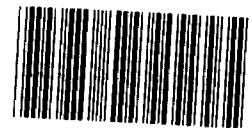


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UNITED STATES GENERAL ACCOUNTING OFFICE  
Washington, D.C. 20548

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STATEMENT OF  
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SENIOR ASSOCIATE DIRECTOR  
HUMAN RESOURCES DIVISION  
BEFORE THE  
SUBCOMMITTEES ON SOCIAL SECURITY AND OVERSIGHT  
OF THE  
HOUSE COMMITTEE ON WAYS AND MEANS  
ON THE  
UNDERFUNDING OF  
SINGLE EMPLOYER PENSION PLANS



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Mr. Chairmen and Members of the Subcommittees, we are pleased to be here today to discuss private pension plan underfunding. In 1974, the Employee Retirement Income Security Act (ERISA) established funding standards to help ensure that assets of defined benefit plans were adequate to pay promised pension benefits. The act also set up a government insurance program, administered by the Pension Benefit Guaranty Corporation, to guarantee, within certain limits, benefits of single employer plans not funded by employers at plan termination. About 30 million people are now covered by 110,000 insured plans. The insured plans finance the program through annual premiums.

Between ERISA's enactment and the end of fiscal year 1985, 68,000 insured plans terminated. About 1,100 of these plans, covering about 160,000 insured participants, filed claims against the insurance program because they were underfunded, that is, they did not have enough assets to pay guaranteed benefits. Claims have exceeded premium revenues from ongoing plans, causing the insurance program to operate at a deficit. The program's estimated deficit at September 30, 1985, was \$1.3 billion (liabilities of \$2.7 billion minus assets of \$1.4 billion). The Single Employer Pension Plan Amendments Act of 1986 was designed to help avoid or reduce claims, and improve the program's financing.

I would now like to provide information and observations on plan underfunding and its effects. This information has been developed in response to your February 12, 1986, request that we

study underfunding and associated trends in insurance claims. My testimony focuses on plan underfunding, its extent and effects, factors contributing to underfunding, the potential of the 1986 amendments for alleviating the effects of underfunded terminations, and alternatives for controlling underfunding and its effects.

#### EXTENT OF PLAN UNDERFUNDING

We analyzed the funding status of large single employer plans (100 or more participants) using the government's latest and most complete plan data (1983) as of November 1985. We considered a plan to be underfunded if the value of its assets was less than the estimated value of participants' earned benefits. Most of these benefits would have been guaranteed by the insurance program if the plans had terminated.

We found that most plans in 1983 were overfunded, but many were underfunded and some by large amounts. Of the 14,500 plans reviewed, over 2,300 (16 percent) were underfunded by more than \$18 billion. These underfunded plans covered almost 4 million (21 percent) of the 19 million participants. In contrast, over 12,200 plans with 15 million participants were overfunded by about \$87 billion.

We also found that the bulk of the underfunding was concentrated in a relatively few plans. Over 90 percent of the total underfunding was in 275 plans that were underfunded by \$5 million or more each. Six plans alone had a total of \$7 billion in unfunded benefits. In addition, one out of every five underfunded plans was less than 50 percent funded.

FUNDING REQUIREMENTS AND  
BENEFIT GUARANTEES

Generally, ERISA's funding standards were established to help ensure that plans accumulate enough assets to pay benefits as participants retire. Actuaries value plan assets and benefits under any of several acceptable funding methods to determine annual minimum contribution requirements under the standards.

Plans may be underfunded at termination for various reasons. Some funding methods result in slower asset accumulation than others. Also, minimum contribution requirements are based on the assumption that the plans will continue rather than terminate and, therefore, on assumptions about future conditions affecting plan assets and benefit liabilities. The plan's actual experience may differ from these assumptions.

Plans may also be underfunded if they terminate before employers make contributions for a particular plan year. Contributions are not required until 8-1/2 months after a year ends. Also, the Internal Revenue Service (IRS) can waive required contributions because of business hardship.

In addition, benefit increases that allow credit for participants' past years of service (e.g., cost-of-living increases for retirees) can create or add to underfunding. Because these increases are permitted to be funded over periods as long as 30 years, plans that grant them (especially those that grant them frequently) can terminate with substantial unfunded benefits.

The insurance program generally guarantees, at termination, plan benefits to which participants have a nonforfeitable right (vested benefits). However, the guarantee of benefit increases is limited to help protect the program. Generally, increases in effect for less than 5 years before termination are insured after each year at a rate of 20 percent of the increase or \$20 per month, whichever is greater. By contrast, the Corporation's insurance program for multiemployer plans does not insure any benefits attributable to increases until they have been in effect for 5 years.

