United States General Accounting Office 132801

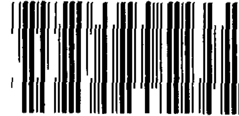
GAO

Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

March 1987

PENSION PLANS

Government Insurance Program Threatened by Its Growing Deficit



released

RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations.

538476

RELEASED

GAO/HRD-87-42

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

Human Resources Division

B-222943

March 19, 1987

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This report responds to your February 12, 1986, request for information on the causes of large claims against the Pension Benefit Guaranty Corporation's single-employer pension plan insurance program and the potential effects of the Single Employer Pension Plan Amendments Act of 1986 on the program. The report discusses several suggested changes that the Congress should consider to enhance the program's long-term financial viability.

As requested by your office, we will not make additional distribution of this report for 24 hours. At that time, we will send copies to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, various congressional committees and subcommittees concerned with pension issues, and other interested parties.

Sincerely yours,

Richard L. Fogel

Richard L. Fogel
Assistant Comptroller General

Executive Summary

Purpose

The Employee Retirement Income Security Act of 1974 (ERISA) established funding standards and an insurance program to protect the benefits of about 30 million participants in over 110,000 single employer defined benefit pension plans. As of September 30, 1985, the insurance program reported a deficit of $1.3 billion. The deficit was estimated to be about $4 billion in January 1987 primarily because plans of the bankrupt LTV Corporation were terminated with unfunded benefits of about $2 billion.

The Single Employer Pension Plan Amendments Act, enacted in April 1986, included provisions to improve the program's financial condition. This report, requested by the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, assesses the causes of large claims against the program and the potential effects of the 1986 amendments on the program.

Background

The funding standards require employers to contribute a minimum amount of money annually for their plans' estimated current year cost and amounts needed to pay off unfunded liabilities, such as those arising from benefit increases for participants' past service, which can be paid over specified periods—generally up to 30 years. The contributions are due not later than 8-1/2 months after the end of the plan year they cover unless waived by the Internal Revenue Service (IRS), which enforces the standards. Unpaid contributions, however, generally come due upon plan termination. (See pp. 13 and 14.)

The insurance program, administered by the Pension Benefit Guaranty Corporation (PBGC), generally guarantees the benefits of participants in terminated plans. Benefits not covered by plan assets represent an insurance claim that is to be financed by (1) collections from employers causing the claims and (2) premiums paid by ongoing insured plans. (See pp. 8 and 9.)

The amendments were designed to (1) prevent claims from plans terminated by employers that are not financially distressed, (2) increase claims recovery from financially distressed employers by raising their liability for unfunded benefits, and (3) raise program revenue by increasing the premium rate. (See pp. 20 and 21.)

Results in Brief

GAO found that $451 million (90 percent) of the program's $501 million in claims during 1983-85 was caused by 23 employers terminating 33 plans. Of these claims,

- 70 percent resulted from the funding standards not requiring sufficient contributions to pay for the plans' rising unfunded guaranteed benefits, in part due to numerous benefit increases within 5 years of termination, and
- 30 percent resulted from required contributions not being paid before the plans were terminated. (See pp. 9, 12, and 13.)

Despite their positive effects, the 1986 amendments may not be enough to ensure the program's long-term financial viability. If the amendments had been in place when the 23 employers terminated their plans, they could have prevented claims from a few of the employers who were not financially distressed and better financed the claims that did occur. However, the majority of the claims dollars came from plans terminated by financially distressed employers. (See ch. 3.)

The 1986 amendments would not likely have resulted in a significant increase in PBGC's recovery of such claims because the employers were in bankruptcy proceedings and PBGC's claims in such proceedings continue to have a low priority. Considering current and expected future conditions, the premium revenue generated under the amendments will not be enough to retire the program's current deficit, much less pay for unrecoverable claims from future plan terminations. More importantly, PBGC officials now expect the program to become insolvent within 15 years. (See ch. 3.)

Principal Findings

Contributions Not Sufficient to Fund Increased Benefits

The unfunded benefits of the 33 terminated plans almost doubled during the 5 years before termination—growing from $232 million to $451 million. Even if all the $262 million in contributions required during the period by the funding standards had been made to the 33 plans, they would still have been underfunded by $317 million. Benefit increases granted in 27 of the 33 plans in the 5 years before plan termination contributed to the rise in underfunding. The increases were generally being financed over the longest periods allowed by the funding standards and, in some cases, became effective while contributions were waived by IRS

or unpaid by employers. Because these increases were generally guaranteed, they contributed to the claims against the insurance program. (See pp. 13 to 15.)

Contributions Not Paid

The 23 employers made only about half of the $262 million in contributions required during the 5-year period. Of the $127 million in unpaid contributions, 45 percent represented amounts that were not yet due because the required payment date had not been reached before the plans terminated. About 32 percent of the unpaid contributions were overdue; IRS waived the requirements that another 23 percent be paid. (See pp. 15 to 19.)

Preventing Claims

The 1986 amendments should help the program to the extent that claims from employers that are not financially distressed are prevented. However, 18 of the 23 employers with large claims in 1983-85 would likely have met the amendments' distress standards and been allowed to terminate the plans because they were involved in bankruptcy proceedings or experiencing financial hardship. These employers accounted for 96 percent of the group's claims. (See pp. 20 and 21.)

Raising Employer Liability

Before the amendments, PBGC recovered or expected to recover 14 percent of the claims from the 23 employers terminating underfunded plans. The recovery was low because employers had little or no net worth and liability for claims was limited to a percentage of available net worth. Also, employers causing large claims were generally bankrupt, and PBGC's claims had a low priority (unsecured creditor status) in bankruptcy proceedings. (See pp. 21 and 22.)

The 1986 amendments, by raising employers' liability to 75 percent of unfunded benefits, should increase PBGC's recoveries. However, a significant increase in recoveries appears doubtful if most employers terminating underfunded plans continue to be bankrupt. (See pp. 22 and 23.)

Raising Revenue

The 1986 amendments increased the annual premium rate from $2.60 to $8.50 per plan participant. The rate increase is projected to generate an average of $298 million in revenue to finance the program's current and future costs. Due primarily to large claims from the LTV Corporation's terminated plans, PBGC officials estimated in January 1987 that the deficit was about $4 billion, three times the previously reported $1.3 billion.

About $446 million a year would be required to retire the newly estimated deficit over 15 years, and other program costs are projected between $775 million and $1.5 billion annually. Under these conditions, an $8.50 premium rate is inadequate. Moreover, annual program benefit payments are expected to be $650 million within the next 2 years, causing an asset drain that could render the program insolvent by 2002. (See pp. 23 and 24.)

Matters for Consideration by the Congress

The Congress may wish to consider additional changes to enhance the program's long-term financial viability. Such changes include

- raising minimum contribution requirements,
- requiring employers to make contribution payments sooner than 8-1/2 months after year end,
- reducing guaranteed benefits,
- raising the priority of PBGC claims against employers in bankruptcy, and
- raising the premium rate again. (See p. 27.)

Recommendations

In light of the matters for congressional consideration, GAO is making no specific recommendations to PBGC or IRS.

Agency Comments

PBGC substantially agreed with GAO's analysis of the causes of large claims and the potential effects of the 1986 amendments on the insurance program. PBGC said that other changes, such as tightening the conditions under which funding waivers are granted, should also be considered for improving the program's financial condition. (See app. II.)

