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

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PENSION PLANS

Possible Effects of Requiring Employers to Make Contributions Sooner

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GAO

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

Human Resources Division

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October 30, 1987

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

Dear Mr. Chairman:

As you requested, we are providing information on how employers could be affected by the administration's proposal to change when employers have to make contributions to their single employer defined benefit pension plans.

The Employee Retirement Income Security Act of 1974 (ERISA) helps ensure that plan assets are adequate to pay benefits by requiring employers to make minimum annual contributions to the plans they sponsor. ERISA also established an insurance program, which generally guarantees participants' benefits should the plans terminate without enough assets to pay guaranteed benefits (terminate underfunded). The insurance program, administered by the Pension Benefit Guaranty Corporation, is in financial trouble because claims from underfunded plans have exceeded income.

Currently, employers can make plan contributions for a year at any time up to 8-1/2 months after the end of the year. The current payment requirement does not pose a risk to participants' benefits or the insurance program as long as a plan continues or contributions are paid by the time of plan termination. However, a significant cause of insurance program claims—at least $105 million over the 3-year period 1983-85—is that required annual contributions have not been paid by employers when the plans terminate.

To enhance plan participants' benefit security and reduce claims against the insurance program, the administration proposed, in February 1987, that contributions be paid sooner than currently required. Under the proposed change to ERISA, employer contributions would have to be paid in quarterly installments during the year, with the total required contribution made within 2-1/2 months after the end of the year.

Findings

Based on interviews with a random sample of 146 employers sponsoring plans with 100 or more participants and an analysis of their plans' financial data, we estimate that:

- About 64 percent of the 6,100 employers covered by our sample would have to change their contribution practices to meet the administration's proposal.
- About half of the 6,100 employers said their business operations would be negatively affected. The most often cited effect was that the employers would have increased administrative costs to determine contribution requirements earlier.
- About 70 percent of the employers sponsor plans that were overfunded by at least 10 percent, the amount that the administration deems sufficient to protect plan participants' benefits and the insurance program (funding security level).

GAO Position

In June 1986 and April 1987 testimony as well as in a March 1987 report, we supported the need to require employers to make contributions to their underfunded plans sooner than currently required. We continue to support that need. However, it may not be necessary to apply the requirement to employers who have plans with funding levels sufficient to protect participants' benefits and the insurance program should the plans terminate, such as the 70 percent of our sample who meet the administration's funding security level. The Congress should consider limiting any change requiring earlier payment of plan contributions to employers sponsoring underfunded plans.

Appendix I contains details of our findings. Appendix II describes our sampling, interview design, and data analysis and verification procedures.

As requested by the Subcommittee, we did not obtain agency comments on this report, and we will not make additional distribution of this report for 2 days. At that time, we will send copies of this report to the Pension Benefit Guaranty Corporation, the Departments of Labor and the Treasury, and other interested parties. Copies will also be made available to others on request.

Sincerely yours,

Richard L. Fogel

Richard L. Fogel
Assistant Comptroller General

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Abbreviations

ERISA	Employee Retirement Income Security Act
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation

Pension Plans: Possible Effects of Requiring Employers to Make Contributions Sooner

Introduction

A single employer defined benefit pension plan pays a specific retirement benefit to employees of the employer sponsoring the plan. The Employee Retirement Income Security Act of 1974 (ERISA) established an insurance program and funding standards for these plans 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 Pension Benefit Guaranty Corporation (PBGC) administers the insurance program which, within certain limits, guarantees participants' benefits at plan termination. When plan assets are not sufficient to cover guaranteed benefits, PBGC assumes responsibility for paying them. Unfunded guaranteed benefits represent a claim against the program at the time that PBGC assumes liability for them.

