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Highlights

Highlights of GAO-05-108T, a testimony before the Committee on Commerce, Science, and Transportation, United States Senate

PRIVATE PENSIONS

Airline Plans' Underfunding Illustrates Broader Problems with the Defined Benefit Pension System

Why GAO Did This Study

At the same time that "legacy" airlines face tremendous competitive pressures that are contributing to a fundamental restructuring of the airline industry, they face the daunting task of shoring up their underfunded pension plans, which currently are underfunded by an estimated $31 billion. Terminating these pension plans confronts Congress with three policy issues. The most visible is the financial exposure of the Pension Benefit Guaranty Corporation (PBGC), the federal agency that insures private pensions. The agency's single-employer pension program already faces a deficit of an estimated $9.7 billion, and the airline plans present a potential threat to the agency's viability. Second, plan participants and beneficiaries may lose pension benefits due to limits on PBGC guarantees. Finally, airlines that terminate their plans may gain a competitive advantage because such terminations effectively lower overall labor costs.

This testimony addresses (1) the situation the airlines are facing today, (2) overall pension developments, and (3) the policy implications of addressing these issues.

www.gao.gov/cgi-bin/getrpt?GAO-05-108T.
To view the full product, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-5491 or bovbjergb@gao.gov or JayEtta Hecker at (202) 512-8984 or heckerj@gao.gov.

What GAO Found

The problems posed by the airlines' underfunded plans, while extremely serious in the short term, are only the latest symptom of the decline in the health of our nation's defined benefit (DB) pension system. These problems illustrate weaknesses in the pension system overall and demonstrate that the way plans currently fund and insure pension benefits has to change.

Underfunded pension plans are a symptom of the financial turmoil currently facing the airline industry. Industry trends, including the emergence of well-capitalized low cost airlines and other factors, have created a highly competitive environment that has been particularly challenging for the legacy airlines. Since 2000, the financial performance of legacy airlines has deteriorated significantly. Legacy airlines have collectively lost $24.3 billion over the last 3 years. Despite cost-cutting efforts, legacy airlines continue to face considerable debt and pension funding obligations. In this context, a number of legacy airlines have begun to consider terminating their DB pension plans. For example, United Airlines recently announced that it would not make roughly $500 million in contributions to its pension plans this year and US Airways announced that it does not plan to make roughly $100 million in contributions.

The problems of underfunded DB pension plans extend far beyond the airline industry. We have highlighted several problems that have contributed to the broad underfunding of DB plans generally, including airline plans. These problems include cyclical factors like the so called "perfect storm" of key economic conditions, in which declines in stock prices lowered the value of pension assets used to pay benefits, while at the same time a decline in interest rates inflated the value of pension liabilities. The combined "bottom line" result is that many plans today have insufficient resources to pay all of their future promised benefits. Other long term trends suggest more serious structural problems to the system, including a declining number of DB plans, a decline in the percentage of participants that are active (as opposed to retired) workers, and other factors. Existing pension funding rules and the current structure for paying PBGC insurance premiums have not ensured that sponsors contribute enough to their plans to pay promised benefits.

The current pension crisis facing the airline industry and PBGC, and how the Congress chooses to address that crisis, has wide-ranging implications for airlines and other industries, as well as for pension participants, PBGC, and potentially the American taxpayer. This crisis also illustrates the need for comprehensive pension reform that tackles the full range of challenges crossing all industries and not just airlines. Such a comprehensive reform would include meaningful incentives for sponsors to adequately fund their plans, provide additional transparency for participants, and ensure accountability for those firms that fail to match the benefit promises they make with the resources necessary to fulfill those promises.