IRS expressed concern about the limited scope of GAO's study. IRS commented that adequate information was not developed to (1) present a complete picture of the situation involving funding waivers or (2) make overall judgments about changes in the funding standards. Although GAO's study did not include plans that received waivers and did not terminate, GAO believes that it is adequate to show the impact of waivers on claims incurred by the insurance program. Because the study covered 90 percent of the fiscal year 1983-85 program claims, GAO believes that it affords a reasonable basis for suggesting that the Congress consider changing the funding standards. (See app. II and III, and pp. 29 and 30.)

Contents

Executive Summary		2
Chapter 1 Introduction		8
	Program's Claims Experience	8
	Program's Financial Condition	9
	Objectives, Scope, and Methodology	10
Chapter 2 Causes of Large Insurance Program Claims		12
	Funding Standards and Guaranteed Benefits	13
	Required Contributions Insufficient to Fund Guaranteed Benefits at Termination	14
	Required Contributions Unpaid at Termination	15
Chapter 3 Potential Effects of 1986 Amendments on Program's Claims and Financing		20
	Preventing Claims From Nondistressed Employers	20
	Raising Employer Liability for Claims	21
	Raising Premium Revenue	23
Chapter 4 Conclusions and Matters for Consideration by the Congress		26
	Conclusions	26
	Matters for Consideration by the Congress	27
	Examples of Potential Effects of Suggested Changes	27
	Agency Comments and Our Evaluation	28
Appendixes	Appendix I: Characteristics of Participants in 33 Sampled Plans Reviewed	32
	Appendix II: Comments From the Pension Benefit Guaranty Corporation	33
	Appendix III: Comments From the Internal Revenue Service	35
Tables	Table 1.1: Size of Insurance Claims by Employers and Claims Amount (1983-85)	9

Table 2.1: Plans' Funded Status at Termination Compared to 5 Years Before Termination 12
Table 3.1: Operating Condition of Employers Causing Large Program Claims (1983-85) 21
Table 4.1: Examples of Potential Effects of Suggested Changes 28
Table I.1: Industries in Which Participants Were Employed 32

Figures

Figure 1.1: Insurance Program Claims (Fiscal Years 1975-85) 9
Figure 2.1: Decline in Ratio of Actual to Minimum Contributions to 33 Plans Within 5 Years of Plan Termination 16
Figure 2.2: Causes of Unpaid Minimum Contributions at Plan Termination 17
Figure 3.1: Financing of Large Claims Through Recoveries From Employers Terminating Underfunded Plans and From Premium Revenue (1983-85) 22
Figure I.1: Status of Participants When Plans Were Terminated 32
Figure I.2: Number of Participants Eligible to Receive Guaranteed Benefits 32
Figure I.3: Union Membership of Plan Participants 32

Abbreviations

ERISA	Employee Retirement Income Security Act of 1974
GAO	General Accounting Office
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation
SEPPAA	Single Employer Pension Plan Amendments Act of 1986

Introduction

A single employer defined benefit pension plan pays a specific retirement benefit, generally determinable in advance by a formula, to employees of the employer sponsoring the plan. The Employee Retirement Income Security Act of 1974 (ERISA) established funding standards and an insurance program to help ensure that employees and their beneficiaries (participants) receive their earned benefits. The program covers about 110,000 plans with about 30 million participants.

The funding standards require employers to contribute minimum amounts annually to their plans unless they receive a contribution waiver from the Internal Revenue Service (IRS), which enforces the standards. The insurance program, which is administered by the Pension Benefit Guaranty Corporation (PBGC), guarantees, within certain limits, participants' vested benefits at plan termination.[1] When plan assets are not sufficient to cover guaranteed benefits, PBGC assumes responsibility for paying these benefits by becoming plan trustee. Such unfunded but guaranteed benefits are counted as a claim against the program at the time that the liability is assumed by PBGC.

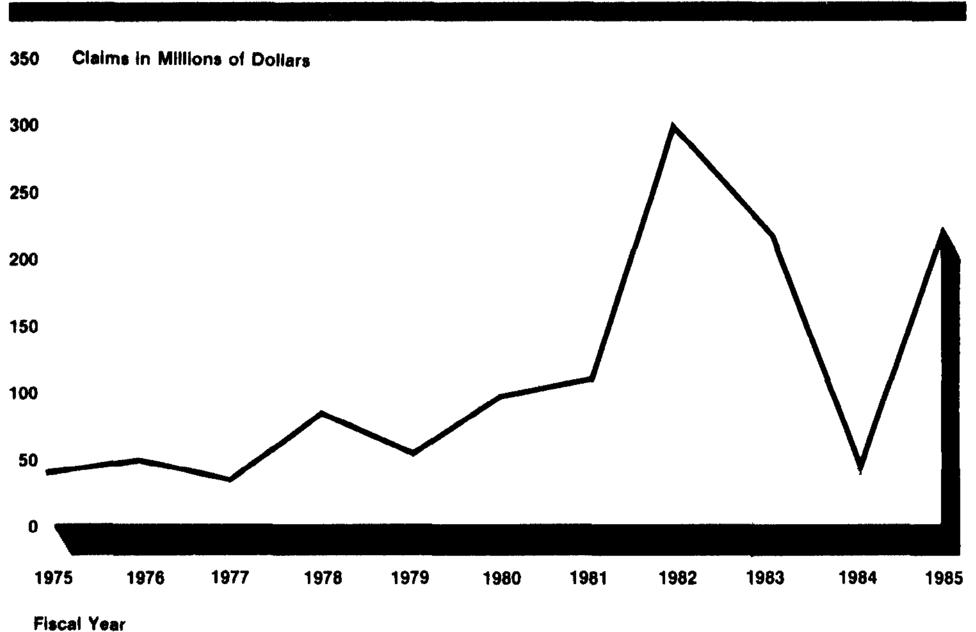
Program's Claims Experience

PBGC's data show that, during the program's first 11 years (1975-85), 922 employers terminated 1,115 pension plans that did not have enough assets to pay guaranteed benefits to about 160,000 insured participants. Claims from these plans totaled about $1.3 billion. By contrast, about 67,000 plans terminated during this period with enough assets to pay guaranteed benefits.

As shown in figure 1.1, annual program claims from 1975 through 1985 varied in size—from a low of $32 million in fiscal year 1977 to a high of about $296 million in 1982. However, the trend in the annual amount of claims was increasing during the period, with about 64 percent of total claims occurring in fiscal years 1982-85.

[1] ERISA requires plans to provide that participants will, after meeting certain requirements, retain a nonforfeitable right to the benefits they have earned even if they terminate employment with the plan sponsor before retirement. Such nonforfeitable benefits are called vested benefits

Figure 1.1: Insurance Program Claims
(Fiscal Years 1975-85)



Our analysis of PBGC's data showed that, during fiscal years 1983-85, 205 employers terminated 241 underfunded plans, leading to claims of about $501 million. Table 1.1 shows the breakdown of this group.

