SECTION 14 - THE PENSION BENEFIT GUARANTY CORPORATION

CONTENTS

EXPLANATION OF THE CORPORATION AND ITS FUNCTIONS

The Pension Benefit Guaranty Corporation (PBGC) was established under title IV of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 829, Public Law 93-406) to insure private pension beneficiaries against the complete loss of promised benefits if their defined benefit pension plan is terminated without adequate funding. The PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for the trusteed plans.

ADMINISTRATION

The PBGC is a government-owned corporation. A three-member board of directors, chaired by the Secretary of Labor, administers the Corporation. The Secretary of Commerce and the Secretary of the Treasury are the other directors. ERISA provides for a seven-member Advisory Committee, appointed by the President, for staggered 3-year terms. The Advisory Committee advises the PBGC on issues such as investment of funds, plan liquidations, and other matters.

PLAN TERMINATION INSURANCE

Defined Benefit and Defined Contribution Plans

There are two basic kinds of pension plans: "defined benefit" and "defined contribution" plans. Under a defined benefit plan, employees receive a fixed benefit at retirement prescribed by a formula set forth in the plan. The employer makes annual contributions to the plan based on actuarial calculations designed to ensure that the plan has sufficient funds to pay the benefit prescribed by the formula. Under a defined contribution plan, no particular benefit is promised. Instead, benefits are based on the balance of an individual account maintained for the benefit of the employee. The benefit received by an employee at retirement is generally dependent on two factors: total contributions made to the plan on the employee's behalf during the employee's participation in the plan, and the investment experience of the amounts contributed on the employee's behalf. Under either type of pension plan, employees also may be permitted to make contributions.

Under a defined contribution plan, the employee bears all the risk of poor investment performance of the assets invested in a plan. Whether the funds are invested well or poorly, the employee gets at retirement only what was contributed plus the amount actually earned.

Under a defined benefit plan, the employer bears more of the risk of loss. The Internal Revenue Code and ERISA contain minimum funding standards that require the employer to make contributions to a defined benefit plan to fund promised benefits. Thus, for example, if the plan experiences poor investment performance, actuarial miscalculations, or low benefit estimates, the employer will be required to make additional contributions to the plan. However, the minimum funding rules provide for funding over a period of time, and do not require that the plan have assets to pay all the benefits earned under the plan at any particular time. Thus, it is possible for a defined benefit plan to terminate without having sufficient assets to pay promised benefits. The PBGC insures defined benefit plan benefits up to certain limits to protect plan participants in the event of such a termination. However, the PBGC may not protect all benefits promised under a plan so that even under a defined benefit plan, the employees bear some risk of loss. An additional benefit available to plan participants aged 55-64 who are receiving pensions from PBGC is a tax credit equal to 65 percent of the premiums they pay for health insurance.

The total number of private defined benefit plans is less than the number of private defined contribution plans.

Beginning in the early-1990s, participants in defined contribution plans exceeded those in defined benefit plans. Similarly, in the mid-1990s, assets held in defined contribution plans surpassed those held in defined benefit plans.

The operations of the insurance program, and insurance limits, are described below. Defined contribution plans are not insured by the PBGC.

Single-Employer and Multiemployer Plans

Defined benefit plans insured by the PBGC fall into two categories: single-employer plans and multiemployer plans. Multiemployer plans are collectively bargained arrangements maintained by more than one employer. Single-employer plans, whether or not collectively bargained, are each maintained by one employer. Non-collectively-bargained plans maintained by more than one employer are classified as single-employer plans.

The risk to the PBGC posed by single-employer plans is different from that posed by multiemployer plans. Generally, single-employer plans are more vulnerable to the risk of underfunding due to financial weakness of the sponsoring employer; the PBGC is more vulnerable to the risk that a single employer will be unable to make up the difference between funded and promised benefits. Issues concerning insurance of multiemployer plans are more likely to concern the allocation of liabilities as firms enter and leave the participating group.

The PBGC insures the benefits of nearly 44 million pension plan participants, including active workers and retirees. Of these, 78 percent, or just over 34 million, are covered by approximately 31,000 single-employer pension plans, and 22 percent, or about 9.5 million, are covered by approximately 1,700 multiemployer plans.

Other Requirements for PBGC Coverage

The PBGC covers only those defined benefit plans that meet the qualification requirements of section 401 of the Internal Revenue Code. These are also the requirements that plans must meet in order to receive the significant tax benefits available to qualified pension plans.

