers in event of plan termination.

Waived contributions represent the minimum resources necessary to fund normal costs and accrued past service liability for the plan year in which the waiver was received. To the extent that these costs remain unfunded when a plan later terminates, the Congress could place limitations on the level of benefits that will be guaranteed by the insurance program. Although there is no simple method of deriving a standard that would equate benefits with waiver amounts remaining to be paid, one way program guarantees could be limited is by excluding coverage of benefits accrued during the plan year for which the waiver was granted until the waived amount or a fixed portion (such as 75 percent) of that amount was paid to the plan. Thus, participants would not receive credit for a single year of benefit accruals if their plan received a waiver for 1 year's contributions and later terminated. Benefits accrued during all other years would continue to be insured under the program's present policies. Under this option, plan sponsors could be required as a condition precedent to applying for a funding waiver to obtain concurrence of affected employees, employee organizations, or collective bargaining units.

Because sponsors are experiencing financial hardship at the time the waiver is granted, we do not believe that the costs of the plan subject to insurance coverage should be increased by amending plans to promise new benefits. To avoid exposure of the insurance program, ERISA could be amended to permit PBGC to

place conditions on benefit increases IRS grants that would exclude plan termination insurance coverage for these increases.

MATTERS FOR CONSIDERATION BY THE CONGRESS

If the Congress wishes to strengthen PBGC's insurance program against the impact of funding waivers at plan termination, it could amend ERISA to make all unpaid waiver amounts due upon plan termination and to either

--exclude coverage of benefits accrued during the plan year for which the waiver was granted or

--authorize PBGC to place conditions on minimum funding waivers granted by IRS.

The Congress could also amend ERISA to authorize PBGC to place conditions on benefit increases granted by IRS. This authority would permit PBGC to limit the amount of insurance coverage of benefit increases granted during any plan year when waived contributions are outstanding.

AGENCY COMMENTS AND OUR EVALUATION

PBGC stated that the administration strongly supports legislative changes needed to protect PBGC from undue losses resulting from minimum funding waivers. They stated that, in addition to making all unpaid waiver amounts due upon plan termination, PBGC would prefer to have formal input into existing IRS processes allowing PBGC to establish terms and conditions on payment of the waived amounts as provided under S. 1227. PBGC did not address our proposal that the Congress consider amending ERISA to limit benefits guaranteed while funding waivers are in force. The draft report provided to PBGC for comment included a suggestion that ERISA be amended to deny insurance coverage for benefit increases granted while waivers are outstanding. This suggestion was modified in order to give PBGC the discretion to set conditions on benefit increases.

CHAPTER 5

PBGC AUTHORITY LIMITED IN RECOVERING UNFUNDED LIABILITY FROM TERMINATING PLAN SPONSORS

ERISA employer liability provisions limit PBGC recovery of unfunded pension obligations from sponsors terminating pension plans. During the first 7 years of operation, the insurance program incurred $397 million in claims for underfunded plans, of which it expected to recover an estimated $60 million of employer liability. Pension obligations not recovered from sponsors of terminating plans are funded from premiums paid to the program by ongoing plans.

When a plan terminates, the plan's sponsor is obligated by ERISA to finance any deficiency in plan assets needed to meet the insurance program's guarantee levels up to a limit equal to 30 percent of the sponsor's net worth--the difference between the value of business assets and liabilities accumulated at a point in time. Such liability provisions were expected to deter solvent sponsors from terminating underfunded plans and produce a reasonable, although limited, recovery of liability from insolvent sponsors. These objectives are not being met because most sponsors do not have a positive net worth or their net worth is low in relation to the level of unfunded guaranteed benefits in terminated plans.

Our review of 38 pension plan terminations by 25 sponsors (which included 8 ongoing and 17 in bankruptcy or business liquidation) showed that PBGC's recovery from the terminating plans' sponsors was limited because:

--Thirty percent of their net worth was not sufficient to pay the unfunded pension plan liability for seven sponsors that continued in business after terminating plans.

--Contingent liabilities were not established against six companies that divested portions of their businesses, including underfunded pension plans terminated later by insolvent sponsors.

--Six insolvent sponsor's assets were distributed to unsecured creditors, but PBGC recovered little or none of its claim, which was limited by the sponsor's net worth.

LIMITATIONS ON RECOVERY OF EMPLOYER LIABILITY FROM ONGOING SPONSORS

The insurance program is absorbing large plan insufficiencies when ongoing plan sponsors voluntarily terminate insufficient plans. PBGC absorbs the pension liabilities of these plans without significant recovery of employer liability when the sponsor terminates a deficient plan at a time when business net worth is low and PBGC has little or no financial basis under ERISA to recover employer liability.

Almost one-third of terminated pension plans trusteed or expected to be trusteed by the insurance program as of September 30, 1981, were sponsored by employers who continued in business while avoiding about $17 million in liabilities for plan asset insufficiencies (see table 3, p. 11). While this sponsor group has the highest employer liability collection rate, it is questionable whether the program should act as a financial relief mechanism for solvent sponsors to avoid the consequence of pension plan underfunding.

The Congress and authorities in the pension community have raised concerns that other ongoing businesses in financial distress seeking relief from pension liabilities they have created could take advantage of ERISA provisions and terminate pension plans when company net worth is low. PBGC has identified 34 major firms with large unfunded pension liabilities that are under financial pressure. Should these companies terminate their plans, PBGC estimates they could generate claims of about $4.4 billion against the insurance program.

Eight of the sponsors in our review terminated pension plans and were still in business in 1982. About $12.8 million of plan asset insufficiencies totaling $26.3 million was expected to be collected from seven sponsors (PBGC's evaluation of one sponsor's net worth was not completed at the time of our review). The following examples illustrate ways in which ERISA's 30-percent net worth limitation prevented PBGC from recovering additional unfunded liabilities.

