United States General Accounting Office

GAO

Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

April 1991

PRIVATE PENSIONS

Millions of Workers Lose Federal Benefit Protection at Retirement

GAO

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

Human Resources Division

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April 25, 1991

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking, Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

In your March 7, 1990, letter, you expressed concern about the security of pension benefits. Subsequent discussions with your office focused on retirees paid by insurance companies,[1] whose risks have increased in today's volatile financial markets. Specifically, you wanted to know what protection is available for retirees in case of insurance company failure.

The Pension Benefit Guaranty Corporation (PBGC) has announced that it does not guarantee insurance annuities (periodic, lifelong payments by insurance companies to retirees or their survivors) purchased by pension plans. Therefore, if an insurance company should fail, pensioners holding annuities must rely on the various state insurance guarantee laws, which will not fully cover all of them.

We agreed to report on the protection available for retirees receiving benefits from an insurance company. Specifically, we agreed to

- provide an estimate of how many retirees receive their benefits from insurance companies,
- outline the federal and state guarantees available for these annuitants, and
- summarize available data on recent financial difficulties in the insurance industry.

Results in Brief

Insurance industry and government data suggest that 3 to 4 million retirees and surviving dependents of retirees receive annuities that their pension plans have purchased for them from life insurance companies. Even though pension plan benefits are guaranteed under the Employee Retirement Income Security Act of 1974 (ERISA), these pensioners lost this federal guarantee at the time they became dependent on an insurance company for retirement income. Furthermore, retirees holding

[1] As used in this report, a retiree is a person aged 40 or over who is receiving a lifelong pension or a person who received a lump sum at age 55 or older.

these annuities may be unaware that federal guarantees do not extend to them.

Without federal guarantees, pensioners holding such insurance annuities must rely on state guarantees, which provide incomplete coverage. As of March 1991, three states and the District of Columbia still had no provisions for guaranteeing insurance annuities. Many of the remaining state laws cover a smaller portion of benefits than the federal guarantee covers. Thus, some pensioners will remain unprotected, or only partially protected, should insurance companies providing their annuities go out of business.

We are unable to determine the likelihood or value of potential annuitant losses because data are limited. To date, according to industry and government sources, no retiree has lost benefits.[2] However, since 1975, 170 life insurance companies have failed—40 percent of them in the last 2 years.

Background

To protect working Americans from a loss of pension benefits, in 1974 the Congress passed ERISA, providing for federal oversight of the private pension system and for guarantees of benefits. Previously, there was no pension oversight and benefits were not guaranteed; this allowed thousands of workers to lose benefits. An example of this was the 1963 shutdown of the Studebaker company. This shutdown resulted in 4,500 workers losing 85 percent of their promised benefits because the company's pension plan lacked sufficient assets to pay them. Under ERISA, two agencies have roles in directly protecting pension payments.[3] The Department of Labor is tasked with ensuring that plans are operated in the best interest of their participants. PBGC, a corporation chaired by the Secretary of Labor, insures certain types of plans. PBGC insures employees against the loss of specified pension benefits if the plan terminates without sufficient assets to pay them. To fund this guarantee, PBGC collects premiums from plans. However, no premium is collected for retirees paid through an insurance annuity.

[2]On April 11, 1991, the California Insurance Commissioner placed a major insurance company, Executive Life Insurance Company, under court-supervised conservatorship. At that time, final disposition of annuitants' benefits being paid by this company was undetermined.

[3]A third agency, the Internal Revenue Service, oversees ERISA's participation, vesting, and funding standards.

PBGC also oversees certain voluntary terminations of plans with sufficient funds to pay accrued benefits. In such cases, PBGC is responsible for making sure that the plan provides participants with all benefits they are entitled to—either in cash or as an insurance annuity.

PBGC Guarantee Depends on Type of Pension Plan

Of the two basic types of pension plans, PBGC coverage applies only to the "defined benefit" plan, which promises each employee a specified monthly benefit at retirement. Under this type of plan, the employer contributes periodically to the plan's assets, to ensure that future benefits are adequately funded, and must make up for losses in investments of the plan's assets. If the employer goes bankrupt and the plan contains insufficient assets to pay benefits, PBGC takes over the plan and guarantees continued payments.[4]

In contrast, PBGC does not cover the second type of plan, "defined contribution," which does not promise a specified benefit at retirement. Under this type of plan, each employee has an account, to which the employer, the employee, or both contribute. The retirement benefit depends on the accumulation of employer and employee contributions and the employee's proportionate share of the plan's investment gains and losses. Thus, if the plan suffers losses, the employee will receive a lesser benefit at retirement.