Generally, to be qualified under the Internal Revenue Code, a pension plan must be established with the intent of being a permanent and continuing arrangement; must provide definitely determinable benefits; may not discriminate in favor of highly compensated employees with respect to coverage, contributions or benefits; and must cover a minimum number or percentage of employees.

Pension plans specifically excluded from insurance by the PBGC include government and church plans, defined contribution plans, plans of fraternal societies financed entirely by member contributions, plans maintained by certain professionals with 25 or fewer participants, and plans established and maintained exclusively for substantial owners.

PLAN TERMINATION

Single-Employer Plans

An employer can voluntarily terminate a single-employer plan only in a standard or distress termination. The participants and the PBGC must be notified of the termination. The PBGC may involuntarily terminate a plan.

Standard Terminations --A standard termination is permitted only if plan assets are sufficient to cover benefit liabilities. Generally, benefit liabilities equal all benefits earned to date by plan participants, including vested and nonvested benefits (which automatically become vested at the time of termination), and including certain early retirement supplements and subsidies. Benefit liabilities also may include certain contingent benefits (for example, plant shutdown benefits). If assets are sufficient to cover benefit liabilities (and other termination requirements, such as notice to employees, have not been violated), the plan distributes benefits to participants. The plan provides for the benefit payments it owes by purchasing annuity contracts from an insurance company, or otherwise providing for the payment of benefits, for example, by providing the benefits in lump sum distributions.

Assets in excess of the amounts necessary to cover benefit liabilities may be recovered by the employer in an asset reversion. The asset reversion is included in the gross income of the employer and also is subject to a nondeductible excise tax. The excise tax is 20 percent of the amount of the reversion if the employer establishes a qualified replacement plan, or provides certain benefit increases in connection with the termination. Otherwise, the excise tax is 50 percent of the reversion amount.

Distress Terminations--If assets in the plan are not sufficient to cover benefit liabilities, the employer may not terminate the plan unless the employer meets one of four criteria necessary for a "distress" termination:

– The contributing sponsor, and every member of the controlled group of which the sponsor is a member, has filed or had filed against it a petition seeking liquidation in bankruptcy or any similar Federal law or other similar State insolvency proceedings;
– The contributing sponsor and every member of the sponsor's controlled group has filed or had filed against it a petition to reorganize in bankruptcy or similar State proceedings. This criteria also is met if the bankruptcy court (or other appropriate court) determines that, unless the plan is terminated, the employer will be unable to continue in business outside the reorganization process and approves the plan termination;
– The PBGC determines that termination is necessary to allow the employer to pay its debts when due; or
– The PBGC determines that termination is necessary to avoid unreasonably burdensome pension costs caused solely by a decline in the employer's work force.

These requirements, added by the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA) and modified by the Pension Protection Act of 1987 (PPA), and the Retirement Protection Act of 1994 (RPA) are designed to ensure that the liabilities of an underfunded plan remain the responsibility of the employer, rather than the PBGC, unless the employer meets strict standards of financial need indicating genuine inability to continue funding the plan.

Involuntary Terminations--The PBGC may terminate a plan involuntarily, either by agreement with the plan sponsor or pursuant to a court order. The PBGC may institute such proceedings only if the plan in question has not met the minimum funding standards, will be unable to pay benefits when due, has a substantial owner who has received a distribution greater than $10,000 (other than by reason of death), or the long-run loss to the PBGC with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. The PBGC must terminate a plan if the plan is unable to pay benefits that are currently due. A court may order termination of the plan in order to protect the interests of participants, to avoid unreasonable deterioration of the plan's financial condition, or to avoid an unreasonable increase in the PBGC liability under the plan.

PBGC Trusteeship--When an underfunded plan terminates in a distress or involuntary termination, the plan effectively goes into PBGC receivership. The PBGC becomes the trustee of the plan, takes control of any plan assets, and assumes responsibility for liabilities under the plan. The PBGC makes payments for benefit liabilities promised under the plan with assets received from two sources: assets in the plan before termination, and assets recovered from employers. The balance, if any, of guaranteed benefits owed to beneficiaries is paid from the PBGC's revolving funds (see below).

Employer Liability to the PBGC--Following a distress or involuntary termination, the plan's contributing sponsor and every member of that sponsor's controlled group is liable to the PBGC for the excess of the value of the plan's liabilities as of the date of plan termination over the fair market value of the plan's assets on the date of termination. The liability is joint and several, meaning that each member of the controlled group can be held responsible for the entire liability. Generally, the obligation is payable in cash or negotiable securities to the PBGC on the date of termination. Failure to pay this amount upon demand by the PBGC may trigger a lien on the property of the contributing employer's controlled group for up to 30 percent of its net worth. Obligations in excess of this amount are to be paid on commercially reasonable terms acceptable to the PBGC.

