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Briefing Report to the Chairman,
Select Committee on Aging
House of Representatives

April 1986

PENSION PLANS

Termination of Plans With Excess Assets

130018

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

April 30, 1986

B-222943

The Honorable Edward R. Roybal
Chairman, Select Committee on
Aging
House of Representatives

Dear Mr. Chairman:

In response to your June 19, 1985, request and agreements with your office, this briefing report provides information on defined benefit pension plan terminations involving the reversion of excess plan assets to employers. A plan's assets consist of the employer's contributions required by federal funding standards and investment return on the contributions. When a plan is terminated, assets in excess of those needed to pay plan participants' benefits may revert to the employer.

Employers terminating their defined benefit plans may provide replacement pension plans covering their employees. To encourage their continued use, in May 1984 the administration issued guidelines clarifying that employers could establish defined benefit, as well as defined contribution, replacement plans.

Our specific objectives were to obtain information on the reasons defined benefit plans had excess assets at termination, the reasons plans were terminated, the types of replacement plans provided, and the effect of the administration's guidelines on employers' termination and replacement decisions. To obtain information on these topics, we sent a questionnaire to the universe of over 700 defined benefit pension plans with excess assets of over $1 million that had terminated or announced their intent to terminate from January 1, 1980, through June 30, 1985. These plans covered about 900,000 participants and had excess assets of about $7.6 billion. When plan officials did not return a completed questionnaire, we tried to obtain at least some information from them through a telephone survey.

Information was obtained on 432 plans, which reportedly covered about 642,000 participants and had about $5.3 billion in excess assets at termination. Many plans did not provide any information, and information provided by others did not address one or more of the topics. Therefore, our observations may not be representative of all plans terminating with excess assets of over $1 million during the period. Also, we did not independently verify information provided by plan officials.

In summary, the information obtained showed:

--A higher-than-expected rate of return on investments was cited most often as the reason plans had excess assets at termination.

--A change in corporate structure (e.g., sale of a company) and employers' desire to use excess plan assets for non-pension-related purposes (e.g., to alleviate adverse business conditions) were cited most often as primary reasons for plans' terminations.

--Most terminated plans were replaced by other plans, and defined contribution plans were used more often than defined benefit plans as replacements.

--The guidelines encouraged some employers to provide defined benefit replacement plans rather than defined contribution plans or no replacement plans at all.

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As requested by your office, we did not obtain agency comments on this document. Unless you publicly announce or authorize release of its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, the Department of Labor, and other interested parties and make copies available to others on request.

As agreed with your office, we plan to provide you later with information on other matters related to the termination of plans with excess assets, such as the extent of pension plan overfunding. Should you wish to discuss the information provided or our ongoing work, please call me on 275-6193.

Sincerely yours,

J. F. Delfico

Joseph F. Delfico
Associate Director

Contents

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act of 1974
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation

PENSION PLANS:

TERMINATION OF PLANS

WITH EXCESS ASSETS

INTRODUCTION

Employers establish single employer defined benefit pension plans[1] to provide retirement income to their employees. They make contributions to trust funds to pay participants' earned benefits. At present, over 110,000 defined benefit plans cover about 30 million participants (employees and their beneficiaries).

The Employee Retirement Income Security Act of 1974 (ERISA) established funding requirements and other provisions to help protect participants' benefits. Also, the Pension Benefit Guaranty Corporation (PBGC) was established to insure, within limits, participants' benefits not paid by employers sponsoring certain defined benefit plans. ERISA provides that excess assets in defined benefit plans (assets remaining after benefits owed to participants are paid) may revert to the employer, if the plan allows.

According to PBGC records, over 1,000 defined benefit plans, each with over $1 million in excess assets, terminated or announced their intent to terminate from January 1980 through December 1985. The plans covered about 950,000 participants and had excess assets totaling about $11.5 billion.

Employers terminating plans may provide another (replacement) pension plan(s) to cover their employees. Replacement plans may be defined benefit or defined contribution plans.[2] In May 1984, PBGC, the Internal Revenue Service (IRS), and the Department of Labor jointly issued guidelines (hereafter referred to as the administration's guidelines) covering plan terminations in which excess assets revert to employers. The administration's guidelines were established to encourage employers to establish replacement defined benefit plans.

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[1]Defined benefit pension plans generally provide definitely determinable benefits to participants based on such factors as years of employment, retirement age, and compensation received.

[2]A defined contribution plan is a plan in which the contributions, but not the benefits, for each participant are specified.