Different Methods of Paying Retirement Benefits

About 7.9 million private pension plan retirees receive annuities. An additional 1.9 million pensioners receive annuities as surviving dependents of a deceased retiree. Annuities are paid either by the plan itself (plan annuities) or by an insurance company (insurance annuities). In addition to plans that terminate with sufficient funds, some ongoing plans routinely buy annuities from insurance companies. The insurance companies then assume the responsibility for benefits the pension plan promised.

The plan, not the retiree, decides whether benefits are paid by an insurance company. In making the decision and in selecting the company, the plan must exercise appropriate fiduciary responsibility—that is, act in the best interest of the retiree. Once the plan purchases an annuity, its financial responsibility for pension benefits normally ends. The plan

[4]Some defined benefit plans are not covered. For example, one small group of defined benefit plans—those sponsored by professional service corporations with 25 or fewer employees—is not covered by PBGC guarantees.

retains responsibility only if it can be shown that the plan fiduciaries failed to exercise their duty in making the initial purchase.

Some pension plans give retirees the choice of receiving a lump sum (a fixed payment) instead of a lifelong pension. About 1.2 million retirees aged 55 or older have received only lump sum benefits from their plans, taking on responsibility for their own financial futures. Since a worker can participate in more than one plan, some persons receiving regular pension payments have also received lump sums, while some may be receiving more than one lifelong payment from plans, insurance companies, or both.

Scope and Methodology

To understand the system of pension guarantees, we (1) interviewed government and industry officials and (2) researched publicly available information on the guarantees offered to retirees. We obtained background information on the insurance industry from regulators and industry representatives, but we did not independently assess the industry's financial stability. To obtain general information about retirees, we used data from the Bureau of the Census and the Department of Labor. Our work was conducted between April 1990 and March 1991, in accordance with generally accepted government auditing standards.

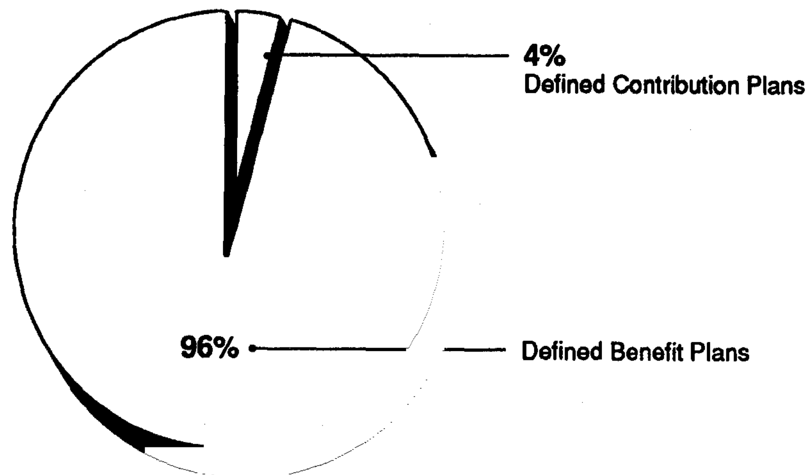
Details on the sources of data, our estimating methods, and the limitations of our results are included in appendixes I and II.

Millions of Pensioners Rely on Insurance Companies for Benefits

Almost all current pensioners were formerly participants in defined benefit plans and thus formerly had their benefits guaranteed by PBGC. Although defined contribution plans cover a large and growing number of workers, the trend towards these plans is recent. Thus, they currently have few pensioners. Bureau of the Census data indicate that 96 percent of private plan pensioners earned their pensions while participating in a defined benefit plan.[5] (See fig. 1.)

[5]GAO sampling errors for data from Census are included in appendix II.

Figure 1: Almost All Pensioners Came From Defined Benefit Plans



Notes: Data include only responses of those pensioners who could identify the type of plan providing their benefits.

Some pensioners receive benefits from more than one plan. Data in this figure include only the plan providing the largest benefit.

Source: Current Population Survey, Bureau of the Census, Dec. 1989.

Although definitive data are not available, we estimate that between 3 and 4 million retirees and their survivors receive benefit payments from insurance companies. Industry data collected from insurance companies by the American Council of Life Insurance (ACLI) indicate that roughly 4 million retirees and survivors receive pension benefits from insurance companies.

Similar government data are not available. However, by comparing data from different government sources, we were able to independently estimate that about 3 million pension plan retirees and survivors receive insurance payments (see app. I). Because our independent estimate excludes some categories of pensioners for which we could not obtain data, we believe that the number of insurance annuitants falls between 3 and 4 million.