Benefit Payments--When an underfunded plan terminates, the benefits that the PBGC will pay depend on the statutory guaranty, asset allocation, and recovery on the PBGC's employer liability claim.

Guaranteed Benefits--Within certain limits, the PBGC guarantees any retirement benefit that was nonforfeitable (vested) on the date of plan termination other than benefits that vest solely on account of the termination, and any death, survivor or disability benefit that was owed or was in payment status at the date of plan termination. Generally only that part of the retirement benefit that is payable in monthly installments (rather than, for example, lump sum benefits payable to encourage early retirement) is guaranteed. Retirement benefits that commence before the normal age of retirement are guaranteed, provided they meet the other conditions of guarantee. Contingent benefits (for example, early retirement benefits provided only if a plant shuts down) are guaranteed only if the triggering event occurs before plan termination.

There is a statutory ceiling on the amount of monthly benefits payable to any individual that may be guaranteed. This ceiling, which is indexed according to changes in the Social Security wage base, is $3,664.77 for the year 2003 for a single life annuity payable at age 65. This limit is actuarially reduced for benefits payable before age 65, or payable in a different form.

The reduction in the maximum guarantee for benefits paid before age 65 is 7 percent for each of the first 5 years under age 65, 4 percent for each of the next 5 years, and 2 percent for each of the next 10 years. The reduction in the maximum guarantee for benefits paid in a form other than a single life annuity depends on the type of benefit, and if there is a survivor's benefit, the percentage of the benefit continuing to the surviving spouse and the age difference between the participant and spouse.

For example, consider a retiree who, at plan termination in 2003, is age 60 and whose spouse is 2 years younger. The participant is receiving a joint and 50 percent survivor's benefit (a benefit that continues to a surviving spouse upon the death of the participant at a reduced level of 50 percent). In this case, the maximum guarantee applicable to the participant is $2,101.01 per month [$3,664.77 x 0.90 (joint and survivor benefit) x 0.65 (participant age) x 0.98 (spouse 2 years younger)].

The guarantee for any new benefit, including benefits under new plans and benefits provided by amendment to already existing plans, is phased in over 5 years following creation of the benefit.

Asset Allocation--Assets of a terminated plan are allocated to pay benefits according to a priority schedule established by statute. Under this schedule, some nonguaranteed benefits are payable from plan assets before certain guaranteed benefits. For example, benefits of participants who have been in pay status for more than 3 years have priority over guaranteed benefits of participants not in pay status.

Section 4022(c) Benefits--The PBGC also is required to pay participants a portion of their unfunded, nonguaranteed benefits based on a ratio of recovery on the employer liability claim to the amount of that claim.

As a result of the asset allocation and section 4022(c) benefits, reimbursement to the PBGC for its payment of guaranteed benefits may be less than the total value of assets recovered from the terminated plan.

Multiemployer Plans

In the case of multiemployer plans, the PBGC insures plan insolvency, rather than plan termination. Accordingly, a multiemployer plan need not be terminated to qualify for PBGC financial assistance, but must be found to be insolvent. A plan is insolvent when its available resources are not sufficient to pay the plan benefits for the plan year in question, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year.

If it appears that available resources will not support the payment of benefits at the guaranteed level, the PBGC will provide the additional resources needed as a loan. The PBGC may provide loans to the plan year after year. If the plan recovers from insolvency, it must begin repaying loans on reasonable terms in accordance with regulations.

The PBGC guarantees benefits under a multiemployer plan of the same type as those guaranteed under a single-employer plan, but a different guarantee ceiling applies. The Multiemployer Pension Plan Amendments Act of 1980 (Public Law 96-364, referred to as MPPAA), established a benefit guarantee limit for participants in multiemployer plans equal to the participant's years of service multiplied by the sum of (1) 100 percent of the first $5 of the monthly benefit accrual rate and (2) 75 percent of the next $15 of the accrual rate. For a participant with 30 years of service under the plan, the maximum PBGC-guaranteed benefit was $5,850 per year. The Consolidated Appropriations Act of 2001 (Public Law 106-554), signed into law on December 21, 2000, increased the benefit guarantee in multiemployer plans to the product of a participant's years of service multiplied by the sum of (1) 100 percent of the first $11 of the monthly benefit accrual rate and (2) 75 percent of the next $33 of the accrual rate. For someone with 30 years of service, this raised the guaranteed limit to $12,870. The old benefit guarantee formula remains in effect for participants in multiemployer plans that received financial assistance from PBGC at any time during the period from December 22, 1999, to December 21, 2000.

