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GAO

Report to the Chairman, Select Committee on Aging
House of Representatives

November 1986

PENSION PLANS

Government Data on Terminations With Excess Assets Should Be Improved

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Human Resources Division

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The Honorable Edward R. Roybal
Chairman, Select Committee on Aging
House of Representatives

Dear Mr. Chairman:

On many occasions, you have expressed concern that defined benefit pension plan terminations with excess assets can adversely affect active (working) participants if the participants do not receive continuing pension coverage or if the coverage received does not provide at least the same benefits as before the termination. Members of Congress and government agency officials (policymakers) have been considering options for mitigating the potential adverse effects on participants' pension coverage. This report responds to your office's request that we review the data reported by the Pension Benefit Guaranty Corporation (PBGC) and distributed to you and others on so-called "spinoff" terminations with excess assets.

Policymakers generally view a spinoff termination with excess assets as a separation of a plan into two plans, one of which terminates while the other continues. Further, they view spinoffs as not affecting working participants' pension coverage because these participants are covered by the continuing plan, which provides the same coverage and benefits as before.

Specifically, you were concerned that information reported by PBGC on spinoff terminations could include those in which working participants' pension coverage changed. If so, the information could unintentionally mislead policymakers who view spinoffs as not affecting participants' pension coverage.

We found that some reported spinoffs did involve working participants whose pension coverage changed. According to PBGC officials, PBGC, in its monthly report on terminations with excess assets, categorizes a termination as a spinoff when a plan is separated into two plans and one is terminated, irrespective of how working participants' pension coverage is affected.

Further, we reviewed 18 of 65 plan terminations that PBGC categorized in its 1985 monthly reports as spinoffs to determine the types of continuing pension coverage working participants received. Our review showed that

- 14 of the terminations covering 96 percent of the participants in the 18 plans resulted in working participants receiving the same coverage as before the spinoff,
- 2 terminations with 3 percent of the participants in the 18 plans resulted in working participants receiving different coverage, and
- 2 terminations with 1 percent of the participants resulted in working participants receiving no continuing coverage.

Because the 18 spinoff terminations we reviewed were judgmentally selected, our analysis results may not be representative of the overall extent to which terminations reported as spinoffs by PBGC result in participants receiving the same or different coverage than before. However, the results do demonstrate that working participants' pension coverage can be affected by spinoffs. Therefore, PBGC should improve the data it reports on spinoff terminations with excess assets by specifying how the pension coverage of working participants is affected after the spinoff.

In commenting on a draft of this report, PBGC said that the number of spinoff terminations in which working participants' coverage was affected has been small. However, PBGC said it would improve its reports to show how participants' pension coverage is affected.

Background

Employers establish defined benefit pension plans to pay retirement benefits, generally determinable in advance by a formula, to employees. The Employee Retirement Income Security Act of 1974 (ERISA) established funding standards, an insurance program, and other provisions to help protect participants' benefits in such plans. Available data show that there are more than 110,000 insured single employer defined benefit plans covering about 30 million participants (employees and their beneficiaries). PBGC administers the insurance program, and the Internal Revenue Service and the Department of Labor administer and enforce the other ERISA provisions.

Generally, assets of a terminated defined benefit plan in excess of those needed to pay all participants' accrued benefits may revert to the sponsoring employer if the plan's provisions permit. According to PBGC records, about 1,200 plans with excess assets of at least $1 million each either terminated or were pending termination[1] between January 1980

[1] A pending termination is one in which a notice of termination has been filed with PBGC, but PBGC has not authorized the distribution of plan assets.

and June 1986. The plans covered more than 1.4 million participants and had about $14 billion in excess assets.

Plan terminations can adversely affect working participants if the participants receive no continuing pension coverage. Also, participants may be affected if they receive different coverage than that provided by the terminated plan. In this regard, continuing coverage may be provided through a defined contribution plan[2] or a different defined benefit plan from the one terminated. When this happens, future benefit amounts of working participants in the terminated plans are difficult to predict and, depending on the circumstances, could be higher or lower than the benefits that they would have received if their coverage had not changed. For example, pension benefits from a defined contribution plan depend on the contributions made to the plan over time, the investment return on the contributions, and the allocation of these amounts to individual participants.

To consider options for reducing the potential adverse effects of plan terminations with excess assets, members of Congress and ERISA agency officials need data on how terminations are affecting working participants' pension coverage. They have frequently used PBGC's periodic report on pending terminations with excess assets as a primary source of such data.

Generally, these reports, which have been cited in hearings in the House and the Senate and are made available to others on request, show the excess assets and number of participants in pending terminations with at least $1 million in excess assets. Based on the information PBGC collects when it processes a termination, PBGC divides the report into four categories. Three categories indicate the type of replacement pension coverage, if any, working participants are to receive. The three categories are (1) complete termination of the plan with the reestablishment of another defined benefit plan, which may be the same or different than before; (2) complete termination with a replacement defined contribution plan; and (3) termination with no replacement coverage.

The fourth category, called spinoffs, does not indicate the type of pension coverage participants receive. According to PBGC's June 1986

[2]A defined contribution plan is one in which an individual account is established for each participant. The participant's benefits at retirement or separation from service are equal to the contributions made to the account plus earnings on the contributions.

report, spinoffs accounted for 26 percent of the 222 pending terminations and 77 percent of the $4 billion in excess assets.

Scope and Methodology

To determine how policymakers view spinoff terminations with excess assets, we reviewed congressional hearings and other available documents.