--A sporting goods manufacturer experienced net losses of $2.8 million and $4 million in 1976 and 1977, respectively. Citing adverse financial conditions, the company terminated two pension plans in December 1977. The plans were insufficient by about $1.8 million. Because the company's net worth was $200,000 at the time it terminated the plans, PBGC expected to collect only $60,000 in employer liability. An August 1982 Dun & Bradstreet, Inc., report showed that, despite the depressed economy, the company's sales increased and an operating profit of

$145,000 after taxes was realized in 1980. Hence, this employer's net worth did not prove to be an adequate gauge of its ability to meet pension obligations.

--A mattress manufacturer adopted a pension plan for its hourly employees in 1950 and one for its salaried employees in 1960. The company, after suffering losses of about $3.9 million during fiscal years 1973-76 and reporting a net worth of $50,000 as of March 1976, terminated its salaried plan in 1976 and its hourly plan in 1978. The 1976 termination resulted in a claim of $596,941 on the insurance program and a collection of $15,000 in employer liability. The 1978 termination resulted in a claim of $512,432, and PBGC expects that employer liability will be low. A September 1982 Dun & Bradstreet report showed the company continuing in business with estimated annual sales of about $8 million compared to about $4.4 million in 1978. Despite its financial distress, the company established a successor plan for its hourly employees which provided defined benefits covered by PBGC's insurance program, including past service benefits for the same employees extending back to the years covered by the terminated insufficient plan.

When an ongoing sponsor terminates its plan(s), there are other negative implications for the insurance program and for plan participants. Plan participants must accept guaranteed benefit levels that are often reduced by ERISA benefit ceilings in lieu of the plan's higher benefit levels. The added requirements for benefit payment administration associated with participants in the plans that ongoing sponsors terminate increase insurance program costs paid by all plans.

LIMITED INCREASE IN RECOVERY OF UNFUNDED PENSION LIABILITY ATTAINABLE IN BANKRUPTCY AND BUSINESS LIQUIDATION

ERISA's net worth limitation substantially limits PBGC's recovery of employer liability for unfunded pension benefits from the proceeds of assets liquidated in bankruptcy proceedings and other business closures because the sponsors of terminated plans were in extreme financial difficulty. Although the insurance program was created to avoid pension losses to plan participants that accompany sponsor insolvency, being insolvent does not necessarily mean that sponsors are without assets to pay a portion of unfunded pension benefits.

Nine of 12 bankrupt sponsors in our sample did not have a positive net worth, and PBGC was precluded from sharing in the

distribution of assets available to unsecured creditors. In addition, PBGC did not recover any employer liability from four out of five sponsors in our sample that were liquidating their business outside of bankruptcy proceedings because the sponsor did not have a positive net worth.

For 13 of the 17 sponsors in our review that were in bankruptcy or business liquidation, information was available in PBGC files to assess the potential to collect additional employer liability had PBGC been able to sustain a claim for total plan asset insufficiency as an unsecured creditor without limitation by sponsor net worth.[1] We found that limited increased recovery of assets may have been obtained from six sponsors and that seven other sponsors had no assets left to make distributions to unsecured creditors (thus PBGC's recovery would have been unchanged). Recovery for two of the six sponsors could have been increased without materially affecting the level of payments to other unsecured creditors (PBGC's claim was small in relation to other unsecured claims against these sponsors).

Using PBGC data, we determined that, if PBGC could have pursued its claim as an unsecured creditor rather than going against 30 percent of the sponsor's net worth, collection of plan asset insufficiency could have increased for sponsors in our review, as illustrated in the following examples.

--A meat processing company entered bankruptcy liquidation proceedings in November 1977. The company's two pension plans had $228,000 in unpaid contributions and $602,000 in plan asset insufficiency. Since the company had no net worth, PBGC was not able to collect employer liability for plan asset insufficiency. After negotiations, the receiver and PBGC reached an agreement in which PBGC accepted $132,200 as a compromise payment of its unpaid contribution claims. The court approved the agreement, thus ending PBGC's efforts to make further collections from the sponsor. After the agreement, the sponsor's financial condition can be summarized as follows:

---

[1]For three plan sponsors, sufficient information was not available in PBGC's files to make a determination. In the fourth case, PBGC was able to recover all of a small claim under the net worth provisions; sufficient information was not available to determine if recovery would have changed in this case if PBGC had pursued the claim as an unsecured creditor.

Type of claim	Estimated claim	Payments
	(millions)	
Secured	$ 7.7	$ 7.7
Priority unsecured	1.1	1.0
General unsecured	6.9	4.2
Subordinated unsecured	1.0	0
Total	$16.7	$12.9

The expected payout to the general unsecured creditors based on the above is about 61 cents on the dollar. Had PBGC been able to assert a general unsecured claim for the plan asset insufficiency, total general unsecured claims would have risen to about $7.5 million, the expected payout to creditors would have dropped to about 56 cents, and PBGC could have received $337,120.

--A steelmaker with 3,500 active, laid-off, and retired employees filed for bankruptcy reorganization in June 1977 and later terminated its two pension plans. Since the company did not have a positive net worth, PBGC was not able to collect employer liability for almost $40.5 million in claims for the two plans.

Since liquid assets were substantially limited, secured creditors accepted much lower amounts in the interest of facilitating the reorganization plan needed to keep about 400 employees working in a company consisting of two subsidiaries. Certain secured creditors recovered securities in the reorganized company under the plan of arrangement, and others received subordinated notes and a profit-sharing arrangement. Unsecured trade creditors were entitled to receive a minimum cash dividend of 10 percent of their claims in addition to a pro rata distribution of 800,000 shares of newly issued stock in the reorganized company and any funds not otherwise distributed. Had PBGC been able to pursue a claim as an unsecured creditor, irrespective of net worth, it would have added its claim for employer liability to the other unsecured trade claims. Even so, PBGC was not likely to have obtained cash recovery under the plan of arrangement because liquid assets were so limited. However, PBGC could have recovered as much as 25 percent of the newly issued stock.