The MPPAA requires that PBGC conduct a study every 5 years to determine whether changes are needed in the multiemployer premium rate or guarantee. The next study is due in 2005.

FINANCIAL CONDITION OF THE PBGC

OVERVIEW

According to its most recent annual report, the PBGC's multiemployer plan insurance program is in sound financial condition. Assets exceeded liabilities by $158 million at the end of fiscal year 2002.

However, the larger single-employer program suffered its largest 1-year financial loss in the 28-year history of the Corporation. The net loss of $11.4 billion for the year caused the program to swing from a surplus position of $7.7 billion in fiscal year 2001 to a deficit position of $3.6 billion for fiscal year 2002. This is the result of several large plan terminations in 2002.

The PBGC's assets are comprised of premiums collected, assets recovered from terminated plans and recoveries from employers, and accumulated investment income. The PBGC's liability for future benefit payments is the (discounted) present value of the stream of future benefit payments PBGC is obligated to pay participants and beneficiaries of terminated plans and plans booked as probable terminations. The current deficit does not create an immediate crisis for the PBGC, which will be able to continue paying benefits for a number of years.

CLAIMS FROM UNDERFUNDED PLANS

Through the end of fiscal year 2002, the PBGC's single-employer program had incurred net claims of $9.8 billion (see table 14-1). This includes PBGC's largest single loss of about $1.9 billion with the termination of the LTV pension plans.

The PBGC's net claims equal the portion of guaranteed benefit liabilities not covered by plan assets or recoverable employer liability. These claims will eventually have to be covered through premiums, earnings on PBGC assets, or other sources of revenue.

The claims against PBGC have increased considerably over its history. Within that trend, there has been substantial annual variability due to the sporadic terminations of very large underfunded plans. Two major industrial sectors–steel and airline transportation–have produced over half of all claims in the single-employer program and represent 8 of the top 10 claims against the PBGC.

TABLE 14-1-- CLAIM EXPERIENCE FROM SINGLE-EMPLOYER PLANS, 1975-2002 AND PROBABLE FUTURE TERMINATIONS [1]
[Dollars in Millions]

Year of Termination	Number of Plans	Benefit Liability	Trust Plan Assets	Recoveries from Employers	Net Claims	Average Net Claim Per Terminated Plan
1975-1979	586	$397.4	$152.2	$58.9	$186.3	$0.3
1980-1984	621	$1,257.3	$517.1	$159.7	$580.5	$0.9
1985-1989	537	$2,351.4	$652.4	$162.0	$1,537.0	$2.9
1990-1994	692	$5,116.5	$2,277.6	$459.3	$2,379.6	$3.4
1995-1999	435	$2,196.5	$1,410.7	$68.6	$717.2	$1.6
2000-2002	251	$11,885.3	$7,160.0	$306.5	$4,418.8	$17.6
Subtotal	3122	$23,204.4	$12,170.1	$1,215.0	$9,819.3	$3.1
Probable Future Terminations	41	$12,391.7	$6,070.1	$0.0	$6,321.6	--
Total	3163	$35,596.1	$18,240.2	$1,215.0	$16,140.9	--

[1]Stated amounts are subject to change until PBGC finalizes values for liabilities, assets, and recoveries of terminated plans. Amounts in this table are valued as of the date of each plan's termination and differ from amounts reported in PBGC's Financial Statements which are valued as of the end of the State fiscal year.
Note: Numbers may not add up to totals due to rounding.
Source: Pension Benefit Guaranty Corporation.

Table 14-1 demonstrates the growth in net claims over the Corporation's history. PBGC reported net claims, not including probable terminations, of $3.2 billion in 2002. This represents over 32 percent of all net claims in the single-employer program and is an increase of almost 3 times the level in 2001.

In addition, PBGC faces probable net claims of $6.3 billion for 41 plans that are expected to terminate after fiscal year 2002. This includes the termination of plans of two major steel companies in December 2002–National Steel and Bethlehem Steel, with claims of $1.3 and $3.7 billion respectively. If the remainder of the net probable claims actually terminate in 2003, PBGC will report a second record year and total net claims will exceed $15 billion.

As shown by table 14-2, the number of single-employer plan terminations that result in claims against the PBGC is a tiny fraction of all plan terminations. Over PBGC's history, terminations of underfunded plans have made up less than 2 percent of all terminations.