PBGC Concludes That Its Federal Guarantee Does Not Extend to Insurance Annuities

Currently, the millions of pensioners who rely on insurance annuities have lost the federal pension guarantee provided under ERISA—possibly without realizing it. PBGC was established to ensure that workers ultimately were paid the pensions that they earned. However, the transfer of responsibility for payment from a pension plan to an insurance company effectively ends any PBGC guarantee. Consequently, the failure of an insurance company can leave the retirees without federal protection.

ERISA explicitly provides for PBGC to guarantee payment of retirees' benefits in the event of a plan termination. However, the issue of PBGC's liability when responsibility for pension payments is transferred to an insurance company is not expressly addressed in ERISA. In its preamble to regulations published in 1981, PBGC said: "In the unlikely event that an insurance company should fail and its obligations cannot be satisfied . . . PBGC would provide the necessary benefits." On March 26, 1990, however, PBGC's Executive Director testified before a House committee that ERISA does not authorize PBGC to provide such coverage.

In response to our request for clarification, PBGC affirmed its view that ERISA does not provide authority to guarantee annuities purchased from an insurance company. (See app. III.) While PBGC has a statutory basis for its position, it leaves retirees whose pensions are paid by insurance companies, potentially without their knowledge, exposed to a risk not present for retirees whose pensions are paid directly by a pension plan.

PBGC reasons that it has no authority to extend guarantees in the case of failure of an insurance company to pay annuities. The only event identified in ERISA as triggering availability of federal guarantees is termination of a pension plan. PBGC notes that an insurance company's default is unrelated to plan termination and, therefore, cannot trigger the guarantee.

Pensioners holding insurance annuities may be unaware that federal guarantees do not extend to them. Plans covered by PBGC insurance must inform workers that their benefits are federally guaranteed. However, these plans are not required to inform retirees that the federal guarantee has ended. Some retirees have an option of receiving either an annuity or the equivalent lump sum benefit, and information about federal guarantees might influence their choice. If plans do not offer such a choice, such information would allow retirees to better understand what options are available to protect their retirement income or to plan for potential reductions in their income.

State Guarantees Leave Gaps in Coverage and Put Caps on Benefits

Without a federal guarantee, insurance annuitants must rely on each state's guarantee laws. When a life insurance company fails, most states continue payments to annuitants by assessing the remaining companies to cover the loss. But caps on the value of guarantees put some benefits at risk. Gaps in state coverage of annuitants make some benefits vulnerable to loss. To conclude, some insurance annuitants are at risk because (1) a few states do not have these laws and (2) provisions of these laws vary from state to state.

A few states provide no guarantees. Information we obtained from the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) shows that three states—Colorado, Louisiana, and New Jersey—and the District of Columbia lack guarantee laws. That information also shows that some states limit the amount of individual coverage. For example, California guarantees no more than 80 percent of an annuity. In addition, California and 21 other states limit total annuity coverage to $100,000 in present value, or about $994 per month.[6] Census data indicate that almost 900,000 pensioners receive monthly benefits greater than $994.[7] By contrast, PBGC guarantees up to about $2,165 a month at the age of 65, which is greater than the benefits paid to 98 percent of pensioners.[8]

In some instances, however, states do cover larger benefits than does PBGC. Pensioners with large annuities guaranteed by those states may be better off than similar pensioners with PBGC's guarantee. In addition, some pensioners may be able to file claims in the liquidation process to recover losses not covered by the state guarantee.[9]

Recent Insurance Company Failures Have Raised Concern

Although no insurance annuitants to date are known to have suffered losses, recent insurance company failures have led to public concern about annuities. As shown in figure 2, the number of life insurance company failures has risen. Between January 1975 and December 1990, 170 such companies failed—40 percent during 1989 and 1990. Fortunately,

[6] Calculated based on PBGC's standard interest rate of 7.25 percent and life expectancy for a 65-year-old male.