ERISA section 4068 grants tax lien status to PBGC employer liability claims--up to 30 percent net worth, if the employer is in bankruptcy or insolvency proceedings. Although a tax lien has priority status as a claim in bankruptcy liquidation proceedings (11 U.S.C. 726), PBGC has found the lien to be of little value because liens cannot be filed after a sponsor declares bankruptcy, and PBGC often finds out about bankruptcy declarations after the fact. The priority under the federal bankruptcy law for disposition of unsecured assets among claimants is listed in appendix II.

TRANSFER OF UNFUNDED PENSION LIABILITIES THROUGH BUSINESS DIVESTMENT CAN INCREASE INSURANCE PROGRAM COSTS

Responsibility for unfunded pension liabilities may be transferred to a new sponsor when ownership interests in a business, subsidiary, or division are sold or transferred. If the pension plan later terminates, PBGC may not be able to obtain recovery in all cases from the original sponsor of any plan insufficiency that occurred before the plan changed hands. When unfunded pension liabilities are transferred from a financially strong sponsor to a financially weak one, the risk of plan termination and the insurance program's exposure are substantially increased. PBGC is absorbing an estimated $69.3 million in net claims from plan terminations of six sponsors because it did not make any recoveries from the divesting sponsor.

The plans of 6 of the 25 sponsors we selected for review were started by originating sponsors from 8 to over 35 years before they were terminated. The life of these plans after they were transferred ranged from 1 to 4.5 years. These plans were insufficient by about $82.1 million, and all sponsors had low net worth in relation to their pension liability, which limited their combined termination liability to PBGC to about $13 million.

ERISA provides that an employer's net worth for determining employer liability can be increased by the amount of any transfer of assets if PBGC determines that the transfer was improper under the circumstances, including a transfer that would be inappropriate under Federal bankruptcy law. To date, PBGC has not increased the net worth determination, based on improper business transactions made before plan termination, for the six plans in our review that involved transfer of unfunded liabilities to new sponsors. In some instances, however, PBGC has initiated lawsuits to prevent sponsors from terminating plans or to collect employer liability from prior sponsors.

Examples of business divestments affecting recovery of unfunded liabilities

The examples below illustrate the impact that business transfers have had on the insurance program.

Court- and government-ordered divestitures

--A U.S. district court ordered a corporation to divest itself of a canvas footwear manufacturing facility. In April 1977, a newly formed corporation purchased the facility and assumed the seller's liabilities for two pension plans whose asset insufficiency was estimated to be $3.5 million. The buyer made no contributions to the plans. Operating at a loss since its inception, the buyer ceased operations and terminated the plans covering 1,238 employees in January 1981, less than 4 years after the purchase. The plans were insufficient by about $4.8 million at that time. Although the seller's net worth was estimated to be $360 million when the plan terminated, PBGC did not recover any of the plan asset insufficiencies from the seller. Since the purchase had been secured by most of the manufacturing facility's assets, these assets reverted back to the seller when the buyer went into receivership. Although sufficient records to compute the buyer's net worth at the date of termination had not been provided at the time of our review, the PBGC case officer told us it would probably be zero, thus eliminating PBGC's ability to collect employer liability from the buyer.

--To comply with a Federal Trade Commission order, a corporation distributed to its common stock holders all its shares in one of its subsidiaries in April 1976. A new corporation formed as a result of this distribution assumed responsibility for a pension plan with $41 million in unfunded pension liabilities and 2,377 participants at that time. In 1979, the former sponsor transferred $14 million to the pension plan being maintained by the new corporation. Within 5 years of its creation, the new sponsor, citing adverse business conditions, notified PBGC of its intent to terminate the plan and establish two new plans. PBGC refused to accept the termination on the basis that the insurance program was being used to subsidize ongoing retirement plans. However, in August 1982, after almost 2 years of litigation, PBGC and the sponsor reached a settlement in which PBGC accepted the plan termination based on the sponsor's agreement to pay

PBGC $13.3 million in fixed amounts over a 10-year period and up to $21.8 million in 18 annual installments contingent upon its pretax profits. PBGC estimates this arrangement will reduce the net claim against the insurance program from $17 million to $5.7 million. Earlier PBGC attempts had been unsuccessful in recovering unfunded benefits from the original sponsor, a large corporation that reported a net income of $191.6 million in 1980 and $452.8 million in 1981.

In the above two examples, if PBGC could have recovered plan asset insufficiencies from the original sponsors, the net claims of $4.8 million and $5.7 million made against the insurance program could have been eliminated.

Sale to other businesses

--A new corporation was formed in November 1976 to acquire an operating division from a sheet metal manufacturer, including a pension plan with over $3.5 million in unfunded liabilities and 572 participants. During its first 31 months of operation, the corporation experienced losses of about $1.9 million and a severe cash flow drain. Citing its strained financial condition, the corporation notified PBGC of its intent to terminate the pension plan, underfunded by $4.1 million at the time, and adopt two new pension plans.

PBGC initially refused to accept the plan termination because the proposed plans provided essentially identical benefits and vesting schedules as the old one. However, in September 1981, PBGC agreed to accept the termination conditioned on the sponsor's not adopting another defined benefit plan for at least 5 years to protect PBGC from future claims by this sponsor. PBGC recovered about $1.1 million in employer liability from the sponsor, resulting in a net claim of over $3 million against the insurance program.

Sales to employees

--In October 1976 a manufacturer sold 334,000 of its 335,000 shares of common stock in one of its subsidiaries to two employees for a total cost of $10. Within 1 year, the buyer submitted a notice of intent to terminate the pension plan which was later withdrawn when management got four top benefit receivers to waive a portion of their benefits. Later, however, the buyer lost a major customer, which accounted for about one-third of its revenues, and a second notice was submitted in 1979. At

that time the plan was insufficient by an estimated $460,000. Since the new corporation's net worth was negative, the insurance program incurred a claim for the full amount of the unfunded guaranteed benefits. Although the original sponsor had established the plan and maintained it for almost 33 years, the sponsor did not pay any part of the insufficiency.