FINANCING

The sources of financing for PBGC are per-participant premiums collected from insured plans, assets in terminated underfunded plans for which the PBGC has become trustee, investment earnings, and amounts owed to the PBGC by employers who have terminated underfunded plans. In addition, PBGC has the authority to borrow up to $100 million from the Treasury.

Single-Employer Premiums

An employer that maintains a covered single-employer defined benefit pension plan must pay an annual premium for each participant under the plan. Initially set at $1 per participant, the per-participant premium was raised to $2.60 beginning in 1979, and then raised again by SEPPAA to $8.50 beginning in 1986. The PPA, contained in the Omnibus Budget Reconciliation Act of 1987, raised the basic premium to $16, and imposed an additional variable rate, or risk-related, premium on underfunded plans. The variable rate premium was initially set at $6 per each $1,000 of the plan's unfunded vested benefits, up to a maximum of $34 per participant. Accordingly, the maximum premium was $50 per participant.

The Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) increased the basic premium to $19, and the variable rate premium to $9 per each $1,000 of the plan's unfunded vested benefits, up to a maximum of $53 per participant. Thus, beginning in 1991, the maximum premium was $72 per participant. OBRA 1990 did not change the ratio of revenue raised by the basic and variable rate portions of the premium.

The Retirement Protection Act of 1994 (RPA) did not change the $19 basic per participant premium. However, the $53 per participant variable rate premium cap was phased out over a 3-year period beginning in 1994. The variable rate premium is now completely uncapped. RPA also changed the way underfunding is calculated. Effective for 1995 plan years, liabilities have to be calculated using a standard mortality table. Effective for plan years beginning on or after July 1, 1997, liabilities are calculated using an interest rate of 85 percent of the spot rate for 30-year Treasury securities (an increase from the current 80 percent). In the future, plans will be required to use a new mortality table to be prescribed by the Secretary of Treasury for certain funding purposes. At that time the interest rate will rise to 100 percent of the Treasury spot rate and a requirement to use fair market value of plan assets (rather than actuarial value) will become effective. The Job Creation and Worker Assistance Act of 2002 increased the interest rate to 100 percent of the rate for 30-year Treasury securities for plan years beginning after December 31, 2001, and before January 1, 2004.

PBGC's single-employer premium income equaled $787 million in 2002.

Multiemployer Plan Premiums

The premium for multiemployer plans was initially $0.50 per participant. The MPPAA raised the premium to $1.40 for years after 1980. This premium was set to increase gradually to its current level, $2.60. The PBGC’s multiemployer premium income equaled $25 million in 2002.

TABLE 14-2-- TOTAL NUMBER OF TERMINATED SINGLE-EMPLOYER PLANS, NUMBER OF PLANS WITH CLAIMS AGAINST PBGC, AND NET POSITION, 1975-2002

Fiscal Year	Number of Terminated Plans	Number of Plans with Claims Against PBGC	Net Position at End of Year (in millions of dollars)
1975	2,570	100	-16
1976	9,103	171	-41
1977	7,332	130	-95
1978	5,261	103	-138
1979	4,892	82	-146
1980	4,037	104	-95
1981	5,086	137	-189
1982	6,134	131	-333
1983	6,880	150	-523
1984	7,720	99	-462
1985	8,751	116	-1,325
1986	6,961	132	-2,026
1987	10,972	107	-1,549
1988	10,889	99	-1,543
1989	11,483	83	-1,124
1990	11,901	101	-1,913
1991	8,775	175	-2,503
1992	6,827	157	-2,737
1993	5,444	124	-2,897
1994	4,085	135	-1,240
1995	3,991	121	-315
1996	3,905	96	869
1997	3,579	82	3,481
1998	2,537	62	5,012
1999	2,043	74	7,038
2000	1,947	65	9,704
2001	1,658	93	7,732
2002	1,307	93	-3,638
Total	166,070	3,122	--

Source: Pension Benefit Guaranty Corporation.

Assets from Terminated Plans

When the PBGC becomes trustee of a terminated plan, it receives control of any assets in the plan. These assets are placed in one of two trust funds (one for multiemployer plans, one for single-employer plans).

Employer Liability

An employer that terminates an underfunded defined benefit plan is liable to the PBGC for certain amounts. Before the changes made by SEPPAA, an employer's liability was generally capped at 30 percent of the employer's net worth. SEPPAA removed this limit, leaving employers whose liability would have been capped liable for an additional share of unfunded benefit commitments above 30 percent of net worth. The PPA further increased employer liability, leaving employers liable for all amounts up to 100 percent of unfunded benefit liabilities.