OBJECTIVES, SCOPE, AND METHODOLOGY

On June 19, 1985, the Chairman, House Select Committee on Aging, asked us to provide information on terminated defined benefit pension plans that reverted excess assets of over $1 million to employers. Based on agreements with the Committee, this report provides information on

--the reasons terminated plans had excess assets,

--the reasons plans with excess assets were terminated,

--the types of replacement plans provided, and

--the effect of the administration's guidelines on employers' decisions to terminate or provide replacement plans.

Also, appendix I contains additional information requested on (1) rates of return used to determine funding requirements for terminated and replacement defined benefit plans, (2) the extent to which IRS waived employers' funding requirements before plan termination, and (3) years that plans operated before termination.

We used a questionnaire as our principal means of collecting data on the above topics because it was the most efficient way to obtain detailed, current information on as many plans as possible within our time frame and resource constraints. For instances where we did not receive a completed questionnaire, we attempted to obtain certain basic information during structured telephone interviews with plan officials.[3] The questions we asked were: (1) Why was the plan terminated? (2) Was any pension plan provided to replace the terminated plan? (3) Did the administration's guidelines affect the employer's decision to terminate or provide a replacement plan?

When we started our work in June 1985, PBGC's records showed that about 750 plans with over $1 million in excess assets had terminated or announced their intent to terminate between January 1, 1980, and June 30, 1985. Based on our review of the data from PBGC and information from plan officials, we found that the number of plans terminating during the period with excess assets over $1 million was 712. We attempted to

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[3]We sent questionnaires to and/or interviewed the persons (or their representatives) notifying PBGC about the plans' termination.

collect information from the 712 plans, which covered about 900,000 participants and had excess assets of about $7.6 billion.[4]

As table 1 shows, we obtained information, either through questionnaires or telephone interviews, from 432, or 61 percent, of the 712 plans. The 432 plans covered about 642,000 participants, or 72 percent of those in the 712 plans. These plans accounted for about $5.3 billion in excess assets, or 70 percent of the total.

Many plans did not provide any information, and others did not provide information on every question asked. Therefore, our observations may not be representative of all plans terminating during the period. Also, we did not independently verify the information provided by plan officials.

Table 1:

Questionnaire and Telephone Survey Responses by Plans, Participants, and Amount of Excess Assets

Results	Plans		Participants		Excess assets	
	Number	Percent	Number	Percent	Amount	Percent
			(thousands)		(billions)	
Questionnaire completed	251	35	451	50	$ 4.0	52
Telephone survey completed--selected questions	181	25	192	21	1.3	18
Total completed	432	61[a]	642[a]	72[a]	$ 5.3	70
Information not provided	280	39	252	28	2.3	30
Total	712	100	894	100	$7.6	100

[a]Columns do not add to totals due to rounding.

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[4]PBGC records show that another 300 plans, covering about 50,000 participants, terminated or announced their intent to terminate from July through December 1985.

WHY DID TERMINATED PLANS HAVE EXCESS ASSETS?

Under ERISA, employers may contribute more to plans than the minimum amount required by the act's funding standards. To determine the minimum requirement, actuaries periodically value plans' assets and benefit liabilities, using one of several acceptable actuarial cost methods. Some of the cost methods result in assets accumulating faster than others. Also, the actuarial valuations are based on assumptions about future conditions affecting plans' costs, including investment earnings (rate of return) and plan participants' mortality rates, compensation levels, and turnover (i.e., the rate at which workers terminate employment before retirement). Actual experience different than had been assumed can result in higher asset accumulation than expected.

Actual values of benefit liabilities are also affected by assumptions, especially the assumed future rate of return on investments. For example, the cost to purchase annuities for participants' benefits at plan termination may be less than previously assumed because of higher available rates of return. Lower liabilities at termination increase both the likelihood and magnitude of excess assets.

To obtain information on why plans had excess assets at termination, we asked questionnaire respondents to provide their views on the extent (from "very great" to "little or no") that the above reasons contributed to excess assets at plan termination. Responses were received from officials of 249 plans. As shown in table 2, a higher rate of return than assumed in determining contribution requirements was cited most often (153 responses) as contributing to excess plan assets to a great extent. A higher rate of return at plan termination than previously used (72 responses) and the type of actuarial cost method used (71 responses) were the next most frequently cited reasons.

Table 2:

Extent to Which Specific Reasons Contributed to Plans Having Excess Assets at Termination

Reasons	Number of plans responding[a]: Very great to great extent	Moderate extent	Some to no extent	Total
Contributions greater than minimum required	43	44	162	249
Actuarial method used to determine contribution requirements	71	78	100	249
Higher rates of return than assumed	153	63	33	249
Assumptions other than rate of return different from actual conditions	35	53	161	249
Investment return rate used to value benefits at termination higher than ongoing rate previously used	72	44	133	249

[a]Individual columns add to more than 249 plans because some respondents gave more than one reason as having the same degree of effect.