--A company and its pension plan with 216 participants was sold in 1975 to two employees. The company had been losing money since 1971. About 1 year after the sale, the seller, which had secured all the company's assets at the time of the sale, foreclosed on its lien, and the pension plan was terminated. The plan was insufficient by $564,782. Because the buyer had negative net worth, the insurance program could not recover the deficiency from the buyer.

- - - -

As ERISA was originally enacted, many of the problems discussed in this chapter would also have applied to multiemployer defined benefit pension plans. However, after ERISA's provisions became mandatory for such plans, the act was amended by the Multiemployer Pension Plan Amendments Act on September 26, 1980. Under this act, employers who were contributors to multiemployer plans but ceased making contributions to the plan generally remain liable for their portion of the plans' unfunded vested liabilities.

In addition, the 1980 amendments provided that an employer that sold the firm's assets in a bona-fide arm's-length transaction would not incur withdrawal liability if (1) the purchaser contributed to the plan at substantially the same level as the seller, (2) the purchaser provided a bond or an amount held in escrow generally equal to the seller's annual contribution for the 3 plan years preceding the sale of assets, and (3) the sales contract provided that the seller would be secondarily liable for any withdrawal liability assessed if the purchaser withdrew within 5 plan years of the sale. In these instances, the seller must also post a bond or provide an escrow for its withdrawal liability if all or substantially all of the seller's assets are distributed within 5 plan years of the sale. However, additional liability will not be incurred if the stock of an employer who contributes to a multiemployer plan is sold.

We believe that remedies similar to those described above in relation to multiemployer plans can also be applied to single employer plans. The Congress is considering making similar changes to ERISA provisions governing single employer pension

plans that would make certain sponsors and former sponsors liable for their portion of a plan's unfunded vested liabilities. S. 1227, introduced on May 5, 1983, would, among other things:

--Require ongoing sponsors terminating insufficiently funded pension plans to retain responsibility for maintaining the plan unless PBGC determines that it is unlikely that the sponsor can pay its debts as they mature and the sponsor would be forced out of business if it continued contributions.

--Provide that PBGC determine for ongoing sponsors it permits to terminate that PBGC will be able to collect over time the full amount of the insufficiencies.

--Establish a 10-year contingent obligation and levels of liability for sponsors divesting business entities with unfunded pension liabilities of $500,000 or more at the time of transfer.

On June 13, 1983, we gave the Chairman of the Subcommittee on Labor, Senate Committee on Labor and Human Resources, our views on the proposed legislation (see app. III).

On September 20, 1983, H.R. 3930 was introduced with objectives and provisions comparable in certain respects to those of S. 1227. H.R. 3930 differs, among other ways, from S. 1227 in that it

--distinguishes between so-called "distress" terminations and "standard" terminations and provides specific sponsor financial obligations for each,

--would require for "standard" plan terminations (available to any terminating plan sponsor) full funding by plan sponsors and all trades or businesses in common control (control group) of all benefits accrued at the date of termination with additional service beyond the date counted for vesting and eligibility purposes, and

--would provide for "distress" plan terminations (where certain tests of sponsor financial difficulty as defined by the bill are met) payment of the plan asset insufficiency over time from continuing sponsor profits and an additional portion of profits to a trust fund for plan participants or their beneficiaries.

The bill would retain the 30 percent of net worth limitation on liability for plan asset insufficiencies of insolvent and bankrupt plan sponsors.

CONCLUSIONS

The PBGC insurance program is absorbing obligations for unfunded pension liabilities at termination from sponsoring employers under current ERISA provisions because

--sponsors' liability at termination is based not directly on the ability to pay but on the lesser of the plan asset insufficiency or 30 percent of net worth, which can yield little or no liability when net worth is low, and

--solvent sponsors are transferring pension liabilities through divestment to other businesses.

To correct these conditions, we believe that an employer's termination liability should be based on the full amount of plan asset insufficiency rather than a portion of business net worth. We also believe that specific termination obligations of sponsors divesting business entities with unfunded pension liabilities should be established. As proposed in S. 1227, limiting the level of contingent liability to instances in which unfunded guaranteed benefits are $500,000 or more would cover the claims having the greatest impact on the insurance program. We believe that assessing contingent liability on sponsors divesting businesses with insufficiently funded pension plans would further strengthen PBGC claims for employer liability.

Provisions should be made for solvent ongoing sponsors to fund insufficient plans they desire to terminate to the level of guaranteed benefits over a reasonable repayment time period. Such changes will preclude the undesirable effect of ongoing sponsors attempting to transfer pension liabilities they have created to the insurance program, while providing an equitable repayment mechanism for sponsors that wish to discontinue plans. Participants would also benefit because sponsors could be required to pay promised benefits not limited by insurance program guarantee levels.

For this new authority to be carried out effectively, collections by PBGC should be made considering the best interest of employees, employers, and the insurance program. The financial condition of ongoing businesses that terminate pension plans ranges from strong to bordering on insolvency. PBGC must weigh these conditions carefully and set financial terms and conditions under which it will recover the plan asset insufficiency in a manner that will not affect normal business operations or employment levels.

Authorizing PBGC to claim the full amount of plan asset insufficiency as a general unsecured creditor at termination would improve the insurance program's position in bankruptcy proceedings and other insolvency actions and relate the claim for pension plan funding deficiencies more directly to the available assets from which the claim should be paid. Had PBGC been able to assert unsecured creditor claims for certain cases in our review for the full plan asset insufficiency, increased recoveries might have been obtained.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend ERISA to provide that sponsors that remain in business and terminate pension plans continue to be liable for payment of the plans' asset insufficiencies. We also recommend that the Congress authorize PBGC to

--claim, as an unsecured creditor in lieu of a claim limited to a portion of the sponsor's net worth, the full amount of plan asset insufficiency from sponsors discontinuing businesses that terminate pension plans and

--hold, for a limited time, all prior contributing sponsors secondarily liable for plan asset insufficiencies they create when the plan terminates within a specified time after its transfer to a new sponsor.