Investment Income

The PBGC maintains two separate financial programs, each consisting of a revolving fund and a trust fund, to sustain its single-employer and multiemployer plan insurance programs. Its revolving funds consist of collected premiums and income resulting from investment of the premiums and is constrained to investments in U.S. Treasury securities. The revolving funds had a value of $1.7 billion as of September 30, 2002.

The trust funds consist of assets received from all terminated plans of which the PBGC is or will be a trustee, and employer liability payments. These assets are constrained to investment in domestic equities and real estate (up to a 5-percent maximum). The net market value of the trust funds was $9 billion as of September 30, 2002.

Chart 14-1 diagrams the relationship between the PBGC's financing and its payment of guaranteed benefits to plan participants.

BUDGETARY TREATMENT

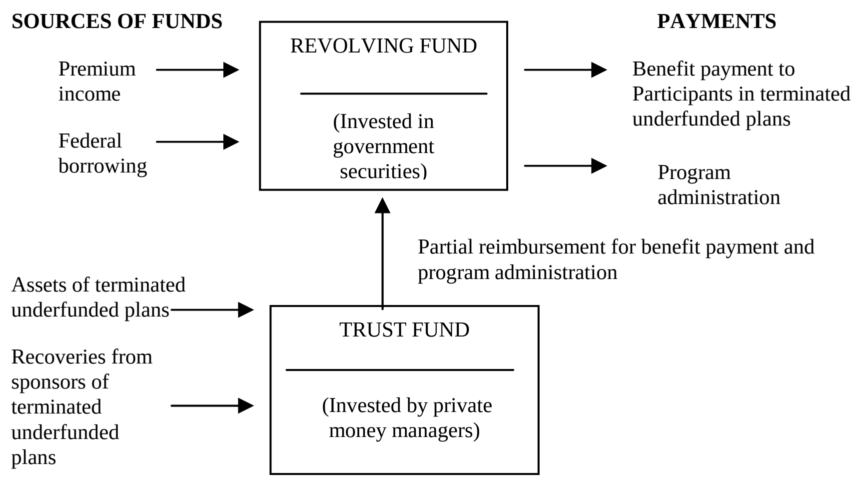
Since 1981, administrative expenses of the PBGC and the benefit payments to participants in plans under the PBGC's trusteeship have been counted as Federal outlays. Certain receipts of the agency--including premium payments, interest on balances in the revolving fund, and transfers to the revolving fund from the trust fund--offset PBGC expenses in the Federal budget. Liabilities for future benefit payments and other accruals are not taken into account. In each year since 1981 (when the program was first included in the Federal budget) the effect of the PBGC has been to reduce overall Federal outlays (see table 14-3). During this period, the PBGC reported receipts in excess of benefit payments and administrative costs by a cumulative total of about $12.3 billion. In years before 1981, Federal accounts for the PBGC also would shown annual inflows exceeding expenses in each year of program operation.

FUTURE FINANCIAL STATUS OF THE PBGC

At the end of fiscal year 2002, the single-employer program recorded its single largest loss with the termination of the LTV pension plans. The program also reported its largest 1-year financial loss of $11.4 billion. While the deficit of $3.6 billion already includes the losses absorbed from the National Steel and Bethlehem Steel pension plans, there is the potential for additional losses from underfunding in plans sponsored by financially weak companies.

Not all pension underfunding represents likely claims upon PBGC's insurance. The PBGC's analyses disclose reasonably possible losses of just over $35 billion as of September 30, 2002, compared to the previous year's projection of $11 billion. In both years, over one-half of the potential exposure was attributable to the air transportation and the steel sectors. These two industrial categories represent combined reasonably possible losses of $17 billion in fiscal year 2002 compared with just over $6 billion in fiscal year 2001.

CHART 14-1-- FINANCIAL STRUCTURE OF THE PENSION BENEFIT GUARANTY CORPORATION



Source: Congressional Budget Office.

The future financial condition of the pension insurance program is highly uncertain because it depends largely on how many private pension plans terminate and on the amount of underfunding in those plans. Both factors are hard to forecast accurately. Moreover, as was discussed above, a few pension plans with extremely large unfunded liabilities have dominated the PBGC’s past claims, and its future may likewise depend significantly on the fate of a few large plans, making liabilities even more difficult to predict. Future terminations will be influenced by overall economic conditions, by the prosperity of particular industries, by competition from abroad, and by a variety of factors that are specific to particular firms – such as their competitive position in the industry, their agreements with labor groups, and the assessments of their financial prospects that are necessary to obtain credit. In addition, PBGC's losses with respect to future terminations will depend on how well companies fund their plans, and on the PBGC's position in bankruptcy proceedings.