Table 1.1: Size of Insurance Claims by Employers and Claims Amount
(1983-85)

Dollars in millions

	Employers		Claims	
Claim size	**Number**	**Percent**	**Amount**	**Percent**
Over $25 million	5	2	$362 6	72
Over $2 million to $25 million	18	9	87 9	18
$2 million or less	182	89	50 8	10
Total	**205**	**100**	**$501.3**	**100**

Program's Financial Condition

Claims dollars that are not recoverable from employers terminating plans are considered to be net claims (losses), which must be financed by premiums paid to PBGC by ongoing insured plans. Since its inception, the program has operated at a deficit; that is, its losses and administrative costs have exceeded premiums paid. As of September 30, 1985, the program reported a deficit of $1.3 billion (liabilities of $2.7 billion minus assets of $1.4 billion), including a liability for a pending claim of over $400 million for plans that were later terminated by the Wheeling-Pittsburgh Steel Corporation in November 1985.

During 1985, PBGC estimated that, initially, premium income and investment return would be enough to cover the program's annual costs—benefit payments to participants and administrative expenses. Eventually, however, program costs were expected to exceed income and drain program assets. PBGC estimated that, by the year 2002, the program would be insolvent—not have enough assets to pay annual program costs—if the then premium rate of $2.60 was not increased.

PBGC proposed legislative actions, including a premium rate increase, to improve the program's financial condition. The Single Employer Pension Plan Amendments Act of 1986 (SEPPAA), enacted April 7, 1986, included provisions similar to those proposed by PBGC. As discussed in chapter 3, however, the insurance program's financial condition has weakened further since SEPPAA's enactment.

Objectives, Scope, and Methodology

On February 12, 1986, the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, asked us to provide information on the extent of plan underfunding and causes of large insurance claims from plan terminations. On June 24, 1986, we testified on these subjects during a hearing held by the Subcommittees on Oversight and Social Security. In a report entitled Pensions: Plans With Unfunded Benefits (GAO/HRD-87-15BR, Oct. 22, 1986), we gave the Chairman of the Subcommittee on Oversight more detailed information on the extent of plan underfunding in ongoing plans.

As agreed with the Subcommittee, this report primarily provides more detailed information related to (1) the causes of 23 employers' large claims[2] (over $2 million) during fiscal years 1983-85 and (2) the potential effects of SEPPAA on claims and their financing. These employers, as noted in table 1.1, accounted for 90 percent of the claims dollars by terminating plans between 1983 and 1985. Our audit work was primarily done between February and September 1986.

To identify the causes of large claims, we interviewed officials of PBGC and IRS and reviewed data maintained by these agencies on the 33 plans terminated by the 23 employers. We also reviewed pension plan reports filed by plan administrators with the Department of Labor. Where appropriate, we interviewed plan representatives (primarily actuaries)

[2]For purposes of this study, we considered all plans terminated by an employer to be a single claim The 23 employers terminated a total of 33 plans Appendix I contains descriptive information on the 35,000 participants in the 33 plans.

and requested plan records that were not available at the government agencies. Our analysis of plan data was limited to the 5-year period before the plans terminated because earlier data were generally not available.

Because SEPPAA was enacted so recently, sufficient time had not elapsed to measure its effects on the insurance program. Therefore, we used the data collected on the large claims from the 23 employers, along with other available information, to get an indication of the potential effects of selected major provisions. Our analysis was based on a comparison of what happened before SEPPAA and what might have happened if the act had been in effect when the large claims occurred.

To ensure compliance with the disclosure provisions of the Internal Revenue Code, we have not identified, by name, the 23 employers in this report. We do, however, identify three other employers who terminated large underfunded plans in fiscal years 1986 and 1987 because the information discussed in this report on their terminations is publicly available and thereby not covered by the disclosure provisions. This review was performed in accordance with generally accepted government auditing standards.

Causes of Large Insurance Program Claims

Our review of the 33 terminated plans that caused 90 percent of the claims dollars against the insurance program during fiscal years 1983-85 showed that their unfunded benefits almost doubled during the 5 years before termination.[1] As shown in table 2.1, 44 percent of the plans' total vested and generally guaranteed benefits were unfunded at the start of the period. At termination, the plans' guaranteed benefits were 66 percent unfunded.

Table 2.1: Plans' Funded Status at Termination Compared to 5 Years Before Termination

Dollars in millions

Funding status	Five years before termination		At termination	
	Amount	Percent	Amount	Percent
Unfunded	$232 3	44	$450 5	66
Funded	298 1	56	227 7	34
Total benefit liability	**$530.4**	**100**	**$678.2**	**100**

Of the $451 million in unfunded guaranteed benefits at termination, about

- $317 million (70 percent) resulted from minimum contributions permitted by the funding standards being insufficient to pay for the plans' rising unfunded benefits by the time they terminated, and
- $134 million (about 30 percent) resulted from minimum contributions computed under the funding standards not being paid at plan termination.

We identified several factors contributing to the increased underfunding during the 5 years before termination.[2] Although we were not able to quantify the dollar effect of all of the factors, we believe that each contributed significantly to the underfunding of the 33 plans. We noted, for example, that the plans were frequently amended to increase benefits during the 5 years before termination and most of the increases were guaranteed by the insurance program at plan termination. Moreover, of the unpaid minimum contributions at termination, more than half represented those that were overdue (32 percent) and those that had been

[1]The funded status at termination is based on PBGC's valuation of the plans' assets and guaranteed vested benefits. The funded status 5 years before termination comes from plan reported figures that were mostly based on long-term interest rates lower than the rates available when the plans actually terminated. To make the two sets of figures comparable, we recalculated the plans' reported vested benefits at PBGC interest rates available at plan termination

[2]Our analysis of the 33 plans showed that the decrease in funds from $298 1 million to $227 7 million was caused primarily by the decline in employer contributions while benefit payments to retirees continued.

waived by IRS (23 percent). The remainder (45 percent) represented contributions for plan periods just before termination that came due as a result of termination.

Funding Standards and Guaranteed Benefits

ERISA's funding standards require an employer to make annual minimum contributions to a plan based on one of several funding methods and on assumptions concerning future plan costs. The funding method determines how contributions needed to pay for a plan's benefits will be spread over future years. Assumptions about mortality rates, employee turnover, compensation levels, and investment earnings are used to project plan assets and benefits.

An employer's minimum contribution generally includes a plan's estimated (1) current year costs and (2) amounts needed to pay off its unfunded liabilities over specified future periods. Unfunded liabilities arise when benefit improvements are granted to working participants for their past service or to retirees (e.g., cost-of-living increases), when assumptions are changed, or when plan experience differs from that anticipated. Increases in unfunded liabilities caused by assumption changes and unanticipated experience can generally be paid off under the funding standards over maximum periods of 30 and 15 years, respectively.

Unfunded liabilities caused by past service benefit improvements can also be paid over 30 years. This long-time financing provides an incentive for employers to establish and maintain defined benefit pension plans and to provide benefit increases that might not otherwise be affordable.

Under ERISA and IRS regulations, employers are not required to make annual contributions until 8-1/2 months after the end of the plan year. If a plan terminates, however, unpaid contributions generally come due as of the termination date. An employer may request and IRS may authorize a waiver of all or part of the required annual contribution if (1) the payment cannot be made without the employer incurring a substantial hardship, and (2) the waiver is in the best interests of plan participants (e.g., the waiver may allow the employer and the plan to continue). Waivers are not permitted for more than 5 of any consecutive 15 years. Amounts waived must be repaid within 15 years.

The insurance program guarantees participants' vested benefits at termination within certain limits. Benefit increases within 1 year of plan

termination are not insured. Increases in effect for longer than 1 year but less than 5 years are phased in at a rate of 20 percent of the increase or $20 of monthly benefit, whichever is greater, for each additional year that the increase has been in effect. Generally, all benefit increases are fully insured after 5 years.