WHY WERE PLANS WITH EXCESS ASSETS TERMINATED?

Plan officials provided information on why 413 plans with excess assets were terminated--248 provided the information through questionnaires and 165 through our telephone survey. Based on their responses, we grouped the primary reasons given for plan terminations into three categories:[5]

--An employer's desire to use a plan's excess assets for a non-pension-related purpose, such as alleviating adverse business conditions or retiring long-term debt.

--Changes in an employer's corporate structure, such as the sale of a company or a plant closing.

--Dissatisfaction with the defined benefit plan that was terminated.

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[5]During the telephone survey, plan officials were asked only to identify the primary reason for plan termination. The questionnaire asked the extent (ranging from very great to little or no) to which 14 specific reasons may have contributed to a plan termination decision. When analyzing questionnaire results, we considered the primary reason to be the one(s) cited as having contributed most to the plan termination decision.

As shown by table 3, a change in corporate structure and a desire to use excess assets for non-pension-related purposes were each cited more often (about 33 percent) than dissatisfaction with the plan that was terminated as primary reasons for termination. Plans that terminated because of employers' desire to use excess assets for non-pension-related reasons accounted for about 45 percent of the participants and over half of the excess assets.

Table 3:

Primary Reasons for Terminating Overfunded Plans by Percent of Plans, Participants, and Excess Assets

Primary reason(s)	Plans (n=413)	Participants (n=633,000)	Excess assets (n=$5.2 billion)
	(percent)		
Desire to use excess assets for non-pension-related purpose(s)	33	45	58
Change in corporate structure	33	20	19
Dissatisfaction with existing defined benefit plan	18	21	14
Other[a]	4	2	1
Combination of above reasons	12	12	9
Total	100	100	100[b]

[a]Some plan officials cited primary reasons for terminations that could not be grouped into the three categories. For example, two questionnaire respondents cited decertification of the union covering plan participants as the primary reason for plan termination.

[b]Column does not add to total due to rounding.

We received information from 250 of the 251 questionnaire respondents on the extent (very great to little or no) that specific reasons, within the general categories, contributed to employers' termination decisions. As shown in table 4, a desire to use reverted assets to alleviate adverse business conditions (59 responses), a change in ownership by sale or transfer (51 responses), and employees' preference for a defined contribution plan (39 responses) were cited most often as having a great to very great effect on the decision to terminate.

Table 4:

Extent to Which Specific Reasons Contributed to Employers' Decisions to Terminate Overfunded Plans

Reasons	Number of plans responding[a] Great to very great extent	Moderate extent	Some to no extent	Total
Desire to use excess assets for non-pension-related purposes:				
Alleviate adverse business conditions	59	22	169	250
Acquire another company	1	8	241	250
Make capital expenditures	14	21	215	250
Retire long-term debt	29	26	195	250
Distribute to shareholders	4	2	244	250
Increase earnings	14	23	213	250
Make company less attractive for purchase by other entities	8	4	238	250
Change in corporate structure:				
Change in ownership by merger	21	2	227	250
Change in ownership by sale or transfer	51	6	193	250
Liquidation or dissolution by employer	13	3	234	250
Plant or location closing	26	5	219	250
Dissatisfaction with defined benefit plan:				
High cost of providing benefits	30	28	192	250
Excessive administrative burden	29	17	204	250
Employees preferred defined contribution plan	39	13	198	250
Other[b]	7	1	242	250

[a]Some plans cited more than one reason as having the same degree of effect on the decision to terminate.

[b]See footnote a in table 3.

WHAT TYPES OF REPLACEMENT PLANS DID EMPLOYERS PROVIDE?

Employers often replace terminated defined benefit plans with other defined benefit or defined contribution plans so that working employees can continue to earn pension benefits.[6] The replacement plans may be newly established or already existing. For example, an existing plan may be used to provide coverage when a company changes ownership and the employees join the new owner's ongoing plan.

Also, working employees may receive replacement coverage when an ongoing plan is separated into two plans--one for working employees and one for retired participants. All or part of the excess assets may be assigned to the retirees' plan, which is then terminated with the assets not needed to pay retirees' benefits reverting to the employer. The plan covering the working employees continues. Such situations are commonly referred to as spinoff/terminations.