To determine what PBGC considers in categorizing a termination with excess assets as a spinoff, we interviewed PBGC officials responsible for processing and reporting on the terminations. We also selected and reviewed a judgmental sample of 18 of 65 plan terminations that PBGC categorized in its monthly reports as spinoffs with a termination date in calendar year 1985 to determine the types of continuing pension coverage working participants received.[3] Our review of the plans included interviews with plan officials and analysis of plan and other related documents obtained from PBGC's files or directly from plan officials. Most of the data we needed to make the determination were routinely made available to PBGC by plans at the time they terminated.

The 18 terminations comprised all of the spinoffs in which the plan officials were located in New York City, Washington, D.C., and the states of Delaware, Maryland, and Virginia. Because the terminations were not randomly selected, the results of our review may not represent the overall extent to which terminations reported as spinoffs by PBGC result in participants receiving the same or different coverage than before. The 18 plans, however, accounted for over half of the 134,000 participants in terminated plans identified as spinoffs and slightly less than half of the $1.7 billion in excess assets in the 65 plans.

This review was performed in accordance with generally accepted government audit standards.

How Policymakers View Spinoffs

Based on our review of congressional hearings and other documents, we found that policymakers generally view spinoffs as the separation of a pension plan into two plans—one for working employees and one for retired employees. All or part of the excess assets are allocated to the retirees' plan, which is then terminated, and the excess assets revert to

[3]Our review did not focus on retirees because, when plans with excess assets terminate, employers are required to purchase annuities to secure retirees' earned benefits. As a result, retirees are generally not affected by spinoff terminations unless they do not receive benefit increases they might otherwise have received.

the employer. In the policymakers' view, the spinoff does not affect the working employees because their defined benefit plan continues unchanged.

Some PBGC-Reported Spinoffs Included Participants Who Received Different Coverage Than Before

The results of our review of 18 of the 65 terminations PBGC reported as spinoffs during calendar year 1985 showed that working participants in 14 cases received the same continuing coverage as before the spinoff, while those in the other 4 cases did not. Of these four terminations, two involved working participants who did not receive any continuing coverage, and two involved participants who received different coverage. As discussed on page 3, depending on the circumstances involved, future benefits received by working participants in the latter two plans could be either higher or lower than they would have been under the terminated plans if they had continued.

The four cases were reported as spinoffs because PBGC, in categorizing terminated plans as spinoffs, does not consider what types of participants—working or retired—were in the terminated plan or whether they received continuing pension coverage. According to PBGC officials, PBGC categorizes a termination as a spinoff only when a plan is separated into two, one of which is terminated. Since no consideration is given to working participants' coverage, the terminated plan can include working participants who receive no continuing coverage, the same coverage, or different coverage.

The four terminated plans covered 2,802 (4 percent) of the 70,108 participants covered by the 18 plans. Of the 2,802 participants, 1,629 were working and 1,173 were retired. The four plans also had about $29 million (4 percent) of the $768 million in excess assets in the 18 plans.

In one case in which working participants did not receive continuing pension coverage, a parent company divided its pension plan in two. One plan, which covered the 68 working and 6 retired employees of a subsidiary, was terminated. The subsidiary was then sold to the employees, who chose not to establish replacement coverage. In the other case involving no continuing coverage, an employer placed 256 retirees and 17 working officers of the company in one plan and the remainder of the working employees in another plan. The plan with the retirees and officers of the company was terminated, and no continuing coverage was provided to the officers. The other plan continued unchanged.

In the third case, a parent company divided a plan in two. One plan, which covered 969 working and 643 retired employees of a subsidiary, was terminated, according to a plan official, to facilitate the sale of the subsidiary. The new owner of the subsidiary provided pension coverage to working participants through a defined benefit plan with different provisions than the one terminated and an optional defined contribution plan. The defined contribution plan required contributions by both the employer and participants.

In the last case, the employer divided a plan into separate plans, one covering union and the other covering nonunion employees. The nonunion employees' plan, which covered 575 working and 268 retired participants, was then terminated, and the working participants became participants in a defined contribution plan.

Conclusion

To decide if changes should be made to mitigate the potential adverse effects of terminations with excess assets on participants' pension coverage, policymakers need data showing the types of continuing coverage, if any, that participants receive after spinoff terminations. We found, however, that PBGC does not provide such information and that some plan terminations reported by PBGC in 1985 as spinoffs included working participants who received no continuing pension coverage or different coverage that may give them higher or lower benefits than before.

We believe that, by using the data it routinely collects from plans at the time they terminate, PBGC can improve its reported spinoff termination data by specifying the types of continuing pension coverage, if any, provided to working participants.

Recommendation to the Executive Director of PBGC

We recommend that PBGC improve the information it reports on spinoff terminations by showing how the pension coverage of working participants is affected after the spinoff.

Agency Comments

PBGC provided oral comments on a draft of this report on November 4, 1986. PBGC said that, as suggested by the results of our review of a limited sample of spinoff terminations, the number of such terminations in which the pension coverage of working participants changed has been small. PBGC said, however, it would implement our recommendation to improve its report on pending terminations with excess assets to show how the coverage of working participants in terminated plans is affected.

We are sending copies of this report to the Executive Director and Board of Directors of PBGC; the Director, Office of Management and Budget; officials of the Department of Labor and the Internal Revenue Service; and other interested parties. Copies will also be made available to others upon request.

Sincerely yours,

Richard L. Fogel
Assistant Comptroller General

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