AGENCY COMMENTS AND OUR EVALUATION

PBGC stated that the administration strongly supports legislative changes needed to strengthen ERISA's employer liability provisions for single employer plans and to protect PBGC from undue losses resulting from the shifting of pension liabilities to weak employers. They stated that our recommendations that plan sponsors who remain in business and terminate pension plans be held liable for the payment of the plan asset insufficiency for guaranteed benefits would reduce PBGC's losses by eliminating the net worth cap for ongoing sponsors.

PBGC also stated that our recommendation that the Congress authorize PBGC to claim the full amount of plan asset insufficiency from sponsors discontinuing businesses that terminate pension plans as an unsecured creditor in lieu of a claim limited to a portion of the sponsor's net worth was similar to provisions in earlier draft legislation that drew considerable criticism from the business community. They explained that concern focused on the belief that such a change would make it harder for businesses to borrow on an unsecured basis or increase the cost of borrowed money. They stated that in an individual case the recommended change to general creditor status

without a net worth cap could increase PBGC's recovery, but it may not help the program in the long run, if businesses have trouble obtaining needed credit.

In our view, employers sponsoring or participating in pension plans, whether single or multiemployer plans under ERISA, should be equitably treated with respect to employer liability obligations for plan underfunding. For multiemployer plans, the Congress amended ERISA in 1980 to make employers withdrawing from such plans fully liable to the plan for their allocated share of any plan asset insufficiency. Provisions of S. 1227 now being considered by the Congress would likewise make ongoing sponsors of single employer plans fully liable to the insurance program for plan asset insufficiencies upon plan termination.

Passage of S. 1227 termination liability provisions for ongoing sponsors of single employer plans should improve businesses' credit positions. Credit decisions involving financially weak businesses have to be based largely on the likelihood of business survival. If the business is perceived for credit purposes as failing, the fact that the sponsor is fully obligated for any pension plan asset insufficiency will have little bearing on whether unsecured or low cost loans can be obtained. If the business is perceived as having a marginal chance for survival, the ability to obtain such loans should be enhanced by passage of provisions in S. 1227 that permit ongoing sponsors to pay plan asset insufficiencies over a number of years from available resources rather than as a full claim against 30 percent of net worth in the year of plan termination.

PBGC agreed with our recommendation that the insurance program be given the authority to hold all prior contributing sponsors secondarily liable, for a limited time, for plan asset insufficiencies they create when the plan terminated within a specified time after its transfer to a new sponsor. In addition, PBGC recommended that such liability extend to all trades or businesses in common control rather than only prior contributing sponsors. PBGC also suggested that members of a sponsor's controlled group should be jointly and severally liable with the terminating plan sponsor, whether or not the plan sponsor continues in business. We have not studied these proposals in depth but believe they have merit and should be considered in development of legislation to amend ERISA's single employer provisions.

GLOSSARY

Actuarial assumption	A prediction of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, and investment earnings.
Actuarial cost method	A procedure that uses actuarial assumptions to measure the present value of future pension benefits and pension fund administrative expenses and that allocates the cost of such benefits and expenses to time periods.
Actuarial gain or loss	A measure of the difference between a plan's actual experience and that expected based on actuarial assumptions.
Actuarial liability	Pension cost attributable, under the actuarial cost method in use, to years before the date of a particular actuarial valuation. As of such date, the actuarial liability represents the excess of the present value of the future benefits and administrative expenses over the present value of future normal cost for all plan participants and beneficiaries. The excess of the actuarial liability over the value of the assets of a pension plan is the unfunded actuarial liability.
Actuarial valuation	The determination, as of the valuation date, of the normal cost, actuarial liability, value of assets, and related present values for a pension plan.
Bankruptcy liquidation	A provision of chapter 7 of the Bankruptcy Code in which the assets of a business are liquidated to pay its debts.
Bankruptcy reorganization	Chapter 11 of the Bankruptcy Code allows a debtor business to restructure its finances so that it may continue to operate, provide its employees with jobs, and pay its creditors. The object of a bankruptcy reorganization is to have a bankruptcy court confirm a plan of reorganization that extends or reduces the business's debts so that it may return to a viable operating state.

Claim	The insurance program incurs a claim when the present value of a terminated plan's guaranteed benefits exceeds the plan's assets (sometimes referred to as the plan asset insufficiency).
Defined benefit plan	Generally, a plan that provides definitely determinable benefits to participants based on such factors as years of employment, retirement age, and compensation received.
Employer net worth	Generally, the difference between the value of the business assets and liabilities accumulated at a point in time. For the insurance program, PBGC determines net worth on a basis that best reflects, in its judgment, the economic value of the sponsor's assets and liabilities.
Full funding	A status that exists for a pension plan when its assets equal or exceed its actuarial liability.
Funding standard account	A special account which compares a plan's cumulative actual contributions with cumulative minimum contributions, both with interest adjustments. Avoiding a negative funding standard account is equivalent to meeting ERISA's minimum funding requirements.
Multi-employer plans	Plans that are established and maintained through collective bargaining between employee representatives and more than one employer.
Net claim	The remaining claim against the insurance program after the amount of employer liability recoverable from the terminating sponsor is deducted.
Normal cost	The portion, as determined by the actuarial cost method in use, of the present value of pension plan benefits and expenses which is allocated to a valuation year.