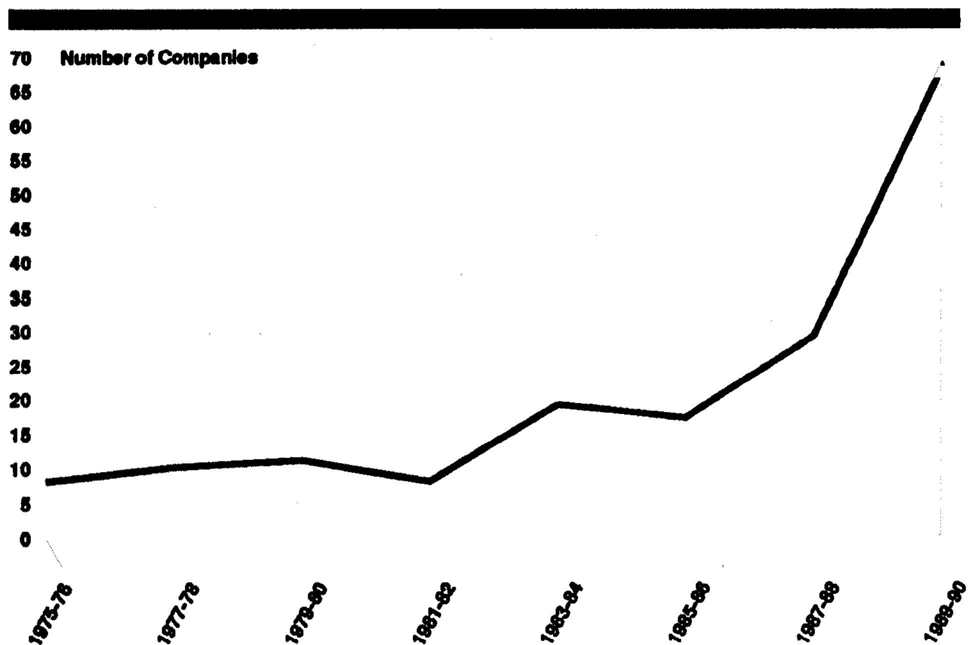
[7] Because of limitations in the Census data, we cannot determine what proportion of these pensioners hold insurance annuities.

[8] PBGC's coverage amount is indexed upward every year. The amount shown represents the coverage for pension plans terminating in 1990.

[9] When an insurance company is liquidated, annuitants may present their claims to the liquidator and receive a share of any remaining assets.

most of these failures have been small companies. NOLHGA information indicates that only 30 of the 170 companies reported suffering $10 million or more in losses at the time of failure. However, one of these companies suffered almost $1 billion in losses.

Figure 2: Insurance Company Failures Have Increased



Source: National Organization of Life and Health Insurance Guaranty Associations.

In addition, some larger insurance companies that provide annuities to pension plans have recently suffered deterioration in the value of their assets. In 1990, one large insurance holding company (First Executive Corporation) had to reduce the book value of its bond holdings by over $800 million. Despite the reduction, the company estimated that the market value of its bond holdings was $2.3 billion below their book value. On April 11, 1991, the California Insurance Commissioner placed this company's largest insurance subsidiary, Executive Life Insurance Company, into court-supervised conservatorship. As of that date, final disposition of annuitants' benefits being paid by this company was undetermined.

Funding and Administrative Issues Would Need Resolution If Federal Guarantees Were Extended to Insurance Annuitants

Because insurance company failures may eventually cost some pensioners a portion of their benefits, we considered the possible funding and administrative consequences of extending PBGC coverage to insurance annuitants. Currently, PBGC finances its pension guarantee fund mostly by collecting premiums from pension plans. No premiums are collected to provide coverage for insurance annuitants. Therefore, additional funding would be needed to cover potential losses.[10]

Further, it would be difficult for PBGC and Labor to administer any extended guarantees. For one thing, they do not have regulatory authority over life insurance companies. Additionally, data are lacking to (1) identify existing insurance annuitants who would be eligible for coverage or (2) accurately estimate the overall risks of loss. Neither PBGC nor Labor maintains complete records of insurance annuitants, so annuitants would have to be identified by their former pension plans, to the extent possible, or by data from the insurance companies that pay them.

Conclusions

Millions of former participants in defined benefit plans are now receiving their pensions in the form of insurance annuities. Without any required notification, they have lost the federal guarantee promised by ERISA. Although these annuitants are protected in general by the state guarantee system, some of them could lose part or all of their pension benefits should the insurance companies providing their annuities fail.

Matters for Congressional Consideration

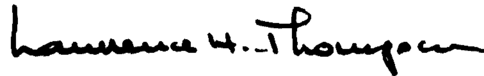
ERISA was passed to protect the interests of participants in pension plans. Because 3 million former participants have lost this protection, the Congress may want to consider approaches for extending federal protections to retirees receiving insurance annuities. In extending these protections, the Congress will need to consider what additional funding, administrative, and regulatory provisions would be necessary. At a minimum the Congress should consider requiring pension plans that purchase insurance annuities to inform their current workers and past retirees that these annuities are not federally guaranteed.

[10]Currently, PBGC reports an accumulated deficit of about $1.8 billion. In addition, PBGC reports that it faces approximately $8 billion in additional liabilities for "reasonably possible" losses.

As agreed, we did not obtain written comments on this report. We discussed its contents with the Department of Labor and PBGC, however, and incorporated their comments where appropriate.