The insurance program is in financial trouble because claims from plan terminations have considerably exceeded insurance premiums paid by ongoing plans and collections from employers causing the claims. Although the insurance program reported a deficit of $3.8 billion at the end of fiscal year 1986, recent action by PBGC to return three underfunded terminated plans to the LTV Corporation could cut that deficit in half. However, the program's continuing financial viability remains uncertain because

- the legality of the return of the plans is being contested in court;
- LTV's ability to pay for the plans' unfunded benefits, considering its bankruptcy status, is questionable; and
- the contingent liability for unfunded benefits of ongoing plans is in the billions of dollars.[1]

The funding standards, which are enforced by the Internal Revenue Service (IRS), establish the minimum amount of money that employers must contribute each year to finance benefits promised by their plans. These minimum contribution requirements are determined through actuarial valuations of projected plan costs. Initially, ERISA allowed employers to make required contributions for a plan year[2] at any time up to 2-1/2 months after the end of the year, but authorized IRS to issue regulations

[1] Pensions: Plans With Unfunded Benefits (GAO/HRD-87-15BR, Oct. 22, 1986)

[2] A plan year is the 12-month fiscal period for which plan records are kept. A specific plan year's designation is based on the calendar year in which the plan year begins. For example, a plan year beginning on any day from January 1 to December 31, 1984, would be designated as plan year 1984.

extending the 2-1/2 month deadline for an additional 6 months. In October 1976, IRS extended the payment deadline to 8-1/2 months after year end.

Total employer contributions for previous years may exceed total contributions required by the funding standards for the same period, creating what is called a funding surplus. Employers can use a funding surplus to reduce or eliminate current and future plan contribution requirements.

Also, employers may request that IRS waive all or part of the required annual contribution. IRS may authorize the request 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). Generally, employers must repay waived contributions over a 15-year period. The government can take action (such as imposing an excise tax or terminating a plan) to protect participants' benefits and the insurance program if employers do not make required contributions.

In June 1986, we testified on the extent of plan underfunding and the causes of large insurance claims (over $2 million) from plan terminations. We pointed out that one of the causes of the large claims was unpaid contributions. We suggested that the Congress consider requiring employers with underfunded plans to make contributions sooner.

In a March 1987 report[3] and April 1987 testimony,[4] we continued to state that employers with underfunded plans should be required to pay contributions sooner. We showed that 33 underfunded plans caused 90 percent of the claims dollars against the insurance program during fiscal years 1983-85. Of the $451 million in unfunded guaranteed benefits in these plans at termination, about $105 million (23 percent) resulted from unpaid contributions that had not been waived by IRS.

In February 1987, the administration proposed several changes to ERISA intended to (1) improve benefit security for plan participants and (2) reduce the potential financial burden on the insurance program. The Congress is considering these changes.

[3] Pension Plans: Government Insurance Program Threatened by Its Growing Deficit (GAO/HRD-87-42, Mar. 19, 1987).

[4] Financial Condition of the Single Employer Pension Plan Insurance Program (GAO/T-HRD-87-8, Apr. 7, 1987).

One of the changes would require all employers to pay annual contributions in quarterly installments, with the total required contribution for the year to be made by 2-1/2 months after the end of the year. Requiring contributions to be made sooner could (1) better ensure that employers have made required contributions should their plans terminate and (2) permit quicker identification of employers who are not making required contributions so that more timely action can be taken to help protect participants' benefits and reduce potential insurance program claims.

In addition to changing the timing of plan contributions, the administration also proposed strengthening ERISA's minimum contribution requirements. Unlike the change in the timing of contributions, however, the increase in the minimum contribution requirement would apply only to employers whose plans are not sufficiently funded to protect participants' benefits and the insurance program should the plan terminate. The proposal defines this funded level as having sufficient assets to pay for 110 percent of the estimated benefits that would be owed to participants should the plan terminate (called the termination liability).

We did not comment on how this proposal would affect employers in our March report or our April testimony.

Objectives, Scope, and Methodology

In April 1987, the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, asked us to determine the potential effect on employers sponsoring single employer defined benefit plans of the administration's proposal to require earlier payment of plan contributions. Such information would give the Congress a better basis for considering the proposed change.

To accomplish this objective, we

- conducted structured telephone interviews between July 13 and 27, 1987, with a random sample of 146 employers sponsoring plans with 100 or more participants during plan year 1984 (large plans) to obtain (1) information on their normal contribution practices and (2) their views on the possible effects the proposed change could have on their businesses, and
- evaluated the contribution requirements and funded status of the 201 plans sponsored by the sampled employers to determine the extent to which (1) employers had sufficient funding surpluses to delay the effect of the proposed change and (2) the proposal could affect employers with overfunded rather than underfunded plans.