Required Contributions Insufficient to Fund Guaranteed Benefits at Termination

The minimum funding standards were designed to provide reasonable assurance that an ongoing pension plan will systematically accumulate sufficient assets to pay benefits to participants and their beneficiaries as they come due. The standards do not, however, assure that a plan's vested (generally guaranteed) benefits will be fully funded in the event of plan termination. Furthermore, the standards do not prohibit a plan's unfunded vested benefits from growing over time.

The information available on the 33 plans terminated by the 23 employers indicated that, although almost all minimum contributions had been paid by employers as of 5 years before plan termination, the plans' vested benefits were underfunded at that time by a total of $232 million. Further, even if all of the additional $262 million in contributions required for the subsequent 5 years had been paid, the plans would still have been underfunded at termination by about $317 million—a 37-percent increase in unfunded benefits during the period.

A plan may operate with large unfunded vested benefits for a variety of reasons even though minimum contribution requirements computed under the funding standards are being met. Some funding methods, for instance, result in slower asset accumulation than others. Unfunded benefits may also arise when a plan's actual experience is less favorable than previously assumed (e.g., earnings from investments may be lower than anticipated). Further, benefit improvements can cause underfunding because vested benefits are increased immediately while their funding can be spread over future plan years. These improvements include both plan amendments raising benefits for participants' past service and salary increases in plans with salary-based benefit formulas.

Another source of underfunding occurs in plans that provide special supplemental benefits—frequently called shutdown benefits—in the event of plant closings. According to PBGC, these benefits generally are not prefunded but may be insured by the insurance program.

We generally could not identify or precisely quantify the extent to which each of these reasons contributed to plan underfunding at termination because of the limited historical plan funding and participant information available on the 33 plans covered by our review. We found indications, however, that benefit improvements during the 5 years before plan termination contributed significantly to increased plan underfunding.

The gradual funding of benefit improvements is not a major concern as long as plans continue. However, such funding of increases can produce larger insurance claims if contributions are not sufficient to pay for the increases by the time plans terminate.

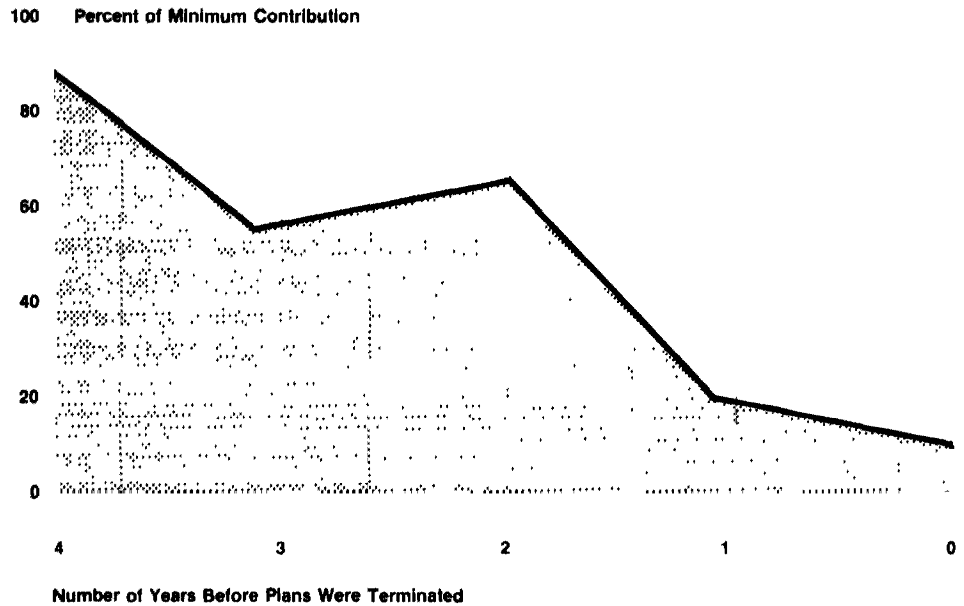
In this regard, we found that 27 of the 33 plans were amended to increase benefits during the 5 years before their termination and most of the increases were guaranteed at termination.[3] Benefits were increased in 16 of the plans three or more times during the period, and increases in 17 plans became effective while contributions were waived or unpaid. Also, when employers made contributions in the 5 years before plan termination, most contributed at the minimum levels required under the funding standards. Therefore, even when required contributions were being made in full, the plans' unfunded benefit liabilities, including those resulting from benefit increases, were being funded over the longest periods allowed by the funding standards.

Required Contributions Unpaid at Termination

As figure 2.1 shows, the percentage of minimum annual contributions determined under the funding standards that were paid to the 33 plans by the 23 employers sponsoring them declined significantly during the 5 years before their termination. These unpaid contributions caused $134 million (about 30 percent) of the plans' $451 million in claims against the insurance program.

[3]Of the six plans that were not amended to increase benefits, three had salary-based benefit formulas.

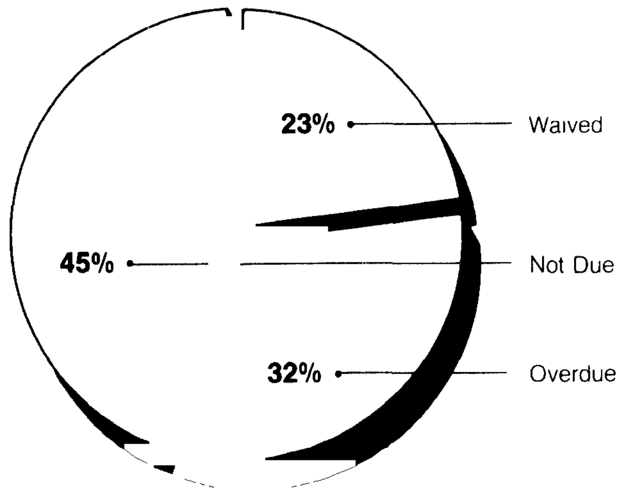
Figure 2.1: Decline in Ratio of Actual to Minimum Contributions to 33 Plans Within 5 Years of Plan Termination



The $134 million consisted of $127 million in unpaid contributions by 20 employers sponsoring 30 of the plans and about $7 million in interest on the unpaid amounts. The $127 million represented about 54 percent of the $235 million in total contributions required from these 20 employers for the 5-year period.

As figure 2.2 shows, overdue contributions and contributions that had been waived by IRS accounted for significant percentages of the $127 million in unpaid contributions. Contributions that were not due before termination, but became due because of termination, accounted for the most significant percentage and amount—45 percent and about $57 million.

Figure 2.2: Causes of Unpaid Minimum Contributions at Plan Termination



Unpaid Contributions Not Due Until Termination

Of the 30 plans with unpaid contributions at termination, all had contributions that did not become due until termination. These unpaid amounts totaled about $57 million. The 20 sponsoring employers owed $35.4 million to the 30 plans for the partial year of termination. Twelve of the employers also owed $21.5 million in contributions to 17 plans for the prior year. These contributions had not come due because the plans were terminated before the required payment date—8-1/2 months after the end of the plan year.

The unpaid contributions covered an average of 14 months of plans' operations, ranging from 1 month to 20 months. The 20 employers owed contributions at plan termination ranging from $94,000 to $24.4 million.