TABLE 14-3--FEDERAL BUDGETARY TREATMENT OF THE PENSION BENEFIT GUARANTY CORPORATION, 1975-2002

[In millions of dollars]

Fiscal Year	Expenses[1]	Offsetting Collections[2]	Outlays Appearing in the Federal Budget[3]
Not Included in the Federal Budget[4]			
1975	$3	$36	NA
1976	13	29	NA
1977	21	41	NA
1978	48	62	NA
1979	52	92	NA
1980	59	90	NA
Total	$196	$349	NA
Included in the Federal Budget[4]			
1981	79	123	-$29
1982	104	157	-67
1983	161	182	-10
1984	180	190	-10
1985	195	210	-19
1986	272	344	-106
1987	509	637	-72
1988	489	560	-278
1989	780	1,190	-149
1990	745	1,175	-680
1991	599	1,339	-787
1992	766	1,491	-655
1993	833	2,323	-1,508
1994	1,017	1,446	-385
1995	872	1,716	-430
1996	1,011	1,812	-851
1997	930	2,147	-1,197
1998	1,001	2,252	-1,218
1999	1,372	1,866	-665
2000	1,160	2,510	-1,144
2001	1,292	2,398	-1,065
2002	2,108	3,058	-965
Total	$16,475	$29,126	-$12,290

[1]Includes primarily administrative costs and benefit payments.

[2]Includes primarily premium income, interest income, and transfers from the pension insurance trust fund to the revolving fund.

[3]Outlays do not equal the difference between expenses and offsetting collections because of changes in obligated program balances between the beginning and the end of the fiscal year.

[4]The Pension Benefit Guaranty Corporation was first included in the Federal Budget in 1981, in accordance with Public Law 96-364.

NA - Not applicable.

Note: This table includes both the single-employer and multiemployer pension insurance programs.

Source: Congressional Budget Office using data from the appendix to the Federal Budget, various years.

PBGC uses a stochastic model--the Pension Insurance Modeling System

(PIMS) to evaluate its exposure and expected claims. PIMS portrays future underfunding under current funding rules as a function of a variety of economic parameters. The model recognizes the uncertainty in companies' chances of future bankruptcy and the uncertainty in key economic parameters (particularly interest rates and stock returns). It simulates the claims that could develop under thousands of combinations of economic parameters and bankruptcy rates.

Under the model, median claims over the next 10 years will be about $1.85 billion per year (expressed in today's dollars); that is, half of the simulations show claims above that amount and half below. The mean level of claims (or average claim) is higher, at approximately $2.25 billion per year, because there is a chance under some scenarios that claims could reach very high levels. For example, under the model there is a 10 percent chance that claims could exceed $4.3 billion per year.

PIMS projects PBGC's potential future financial position by combining simulated claims with simulated premiums, expenses, and investment returns. The median outcome is a $9.6 billion deficit in 2012 (in present value terms), while the mean outcome is a $12.6 billion deficit.

The median projected financial position is considerably lower than that reported in 2001 ($8.4 billion surplus in 2011 in present value terms). The actual experience of the last year approaches the most severe end of the range of possible outcomes. For example, last year's combination of poor financial returns in PBGC-covered plans with a decline in interest rates generated an increase in underfunding that was exceeded in less than 5 percent of last year's simulations of the year 2002.

The model also shows the wide range of outcomes that are possible for PBGC over the next 10 years. In particular, it estimates nearly a 10 percent chance that the deficit could be as large as $43.8 billion and a 10 percent chance that PBGC could have a surplus of $15.6 billion or more. Adverse outcomes are most likely if the economy performs poorly, in which case PBGC may experience both large claims and investment losses.

LEGISLATIVE HISTORY

SINGLE-EMPLOYER PLANS

The PBGC was established under the Employee Retirement Income Security Act of 1974 (ERISA) for the purpose of insuring benefits under defined benefit pension plans. As originally structured, in the case of a single-employer plan, termination of a plan triggered the PBGC insurance mechanism. The contributing employer was liable to the PBGC for unfunded insured benefits up to 30 percent of the net worth of the employer. If unfunded insured liability exceeded this amount, the PBGC had to absorb the excess and spread the loss over insured plans. Employers generally faced no restrictions on their ability to terminate an underfunded plan.