Copies of this report are being sent to other interested congressional committees and the Secretary of Labor; copies will be available to others on request. If you have any questions about this report, please call Joseph F. Delfico at (202) 275-6193. Major contributors to this report are listed in appendix IV.

Sincerely yours,



Lawrence H. Thompson
Assistant Comptroller General

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Abbreviations

ACLI	American Council of Life Insurance
CPS	Current Population Survey
ERISA	Employee Retirement Income Security Act of 1974
NOLHGA	National Organization of Life and Health Insurance Guaranty Associations
PBGC	Pension Benefit Guaranty Corporation

Procedures Used to Estimate the Number of Insurance Annuitants

The American Council of Life Insurance (ACLI) publishes annual statistics on retirement annuities paid by insurance companies. Because we could not verify these statistics directly, we prepared an estimate of insurance annuitants based on information from the Bureau of the Census and the Department of Labor. Neither Census nor Labor data provide specific data on insurance annuitants. As a result, we made several adjustments to their data to complete our government estimate.

ACLI's number and our estimate form upper and lower bounds for an overall estimate of the number of insurance annuitants. ACLI's number provides the upper end of the range because we have not identified information on insurance annuitants in excess of its number. The government-based estimate we prepared is probably below the true number because we were unable to adjust for all the possible shortfalls in available government data.

Source of ACLI Number

ACLI collects data from insurance companies on a voluntary basis. According to these data, 4.3 million retirees and their survivors received payments from annuity contracts purchased by private pension plans. Since some annuitants receive more than one pension, they are counted more than once in ACLI's total number. To compensate for this, we reduced ACLI's number by 8 percent; we based this reduction on the proportion of respondents to a Census Bureau survey who said they had more than one pension. This adjustment results in a final number of about 4 million annuitants.

Since we could not independently verify the reliability of ACLI's number, we calculated our own estimate based on Census's Current Population Survey (CPS) results and data reported by pension plans to Labor. We started with an estimate, based on CPS responses, of total retirees and their survivors who receive lifelong pension benefits. From this total, we deducted our estimate of the number of pensioners paid directly by plans; we based this estimate on the plans' reports to Labor. Since lifelong pensions are paid by either the plan or an insurance company, we concluded that this calculation should produce an estimate of insurance annuitants.[1]

[1] Some annuitants (about 109,000) are paid by the Pension Benefit Guaranty Corporation (PBGC). We did not include this group in our calculation since the number of annuitants paid this way is comparatively small.

CPS Data Used as Starting Point

CPS data compiled in December 1989 were used to determine how many people are receiving lifelong pensions based on private sector employment. For the CPS, Census surveys a sample of U.S. residents in order to estimate employment and other characteristics of the population as a whole. The December 1989 data are the most complete Census information available on retirees. Responses to the CPS indicate that 9.8 million retirees and survivors are receiving lifelong pensions based on private sector employment. To arrive at this number, we made adjustments to CPS data (see table I.1). These adjustments were based on our consultations with Labor.

Table I.1: Estimate of Private Sector Retirees and Survivors Receiving Lifelong Payments

CPS respondent characteristic	Millions of pensioners
Retirees:	
Knew source of pension	7.5
Did not know source of pension	0.2[a]
Survivors	1.9[a]
Adjustment for CPS undercounting of respondents retiring in 1989 after survey conducted	0.2
Total	**9.8**

[a]Information on the source of pensions was not available for these respondents. We estimated the number of private sector pensioners in these categories by prorating respondents according to the ratio of pensioners who knew the pension source.

Our starting number of 7.5 million is based on the number of survey respondents who said that they retired with lifelong pensions earned from employment in the private sector. This number accounts for 59 percent of all respondents who knew whether their benefits stemmed from public or private employment. In addition, respondents representing 331,000 retirees did not know the basis of their pensions. We assumed that 59 percent of these had likewise been employed in the private sector and added 200,000 to account for them.

In addition, CPS respondents, representing 3.3 million persons, said they were receiving pension benefits, but only as survivors of deceased retirees. Since the CPS survey did not ask whether a survivor's benefits were based on a deceased worker's private or public employment, we again assumed that 59 percent of these pensions were based on private employment.

Finally, a Labor analysis of the CPS data shows that the December 1989 survey probably excluded about 175,000 workers who retired with private sector pensions during the last 2 or 3 weeks of 1989. We increased our estimate to compensate for this group.

The results of our analysis provided an estimate of private sector retirees and survivors receiving lifelong annuities. However, the CPS survey did not ask whether lifelong benefits were paid directly by the pension plan or by an insurance company.