For example, an employer terminated a plan in July 1985 without making a $15.6 million contribution for plan year 1984, which ended on December 31, 1984. (The contribution was not due until September 15, 1985.) Also, an $8.8 million contribution for the first 7 months of plan year 1985 came due at plan termination. As a result, the employer at termination owed $24.4 million in contributions and $1.1 million in interest on the unpaid contributions for the prior 19-month period.

Required Contributions Not Waived or Paid

At the termination of 21 plans sponsored by 12 employers, $41 million in unpaid contributions were overdue because the 8-1/2-month period had elapsed. The contributions were overdue by an average of about 14 months at plan termination. Nine of the employers had requested waivers on some or all of the contributions, but some requests were later withdrawn and IRS had denied or not yet reached a final decision on the other requests by the time the plans were terminated. The other three employers had not requested waivers for $7.4 million in unpaid required contributions.[4] The 12 employers included:

- An employer who requested a waiver for $5 million in contributions for two plans' previous plan year of operation on the last day of the 8-1/2 months after the end of the year. The plans were terminated shortly after IRS denied the waiver request.
- An employer who did not make required contributions for 2 consecutive plan years. The employer did not request a waiver for either year, according to IRS records, and the plan was eventually terminated with $6.4 million in unpaid required contributions for the 2 years.

Plans Terminated Before Waived Contributions Were Repaid

Nine employers had about $29 million in unpaid waived contributions to 15 plans at termination. IRS had approved waivers for these employers' contributions ranging from $315,000 to $8.3 million. Four employers received waivers for a single plan year, while five employers received them for 2 years or more. Each employer was required to repay the waived amounts with interest over a 15-year period. When the plans later terminated, unpaid amounts, except for $800,000 for two employers, came due immediately based on agreements reached between IRS and the employers as a condition of waiver approval. Such an agreement was not included in the waiver approvals for the two employers because IRS did not believe such a condition was needed at that time. Eight employers made partial payments before terminating their plans. The original amounts waived for these eight employers were not reduced at plan termination because of interest charges on the waived contributions. The nine employers included:

- an employer who received waivers for $6.1 million in minimum contributions owed to two plans for the years 1981 and 1982. After a few payments, the employer ceased all contributions. When the plans were

[4]The scope of our review did not cover the circumstances surrounding the overdue contributions However, we plan to review pension contribution requirements and IRS's administration of them in a later study.

terminated in 1985, the unpaid contributions had grown with interest to $6.8 million and accounted for 22 percent of the plans' underfunding of $31 million.

- an employer who received a waiver for $315,000 for a single plan year. The employer terminated the plan shortly after the waiver was approved and did not make a payment. The waived amount with interest accounted for 10 percent of the plan's $3.8 million underfunding at termination.

Potential Effects of 1986 Amendments on Program's Claims and Financing

As of September 30, 1985, the insurance program had a $1.3 billion deficit. Based on preliminary data, program officials have estimated that the deficit would be at least $1.8 billion at the end of fiscal year 1986. As of January 1987, the deficit was estimated to be about $4 billion primarily because three plans of the LTV Corporation were terminated with estimated claims of about $2 billion.

A major objective of SEPPAA was to strengthen the insurance program's financial condition. SEPPAA included provisions designed to (1) prevent claims from plans terminated by employers who are not financially distressed, (2) increase recovery of claims from distressed employers by raising their liability for unfunded benefits, and (3) raise premium revenue by increasing the premium rate paid by ongoing plans.

These amendments should help prevent claims from some underfunded plans and better finance claims that do occur. However, these positive effects may not be enough to ensure the program's long-term financial viability. Most of the claims dollars during fiscal years 1983-85 came from financially distressed employers, and PBGC expects the recovery of claims from such employers to continue to be low, even with SEPPAA's increased employer liability. Furthermore, considering current and expected future conditions, the higher premium revenues will not be adequate to retire the program's current deficit, much less pay for future program costs.

Preventing Claims From Nondistressed Employers

Before SEPPAA, any employer could cause a claim against the program by voluntarily terminating an underfunded plan. Now, employers can terminate underfunded plans only if they

- are in bankruptcy liquidation or reorganization, or other insolvency proceedings, and have court approval of the termination;
- do not have the ability to pay debts and continue in business; or
- have unreasonably burdensome pension costs due to a declining work force.

These standards should help the program prevent claims from employers who are not financially distressed. However, large claims in the past have primarily come from financially distressed employers. Should this trend continue, SEPPAA's provisions may not result in significantly lower claims.

As table 3.1 shows, 17 of the 23 employers with large claims in 1983-85 would have met the distress standards because they were involved in bankruptcy proceedings. These employers' plans accounted for $258 million (57 percent) of the total $451 million in claims from plans terminated by the 23 employers. Further, about 90 percent of the remaining $192 million in claims from the nonbankrupt employers was caused by one employer who may have met the standards if they had been in effect at the time of plan termination. According to information provided to PBGC by the employer, it had a declining work force and a highly questionable ability to continue to pay debts and meet pension obligations. In total, these 18 employers' claims accounted for $431 million (96 percent) of the $451 million in claims.

Table 3.1: Operating Condition of Employers Causing Large Program Claims (1983-85)

Dollars in millions

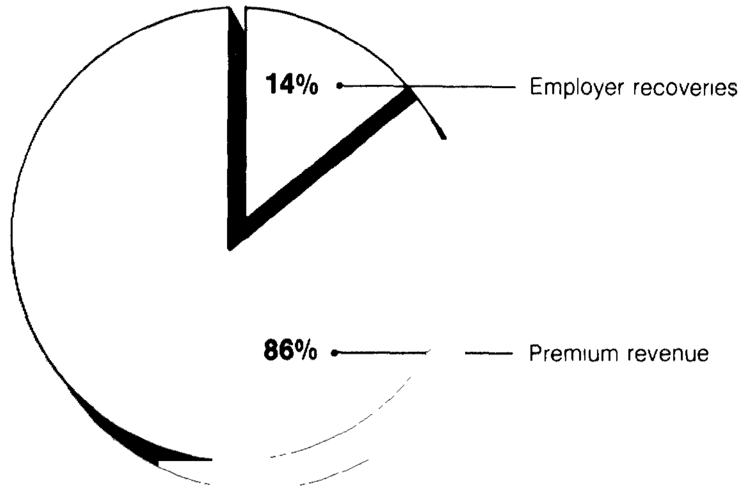
	Employers		Claims	
Operating condition	**Number**	**Percent**	**Amount**	**Percent**
Reorganization in bankruptcy	14	61	$233 7	52
Liquidation in bankruptcy	3	13	24.7	5
Ongoing	4	17	187 1	42
Out-of-business	2	9	5 0	1
Total	**23**	**100**	**$450.5**	**100**

Raising Employer Liability for Claims

Before SEPPAA, PBGC as an unsecured creditor could seek to recover any unpaid contributions from an employer at plan termination. Recovery could also be sought for any remaining claim, but was limited to 30 percent of the employer's net worth.

As shown by figure 3.1, as of January 1986, PBGC had recovered or expected to recover 14 percent ($64 million) of the total claims of $451 million from the 23 employers. This relatively small recovery amount was the result of unpaid contributions having a low priority (unsecured creditor status) in bankruptcy proceedings, employer liability being limited to 30 percent of net worth, and employers generally having little or no net worth. As discussed above, over half of the $451 million in claims came from 17 employers who had filed for bankruptcy.

