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PRIVATE PENSIONS

Changing Funding Rules and Enhancing Incentives Can Improve Plan Funding

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Highlights

Highlights of GAO-04-176T, a report to the Committee on Education and the Workforce, House of Representatives

Why GAO Did This Study

Over the last few years, the total underfunding in the defined-benefit pension system has deteriorated to the point where the Pension Benefit Guaranty Corporation (PBGC), the federal agency responsible for protecting private sector defined benefit plan benefits, estimates that total plan underfunding grew to more than $400 billion as of December 31, 2002, and still exceeded $350 billion as of September 4, 2003. PBGC itself faced an estimated $8.8 billion accumulated deficit as of August 31, 2003. Deficiencies in current funding and related regulations have contributed to several large plans recently terminating with severely underfunded pension plans.

This testimony provides GAO's observations on a variety of regulatory and legislative reforms that aim to improve plan funding and better protect the benefits of millions of American workers and retirees while minimizing the burden to plan sponsors of maintaining defined-benefit plans.

www.gao.gov/cgi-bin/getrpt?GAO-04-176T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbard D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov..

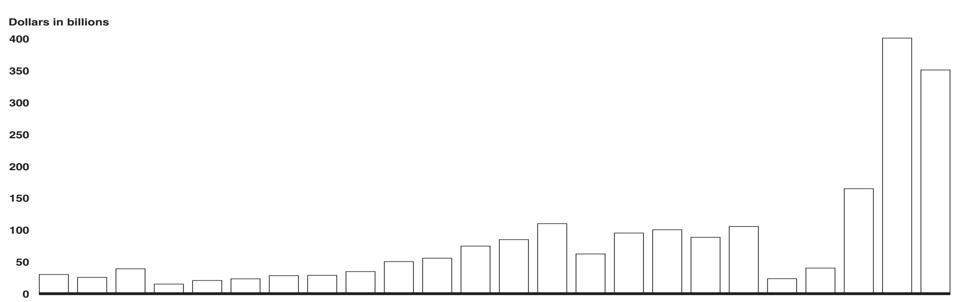
What GAO Found

Recent terminations of severely underfunded pension plans suggest that current funding rules do not provide adequate mechanisms for maintaining adequate funding of pension plans. Funding inadequacies place the retirement security of millions of American workers and retirees, along with PBGC, at risk. While external factors, such as falling stock prices, low interest rates, and slow economic growth, have contributed to widespread pension underfunding, the defined-benefit system also faces structural problems that extend beyond cyclical economic conditions. Stagnant growth of the defined-benefit system, along with several large recent terminations of underfunded pension plans, has left PBGC in a precarious financial condition as the insurer of pension benefits.

There are two general approaches to funding reform that may improve the funding of defined-benefit pension plans. The first approach would change the funding requirements directly. These measures could address reforms to the use of termination liability instead of current liability, additional funding requirements, and lump-sum distributions. The second, more indirect approach would seek to improve plan funding by providing better incentives for sponsors to keep their plans better funded. Options in this category could include requirements broadening the disclosure of plan investments and termination liability information to plan participants and their representatives. These reforms, as part of a comprehensive package, could increase the likelihood that workers and retirees receive promised benefits, while not creating an undue regulatory or financial burden on sponsors.

Recent unfavorable economic conditions have contributed to widespread underfunding and conspired to place well-meaning plan sponsors in difficult positions. Although comprehensive reform should include improving plan funding as the key vehicle to stabilize the long-term health of the defined-benefit system, Congress may seek to balance improvements in funding and accountability against the short-term needs of some sponsors who may have difficulty making plan contributions.

Figure 2: Total Underfunding in PBGC-Insured Single-Employer Plans, 1980-2003



Source: PBGC.

Note: Figure for 2003 is an estimate, as of September 4, 2003.

United States General Accounting Office