Labor Department Data Used to Estimate Number of Pensioners Paid by a Plan

To complete our estimate of insurance annuitants, we started with CPS's derived total pensioner number of 9.8 million and subtracted our approximation of retirees and survivors receiving pensions directly from plans. We used Labor data from 1987, the latest year for which complete data were available, to calculate this estimate.[2] Labor collects information from each pension plan on the number of its retirees and retirement benefit payments.

To calculate this estimate of pensioners paid directly by a plan, we made several adjustments to the data we obtained from Labor, as shown in table I.2. These adjustments were necessary because Labor's data did not directly provide this number.

Table I.2: Adjustments Made to Data on Retirees and Survivors Receiving Pensions Directly From Plans

Adjustment to data	Millions of pensioners
Retirees receiving direct payments	6.9
Estimate for retirees paid by split-funded plans	0.4
Survivors of retirees receiving benefits from plans	0.7
Adjustment for multiple plan participation (based on CPS data)	−0.6
Retirees receiving a lump sum in 1987 (based on CPS data)	−0.5
Total	**6.9**

Note: Numbers based on data reported to Labor by pension plans.

We started with Labor data from plans that only pay retirees directly. Then we increased this number to compensate for retirees from "split-funded" plans, which pay some retirees' benefits directly and some by

[2]To complete our estimate, we combined Labor data from 1987 with CPS data from 1989. However, we also reviewed Labor data for 1988 (which were 85 percent complete), and we did not note a large fluctuation in the number of retirees between 1987 and 1988. We have no reason to believe that a large fluctuation occurred in 1989. Therefore, the difference in years does not materially affect our estimate.

purchasing insurance annuities. Because Labor data do not specify how many of these retirees are paid directly, Labor estimated this number based on a plan-by-plan analysis of the data. Next, we added in survivors being paid because of a deceased worker's employment. The total of these survivors was also obtained from Labor's records and includes a group of survivors who are not yet in payment status. However, according to Labor, this group is relatively small and will not materially affect our estimate.

Further, we reduced Labor data using Census information. With the same percentage used to adjust ACLI's number (see p. 14), we adjusted for pensioners that are being paid by more than one plan. We then used CPS data to adjust for retirees receiving their first lump sum payment in 1987 since Labor data on retirees include recipients of lump sum payments. All these adjustments were based on our consultations with a Labor Department economist.

Labor and Census Data Provide Lower Estimate of Insurance Annuitants

Subtracting the estimate of pensioners paid directly by plans (6.9 million) from the estimate of total pensioners (9.8 million), we get a result of 2.9 million pensioners paid by insurance companies. Because our estimate does not include several factors that would increase the count of annuitants, we believe that it represents the lower bound of the estimated number of insurance annuitants.

For example, according to CPS results, 560,000 persons receiving primary pensions from the public sector were also receiving multiple pensions. An unknown number of these pensioners may be receiving these secondary pensions from private sources. Since we were unable to estimate how many retirees fall into this category, we did not include them in our calculations.

Limitations of Data Bases

We could not verify ACLI's number directly because the Council pledges confidentiality to the insurance companies responding to its survey. Thus, we computed another estimate by combining CPS and Labor data. These data sources, however, may not be directly comparable. For example, the CPS survey was administered in December 1989; the most recent complete Labor data are for 1987. In addition, the CPS data are based on a sample, but Labor obtains data from administrative records. Nonetheless, we did not identify a more precise means of preparing our estimate.

Sampling Errors for CPS Estimates

Because our estimates from the CPS are based on a sample of retirees, each reported estimate has a sampling error associated with it. The size of the error reflects the precision of the estimate—the smaller the sampling error, the more precise the estimate. We calculated sampling errors for estimates in this report at the 95-percent confidence level, meaning that the chances are 19 out of 20 that the actual number or percentage being estimated falls within the range of our estimate, plus or minus the sampling error. For example, where CPS results indicate that 7.5 million retirees have received a pension from a private sector plan and the sampling error is 400,000, there is a 95-percent chance that the actual number of such retirees is between 7.1 million and 7.9 million. The sampling errors for key data from the CPS are shown in table II.1.