Past service benefits	Benefits attributable to service before the date of an actuarial valuation date. These benefits include, but are not limited to, benefits for service before the plan's inception. This term may also be used to mean only the benefits credited for service before the plan's inception.
Past service liability	A term that is sometimes used to refer to the actuarial liability that exists when the pension plan in question is established. It may also be used to mean an increase in the actuarial liability due to an amendment increasing past service benefits or synonymously with actuarial liability at the current date. The several meanings that may be attached to this term have led us not to use it in this report although it appears often in pension literature and is included in ERISA.
Pay-as-you-go	A principle under which PBGC premiums are sufficient only to pay benefits as they become due.
Present value (actuarially computed value)	The current worth of an amount or series of amounts payable or receivable in the future. Present value is determined by discounting the future amount or amounts at a predetermined rate of interest. In pension plan valuations, actuaries often combine arithmetic factors representing probability (e.g., mortality, withdrawal, future compensation levels) with arithmetic factors representing discount (interest). Consequently, to actuaries, determining the present value of future pension benefits may mean applying factors of both types.
Single employer plans	Plans that are established and contributed to by one employer or employer organization.
Unfunded actuarial liability	The excess of the actuarial liability, under the actuarial cost method in use, over the value of the assets of a pension plan.

Vested liability	The present value of vested benefits. For IRS reporting purposes, this liability is commonly computed based on a plan's continued operation. Vested liabilities at termination have generally been smaller than those reported because of the higher interest rates used to compute them.
Vesting	A plan may provide that a participant will, after meeting certain requirements, retain a right to the benefits accrued or some portion of them even though service with the employer terminates before retirement. A participant who has met such requirements is said to have a vested right. Vesting is in the form of future annuity benefits, not the cash paid to purchase the benefits.

THE PRIORITY ORDER OF CLAIMS

IN BANKRUPTCY PROCEEDINGS

In a bankruptcy liquidation under chapter 7 of the Bankruptcy Code, secured creditors have first claim on the debtor's assets, followed by the unsecured creditors. The following is the order of property distribution for payment of unsecured claims in bankruptcy liquidation as provided in 11 U.S.C. 726.

First - property is distributed among priority claimants as determined by the order prescribed in 11 U.S.C. 507:

1. Administrative expenses associated with the bankruptcy and the costs of preserving the estate of the bankrupt.

2. Claims for ordinary expenses incurred by the debtor from the start of a case of involuntary bankruptcy until appointment of a trustee by the bankruptcy court.

3. Claims for up to $2,000 per person for wages, salaries, or commissions, including vacation, severance, and sick leave pay earned within 90 days of the earlier of the filing of bankruptcy petition or cessation of business, whichever occurs first.

4. Claims for contributions to employee benefit plans arising from services rendered within 180 days before the date of the filing of the bankruptcy petition or cessation of business, whichever occurs first, in an amount for each plan not to exceed the number of employees covered by the plan times $2,000 less both (a) claims paid under subsection (3) above and (b) the aggregate sum paid to any other plan(s) for the same employees.

5. Claims of up to $900 per person for deposits for as yet undelivered goods or services intended for personal, family, or household use by the claimant.

6. Claims of governmental units for taxes and any statutory lien, such as an ERISA lien, whose priority is determined in the same manner as a tax lien, is to be treated as a tax lien.

Second - distribution to general unsecured creditors.

Third - unsecured creditors who tardily filed.

Fourth - holders of fines, penalties, forfeitures, or exemplary or punitive damages that are not compensation for actual pecuniary loss suffered by the claimant.

Fifth - interest on any claim above.

Sixth - any remainder to the debtor (bankrupt entity).

In bankruptcy reorganization under chapter 11 of the Bankruptcy Code, finances are restructured so that the debtor may continue to operate, provide its employees with jobs, and pay its creditors. The goal sought is a workable plan so that the end product is a matter for negotiation. However, a reorganization plan cannot be confirmed unless it provides that the holders of priority claims will be paid unless the holder of a particular claim agrees to a different treatment. Priority claims are essentially protected claims granted to certain classes of unsecured debts, which are enumerated above.

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-211961

JUN 13 1983

The Honorable Don Nickles
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate

Dear Mr. Chairman:

We appreciate the opportunity to comment on S. 1227, a bill to amend the Employee Retirement Income Security Act of 1974 (ERISA) for the purpose of improving the single-employer pension plan termination insurance program. The program, administered by the Pension Benefit Guaranty Corporation (PBGC), insures that participants in such plans receive certain benefits when sponsoring employers terminate underfunded plans. The bill would provide PBGC with a premium rate increase and would

--authorize PBGC to place conditions on funding waivers sponsors are granted by the Internal Revenue Service (IRS) to improve insurance program recovery prospects should plans terminate,

--prohibit ongoing sponsors from terminating insufficient plans unless the sponsor shows PBGC that it could be forced out of business if it continued plan contributions and PBGC obtains assurance that it will collect the insufficiency from the sponsor, and

--establish a contingent liability for certain sponsors divesting portions of their business with underfunded pension plans that later terminate.

The bill also provides that PBGC submit reports to the Congress within 2 years that identify (1) alternatives for performing some or all of PBGC's functions through private insurers and (2) alternative premium rates and bases that are derived in whole or in part from risks insured by PBGC.

We have been studying PBGC's assumption of pension plan liabilities under ERISA and believe measures such as those proposed in S. 1227 should be implemented to improve the financial stability of the insurance program. PBGC has operated for 5 years without an increase in premiums at a time when reported program deficits have increased from $95 million in fiscal year 1977 to $333 million in fiscal year 1982.

HR3-BILL-02

B-211961

Based on our assessment we believe that the $6 premium rate is both reasonable and necessary. We also support the other legislative changes proposed in the bill and offer the following suggestions for your consideration.

SECTION 7 - FUNDING WAIVERS

Under current law IRS can waive the employer's payment of minimum plan contributions during periods of business hardship. PBGC's insurance program can benefit if the waiver allows the sponsor to survive and its plan to eventually become sufficient. On the other hand, insurance program claims can increase if plans which received the waivers terminate before payment to the plan is completed.