The Single Employer Pension Plan Amendments Act of 1986 (SEPPAA)

Congress passed SEPPAA (enacted as title XI of the Consolidated Omnibus Budget Reconciliation Act of 1985 (Public Law 99-272)) in response to rapidly growing PBGC deficits. SEPPAA raised the per-participant premium from $2.60 to $8.50, established certain financial distress criteria that a sponsoring employer and every member of the employer's controlled group must meet in order to terminate an underfunded plan, expanded PBGC's employer liability claim, and created a new liability to plan participants for certain nonguaranteed benefits.

Pension Protection Act of 1987 (PPA)

In 1987 Congress passed the Pension Protection Act of 1987 (PPA; as part of Public Law 100-203) which contained additional measures to strengthen PBGC's long-term solvency. The act increased PBGC's basic per participant premium for single-employer plans to $16 and added a variable rate premium for these plans tied to the degree of plan underfunding (capped at $53 per participant). The act also expanded PBGC's employer liability claim to include all plan benefit liabilities, provided that PBGC share a portion of its recoveries from employers with plan participants, and required faster funding of plan benefits to reduce PBGC's exposure in the event of plan termination. The act also contained other provisions relating to the plan termination distress criteria, the bankruptcy treatment of unpaid employer contributions, PBGC's lien authority, and various pension funding requirements.

Retirement Protection Act of 1994 (RPA)

In response to the persistent growth in pension underfunding, Congress passed significant reforms in the Retirement Protection Act (RPA enacted December 8, 1994) as part of the GATT legislation (the Uruguay Round Agreements (Public Law 103-465)). RPA provisions include:

1. Minimum Funding Standards--RPA strengthened the pension funding rules for underfunded plans by accelerating funding, eliminating double counting of certain funding credits, and constraining the assumptions that may be used to calculate pension contributions. RPA also required severely underfunded plans to maintain minimum levels of liquid assets. RPA contained certain transition rules limiting annual increases in pension contributions. In addition, RPA repealed the quarterly funding requirement for fully funded plans and granted excise tax relief for employers with both defined benefit and defined contribution plans.
2. Variable Rate Premium--RPA phased out the $53 per participant cap on the variable rate premium over a 3-year period as an incentive to improve funding in underfunded plans and made certain changes to the interest rate and mortality assumptions used to calculate plan underfunding.
3. Reporting to PBGC--RPA requires sponsors with over $50 million in underfunding to provide PBGC detailed actuarial information on underfunded plans and detailed company financial information. It also requires privately-held companies with over $50 million in underfunding and an aggregate funding ratio of less than 90 percent to provide advance

notice to PBGC of certain corporate transactions.

4. Disclosure to Participants in Underfunded Plans--RPA requires most employers whose plans are less than 90 percent funded to provide a notice to participants regarding the funding status of the plan and the limitations of PBGC's guarantee of participants' benefits.
5. Missing Participants Program--RPA established a program under which PBGC serves as a clearinghouse for benefits of missing participants in plans terminating in a standard (fully funded) termination.

RPA contained other provisions relating to enforcement of minimum funding requirements, PBGC liens for missed pension contributions, and limitation of benefit increases while a company is in bankruptcy.

MULTIEMPLOYER PLAN INSURANCE PROGRAM

Coverage for multiemployer plans under ERISA was structured similarly to that of single-employer plans. However, the PBGC was not required to insure benefits of multiemployer plans that terminated before July 1, 1978. Congress extended the deadline for mandatory pension coverage several times, until enactment of the MPPAA (Public Law 96-364). The MPPAA required more complete funding for multiemployer plans, especially those in financial distress. It also improved the ability of plans to collect contributions from employers. The MPPAA changed the insurable event that triggers PBGC protection to plan insolvency, rather than plan termination. Thus, if a multiemployer plan becomes financially unable to pay benefits at the guaranteed level when due, the PBGC will provide financial assistance to the plan, in the form of a loan. Finally, MPPAA imposed withdrawal liability on employers who ceased to contribute to a multiemployer plan.

The Consolidated Appropriations Act of 2001 (Public Law 106-554), signed into law on December 21, 2000, increased the benefit guarantee in multiemployer plans to the product of a participant's years of service multiplied by the sum of (1) 100 percent of the first $11 of the monthly benefit accrual rate and (2) 75 percent of the next $33 of the accrual rate.

The Trade Act of 2002 (Public Law 107-210) provided a tax credit equal to 65 percent of the premiums they pay for health insurance as an additional benefit available to plan participants aged 55 to 64 who are receiving pensions from either program of the PBGC.