We received replacement plan information from 407 of the 432 questionnaire and telephone survey respondents. As table 5 shows,

--defined benefit plans replaced 27 percent of the terminated plans,

--defined contribution plans replaced 45 percent of the plans,

--a combination of defined benefit and defined contribution plans was used to replace 8 percent of the plans, and

--no replacement coverage was provided for 20 percent of the plans.

Data provided by officials of 243 plans that completed the questionnaire indicate that defined benefit plan coverage was provided to more working employees--171,000 (55 percent)--than was defined contribution coverage--144,000 (47 percent)--including 25,000 who received both types of coverage.[7]

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[6]Retirees in our survey were generally not covered by replacement plans.

[7]The number of employees working when plans terminated was obtained only for plans that completed questionnaires.

Table 5:

Types of Replacement Plans That Employers Provided by Percent of Plans, Working Employees, and Excess Assets in Terminated Plans

Type of replacement plan	Replacement plans (n=407)	Working employees in terminated plans[a] (n=310,787)	Excess assets in terminated plans (n=$5.3 billion)
	(percent)		
Defined benefit:			
Spinoff/termination	10	29	35
New defined benefit plan	14	17	20
Already existing defined benefit plan	3	1	1
Total	27	47	56
Defined contribution:			
New defined contribution plan	35	33	23
Already existing defined contribution plan	9	6	5
Total	45[b]	39	28
Both defined benefit and defined contribution plans	8	8	8
No replacement plan	20	6	9
Total	100	100	100[b]

[a]The number of plan participants and the percentage presented in the column represent data provided by 243 plans.

[b]Columns do not add to totals due to rounding.

What Types of Replacement Plans Were Provided by Employers with Different Operating Conditions?

Plans may be terminated by employers who either plan to continue in business (ongoing) or are going out of business. For the ongoing employers, some may have undergone a change in corporate structure, such as a merger with or acquisition by another company, before the plan was terminated.

Of the 251 questionnaire respondents, 236 indicated that the employers were continuing in business. Of the 236 respondents, 233 gave us information for determining whether replacement plan decisions differed for employers with and without a recent change (within 3 years of plan termination) in corporate structure.

As shown by table 6, over 75 percent of employers with and without a change in corporate structure established replacement plans, and the replacement plans covered at least 95 percent of the working participants in the plans terminated by each group. Defined contribution plans were more often used as the replacement plans regardless of whether the corporate structure changed.

Table 6:

Types of Replacement Plans That Ongoing Employers (With and Without Changes in Corporate Structure) Provided by Percent of Plans and Participants

	Plans		Working employees in terminated plans[a]	
	No change in corporate structure (n=124)	Change in corporate structure (n=109)	No change in corporate structure (n=170,734)	Change in corporate structure (n=131,983)
	(percent)			
Replacement plan:				
Defined benefit	35	23	61	32
Defined contribution	44	38	33	48
Both defined benefit and defined contribution plans	6	16	3	15
Total	85	76[b]	97	95
No replacement plan	15	24	3	5
Total	100	100	100	100

[a]The number of plan participants and the percentage presented in the column represent data provided by 230 plans.

[b]Column does not add to total due to rounding.

What Types of Replacement Plans Were Provided When Union and Nonunion Participants Were Involved?

When employees covered by terminated plans are union members, replacement plan decisions may be a part of a collective bargaining process between the employer and the union. We received sufficient information from completed questionnaires for 233 terminated plans involving ongoing employers to determine if replacement plan decisions were different for terminated plans with and without union members. About 81 percent of the 233 terminated plans involved only nonunion employees, and these employees accounted for about 85 percent of the 302,000 working participants in the 233 plans.

As shown by table 7, 34 percent of the terminated plans with union members were not replaced by other plans, compared to 15 percent of the plans without union members not being replaced. Although the number of defined benefit and defined contribution replacement plans covering union members was about equal, about 86 percent of all union member participants received defined benefit replacement coverage. Nonunion members' plans were more often replaced with defined contribution plans, but about the same percentage of nonunion participants were covered by defined benefit and defined contribution plans.

Table 7:

Types of Replacement Plans That Employers Provided by Percent of Union and Nonunion Plans and Participants

	Plans		Participants	
	Union (n=44)	Nonunion (n=189)	Union (n=44,807)	Nonunion (n=257,679)
	(percent)			
Replacement plan:				
Defined benefit	30	30	81	43
Defined contribution	25	45	3	46
Both defined benefit and defined contribution plans	11	11	5	9
Total	66	85[a]	89	98
No replacement plan	34	15	11	2
Total	100	100	100	100

[a]Column does not add to total due to rounding.

WHAT WAS THE EFFECT OF THE ADMINISTRATION'S ASSET REVERSION GUIDELINES?