PBGC currently has no statutory role in such transactions. Section 7 of the bill would amend ERISA by authorizing PBGC to impose terms and conditions on the waivers granted by IRS. The bill also provides that, as a matter of law, a lien in favor of the plan for the waived amount automatically arises on all of the employer's real or personal property at the time a funding waiver is granted. In case of bankruptcy or insolvency proceedings, the lien is to be treated in the same manner as tax due and owing the United States.

We believe the proposal to give PBGC a role in imposing terms and conditions for the waiver of contributions represents a positive step in improving PBGC's involvement in the minimum funding waiver process.

SECTION 8 - TERMINATION OF INSUFFICIENT PLANS

When pension plans terminate, sponsors are obligated by ERISA to finance any deficiency in plan assets needed to meet guarantee levels of the insurance program up to a limit equal to 30 percent of the sponsor's net worth. Although the Congress anticipated that such liability provisions would deter solvent sponsors from terminating underfunded plans and produce a reasonable, although limited, recovery of liability from insolvent sponsors, it is not clear that these objectives have been effectively met.

Revisions proposed in S. 1227 would make termination of insufficient plans proposed by plan sponsors effective only where PBGC finds that a sponsor has proven that it would be forced out of business if it continued contributing to the plan. Where the sponsor is continuing in business PBGC must, as a condition of termination, find that it

B-211961

--will receive the lesser of 30 percent of the employer's net worth or the plan asset insufficiency;

--will receive all outstanding contributions owed the plan, including amounts waived by IRS; and

--is reasonably assured it will receive any amounts necessary to fund the plan's unfunded guaranteed benefits remaining after the above collections from future employer profits, considering the best interests of the employees, employers and PBGC.

These proposed changes will afford PBGC with a means for collecting plan asset insufficiencies from sponsors terminating pension plans and continuing in business. However S. 1227 leaves intact the 30 percent of net worth limitation for collection of employer liability from sponsors discontinuing business, thus precluding in most cases recovery of any significant portion of the plan asset insufficiencies from these sponsors.

The Committee may wish to amend ERISA to eliminate the 30 percent net worth limitation and provide for PBGC to claim all of the plan insufficiency from the sponsor. This would enable PBGC to recover a greater portion of the plan asset insufficiency where sponsors discontinuing business retained unsecured assets at plan termination. It would also make single-employer liability provisions of ERISA compatible with ERISA multiemployer provisions which were revised in 1980 to make employers participating in such plans fully liable for their allocated portion of the plan asset insufficiency without limitation of net worth. Earlier legislative proposals (S. 1541, H.R. 4330, and H.R. 4334 introduced in July 1981) included provisions giving PBGC the authority to claim the full amount of plan asset insufficiency as a general unsecured creditor at plan termination.

SECTION 9 - CONTINGENT LIABILITY

Responsibility for unfunded pension liabilities can be transferred to a new sponsor when ownership interests in a business, subsidiary, or division are sold, transferred, or otherwise changed. If the pension plan later terminates, PBGC does not have authority under ERISA employer liability provisions to obtain recovery of any plan insufficiency from the original sponsor that existed before the plan changed hands. Where unfunded liabilities are transferred from a financially

B-211961

strong to a financially weak sponsor, the risk of plan termination and exposure of the insurance program are substantially increased.

S. 1227 would amend ERISA to create a contingent liability extending over 10 years following business transfers by a plan sponsor or controlling business entity when unfunded guaranteed benefits of $500,000 or more exist at the time of the transfer. The bill would permit payment of the liability to be amortized over 15 years.

We are in general agreement with the changes in section 9 of S. 1227. Over 80 percent of PBGC's claims through fiscal year 1981 were incurred from plans with claims exceeding $1 million. Based on PBGC's past experience, the floor proposed in S. 1227 would apply contingent liability provisions to claims having the greatest impact on the insurance program.

SECTION 10 - ACTIONS REQUIRED OF PBGC

Section 10 of the bill requires PBGC to provide the Congress with reports that identify the feasibility of and alternatives for performing some or all of PBGC's functions in the private sector and for scheduling premium rates based on risk. These matters have periodically been the subject of discussion and debate in the pension community, and completion of studies proposed in the bill should identify available alternatives for more economical delivery of pension insurance.

Sincerely yours,

MILTON J. SOCOLAR

for Comptroller General
of the United States

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

SEP 13 1983

Mr. Richard L. Fogel, Director
Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Re: Proposed General Accounting Office Report Entitled "Legislative Changes Needed to Financially Strengthen Single-Employer Defined Benefit Pension Plan Insurance Program"

Dear Mr. Fogel:

We appreciate the opportunity to comment on the draft of the proposed report. We heartily agree with your finding that it is essential that the single-employer premium rate be increased as soon as possible in order to assure that the program remains financially sound. The Administration strongly supports legislative changes needed to strengthen the employer liability provisions for single-employer plans and to protect PBGC from undue losses resulting from minimum funding waivers and the shifting of pension liabilities to weak employers.

Following are our comments on some of the specific recommendations contained in the Report.

MECHANISM FOR RAISING PREMIUMS (Chapter 2)

The GAO Report suggests that the Congress consider revising the statutory mechanism for increasing premiums in order to assure that necessary increases be effected more quickly. One option GAO noted was amendment of ERISA to provide an automatic annual adjustment in the premium. GAO suggested that this could be accomplished using the methodology in PBGC's May 1982 premium study. That methodology bases the required premium rate on a 5-year claims forecast developed from the claims experience of several prior years. This is in contrast to adjustments based on the experience of a single year only, when experience and thus the premium rate could fluctuate greatly from year to year.