Figure 3.1: Financing of Large Claims Through Recoveries From Employers Terminating Underfunded Plans and From Premium Revenue (1983-85)



After SEPPAA, PBGC can still seek to recover any unpaid contributions. SEPPAA authorizes PBGC to recover, as a general (unsecured) creditor, up to 75 percent of a terminated plan's underfunding, even if it exceeds 30 percent of the employer's net worth. The act also authorizes IRS to require that employers provide security as a condition of waiver approval for plan contributions accumulating to $2 million or more.[1] These changes may help PBGC recover waived contributions from some employers. However, a significant increase in recoveries of any remaining claims from employers in bankruptcy proceedings appears doubtful.

We found that 3 of the 23 employers causing large claims during 1983-85 each obtained waivers for $2 million or more. If SEPPAA had been in effect, IRS could have required them to provide security for these waivers, which totaled $16.3 million. According to PBGC officials, recoveries for secured creditors can generally be expected to be at or near the full amount claimed. However, full recovery from the 3 employers would have accounted for only about 4 percent of the $451 million in total claims from the plans terminated by the 23 employers.

[1] Before SEPPAA, IRS was not precluded under its general authority from requiring employers to provide security as a waiver condition, but according to IRS, it had done so only once.

PBGC expects a low recovery rate from employers even with SEPPAA's increased employer liability. In this regard, the executive director of PBGC, in June 1986, stated that "... although the PBGC can, in theory, recover some of its losses from plan sponsors, most of our claims have only unsecured creditor status in bankruptcy. Consequently, our claims are worth only about 7 to 15 cents on the dollar." We can understand why the expected recovery rate remains low. Although the employer liability for termination underfunding was increased by SEPPAA, claims filed by PBGC for unfunded guaranteed benefits continue to have a low priority (unsecured creditor) in the order of distribution of employers' assets, which are likely to be limited in bankruptcy proceedings.

Raising Premium Revenue

ERISA initially authorized an annual premium of $1.00 per participant in insured plans to pay claims not recovered from employers who terminated underfunded plans. The premium rate was raised to $2.60 for plan years beginning in 1978. SEPPAA increased the rate to $8.50, effective January 1, 1986.

Based on PBGC's estimate of the number of participants covered by the insurance program, the $8.50 rate should on the average generate about $298 million in revenue annually over 15 years. This represents an additional $207 million over the projected revenue at the $2.60 premium rate.

Despite this tripling of revenue, the program's financial condition is expected to continue to weaken because of recent claims experience and expected low recoveries from financially distressed employers. As of September 30, 1985, the program had reported a deficit of $1.3 billion, which included a liability for a pending claim of over $400 million for plans later terminated by the Wheeling-Pittsburgh Steel Corporation.

In November 1986, PBGC officials advised us that, based on preliminary data, the program's estimated deficit, as of September 30, 1986, should be at least $1.8 billion. Over half of the $500 million increase from the prior year represented claims from underfunded plans terminated by two bankrupt employers, the LTV and Continental Steel Corporations. In January 1987, three other LTV plans that were underfunded by an estimated $2 billion were terminated. Taking these terminations into account, PBGC estimated that its deficit increased to about $4 billion.

Although the $8.50 premium was enacted less than a year ago, PBGC officials now estimate that premium revenues will not be adequate to retire

the single employer program's existing deficit, much less pay for future program claims and administrative expenses. We estimate that annual premium revenues of $446 million would be needed to retire a $4 billion deficit over 15 years at PBGC's current interest rates. Projected annual premium revenues, however, are only $298 million, or 33 percent less than $446 million. Further, additional revenues would be needed to pay future claims and the program's administrative expenses, which by PBGC's most recent forecasts could range between $775 million and $1.5 billion annually.

The program's deficit has not affected PBGC's immediate ability to pay pensions to retired participants in terminated plans because assets received from such plans and revenues from premiums and investments have, so far, exceeded such payments. However, PBGC expects benefit payments to retired participants of recently terminated plans to raise the program's total payments from $270 million in fiscal year 1986 to over $650 million within the next 2 years. Considering the projected $298 million in annual premium revenues, this large increase in benefit payments would cause a significant drain on the program's assets.

PBGC officials expect that the asset drain could cause the insurance program not to have enough money to pay annual program costs (become insolvent) in 15 years. In 1985, PBGC similarly estimated that the program would become insolvent in 2001. However, at that time, the premium rate was $2.60 and the deficit was $462 million as of September 30, 1984. As a result, the administration is developing additional legislative proposals to improve the program's financial condition, including the charging of higher premiums to employers that do not adequately fund their plans.

Conclusions and Matters for Consideration by the Congress

Conclusions

The insurance program's increasing deficit was caused by (1) an increasing trend in claim amounts since the program's inception, (2) low recoveries from employers causing the claims, and (3) inadequate premium revenue from ongoing plans.

In recent years, most of the claims have been caused by a relatively few employers terminating underfunded plans. During fiscal years 1983-85, the large claim amounts resulted primarily from the federal funding standards not requiring sufficient contributions to pay for the plans' unfunded benefits by the time they were terminated.

There are indications that frequent benefit increases during the 5 years before plan termination contributed significantly to the plans' underfunding. The benefit improvements were generally guaranteed by the insurance program. However, they were also typically being financed over the longest periods allowed by the funding standards and, in some cases, became effective while contributions were waived or unpaid.

Large claims also resulted from employers not making minimum annual contributions required under the funding standards in the years leading up to plan termination. Significant percentages of the unpaid contributions either were overdue or had been waived by IRS. Almost half, however, represented contributions covering an average of over a year of plan operations that were not yet due because the payment deadline (8-1/2 months after the end of a plan year) came after plan termination.

Recovery of claims from the employers causing them was low because employer liability was limited to a percentage of their net worth, and the employers typically had little or no net worth and were financially distressed—i.e., in bankruptcy reorganization or liquidation proceedings.

SEPPAA, enacted in April 1986, included provisions that should help prevent some claims and better finance claims that do occur. As designed, the provisions should (1) prevent claims from employers who are not financially distressed by prohibiting them from terminating their underfunded plans, (2) increase somewhat the recovery of claims from distressed employers by raising their liability for unfunded benefits, and (3) more than triple premium revenues by increasing the annual premium rate from $2.60 to $8.50 per plan participant.

However, in January 1987, PBGC officials estimated that the program's deficit had increased to about $4 billion—a considerable increase over

the $1.3 billion deficit reported as of September 30, 1985. The rise in the deficit was mostly the result of large unrecoverable claims from one financially distressed employer. As an unsecured creditor, PBGC expects its recovery of claims from financially distressed employers to continue to be low. Furthermore, considering current and expected future conditions, the higher premium revenue generated under SEPPAA will not be enough to retire the program's deficit, much less unrecoverable claims from future plan terminations. Also, PBGC estimates that the insurance program will not have enough assets to pay annual benefits and administrative costs in 15 years.

Because SEPPAA's positive steps may not be enough to ensure the program's long-term financial viability, further changes may be needed to control program claims and finance those that do occur.

