Highlights of GAO-05-294, a report to congressional committees

May 2005

PRIVATE PENSIONS

Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules

Why GAO Did This Study

Pension funding rules are intended to ensure that plans have sufficient assets to pay promised benefits to plan participants. However, recent terminations of large underfunded plans, along with continued widespread underfunding, suggest weaknesses in these rules that may threaten retirement incomes of these plans' participants, as well as the future viability of the Pension Benefit Guaranty Corporation (PBGC) single-employer insurance program. We have prepared this report under the Comptroller General's authority, and it is intended to assist the Congress in improving the financial stability of the defined benefit (DB) system and PBGC. We have addressed this report to each congressional committee of jurisdiction to help in their deliberations. This report examines: (1) the recent funding and contribution experience of the nation's largest private DB plans; (2) the funding and contribution experience of large underfunded plans, and the role of the additional funding charge (AFC); and (3) the implications of large plans' recent funding experiences for PBGC, in terms of risk to the agency's ability to insure benefits.

What GAO Recommends

The Congress should consider broad pension reform that is comprehensive in scope and balanced in effect. However, if features of current regulation are retained, Congress should consider measures to strengthen the AFC and limit the use of funding standard account credits to substitute for cash contributions.

www.gao.gov/cgi-bin/getrpt?GAO-05-294.

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

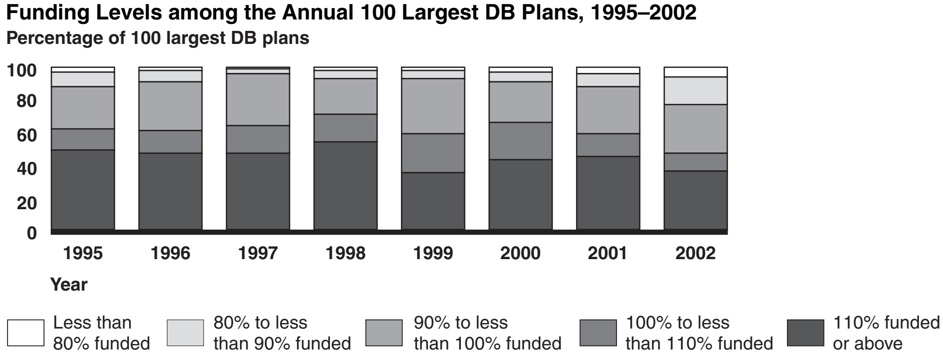
What GAO Found

Each year from 1995 to 2002, while most of the largest DB pension plans had assets that exceeded their current liabilities, 39 percent of plans on average were less than 100 percent funded. By 2002, almost one-fourth of the 100 largest plans were less than 90 percent funded. Further, because of leeway in the actuarial methodology and assumptions sponsors may use to measure plan assets and liabilities, underfunding may actually have been more severe and widespread than reported. Additionally, 62.5 percent of sponsors of the largest plans each year on average made no cash contribution because the rules allow sponsors to satisfy minimum funding requirements through plan accounting credits that substitute for cash contributions.

From 1995 to 2002, only 6 unique plans in our sample were subject to an additional funding charge (AFC), the primary funding mechanism to address underfunding, a total of 23 times. By the time a firm was subject to an AFC, its plan was likely significantly underfunded, and such plans remained poorly funded. By using other funding credits, just over 30 percent of the time sponsors of these plans were able to forgo cash contributions in the years their plans were assessed an AFC. Two very large and significantly underfunded plans terminated without their sponsors owing a cash contribution in the 3 years prior to termination, illustrating further weaknesses in the AFC.

To the extent that financially weak firms sponsor underfunded plans, weaknesses in funding rules create a potentially large financial risk to PBGC and thus retirement security generally. From 1995 to 2002, on average each year, 9 of the largest 100 plans had a sponsor with a speculative grade credit rating, suggesting financial weakness and poor creditworthiness. Plans of speculative grade-rated sponsors had lower average funding levels and were more likely to incur an AFC than other plans. As of September 30, 2004, PBGC estimated that plans of financially weak companies with a "reasonably possible" chance of termination had plans with an estimated $96 billion in underfunding.

Funding Levels among the Annual 100 Largest DB Plans, 1995–2002



Source: GAO analysis of PBGC Form 5500 research data.