According to their most recent annual reports, the 201 plans covered about 222,000 participants. The sample results can be generalized to about 6,100 employers, who sponsor about 7,900 large plans covering over 11 million participants, with a maximum sampling error (at a 95-percent confidence level) of plus or minus 8 percentage points.

We selected our sample from a partial universe of IRS's November 1986 computerized file of about 15,200 employers sponsoring almost 22,000 single employer defined benefit plans filing ERISA annual reports[5] for plan year 1984. The 1984 data on large plans were used because (1) they were the most current and complete pension plan data readily available when we began our work and (2) using these data would enable us to provide the needed information in a timely manner.

Appendix II provides more detail on our interview design and sampling methodology, including why our sample represents only a partial universe of defined benefit plans filing 1984 annual reports.

To obtain the most current data available on the financial condition of employers' plans, we asked the sampled employers to provide us with their most recent ERISA annual reports. As a result, our plan analysis is based on 1984 data for 48 of the 201 plans and more recent data for the other 153. We did not verify the accuracy of annual report information, but we performed mathematical checks to ensure that it was sufficiently complete to enable us to analyze aspects of plan funding.

We used the ERISA annual report data for the 201 plans to determine their contribution requirements, funded status, and funding surpluses using the current funding requirements. To compute the plans' funded status, we divided the plans' reported current value of assets by the value of accrued benefits. This approximates the plans' termination liability as defined under the administration's proposal to increase the minimum amount of contributions required by the funding standards.

In our analysis, we did not consider the effect of other changes proposed by the administration, such as increasing the contributions required by the funding standards.

[5]ERISA requires most employee benefit plans to file annual reports with IRS showing various financial, actuarial, and demographic data. Plans report using the Form 5500 series, Annual Return Report of Employee Benefit Plan and, where appropriate, other schedules, such as Schedule B, Actuarial Information.

As requested by the Subcommittee, we did not obtain agency comments on this report. This review was performed in accordance with generally accepted government auditing standards.

Proposed Change Would Require Most Employers to Change Contribution Practices

We estimate that, considering plan funding surpluses, about 64 percent of the 6,100 employers covered by our sample would have to change their pension plan contribution practices if the administration's proposal to require contribution payments sooner were adopted. Although about half of the employers met the proposal's final payment requirement, 70 percent of the employers told us that they make contribution payments less frequently than quarterly.

Most Employers Normally Pay Contributions Later Than Required by Proposal

As shown in table I.1, about 40 percent of the employers told us that they neither pay contributions in quarterly installments nor make final payments within 2-1/2 months after the end of the year. About 6 percent of the employers paid contributions quarterly, but did not make a final payment until after the 2-1/2 month period. Also, 30 percent met the final payment requirement, but did not make quarterly payments. Only 21 percent of the employers said they paid plan contributions as required by the proposed change. Overall, about 51 percent of the employers paid total required annual contributions before 2-1/2 months after the end of the year, and 27 percent of the employers made payments at least quarterly.

Table I.1: Employers' Contribution Practices

	Percent of employers
Made neither quarterly contributions nor final payment within 2-1/2 months	40
Made final payment within 2-1/2 months, but did not make quarterly contributions	30
Made quarterly contributions, but did not make final payment within 2-1/2 months	6
Subtotal	**76**
Made both quarterly contributions and final payment within 2-1/2 months	21
Unknown[a]	3
Total	**100**

[a]Represents employers that did not provide us information on whether they made quarterly contributions and a final contribution payment within 2-1/2 months after the end of the plan year

Employers' Plan Funding Surpluses May Be Insufficient to Delay Changing Contribution Practices

A plan funding surplus can be used in lieu of actual payments to meet contribution requirements, thereby delaying, perhaps indefinitely, when employers would have to comply with the proposed change. However, our analysis of the most recently available annual report data for the sampled employers' plans indicates that most plans may not have sufficient surpluses to permit such a delay.

As table I.2 shows, the plans of about 34 percent of sampled employers either met the proposed change or had a sufficient surplus to cover at least a year's worth of required contributions, which could be used to delay changing their contribution practices. However, about 64 percent of the employers did not meet the proposed contribution payment change and had less than a year's surplus in at least one of their plans. Assuming that these employers' plans continue to have less than a year's funding surplus, they would be required to make contribution payments sooner if the administration's proposal were enacted.