#### EFFECTS OF PLAN UNDERFUNDING

Plan underfunding adversely affects the insurance program when plans voluntarily terminate with large amounts of unfunded benefits that cannot be recovered from sponsoring employers. The program's large deficit is a direct result of a rising trend in the size of claims. These claims have come from relatively few employers. For example, during fiscal years 1983 through 1985, 23 employers terminated 33 plans that accounted for \$450 million in claims (90 percent of total claims in the period). Of these claims, the Corporation expects to recover \$64 million (14 percent) from the sponsoring employers. Premium payments from ongoing plans will have to finance the remainder.

Permitting plans to be underfunded results in some employers granting immediate pension benefit increases and funding them over time. Such increases, which might not otherwise be affordable, help to protect participants' pensions against inflation.

As long as employers eventually pay these unfunded benefits, or the insurance program remains viable, plan underfunding has a negative impact on few participants. For example, 4,000 participants in the 33 terminated plans lost earned benefits because they were not vested and, therefore, not guaranteed by the insurance program. The other 31,000 plan participants, however, were vested and generally assured of receiving most earned benefits because they were guaranteed.

FACTORS CONTRIBUTING TO PLAN  
UNDERFUNDING AT TERMINATION

We reviewed the funding practices for the 33 plans that resulted in 90 percent of the claims against the insurance program during 1983 through 1985. Our review was limited to the 5-year period before plan termination because earlier data were generally not available.

We found that most of the 23 employers sponsoring the terminated plans were experiencing business hardship during the 5 years before termination. At plan termination, 17 of the employers were in bankruptcy reorganization or liquidation proceedings.

The 33 plans' unfunded benefits increased significantly during the 5-year period. The plans' assets did not cover 44 percent of their vested benefits at the start of the period. At termination, the plans were 66 percent unfunded. During the 5 years, unfunded benefits almost doubled, to \$450 million.

We identified several factors contributing to the increased underfunding during the 5 years before termination. Although we were not able to quantify the dollar effect of all of the factors, we believe that each contributed significantly to the underfunding of the 33 plans. Specifically, we found that

- 9 employers received business hardship funding waivers for contributions totaling \$29 million that were unpaid at termination,
- 12 employers did not make \$41 million in required contributions that had not been waived before termination,
- 20 employers had \$57 million in current contributions that became due when they terminated their plans,
- 18 employers increased 27 plans' benefits which were generally guaranteed by the insurance program and unfunded at termination (benefits increased in 16 plans three or more times and benefit increases in 17 plans became effective while contributions were waived or unpaid), and
- Most contributions made to the plans before termination did not exceed the minimum required levels.

#### POTENTIAL EFFECTS OF THE 1986 AMENDMENTS

The 1986 amendments were primarily designed to strengthen the insurance program's financial viability by increasing program revenues and helping to control claims or increase collections from employers terminating underfunded plans. These provisions include (1) raising the annual premium from \$2.60 to

\$8.50 per plan participant, (2) requiring employers to meet prescribed standards of financial distress in order to terminate plans, (3) increasing the employer liability for terminated plans' unfunded benefits, and (4) allowing IRS, when needed, to require that employers provide security for funding waivers of \$2 million or more.

These amendments should help avoid claims from some underfunded plans and better finance claims that do occur. For example, the higher premium rate will raise program revenues by an estimated \$180 million this year. Also, the distressed employer termination provisions should help the program avoid claims from employers not distressed. Further, collections of waived contributions after termination should be improved to the extent that IRS requires security.

However, it is too early to tell whether the amendments will ensure the long-term viability of the insurance program. Our review indicates that about half of the \$500 million in program claims during the 1983-85 period came from underfunded plans of 17 employers who were in bankruptcy proceedings at plan termination. Considering this, the Corporation's ability to sufficiently improve its recovery of claims from distressed employers is doubtful, even with the increased employer liability.

Recent large claims now raise serious doubt about the ability of the \$8.50 premium to cover future claims and pay off the program's deficit. An \$8.50 rate will retire the newly estimated deficit of \$1.3 billion within 15 years if future



claims average \$100 million a year. However, the Corporation now forecasts future claims to average between \$220 million and \$450 million a year. Based on these forecasts, the Corporation estimates that the program's deficit could grow to between \$1.5 billion and \$2.5 billion within 5 years without another premium increase. We believe these forecasts are reasonable, given our past analyses of premium needs and the program's recent claims experience.

ALTERNATIVES FOR CONTROLLING PLAN  
UNDERFUNDING AND ITS EFFECTS

Some plans are significantly underfunded. Current law may not be adequate to protect the insurance program from potential large claims should these plans terminate. Therefore, further changes should be considered to protect the program's viability. Such changes could include modifying current law to

- require more rapid payment of unfunded benefits, especially those resulting from benefit increases,
- require employers to make minimum contribution payments to their underfunded plans sooner than 8-1/2 months after the end of the plan year,
- further limit the guarantee of benefit increases, and
- raise the premium rate to provide the revenue needed to retire the program's deficit and pay for estimated future claims.

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This concludes my testimony. We will be happy to answer any questions at this time.