Table II.1: GAO Sampling Errors for Estimates From the Current Population Survey

Pensioner characteristic	Estimate in millions	Sampling error (+/-)
Pension from a private sector pension plan	7.5	0.4
Did not know if pension was from a private sector plan	0.3	0.1
Lump sum payment after age 55	1.2	0.1
Survivors of retirees	3.3	0.2
Lump sum in 1987	0.5	0.1
Receiving over $994 a month in benefits	0.9	0.1
	Estimate in percent	**Sampling error (+/-)**
From defined benefit plans	96	1.0
From defined contribution plans	4	1.0
Benefits below $2,165 a month	98	0.7
Benefits from more than one plan	8	1.3
Benefits from private sector plans	59	1.9

PBGC's Position on Its Liability for Insurance Annuities

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006-1860

January 14, 1991

Donald C. Snyder, Assistant Director
Pension Equity Issues, Human Resources Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Snyder:

The Executive Director has referred your letter of December 11, 1990 to me for reply. You have asked that we clarify the PBGC's position with respect to annuities purchased by plan administrators to satisfy their obligation to participants and beneficiaries in terminating pension plans. Specifically, you ask whether the PBGC is obligated to pay pension benefits provided by insurance company annuities if the insurance company fails, and if not, whether the PBGC is prohibited from doing so. After completing a thorough legal analysis of the statutory provisions under which the PBGC single-employer termination insurance program is administered, we have concluded that the statute does not authorize PBGC to guarantee benefits distributed in the form of irrevocable annuity contracts from insurance companies. A summary of our analysis follows.

Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA") (29 U.S.C. §§ 1301-1461), which established the PBGC and its insurance programs, requires the PBGC to guarantee the payment of basic pension benefits when a covered single-employer pension plan terminates with insufficient assets to pay for those benefits. Under those circumstances, the PBGC normally assumes trusteeship of the plan and pays guaranteed benefits in the form of a monthly benefit. _See generally_ ERISA §§ 4022, 4041(c), 4042, 4044, 4061. If a covered plan terminates with sufficient assets to pay for all benefits under the plan, including those in excess of guaranteed benefits, ERISA provides that PBGC shall oversee the plan administrator's allocation of plan assets and distribution of benefits, to ensure that plan participants receive the proper benefits upon termination. _See generally_ ERISA §§ 4041(b), 4044.

Since the inception of the single-employer insurance program, the program's "insurable event" has been plan

termination. Thus, for example, ERISA § 4022(a) provides: "Subject to the limitations contained in subsection (b), the [PBGC] shall guarantee in accordance with this section the payment of all nonforfeitable benefits (other than benefits becoming nonforfeitable solely on account of the termination of a plan) under a single-employer plan <u>which terminates</u> . . . ." (Emphasis added.) Similarly, ERISA § 4061 provides that "[t]he [PBGC] shall pay benefits under a plan <u>terminated</u> under this title subject to the limitations and requirements of subtitle B of this title." (Emphasis added.) Nowhere in the statute is PBGC authorized to pay benefits upon the occurrence of any other event, such as the failure of an insurance company.

In a "standard" termination, where plan assets are sufficient to satisfy all of the plan's benefit liabilities, the plan administrator is required to distribute all plan assets in satisfaction of all plan benefits. <u>See</u> Allocation of Assets, Supplemental Notice of Proposed Rulemaking, 41 Fed. Reg. 48492 (November 3, 1976); 29 C.F.R. § 2618.3(b) (proposed as 29 C.F.R. § 2608.3(b)); Determination of Plan Sufficiency and Termination of Sufficient Plans, Proposed Rulemaking, 41 Fed. Reg. 48504 (November 3, 1976); 29 C.F.R. § 2617.4 (proposed as 29 C.F.R. § 2615.3). These rules were codified by the Single-Employer Pension Plan Amendments Act of 1986 (Pub. L. 99-272). <u>See</u> ERISA § 4041(b)(3). This final distribution of all plan assets completes the plan termination process, and accordingly extinguishes the PBGC's statutory guarantee obligation. <u>See</u> 29 C.F.R. §§ 2617.20-2617.23.[1]

Thus, the PBGC was established to guarantee basic benefits in plans that terminate with insufficient funds to pay those benefits, and to oversee the proper allocation and distribution of plan assets to cover those benefits in sufficient

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[1] Similarly, a complete distribution of an individual's benefit in an ongoing plan satisfies, and therefore extinguishes, the obligation of both the plan and the PBGC to that individual, even if the plan subsequently terminates. "Participant" is defined in ERISA § 3(7) to mean an individual who is or may become eligible to receive a benefit from a plan. The agencies charged with the administration of ERISA (the Department of Labor, the Internal Revenue Service, and the PBGC) have consistently interpreted this to exclude those individuals whose benefits have been fully satified by the purchase from an insurer of an irrevocable commitment to pay those benefits. <u>See</u> 29 C.F.R. § 2610.2; Form 5500 (issued jointly by DOL, IRS, and PBGC). <u>See also</u> ERISA § 4044(d)(3). Indeed, because the individual ceases to be a participant in the plan once an irrevocable annuity contract is purchased in complete satisfaction of his or her benefit, no further PBGC premiums are paid with respect to that individual. 29 C.F.R. §§ 2610.2, 2610.22, 2610.32.