In May 1984, PBGC, IRS, and the Department of Labor issued joint guidelines covering plan terminations in which excess assets reverted to employers. The guidelines were intended to encourage the continuation of defined benefit coverage for employees by clarifying that defined benefit, as well as defined contribution, plans could be used as replacements for terminated plans.

Employers may not have terminated their existing defined benefit plans if they believed that a defined benefit plan could not be used as a replacement. In such instances, the guidelines may encourage employers to terminate plans that they otherwise would not have terminated.

The guidelines did influence some employers to terminate their plans, according to information provided through completed questionnaires or telephone interviews for 407 terminated plans. Of these plans, 218 were terminated after the guidelines were issued. According to the responses, four (2 percent) of the plans would not have terminated if the guidelines had not been issued. The four plans had a total of 2,600 retired and active participants.

The information obtained also indicates that, for the 407 plans, (1) the percentage of terminated plans replaced by defined benefit plans increased after the guidelines were issued and (2) the guidelines contributed to the increase. As shown by table 8, 24 percent of the 189 plans terminated before the guidelines were issued were replaced by defined benefit plans, but 43 percent of the 218 plans terminated after the guidelines were replaced by such plans. Also, officials of 29 (13 percent) of the 218 terminated plans told us their plans were replaced by defined benefit plans because of the guidelines. They said that the plans would not have been replaced at all or would have been replaced by defined contribution plans if the guidelines had not been issued. Twenty-six of the 29 plans had about 19,600 working participants.[8]

[8]Information on the number of working participants in three of the plans was not available.

Table 8:

Types of Replacement Plans That Employers Provided Before and After the Administration's Guidelines by Percent of Plans and Participants[a]

Type of replacement plan	Plans: Before guidelines (n=189)	Plans: After guidelines (n=218)	Participants[b]: Before guidelines (n=130,871)	Participants[b]: After guidelines (n=179,916)
	(percent)			
Defined benefit plan:				
Spinoff/termination	5	14	23	34
New defined benefit plan	8	19	7	25
Already existing defined benefit plan	3	3	0	1
Total	16	36	30	60
Defined contribution plan:				
New defined contribution plan	40	31	48	21
Already existing defined contribution plan	10	10	9	4
Total	50	41	57	25
Both defined benefit and defined contribution plans	8	7	3	11
No replacement plan	26	15	10	4
Total	100	100	100	100

[a]"Before guidelines" includes plans terminated between January 1, 1980, and May 23, 1984, and "after guidelines" includes plans terminated between May 24, 1984, and June 30, 1985.

[b]The number of plan participants and the percentage presented in the column represent data provided by 243 plans.

[c]Column does not add to total due to rounding.

TABLES PROVIDING INFORMATION ON FUNDING WAIVERS, INVESTMENT RETURN ASSUMPTIONS, AND AGE OF PLANS

Table I.1:

Information on Whether 249 Terminated Plans Received Funding Waivers Within 3 Years Before Termination by Percent of Plans and Excess Assets[a]

Funding waiver	Plans (n=249)	Excess assets (n=$4.0 billion)
	----------(percent)----------	
Funding waiver granted by IRS	1	2
No funding waiver	99	98
Total	100	100

[a]Of 251 questionnaire respondents, 249 gave us information on whether IRS waived contribution requirements within 3 years of termination.

Table I.2:

Difference in Rate of Return Assumptions Used to Determine Funding Requirements for 78 Terminated Plans Replaced by Defined Benefit Plans[a]

	Number of plans						
		Extent interest rate lower in replacement plan	Extent interest rate higher in replacement plan				
Type of replacement plan	No difference	0.1-1%	0.1-1%	1.1-2%	2.1-3%	3.1-4%	Total
Spinoff/termination	25	1		2	1		29
New defined benefit plan	21	1	7	3		1	33
Already existing defined benefit plan	8	–	6	2	–	–	16
Total	54	2	13	7	1	1	78

[a]Of the 251 plans responding to our questionnaire, 93 were replaced with defined benefit plans. Of the 93 plans, 78 gave us information about interest rate assumptions used to determine funding requirements in both the terminated and replacement plans.

Table I.3:

Number of Years 245 Plans Operated Before Termination by Percent of Plans and Excess Assets[a]

Years operated prior to termination	Plans (n=245)	Excess assets (n=$4 billion)
	---------(percent)----------	
0 - 10	19	33
11 - 30	53	29
31 - 50	27	35
Over 50	1	3
Total	100	100

[a]Of the 251 questionnaire respondents, 245 provided information on the plan age at termination.

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