Table I.2: Employers' Contribution Practices Compared to Their Plans' Funding Surplus

Number of years funding surplus available	Percent of employers whose practices: Meet proposed change	Do not meet proposed change	Total
Less than one year	15.1	63.7	**78.8**
One year or more	6.2	12 3	**18.5**
Unknown[a]	•	•	**2.7**
Total[b]	**21.3**	**76.0**	**100.0**

[a]Represents employers that did not provide us information on when they made contribution payments

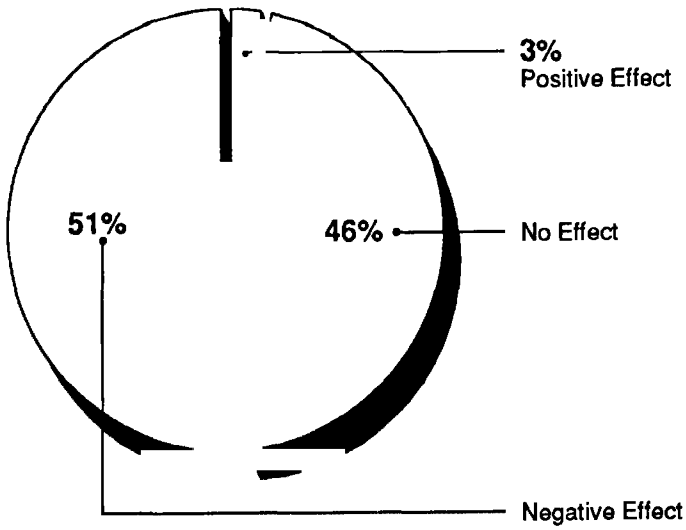
[b]The row total does not add to 100 percent because it excludes the percentage of unknown employers

About Half the Employers Said the Proposal Would Negatively Affect Their Business

As shown in figure I.1, about half of the sampled employers said that the proposed contribution payment change would negatively affect their business operations. The most often cited effect was that employers would incur additional administrative costs to determine their contribution requirements earlier. Our statistical tests show that employers who would have to change contribution practices were more likely to view the changes negatively.

Our statistical tests show that employers who normally make contributions as proposed were more likely to view the proposal as not having a negative effect on their business operations. For example, about 90 percent of the employers who normally made plan contributions as proposed by the administration said their business operations would not be

Figure I.1: Effect of the Change on Employers' Business Operations



negatively affected by the proposed change. However, only about 37 percent of the employers who would have to change their normal contribution practices to comply with the administration's proposal said their business operations would not be negatively affected.

Specific Effects on Employers' Business

Regardless of whether employers said that the change in contribution practices would negatively affect their overall business operations, they cited certain specific effects the changes would have. Table I.3 shows the specific effects that were cited most often by the sampled employers. About 56 percent of the employers were concerned that the change would require them to complete the calculation of required plan contribution amounts more quickly than now, thereby increasing their administrative costs. Other employers cited specific effects that appear to be related to how they manage their cash. For example, about 51 percent of the employers said the proposed change would limit their flexibility in determining when contribution payments are made.

Table I.3: Specific Effects of Proposed Change on Employers

Effects cited	Percent of employers[a]
More expensive for company to complete actuarial valuation within a shorter period of time	56
Loss of flexibility in determining when payments are made	51
Reduced amount of cash available for other business uses	41
Would have to request a time extension for making plan contributions	31
Would have to borrow money to make contributions sooner	24

[a]Does not add to 100 percent because employers cited more than one effect

Results from our statistical tests show whether the specific effects employers said the proposed change would have on their business operations were related to their overall views on the proposal. For example, employers who said that the proposal would cause them to borrow money to make contributions sooner were more likely to view the proposal as having a negative effect on their business. Other specific effects reported by employers that were related to their views included (1) the loss of flexibility in determining when contributions are made, (2) the reduced amount of cash available for other business uses, and (3) the need to request a time extension for making plan contributions.

