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Highlights

Highlights of GAO-05-772T, testimony before the Committee on the Budget, House of Representatives

Why GAO Did This Study

More than 34 million workers and retirees in over 29,000 single-employer defined benefit plans rely on a federal insurance program managed by the Pension Benefit Guaranty Corporation (PBGC) to protect their pension benefits. However, the single-employer insurance program's long-term viability is in doubt, and this may have significant implications for the federal budget. In fiscal year 2004, PBGC's single-employer pension insurance program incurred a net loss of $12.1 billion, and the program's accumulated deficit increased to $23.3 billion. Further, PBGC has estimated that it is exposed to almost $100 billion of underfunding in plans sponsored by companies with credit ratings below investment grade.

This testimony provides GAO's observations on the nature of the challenges facing PBGC and why it is preferable for Congress to act sooner rather than later. This testimony also notes the broader context in which reform proposals should be considered and the criteria that GAO has suggested for reform.

www.gao.gov/cgi-bin/getrpt?GAO-05-772T.

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PRIVATE PENSIONS

The Pension Benefit Guaranty Corporation and Long-Term Budgetary Challenges

What GAO Found

A combination of recent events, long-term structural problems, and weaknesses in the legal framework governing the defined benefit system has left PBGC with a significant long-term deficit and many large plans badly underfunded. Lower interest rates and equity prices since 2000 have increased the present value of pension liabilities and lowered the value of significant portions of pension plan assets. Meanwhile, PBGC is exposed to significant risk from underfunded plans in key industries at the same time that its revenue base is threatened by the long-term decline in defined benefit plan participation. In addition, the basic legal framework governing pension insurance and plan funding has failed to help ensure that plan sponsors deliver on their pension promises and safeguard the PBGC's financial condition. PBGC's current premium structure does not properly reflect the risks to its insurance program and facilitates moral hazard behavior by plan sponsors. Further, current pension funding rules have not provided sufficient incentives for plan sponsors to properly fund their benefit obligations. As a result, bankrupt plan sponsors, acting rationally and within the rules, have transferred the obligations of their large and significantly underfunded plans to PBGC. These weaknesses contribute to and are exacerbated by a lack of timely, accurate and transparent information that make it difficult for participants, investors, and others to have a clear understanding of the true financial condition of pension plans.

Comprehensive reform is required to ensure that workers and retirees receive the benefits promised to them. Ideally, effective reform would

- improve the accuracy of plan funding measures while minimizing complexity and maintaining contribution flexibility;
- revise the current funding rules to create incentives for plan sponsors to adequately finance promised benefits;
- develop a more risk-based PBGC insurance premium structure and provides incentives for sponsors to fund plans adequately;
- address the issue of underfunded plans paying lump sums and granting benefit increases;
- modify PBGC guarantees of certain plan benefits
- resolve outstanding controversies concerning hybrid plans by safeguarding the benefits of workers regardless of age; and
- improve plan information transparency for pension plan stakeholders without overburdening plan sponsors.

Pension reform is only part of a broader fiscal, economic and retirement security challenge. Looking ahead in the federal budget, Social Security, together with Medicare and Medicaid, will dominate the federal government's future fiscal outlook. Reform should also be considered in the context of the problems currently facing our nation's Social Security system. Importantly, as is the case with Social Security, acting sooner rather than later will make comprehensive pension reform less costly and more feasible.