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Financial Condition of the Pension Benefit Guaranty Corporation

Statement of
Joseph F. Delfico, Director
Income Security Issues
Human Resources Division

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SUMMARY

The Pension Benefit Guaranty Corporation's (PBGC) deficit is large, has grown significantly in recent years, and is expected to continue to grow. The growth in its deficit will come from underfunded plans that terminate in the future. PBGC currently has sufficient cash flow to pay its current benefit obligations, but this may not continue. Now is the time for serious deliberations on developing solutions to improve funding in underfunded plans so as to reduce the risk to PBGC from future terminations.

The Administration has introduced several legislative proposals designed to reduce future claims against PBGC. None of these proposals is designed to reduce PBGC's current deficit. GAO supports the goals of many of these proposals. But GAO believes that certain issues require further study of their potential impact on plan participants, plan sponsors, the adequacy of plan funding, and federal revenues before they are enacted. Other avenues of reducing PBGC's potential claims and current deficit should be studied, such as improving funding in flat benefit plans, making greater use of PBGC's existing termination authority, and restructuring PBGC premiums to better reflect its potential risks.

PBGC is burdened not only by its current deficit and looming potential claims, but also by significant internal operations problems. Because of significant internal control and systems weaknesses, GAO has never been able to express an opinion on PBGC's financial statements. In addition, continuing problems with its premium collection system have prevented PBGC from preparing an accurate accounting of premium revenue. These problems indicate PBGC needs to put more emphasis on its operations.

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss the Pension Benefit Guaranty Corporation's (PBGC's) financial condition. Few public deficits have received more attention in recent months than the deficit in PBGC's single-employer insurance fund. Several years ago GAO placed the private pension system on its "high-risk" list because of the potential for material losses to American taxpayers and long-standing control weaknesses at PBGC. Since that time, we have devoted significant attention to problems with regulation of pension plans in general and PBGC in particular.

PBGC was created by the Employee Retirement Income Security Act of 1974 (ERISA) to administer the insurance program to protect the benefits of participants in defined benefit pension plans. These plans pay specific retirement benefits, generally based on years of service or earnings. PBGC insures benefits of such plans that terminate with assets too small to cover future benefit liabilities.

In my statement today I would like to highlight four points that we hope will be helpful in congressional policy formulation. We believe such policy should focus on reducing unfunded liabilities in PBGC-insured pension plans because such actions are the key to reducing future PBGC liabilities. We are also concerned about PBGC's long-standing operational problems.

1. PBGC's deficit is large--$2.3 billion at the end of fiscal year 1991--and has grown significantly in recent years. The major threat to the agency is the large unfunded liabilities in the ongoing plans it currently insures. PBGC's most pessimistic estimate indicates that its deficit may grow to $17.9 billion by the year 2001. Unless proper steps are taken to improve plan funding, this pessimistic estimate may become a reality.

2. PBGC's cash flow is currently sufficient to meet its current benefit obligations. Nonetheless, the Congress should address the threat to the agency from underfunded plans. If the Congress now begins the process of developing solutions, it should not be necessary to legislate in haste at some future date or to seriously erode the protections afforded workers in the process of solving PBGC's problems. We are encouraged by this Committee's efforts to start the legislative debate at this time.

3. The Administration has introduced several legislative proposals designed to reduce the future claims PBGC might incur. None of these proposals directly addresses PBGC's current deficit. Rather, each seeks to limit the size of additional liabilities PBGC will have to assume. Though we support the goals of many of these proposals--especially those

aimed at improving plan funding--we believe that, for some, a careful analysis should be done of their potential impact on plan participants, plan sponsors, federal revenue, and the adequacy of pension plan funding.

In addition to the Administration's proposals, other avenues of addressing PBGC's potential claims and existing deficit should be analyzed, such as improving funding of flat benefit plans, making greater use of PBGC's existing authority to terminate financially troubled plans, and establishing premiums that better reflect the risk to PBGC.

4. In addition to PBGC's current deficit and looming potential claims, the agency has significant internal operations problems. Because of significant internal control and systems weaknesses, we have never been able to express an opinion on PBGC's financial statements. Unaudited financial statements cannot be relied upon to accurately portray PBGC's financial health. In addition, continuing problems with PBGC's premium collection system have prevented PBGC from preparing an accurate accounting of premium revenue. However, PBGC has recently moved to address these problems.

INCREASING PLAN UNDERFUNDING THREATENS PBGC

PBGC has had a deficit since its inception in 1974, and the deficit is growing. Its 1991 annual report listed assets of $5.9 billion and liabilities of $8.2 billion, an accumulated deficit of $2.3 billion--up from $1.8 billion in 1990.