Paying Contributions Sooner Could Negatively Affect Employers With Overfunded Plans

To determine the extent to which plans had sufficient assets to provide security for participants' benefits and protect the insurance program against claims should they terminate, we computed the funded status of the plans sponsored by the sampled employers using the most recent data available. There are different views on the level of plan funding needed to achieve these objectives. As discussed on page 8, the administration's proposal states that, to ensure the security of participants' benefits, plans should maintain enough assets to cover 110 percent of their termination liability. We also compared the funded status of the employers' plans with their views on the effects of the proposed contribution payment change to determine whether employers could be affected by the change even though their plans may provide sufficient funding to ensure benefit security.

Table I.4 shows that, based on the most current data available, the plans sponsored by almost 80 percent of the sampled employers were overfunded, and the plans sponsored by about 72 percent of the employers met or exceeded the administration's funding security level of 110 percent. Further, three out of four employers who said that the proposal would have a negative effect on their business operations had overfunded plans, and about 70 percent of the employers with negative views had plans that were overfunded by at least 10 percent. About 38 percent of all employers had plans with assets worth at least 150 percent of their estimated termination liability.

Table I.4: Employers' Views Compared With Their Plans' Funded Status

	Percent of employers		
Percent of plan funding	**No negative effect**	**Negative effect**	**Total**
Overfunded			
200 and over	8.2	5.5	**13.7**
150 to 199	11 0	13.0	**24.0**
125 to 149	11.0	8.2	**19.2**
110 to 124	5.5	9.6	**15.1**
100 to 109	4.8	2.7	**7.5**
Underfunded			
Less than 100	8.2	12.3	**20.5**
Total	**48.7**	**51.3**	**100.0**

Conclusions

The financial viability of the insurance program is threatened by large claims from underfunded plan terminations. A significant cause of the underfunding is that required annual contributions have not been paid by employers when the plans terminate. The administration's proposed change to require employers to pay contributions sooner could help alleviate this problem by (1) ensuring that employers make required contributions and (2) permitting quicker identification of employers who are not making required contributions so that more timely action can be taken to help protect participants' benefits and reduce potential insurance program claims.

An estimated 64 percent of 6,100 employers would have to change their current contribution practices if the proposed change is adopted. About half of the employers said the change would negatively affect their business operations. The concerns cited most often by the sampled employers were that the proposed change would increase their administrative costs and require them to change the way they managed their cash.

Although we continue to support the need for employers sponsoring underfunded plans to be required to pay their contributions sooner, it may not be necessary to apply the requirement to all employers to protect plan participants and the insurance program. Most plans are overfunded, with an estimated 70 percent of the sampled employers sponsoring plans overfunded by 10 percent or more—the level of funding suggested by the administration as being adequate to provide security for participants and the insurance program should the plans terminate.

Therefore, to minimize the burden on employers to comply with ERISA's funding standards, we believe that employers sponsoring plans with funding levels sufficient to protect plan participants and the insurance program, such as the funding security level proposed by the administration, should not be required to pay contributions sooner.

Matter for Consideration by the Congress

In debating legislation that would amend ERISA to require employers to pay contributions sooner, the Congress should consider limiting the requirement to employers sponsoring plans that do not have a sufficient funding level to provide security for participants' benefits and to protect the insurance program from claims.

Sampling, Interview Design, and Data Analysis and Verification Procedures

This appendix contains a more detailed description of the sampling, interview design, and data analysis and verification procedures we used for determining the possible effects on employers of the administration's proposal to require single employer defined benefit pension plan contributions to be paid sooner than currently required.

Sampling Methodology

We selected our sample from IRS's November 1986 computerized file of plan year 1984 ERISA annual reports. This file contains information on all types of employee benefit plans, including single employer defined benefit pension plans. The plan year 1984 data were the most current and complete pension plan data available in April 1987 when we began our work.

We limited our selection to plans on IRS's file with 100 or more participants (large plans) because we had already examined the data for these plans to determine whether they were complete and consistent with other reported data. We did not include plans with fewer than 100 participants because we had not performed a similar review of the data for these plans.

IRS's file contained data on 15,185 employers sponsoring 21,720 large single employer defined benefit plans covering about 28 million total participants. However, we excluded about 6,000 employers from the universe because our previous examination of these employers' plans found data that were incomplete or inconsistent with other reported data, and thus could not be used for our analysis. Also, using only these already examined data would permit us to complete our review in the time allowed. As a result, our sample was selected from a total of 9,153 employers sponsoring 11,811 large plans covering almost 17 million participants on which we had complete data.

