House Education & the Workforce Committee

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FACT SHEET

Pension Underfunding Undermines Financial Health of the PBGC, Worker Retirement Security

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On March 26, 2003, Education & the Workforce Committee Chairman John Boehner (R-OH) and Employer Employee Relations Subcommittee Chairman Sam Johnson (R-TX) sent a letter to the General Accounting Office (GAO) requesting that it study the Pension Benefit Guaranty Corporation (PBGC), assess why the PBGC had accumulated a significant deficit, and determine what other liability risks that the agency faces.

After conducting a broad review of the PBGC, the GAO on July 23 announced that it was including the agency on its list of "high-risk" programs that require additional federal oversight, noting that there are structural problems in the defined benefit pension system that are jeopardizing the financial health of the agency and generating concern about its future. Programs or activities that receive a high-risk designation receive more comprehensive oversight from GAO and their progress is assessed in regular biennial reports.

Today's hearing, the third in a series on the future of the defined benefit pension system that the Committee launched at the beginning of the summer, will examine federal pension funding and the financial condition of the debt-laden PBGC. The agency's rising debt burden also brings into question whether a taxpayer bailout of the PBGC would be necessary if its financial condition continues to deteriorate. GAO will be presenting some of their findings at the hearing and the PBGC will discuss the current financial state of the agency and the impact it has on workers and their benefits.

PBGC Insures Workers in Terminated Defined Benefit Pension Plans

The PBGC is a federal agency created by the 1974 Employee Retirement Income Security Act (ERISA) to guarantee and protect pension benefits in private traditional pension plans known as defined benefit plans, the type that promise to pay a specific monthly benefit at retirement. The PBGC assumes the liabilities for basic pension benefits of a company's workers and retirees when the company can no longer afford to maintain its pension plan. The agency, which receives no federal tax dollars, is funded in four ways: insurance premiums paid to PBGC by defined benefit plan sponsors; assets of pension plans that the agency has taken over; recoveries in bankruptcy from former plan sponsors; and earnings on invested assets.

The PBGC currently guarantees payment of basic pension benefits earned by about 44 million American workers and retirees participating in some 30,000 private sector defined benefit pension plans. This year, the agency is responsible for paying almost $2.5 billion in benefits to nearly one million people in FY 2003, up from $1.5 billion in FY 2002. The PBGC's board of directors consists of the Secretary of Labor, who is the chair, and the Secretaries of Treasury and Commerce.

PBGC Deficit the Largest in Agency History

Over the past year, the PBGC has assumed the obligations of paying out basic pension benefits for several large pension plans, and the agency's surplus has quickly evaporated. During FY 2002, PBGC's single-employer insurance program went from a surplus of $7.7 billion to a deficit of $3.6 billion, a loss of $11.3 billion in just one year. Agency officials estimate that the deficit has grown to approximately $5.4 billion as of April this year, the largest in PBGC history. The termination of large underfunded pension plans of bankrupt companies in troubled industries like steel or airlines is the major cause of deficit.

In addition, the PBGC has confirmed that underfunding in the defined benefit system as a whole exceeds $300 billion. With more struggling companies with pension plans that face severe underfunding problems, the PBGC may have to assume responsibility for even more pension burdens in the near future. This problem is exacerbated by the fact that defined benefit plans last year suffered their worst funding year ever. Currently, 89 percent of pension plans are considered underfunded because of a number of factors that include struggling markets and low interest rates.

The PBGC estimates that among financially weak companies, there is an additional $35 billion in unfunded pension benefits looming on the horizon – pension benefits that may become the PBGC's responsibility. This poses a serious question of whether a taxpayer bailout of the PBGC would be necessary if the financial condition of the agency continues to deteriorate further. More than a decade ago, the federal government stepped in to bail out the savings and loan industry at the cost of billions of dollars. According to the Federal Deposit Insurance Corporation (FDIC), the bailout cost taxpayers approximately $124 billion.

While there are some obvious differences, it is important that hard-working taxpayers aren't saddled with another S&L-style bailout that costs billions of dollars. The alarming trend of underfunded defined benefit plans today only increases the pressure on the PBGC, threatening its ability to protect and insure worker pension benefits and putting taxpayers' interests in real jeopardy.

Pension Underfunding Undermines Worker Retirement Security

The financial health of defined benefit pension plans is a critical issue for millions of workers, and the funding of these plans has become more challenging for many employers. According to the PBGC, there were 30,660 defined benefit plans insured by the agency last year, down from 112,000 in 1985. Furthermore, the percentage of active workers covered by these plans is down from 38 percent in 1985 to 23 percent today. Fewer and fewer defined benefit plans means workers have fewer and fewer retirement security options available to them.

Many factors have contributed to the decline of the defined benefit pension system. Struggling stock markets, severely low interest rates, and an increasing number of retirees have produced a 'perfect storm' scenario that has weakened the funding status of these plans and resulted in decisions by many employers to terminate or freeze a large number of plans. Moreover, a complex statutory and regulatory structure for defined benefit plans has resulted in an increasingly expensive and complicated system to administer that provides little flexibility for employers who voluntarily offer these pension plans.

These factors, however, mask broader trends that pose serious risks to the defined benefit system and the PBGC's ability to insure pension benefits for firms concentrated in manufacturing industries. For example, the program's insured participant base continues to shift away from active workers, falling from 78 percent of all participants in 1980 to 53 percent in 2000. This means that a shrinking pool of workers in companies that offer defined benefit plans are working to pay for the pension benefits of an ever-increasing pool of retirees – a situation that may be unsustainable in the long term. General Motors, for example, has three retirees for each active worker.

The trend of underfunded defined benefit pension plans threatens the retirement security of millions of workers who rely on the safe and secure benefits that these pension plans provide and endangers the future of the defined benefit pension system as a whole. This ongoing series of hearings is designed to take a broad look at the problems facing the future of the defined benefit system and set the table for possible reforms that focus on enhancing the system to ensure that workers have as many retirement security choices available to them as possible.