Automatic adjustments may provide greater assurance that the program would remain funded on a sound actuarial basis and would help avoid large increases in the premium at any one time. In addition, automatic adjustments may help assure that claims are financed by plans covered in the years those claims

were incurred rather than by new plans established at a later date. However, PBGC has not had an opportunity to explore the GAO proposal and cannot at this time definitively conclude that it would be the most effective method of setting premium rates.

UNFUNDED PAST SERVICE BENEFITS (Chapter 3)

The GAO Report notes that PBGC's costs can increase because a terminated plan had granted past service benefits. The Report suggests that Congress consider tightening the amortization period for funding past service benefits. Reducing the funding amortization period would affect both well-funded and poorly-funded plans. Because PBGC's losses come only from poorly-funded plans, we do not understand the need for rules that would affect well-funded plans. Rules could be adopted that would affect only newly adopted and poorly-funded plans. For example, the minimum contribution could be the greater of the current statutory minimum contribution or a minimum contribution that generally would amortize currently unfunded vested liabilities over x years and increases in unfunded vested liabilities over y years, where y is less than x. If more stringent funding requirements were adopted for poorly-funded plans, there probably would have to be transition rules so as not to impose unreasonably high contributions on those plans in the early years. Any change in the funding standards must be designed so that, consistent with the Act's statement of purposes in section 4002(a), it does not discourage establishment or continuation of defined benefit plans, while maintaining premiums at the lowest level consistent with the PBGC's carrying out its obligations.

MINIMUM FUNDING WAIVERS

GAO recommends that ERISA be amended to provide specifically for making the outstanding balance of all previously waived amounts due upon plan termination. This condition has sometimes been included in waivers granted by the IRS. This condition alone has not been sufficient to assure collection of those unpaid amounts. This is because the employer's condition at plan termination generally is very weak, often significantly weaker than on the earlier date on which a funding waiver was granted. PBGC believes that plans would be able to collect a larger percentage of the outstanding balance of waived amounts at termination if funding waivers are made subject to terms and conditions on payment set by the PBGC. S. 1227 contains a provision which would give the PBGC this authority, and the GAO report cites it as a positive step

in improving PBGC's involvement in the minimum funding waiver process. We urge the GAO to include in the recommendations section a recommendation that PBGC be given the statutory authority to set terms and conditions on payment of waived contributions. This legislative change would better protect participants and PBGC from financial losses resulting from funding waivers.

EMPLOYER LIABILITY (Chapter 5)

The GAO Report recommends that a plan sponsor that remains in business and terminates its plan be liable for the payment of the plan's asset insufficiency for guaranteed benefits. This provision would reduce PBGC's losses by eliminating the net worth cap for ongoing sponsors. The Report also recommends that the Congress authorize PBGC to "claim the full amount of plan asset insufficiency from sponsors discontinuing businesses that terminate pension (plans) as an unsecured creditor in lieu of a claim limited to a portion of the sponsor's net worth." S. 1541, introduced in July 1981, contained a similar provision which drew considerable criticism from the business community because of concern that it would make it harder for businesses to borrow on an unsecured basis or increase the cost of borrowed money. While in an individual case the recommended change to general creditor status without a net worth cap could increase PBGC's recovery, it may not help the program in the long run, if businesses have trouble obtaining needed credit. We point out that the termination, and minimum funding waiver provisions of S. 1227, introduced by Senator Nickles this session, accomplish a significant part of GAO's suggestions. The termination provisions assure that underfunded plans terminating for reasons other than the plan sponsor's liquidation will be required to pay to the PBGC a profits interest which will provide the PBGC opportunity to recover the entire plan asset insufficiency. In addition, the provisions of the bill relating to minimum funding waivers will require the plan sponsor to provide security to the plan to collateralize the waiver, insuring that PBGC will incur a smaller loss on termination of plans which have received waivers.

Members of a sponsor's controlled group, however, should be jointly and severally liable with the plan sponsor, whether or not the plan sponsor continues in business.

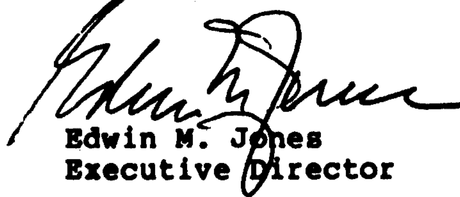
CONTINGENT LIABILITY (Chapter 5)

GAO recommends that PBGC have the authority to hold all prior contributing sponsors secondarily liable, for a limited time, for plan asset insufficiencies they create when the plan terminates within a specified time after its transfer to a new

sponsor. We recommend that secondary liability attach to the prior plan sponsors and all trades or businesses in common control.

We greatly appreciate the efforts of your staff and GAO's support for a premium increase and legislative changes which will improve the financial stability of the insurance program. If I can be of further assistance to you and your staff in finalizing the Report, please do not hesitate to contact me.

Sincerely yours,



Edwin M. Jones
Executive Director

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

SEP 1 1983

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

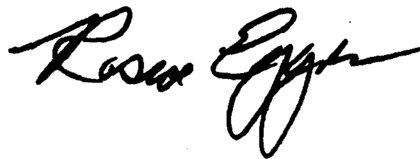
Dear Mr. Anderson:

This is in response to your letter of August 3, 1983, requesting comments on your draft report, "Legislative Changes Needed to Financially Strengthen Single Employer Defined Benefit Pension Plan Insurance Program." We do not oppose its adoption.

Thank you for giving us the opportunity to comment on your draft report.

With kind regards,

Sincerely,



Department of the Treasury Internal Revenue Service

U.S. Department of Labor

Assistant Secretary for
Labor-Management Relations
Washington, D.C. 20210

21 SEP 1983

Mr. Philip A. Bernstein
Director
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Bernstein:

In reply to your request for comments on the draft GAO report entitled "Legislative Changes Needed to Financially Strengthen Single Employer Defined Benefit Pension Plan Insurance Program," the Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,

Ronald J. St. Cyr
Deputy Assistant Secretary

Enclosure