PBGC's financial condition looks worse when potential terminations of underfunded plans are considered. In its 1991 Annual Report, Strengthening the Pension Safety Net, PBGC said that some plans, especially in the steel, tire, automobile, and airline industries, are underfunded by a total of about $40 billion (almost 20 times PBGC's current deficit), with over half this amount in a few large plans. Of the $40 billion, PBGC reported $13 billion is in plans sponsored by financially troubled companies. Moreover, plans' funding levels could deteriorate even more if the current economic downturn continues or worsens. PBGC's most pessimistic 10-year forecast shows its potential deficit by the end of fiscal year 2001 could be $17.9 billion.[1]

OPPORTUNE TIME TO ADDRESS PBGC'S THREAT

PBGC continues to have a positive cash flow. For fiscal 1991, PBGC reported its premium and investment income exceeded expenditures

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[1]This estimate assumes the plans with $13 billion in underfunding plus some smaller ones will terminate during the 10-year period; it is not a worst-case scenario.

for benefits and other expenses by $452 million. Reported premium and investment income were $809 million and $309 million, respectively, while disbursements were $666 million. However, predicting whether and how long PBGC will be able to meet its current benefit obligations out of its cash flow is difficult. Therefore, this is the time--while PBGC still has a positive cash flow--to develop solutions to better fund pension promises. Improved plan funding would reduce the size of potential claims against PBGC.

IMPROVING PBGC'S FINANCIAL CONDITION

The Administration has introduced legislative proposals to improve PBGC's financial condition, primarily by reducing future PBGC liabilities. These include revising the minimum funding standards for underfunded plans, freezing PBGC's guarantee of benefit increases by underfunded plans, and clarifying and improving the priority of PBGC bankruptcy claims. The proposals do not specifically address the reduction of PBGC's current deficit, which historically has been dealt with by raising premiums. Rather, they seek to limit the size of the liabilities PBGC will be asked to assume in the future.

In January 1992, the Administration also proposed budgeting for PBGC's potential costs on an accrual basis so that policymakers can fully assess the costs of the pension insurance program and adequately monitor and plan for the program's future. Though we did not support that specific proposal due to certain implementation concerns, we believe that the concept of reporting accruals in the federal budget is sound.

We believe that, in addition to these proposals, other measures for improving PBGC's financial condition should be thoroughly analyzed and considered.

Funding

The Administration's proposed new funding standards are aimed at further strengthening plan funding. We believe the proposals have merit and support their goals. However, we have not fully analyzed all technical aspects of the proposals and cannot currently comment on their specific language.

We have long supported strong and effective funding standards for the nation's defined benefit pension plans. ERISA established funding standards to help ensure plan sponsors would fund their pension promises. The 1987 Omnibus Budget Reconciliation Act established additional funding standards aimed specifically at underfunded plans. We are currently evaluating the 1987 standards to determine whether they are working as intended.

We note that the Administration's proposed funding standards will lead to larger contribution requirements for some plans. This will increase the federal deficit in the short run because contributions are tax deductible business expenses. Also, some financially troubled sponsors may have difficulty meeting the new standards.

Benefit Guarantee Limitations

The Administration's proposals would limit guarantees on benefit increases and deny guarantees on new shutdown benefits. We would prefer that the threat to PBGC from underfunded plans be addressed by better plan funding rather than denying guarantees. However, we have not thoroughly studied these proposals and have not considered alternatives so we do not have a position at this time.

ERISA was enacted to protect plan participants from abuses in the pension system. We are concerned that the proposals would limit benefit guarantees and, thus, adversely affect plan participants rather than strengthen underfunded plans.

We are also concerned about the proposals because they raise the sensitive issue of inequitable treatment of participants in different types of plans. The proposals to suspend PBGC's guaranty for benefit increases apply only to new plans and plans whose benefit increases result from plan amendments. The proposals effectively apply primarily to one type of existing plan--referred to by PBGC as flat benefit plans, which usually are collectively bargained and serve primarily unionized, blue collar workers.

The proposals would also deny PBGC's guarantee to new or increased "unpredictable contingent event benefits" (for example, shutdown benefits). Such events sometimes occur shortly before plan termination. These benefits have been a problem for PBGC because they generally are not funded when the plan terminates.

In general, we prefer that the threat to PBGC from underfunded plans be addressed through improved funding. One measure might be to require sponsors of flat benefit plans to anticipate future benefit increases when calculating the plan's liabilities. Similarly, the Congress could require better advanced funding of shutdown benefits as a condition for PBGC insurance coverage.