We selected a random sample of 225 of the total of 9,153 employers.[1] We were able to interview 146 of the 225 sampled. We did not interview the other 79 because 28 (12 percent) had terminated their single employer plans, 12 (5 percent) were sponsors of multiemployer rather than single employer plans, 13 (6 percent) declined to participate, and 26 (12 percent) were excluded for other reasons.[2]

[1] An employer is defined as an entity with a unique employer identification number.

[2] Other reasons for excluding employers included such factors as (1) we were unable to locate them, (2) they were out of business, and (3) they were used in our pretest of the telephone survey

Because of the sample results, our findings can be generalized only to a partial universe of about 6,100 employers sponsoring about 7,900 plans covering over 11 million participants, and may not represent the entire universe of large plans. The 6,100 employers represent those that have continued to sponsor one or more large plans since plan year 1984.

Each projection of our sample results has a sampling error associated with it. A sampling error is the most an estimate can be expected to differ from an actual universe characteristic. Sampling errors are usually stated at a specific confidence level. The results of our review are projectable at a 95-percent confidence level to the estimated 6,100 employers. This means that the chances are 95 out of 100 that the estimates made from our sample would not differ by more than the sampling errors from the actual values for the projected 6,100 employers sponsoring large pension plans continuously since 1984. The sampling error rate for each estimate from this sample does not exceed plus or minus 8 percentage points.

Interview Design

Between July 13 and 27, 1987, we used a computer-assisted telephone interview technique to administer a standardized interview to our random sample of employers. The interview was designed to (1) elicit information from employers about their normal pension plan contribution practices and (2) obtain their views on how the proposed contribution payment changes would affect their businesses.

We interviewed individuals who were identified by plan administrators or employer officials as being knowledgeable enough to answer questions about how the proposal would affect their company. Generally, the individuals we interviewed represented an employer's comptroller, treasurer, or employee benefits department.

Specifically, we asked the employers

- if they continued to sponsor the defined benefit plans they sponsored during plan year 1984;
- when they normally made contributions to their pension plans;
- when they conducted the actuarial valuation of their plan to determine the amount of the contribution for the plan year; and
- whether and to what extent the proposed changes in the timing of plan contributions would affect their business operations and, if so, how.

Before the standardized interview was used, it was pretested with several employers sponsoring large plans. Trained GAO staff conducted the pretest interviews by telephone using the computer-aided telephone interview program as if it were an actual interview session. We recorded the time required to complete the interview and identified any problems the respondents had in answering the questions.

The results of each pretest were used to revise the questions to ensure that (1) the respondents could provide the information requested and (2) the questions were clear, relevant, easy to answer, and free of design flaws that may introduce bias or error into the answers. We also attempted, through the pretest, to revise questions in a way that would minimize the burden placed on the respondents.

Data Analysis and Verification

An extensive set of internal checks was conducted on the interview data to locate inconsistencies and extreme values that could indicate inaccurately recorded information. Where such values were detected, the data records were reviewed, and if necessary, employers were called again to resolve discrepancies.

We used the chi-square test to determine whether a relationship existed between employers' overall views of the proposal and each of several other employer or plan factors that may be associated with their views. The factors that we examined included employers' pension plan contribution practices, plans' funded status, and information on specific effects of the proposal on employers' business operations. The results of the chi-square test were judged significant when there was less than a 5-percent probability that the results would occur by chance. Factors associated with how employers view the proposal are listed on page 13.

To obtain the most current data available for evaluating the funded status of employers' plans, we asked the sampled employers to send us their most recent ERISA annual reports—for plan year 1985 or 1986. In response, 107 employers sent us plan year 1985 or 1986 annual reports for 153 sponsored plans with complete information needed for our analysis. We used plan year 1984 annual reports to evaluate the funded status for the other 48 plans sponsored by the remaining 39 employers.

Although we performed mathematical checks to insure that the plans' annual report data were complete and mathematically correct, we did not verify the accuracy of the annual reports through an audit of plan records.

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