terminating plans. The "insurable event" is plan termination which, in the case of a sufficient plan, is completed upon final distribution of assets in payment of all benefits under the plan through the purchase of annuity contracts or the distribution of lump sum amounts. The distribution of plan assets in the correct amount and proper form extinguishes the PBGC's guarantee obligation. For example, PBGC does not stand behind benefits distributed in a lump sum payment, nor protect from subsequent loss a participant who chooses to "roll over" a lump sum distribution into an Individual Retirement Account. Similarly, the failure of an insurance company subsequent to a proper distribution of plan assets through the purchase of annuity contracts does not result in an insurable event or reinstate the PBGC guarantee.[2]

It is clear from the manner in which the PBGC's single-employer insurance program is financed that Congress did not intend for PBGC to guarantee benefits that have been satisfied by a full distribution of plan assets upon plan termination. The PBGC's guarantee is financed primarily through the payment of premiums by covered plans. ERISA § 4007(a) provides: "Premiums shall continue to accrue [for a sufficient plan] until a plan's assets are distributed pursuant to a termination procedure [under section 4041(b)]." Thus, once a sufficient plan has terminated in a standard termination, no further premiums are paid with respect to that plan. Obviously, had Congress intended the PBGC to guarantee against a subsequent failure of the insurance company from which annuities were purchased, it would have designed a premium structure to protect PBGC against that continued exposure.[3]

Since ERISA's enactment in 1974, the amount of the annual premium owed by a plan has been based on the number of participants in the plan. ERISA § 4006. And, until 1987, the premium was simply a flat rate dollar amount, per year, per participant. In 1987, however, Congress enacted the Pension Protection Act (Subtitle D of Title IX of OBRA 1987, Pub. L. 100-203) ("PPA"). As part of the PPA reforms to strengthen the single-employer insurance program, Congress amended ERISA

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2 Cf. ERISA § 4041(b)(4) (PBGC remains obligated to insure the payment of guaranteed benefits only if the plan administrator has not made a proper distribution, i.e., if a participant is overlooked or paid an incorrect amount and if the plan administrator does not promptly correct the error in distribution). H.R. Rep. No. 99-241, Part 2, 99th Cong., 2d Sess., reprinted in, 1986 U.S. Code Cong. & Admin. News 706.

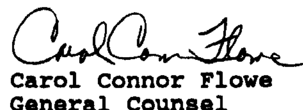
3 In this regard, we also note that the PBGC has no regulatory authority over insurance companies.

§ 4006 to revise the single-employer plan premium structure. Under the revised structure, the existing flat rate premium was supplemented by an additional premium amount that is based on a plan's unfunded vested benefits.[4] Congress thereby reinforced the concept that premiums are based on PBGC's exposure from insufficiently funded plans. Had Congress intended for PBGC to insure against the failure of insurance companies from which annuities have been purchased, it surely would have also addressed the liabilities to which this would expose the PBGC. Significantly, we have estimated that that exposure could be as high as $50 billion.

As you note, in a 1981 preamble to PBGC's sufficiency regulation, the PBGC responded to a comment on an earlier notice of proposed rulemaking by indicating that we would pay guaranteed benefits in the event that an insurance company should fail and the state reinsurance fund did not satisfy the annuity obligations. See 46 Fed. Reg. 9532, at 9534 (January 28, 1981). We have searched PBGC records and found no legal memoranda or other document to support this statement. And, after a detailed and extensive legal analysis of the statutory provisions, we have reached a contrary conclusion. Thus, the statement in the preamble was made without legal analysis, and was simply incorrect.

Please do not hesitate to let me know if you have any further questions about this matter.

Sincerely yours,



Carol Connor Flowe
General Counsel

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[4] The premium amount was increased by section 12021 of The Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508.

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Glossary

Annuity	An amount payable yearly or at other regular intervals. As used in this report, a periodic payment by a pension plan or an insurance company to a pensioner.
Defined Benefit Plan	A pension plan that pays specified, periodic benefits to retirees.
Defined Contribution Plan	A pension plan that invests employees' or employer's contributions (or both) and pays each retiree a share of the investment returns.
Insurance Annuity	A periodic payment by an insurance company. As used in this report, an annuity paid by an insurance company to a pensioner as a result of participation in a defined benefit plan.
Lump Sum	A cash payment or (as used in this report) a finite series of payments to a retiree in lieu of a lifelong pension.
Retiree	As used in this report, a person aged 40 or over who is receiving a lifelong pension or a person who received a lump sum at the age of 55 or older.

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