Highlights of GAO-03-313, a report to Congressional Requesters

February 2003

PRIVATE PENSIONS

Process Needed to Monitor the Mandated Interest Rate for Pension Calculations

Why GAO Did This Study

Employers with defined benefit plans have expressed concern that low interest rates were affecting the reasonableness of their pension calculations used to determine funding requirements under the Employee Retirement and Income Security Act of 1974 (ERISA). ERISA requires employers to use a variation of the 30-year Treasury bond rate for these calculations; however, in 2001 Treasury stopped issuing the 30-year bond. This report provides information on (1) what characteristics of an interest rate make it suitable for determining current liability and lump-sum amounts; (2) what alternatives to the current rate might be considered; and (3) how using an alternative rate might affect plan participants, employers, and the Pension Benefit Guaranty Corporation (PBGC).

What GAO Recommends

GAO is not recommending executive action. However, in order to allow the Congress an opportunity to respond expeditiously to changes in interest rates that might affect the reasonableness of defined benefit pension calculations, the Congress may wish to consider providing the cognizant regulatory agencies (the Department of the Treasury, PBGC, and the Department of Labor) the authority to jointly adjust the rate within certain boundaries as specified under the law.

www.gao.gov/cgi-bin/getrpt?GAO-03-313.

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

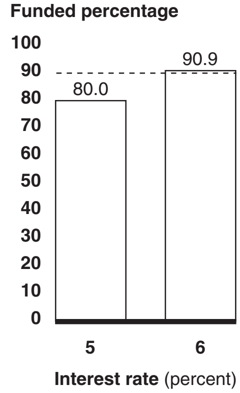
What GAO Found

GAO analysis indicates the Congress intended that the interest rates used in current liability and lump-sum calculations should reflect the interest rate underlying group annuity prices and not be vulnerable to manipulation by interested parties. In 1987, 30-year Treasury bond rates appeared to have both of these characteristics. However, the Department of the Treasury stopped issuing new 30-year Treasury bonds in 2001.

Actuaries and other pension experts have proposed a number of alternative interest rates, including alternatives based on interest rates set in various credit markets—including composite rates for long-term Treasury securities, long-term high-quality corporate bond indices, 30-year rates on securities issued by government-sponsored enterprises, such as Fannie Mae, 30-year interest rate swap rates—and PBGC interest rate factors based on surveys of insurance company group annuity purchase rates. Each alternative has attributes that may make it more or less suitable as an interest rate for the calculation of current liabilities, PBGC premiums, and lump-sum amounts. Additionally, the relationship of any interest rate to the underlying group annuity purchase rates may change over time and, unless the relationship is periodically evaluated, the Congress may be unable to appropriately respond to those changes.

If the alternative interest rate selected to replace the current statutory rate immediately results in a higher interest rate level, which is likely, it would generally lower participant lump-sum amounts, lower minimum employer funding requirements, and reduce PBGC premium revenue. However, if the alternative interest rate produces a lower interest rate level, plan participants would generally receive larger lump sums, some employers would need to increase contributions to their plans, and PBGC may experience an increase in revenue.

Effect of a 1-Percentage Point Increase in the Interest Rate on the Funded Percentage of a Hypothetical Defined Benefit Plan with a Typical Participant Distribution



Source: GAO calculations.

Note: At 90 percent funded and above for current liability, the plan is not subject to the deficit reduction contribution, which is the portion of the minimum funding requirements that uses the 30-year Treasury rate.