Improved Status in Bankruptcy

The Administration's proposals clarify and improve PBGC's priority in bankruptcy, and provide for the continued payment of contributions while a plan sponsor is in bankruptcy. We have not seen any studies of the dynamics of these proposals or their effects on other parties, including creditors and the federal government. Therefore, we currently do not have a position on them. We do, however, support the proposal to strengthen plan funding while the sponsor is in bankruptcy.

The bankruptcy protections afforded PBGC by ERISA have not always been followed in bankruptcy court cases because these protections are not part of federal bankruptcy law. Unfunded plan liabilities often increase and company assets waste away before and while the company is going through bankruptcy proceedings. The proposals would require sponsors in bankruptcy to make contributions to their plans and improve PBGC's priority position to increase its recoveries.

We believe contributions should continue while the sponsor is in bankruptcy to maintain plan funding, and we support the thrust of the proposal in this area. History has shown that neglecting contributions while a plan's sponsor is in bankruptcy leads to higher expenses to PBGC.

We recognize that improving PBGC's priority position in bankruptcy would improve its recoveries. However, other creditors of a plan's sponsor may be adversely affected or might be unwilling to extend credit to sponsors of significantly underfunded plans. Because we do not know what kind of economic chain reaction will occur, we cannot support these proposals without further study.

Other Considerations

There are other measures PBGC could take. PBGC currently has the authority to terminate pension plans under certain conditions. Perhaps it should use this authority in a more proactive manner with companies in, or headed for, bankruptcy. This would allow PBGC to freeze benefit accruals and minimize its potential losses. We recognize that this is a highly sensitive approach because actions of this nature could destabilize a failing company and hurt plan participants. In the final analysis, however, someone has to decide where and when to limit PBGC's exposure, before or after bankruptcy.

To address PBGC's current deficit, the Congress also may want to consider making premiums more risk related. The Subcommittee may want to consider whether the existing variable premium rate ($9 per $1,000 of underfunding) and/or overall ceiling on premiums ($72 per person) best reflects the risk to PBGC. To enhance revenues, we believe the Congress should first focus on the premiums paid by underfunded plans because they pose the greatest threat to the program.

In addition, PBGC should benefit from implementation of recommendations in our April 9, 1992, report to this Subcommittee.[2] We recommended that the Congress amend ERISA to require full scope audits of pension plans and to require plan

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[2]Employee Benefits: Improved Plan Reporting and CPA Audits Can Increase Protection Under ERISA (GAO/AFMD-92-14).

administrators and independent public accountants to report on how effective a plan's internal controls are in protecting plan assets. Strong internal controls can help to ensure that plans more accurately report their assets and liabilities, including the amount of any unfunded liabilities, and that plans pay accurate premiums to PBGC.

PBGC'S OPERATIONAL WEAKNESSES

PBGC has had long-standing operational problems. GAO has never been able to express an opinion on PBGC's financial statements because of internal control weaknesses and financial systems deficiencies. Moreover, in our March 2, 1992, report,[3] we said that we could not evaluate the reliability of PBGC's liability estimate because PBGC had not developed documentation and support for its estimating techniques, assessed data used for estimating, or corrected weaknesses in its estimating software.

We are releasing a report to this Subcommittee today that discusses PBGC's premium collection efforts--Pension Plans: Pension Benefit Guaranty Corporation Needs to Improve Premium Collections (GAO/HRD-92-103). We found that PBGC's efforts to identify and collect delinquent (unpaid) premiums, underpaid premiums, and related interest and penalties have been inadequate. Attempts to collect delinquent premiums from large plans have been infrequent, and PBGC has not attempted to identify or collect delinquent premiums from small plans. Moreover, until April 1992, PBGC had not sent bills for underpaid premiums, interest, and penalties to large or small plans for plan years after 1987. A breakdown in PBGC's computerized premium accounting system, after PBGC tried to modify the system to handle variable premiums, was a major factor in some of these problems. PBGC has been trying for almost 4 years to restore the system, and plans to have a new system in place in 1993.[4]

The amount of uncollected premium income resulting from PBGC's inadequate collection efforts is unknown. PBGC has estimated that it may be as much as $45 million. This estimate is probably low, however, because it does not include such potential income as delinquent and underpaid variable premiums.

In our report, we recommended specific actions that PBGC could take to improve premium collections. PBGC generally agreed with our

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[3]Financial Audit: Pension Benefit Guaranty Corporation's 1991 and 1990 Financial Statements (GAO/AFMD-92-35).

[4]Premium Accounting System: Pension Benefit Guaranty Corporation System Must Be An Ongoing Priority (GAO/IMTEC-92-74; Aug. 11, 1992).

recommendations and has already begun taking some steps to improve collections.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Subcommittee members may have.

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