Matters for Consideration by the Congress

Given the uncertainties associated with the long-term effects of SEPPAA on the program's financial condition, the Congress may wish to consider additional changes to enhance the program's financial viability. To help control potential claims against the program, such changes could include

- raising the minimum contribution requirements to reduce plans' unfunded benefits;
- requiring employers to make contribution payments to their plans sooner than 8-1/2 months after a plan year ends; and
- reducing benefits guaranteed by the program, e.g., eliminating coverage of any benefit improvements that become effective within 5 years of plan termination.

To enhance the financing of claims that do occur, possible changes include

- raising the priority of PBGC's claims against employers that are in bankruptcy proceedings and
- raising the premium rate again to provide the revenue needed to retire the program's deficit and pay for projected unrecoverable claims.

Examples of Potential Effects of Suggested Changes

Changes designed to improve the program's financial condition can directly or indirectly affect employers, plan participants, the federal government, and other private companies. For example, raising the minimum contribution requirements directly affects employers that would have to increase their annual contributions. The impact of such a change

on individual employers would depend on the extent of the increased contributions. Further, such a change could affect participants because it may encourage some employers to hold down pension costs by reducing or eliminating future benefit increases.

Table 4.1 provides additional examples of how our suggested changes could affect different parties.

Table 4.1: Examples of Potential Effects of Suggested Changes

Suggested changes	Potential effects of changes on Employers	Plan participants	Other
Raise minimum contribution requirements	Higher annual costs for some employers, which reduce money available for their other business activities Minimize premium rate requirements for ongoing insured plans because of better funded plans	Lower pensions than may otherwise be provided if employers decide to slow or stop benefit increases to reduce plan costs Loss of defined benefit pension coverage if higher costs encourage employers to terminate plans—offset to some extent by higher wages	Because contributions are tax deductible, government tax revenue could (1) increase if terminations occur without an increase in other deductible expenses, or (2) decrease if employers increase contributions without reducing other deductible expenses
Require contributions to be made sooner than 8-1/2 months after plan year end.	Reduced flexibility for financing other business activities Increase requests for minimum funding waivers. Minimize premium requirements		
Reduce guaranteed benefits	More pressure to grant higher wages rather than higher pension benefits during collective bargaining Minimize premium requirements	Lower pensions if underfunded plans terminate Higher wages rather than increased pension benefits in ongoing plans because of collective bargaining trade-offs	
Raise priority of PBGC's claims in bankruptcy proceedings	Limit ability to borrow money due to restricted loan covenants, especially during periods of financial distress Minimize premium requirements	Lower pensions than may otherwise be provided or loss of defined benefit pension coverage depending on employer's ability to borrow money	Lower private lenders' and creditors' recoveries from bankrupt employers
Raise the premium rate	Higher pension costs for employers sponsoring ongoing plans Encourage terminations	Same as changes to contributions	

Agency Comments and Our Evaluation

In a February 18, 1987, letter commenting on a draft of this report (see app. II), PBGC's executive director expressed substantial agreement with our analysis of the causes of large claims against and the potential effects of SEPPAA on the insurance program. She stated that strengthened funding standards are essential to the program's long-run viability and

that accelerated funding is needed for existing unfunded liabilities as well as for future benefit increases. Also, on February 19, 1987, the administration unveiled a proposal to strengthen the funding standards to protect plan participants' benefits as well as the insurance program.

In a letter dated February 27, 1987 (see app. III), the commissioner of IRS commented that our study was limited in scope and did not address funding standards from any perspective other than PBGC's financial viability. He said that our analysis did not provide information sufficient to make overall judgments or recommendations about changes in the funding standards.

Our analysis, which covered plans causing 90 percent of the claims against the insurance program during fiscal years 1983-85, showed that $317 million (70 percent) of the claims resulted from insufficient contributions permitted by the funding standards. We believe our analysis demonstrates that changes in the funding standards could strengthen the program's financial condition and merit congressional consideration. We agree that the scope of the study was not sufficient to make specific recommendations about funding standard changes and, as a result, we are not making recommendations.

The executive director of PBGC stated that, although our report points out problems caused by minimum funding waivers, it does not cite possible corrective actions as a matter for congressional consideration. She commented that the conditions under which funding waivers are granted should be tightened considerably. The commissioner of IRS stated that the report, although correctly pointing out that many insufficient plans were granted waivers, may not present a complete picture of the situation. He said that more information is needed to assess the impact of waivers on the PBGC deficit and overall funding policy.

The executive director said that funding waivers can defeat the purpose of the funding standards. However, we are not making any recommendations because, as noted by the commissioner, more information than provided by our analysis, which did not include plans that received waivers and did not terminate, is needed to determine whether specific changes are needed in the funding waiver process to protect the program's financial viability.

According to the executive director, shutdown benefits provide a form of supplemental unemployment compensation to plan participants until

they become eligible for social security, but most plans make no provision to fund the benefits before a shutdown. She said that such benefits can immediately double or triple a participant's benefit at the moment a shutdown occurs, resulting in plan assets being consumed faster than contemplated.

The executive director commented that shutdown and other contingent benefits that have become a major factor affecting PBGC's financial condition were not addressed in our draft report. She suggested that one option would be to explore arrangements that could lead to better funding of shutdown benefits. The report has been revised to recognize that the payment of shutdown benefits can contribute to claims against the insurance program. However, we do not address the matter in the report in detail because of the limited data available on the plans covered by our review for measuring the impact of shutdown benefits on the insurance program.

The report suggests that the Congress might want to consider increasing the program's premium rate and points out that the administration is developing a proposal for charging higher premiums to employers who do not adequately fund their plans. The executive director of PBGC commented that such a premium rate structure will be (1) more equitable, charging less to better funded plans, and (2) significant in keeping better funded plans in the defined benefit system.

