



Highlights of [GAO-06-42](#), a report to congressional requesters

Why GAO Did This Study

The nation's private defined benefit (DB) pension system, a key contributor to the financial security of millions of Americans, is in long-term decline. Since 1980, the number of active participants in Pension Benefit Guaranty Corporation (PBGC) insured single employer DB plans has dropped from 27.3 percent of all national private wage and salary workers in 1980, to about 15 percent in 2002, and more recently the PBGC has assumed billions of dollars in unfunded benefit obligations from bankrupt plan sponsors. Some analysts have identified hybrid DB plans like cash balance (CB) plans as a possible means to revitalize this declining system. However, conversions from traditional DB plans to CB plans have sometimes been controversial because of the effect conversions may have on the benefits of workers of different ages.

As House and Senate committees consider comprehensive pension reform legislation that includes efforts to resolve uncertainties about CB plans, GAO was asked to (1) review current research about the implications of CB conversions for employee benefits, (2) describe the prevalence and type of transition provisions used to protect workers' benefits in past CB conversions, and (3) estimate the effects of CB conversions on the benefits of individual participants under a hypothetical conversion to a typical CB plan from a typical traditional DB plan.

www.gao.gov/cgi-bin/getrpt?GAO-06-42.

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.

PRIVATE PENSIONS

Information on Cash Balance Pension Plans

What GAO Found

Current pension and economic literature provides little conclusive evidence about the effects of CB plan conversions on benefits. In many cases, data and other methodological issues (e.g., sampling methods) limit the generalization of results. Nonetheless, cash balance research indicates that the effects of a conversion depend on many factors, including the generosity of the CB plan, transition provisions that might limit any adverse effects on current employees, and firm-specific employee demographics. CB plan conversions are posited to have distributional effects on expected pension wealth: younger, more mobile workers usually benefit while older workers with long job tenure are likelier to experience a loss, particularly if they are nearly eligible for early retirement.

GAO's analysis of a representative sample of plan conversions determined that most conversions occurred between 1990 and 1999 and primarily in the manufacturing, health care, finance and insurance industries. Most conversions set participants' opening account balances equal to the present value of benefits accrued under the previous plan, although the interest rate used to calculate the balance varied around the 30-year Treasury bond rate. Most plans provided some form of transition provisions to mitigate the potential adverse effects of a conversion on workers' expected benefits for at least some employees. About 47 percent of all conversions grandfathered at least some of the employees into the former traditional DB plan. In most cases, grandfathering eligibility was limited to employees meeting a specified minimum age and/or years of service.

GAO's simulations of the effects of conversions on pension benefits show the following:

- In conversions from a traditional DB plan to a typical CB plan, most workers, regardless of age, would have received greater benefits under the DB plan. Unless grandfathered into the former plan, older workers experience a greater loss of expected benefits than younger workers.
- In comparing a typical CB plan to a terminated FAP plan, all vested workers would do better under the CB plan.
- In conversions from a traditional DB plan to a CB plan of equal cost to the sponsor and more generous than the typical CB plan, while more workers at age 30 have benefit increases under the CB plan, this was not true for those at age 40 and 50.
- In comparing an equal cost CB plan to a terminated FAP plan, again all vested workers would do better under the CB plan.
- GAO's comparisons focusing on the lifetime present value of benefits did not change the basic findings of GAO's analysis of monthly benefits.