Characteristics of Participants in 33 Sampled Plans Reviewed

Figure I 1 Status of Participants When Plans Were Terminated

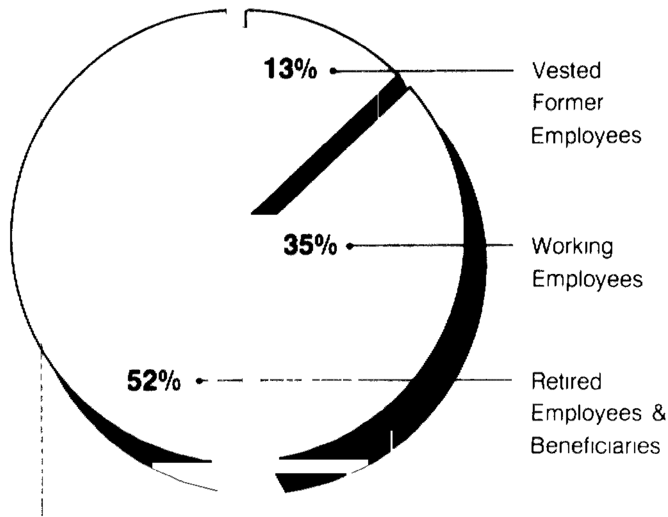


Figure I 2 Number of Participants Eligible to Receive Guaranteed Benefits

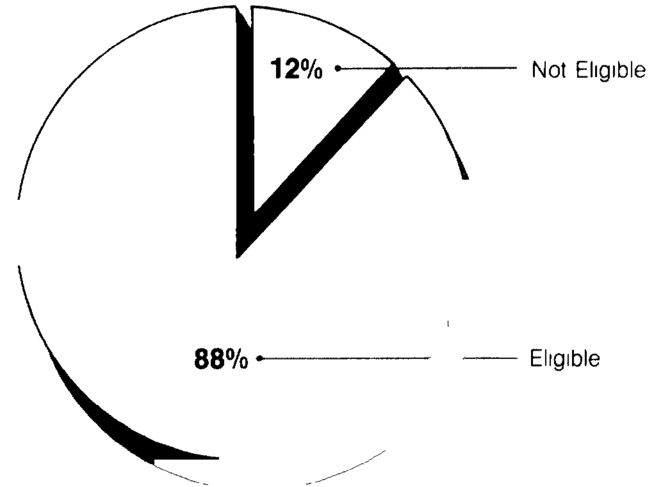


Figure I 3 Union Membership of Plan Participants

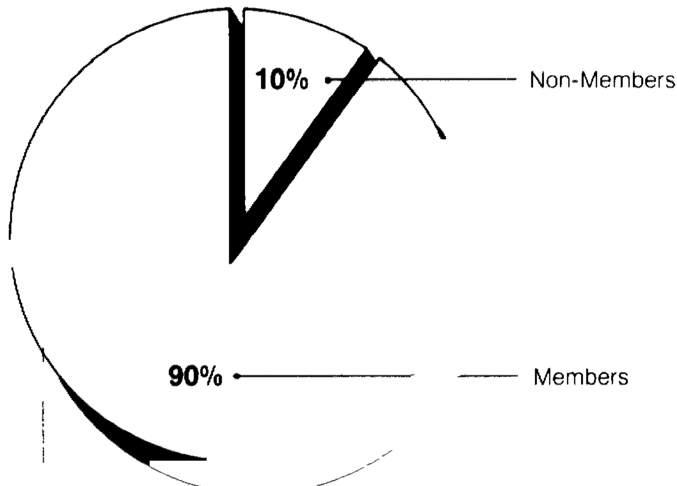


Table I 1 Industries in Which Participants Were Employed

Manufacturing	
Primary metals	**26%**
Machinery	**37%**
Fabricated metals	**14%**
Food products	**11%**
Other	**8%**
Subtotal	**96%**
Mining	**2%**
Transportation	**1%**
Wholesale-retail trades	**1%**
Total	**100%**

Comments From the Pension Benefit Guaranty Corporation

Pension Benefit Guaranty Corporation
2020 K Street, N W , Washington, D C 20006-1806

Office of the Executive Director

FEB 18 1987

Mr. Richard L. Fogel
Assistant Comptroller General
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for the opportunity to review and comment on GAO's draft proposed report on the causes and financing of claims against the Pension Benefit Guaranty Corporation's single-employer insurance program.

The PBGC is pleased that the Congress and the GAO are interested in the effects of pension plan underfunding on the ability of the PBGC insurance program to continue to provide retirement income security. GAO's report makes an important contribution to documenting problems causing PBGC's financial difficulties. The PBGC is in substantial agreement with GAO's analysis of the causes of large claims and the potential effects of the 1986 amendments of the single-employer program.

Our specific comments cover four areas: (1) strengthening the minimum funding standards; (2) waiver of the minimum funding standards; (3) plant shutdown and other subsidized benefits that are not pre-funded and (4) premiums.

Minimum Funding Standards

The draft report suggests the need for strengthening the minimum funding standards to enhance PBGC's financial viability. Specifically, the draft report states that one possible change to the funding standards is "raising the minimum contributions requirements to reduce plans' unfunded benefits, especially those resulting from benefit increases." We agree that strengthened funding standards are essential to the long-run viability of the termination insurance program, and we believe that accelerated funding is needed for existing unfunded liabilities as well as for future benefit increases.

Funding Waivers

Although the draft report points out problems that have been caused by minimum funding waivers, no possible corrective actions are cited in the report as a matter for consideration by the Congress. Funding waivers can defeat the purpose of funding standards. The PBGC believes that troubled employers should not borrow from their employee's pension funds but should use traditional credit sources. The conditions under which funding waivers are granted should be tightened considerably.

Shutdown Benefits

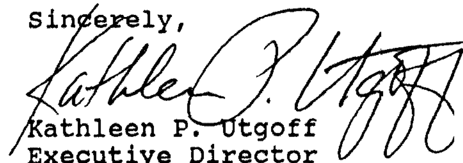
Shutdown benefits and certain other contingent benefits, which have become a major factor affecting PBGC's financial condition, are not mentioned in GAO's report. Shutdown-type benefits provide a form of supplemental unemployment compensation to pension plan participants until they become eligible for Social Security. Most plans make no provision to fund shutdown-type benefits prior to a shutdown event, but such benefits can immediately double or triple a participant's benefit at the moment a shutdown occurs. As a result, plan assets that have been accumulated to provide pension benefits are consumed by benefits that are essentially supplemental unemployment compensation. One option would be to explore arrangements that could lead to better funding of shutdown benefits. Examples of such arrangements could include changing funding standards or establishing separate health and welfare trusts for these benefits to isolate pension plans from unpredictable losses that reflect severance rather than pension benefits.

Premiums

The study notes the PBGC needs greater premium revenue. The Administration has proposed that the premium be changed from a flat rate to a variable rate structure. A variable rate structure will be more equitable, charging less to better funded plans. This improved equity will be significant in keeping better funded plans in the defined benefit system. Employers of well-funded plans should not have to and may eventually refuse to shoulder an unfair share of insurance costs.

We hope our comments will be helpful to you in completing your report.

Sincerely,



Kathleen P. Utgoff
Executive Director

Comments From the Internal Revenue Service

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

FEB 27 1987

Mr. William J. Anderson
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

This is in response to your request that the Internal Revenue Service (IRS) review and comment on the draft GAO report Pension Plans: Government Insurance Program Threatened By Its Growing Deficit. The report assesses the impact of the current funding standards for defined benefit pension plans on the deficit of the Pension Benefit Guaranty Corporation (PBGC). It also attempts to measure whether the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA) will significantly impact on this deficit.

The report makes recommendations to Congress for changes in the funding standards, bankruptcy laws and PBGC premium rates in order to improve the PBGC's "financial viability." The report makes no recommendations to the IRS or Treasury.

The study itself is limited in scope. It does not address funding standards from any perspective other than the PBGC's financial viability. Further, it bases its conclusions on 33 plans that terminated with unfunded liabilities. While analysis of these plans provides information relating to the PBGC's deficit, it does not provide information sufficient to make overall judgments or recommendations about changes in the funding standards.

The report notes that many insufficient plans were granted funding waivers. Although this statement is correct, it may not accurately present a complete picture of the situation. More information is needed to assess the impact of funding waivers on the PBGC deficit and overall funding policy. For example, one would need to know whether the contributions would have been made if waivers were not granted and how many plan terminations (and resulting increases to the PBGC's deficit) were avoided because of the granting of waivers in other cases.

Department of the Treasury Internal Revenue Service

-2-

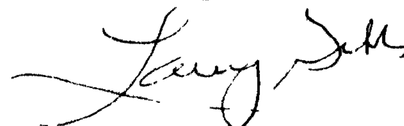
Mr. William J. Anderson

We would suggest that the study's conclusions and recommendations emphasize the limited scope of the study.

We appreciate the opportunity to comment on the report.

With best regards,

Sincerely,



Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

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

Official Business
Penalty for Private Use $300

Address Correction Requested

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100