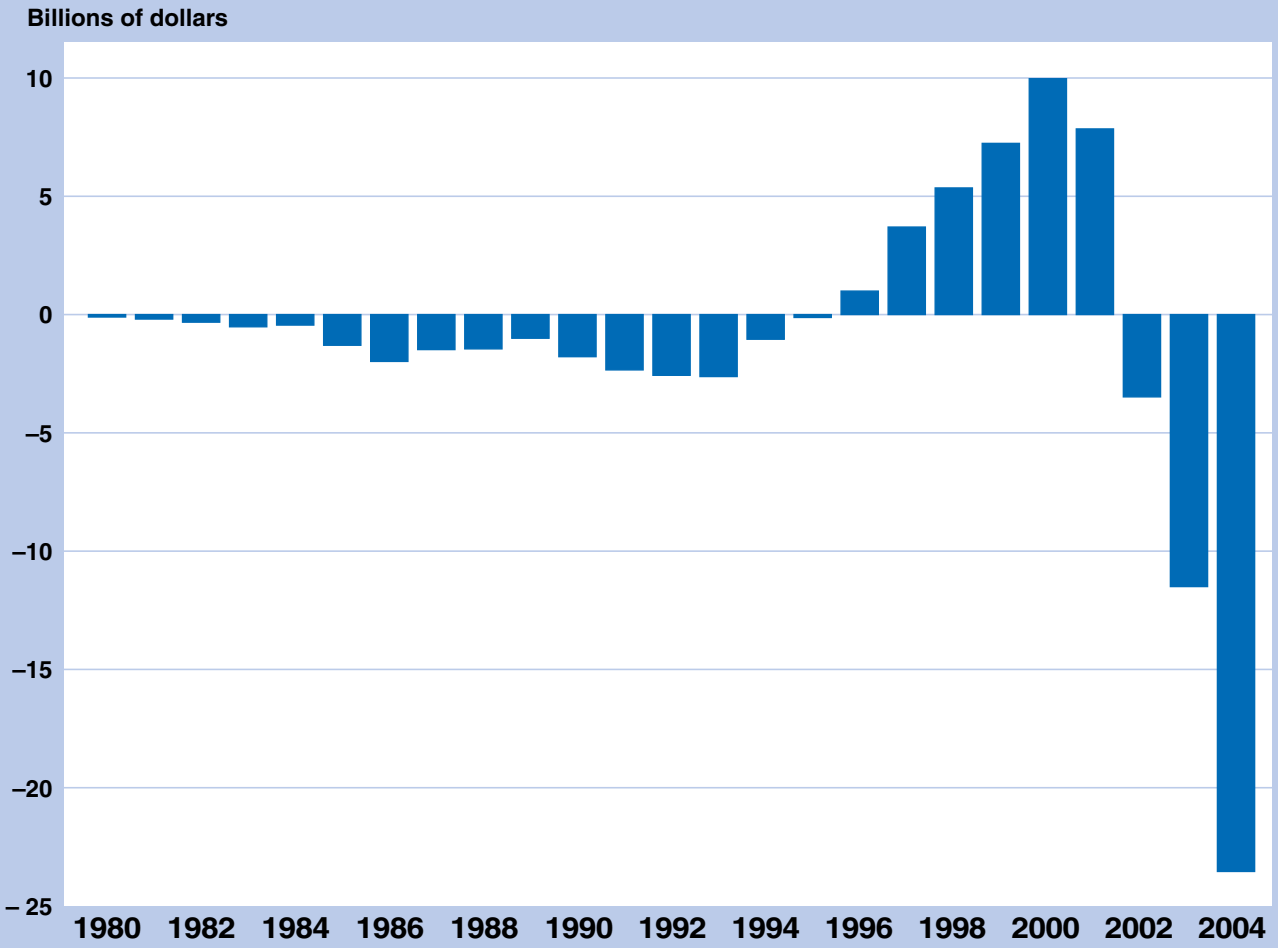
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

A Guide to Understanding the Pension Benefit Guaranty Corporation

PBGC's Net Financial Position



SEPTEMBER 2005

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A Guide to Understanding the Pension Benefit Guaranty Corporation

September 2005

The Congress of the United States ■ Congressional Budget Office

Notes

Numbers in the text and tables may not add up to totals because of rounding.

Unless otherwise indicated, all years referred to in this paper are fiscal years.

All dollars referred to are nominal.

Preface

Although the federal government's Pension Benefit Guaranty Corporation (PBGC) has been providing pension insurance for nearly 30 years, the agency's financial situation has been particularly volatile over the past decade and has deteriorated significantly during the past several years. At the end of 2000, the total value of assets held by PBGC exceeded the estimated present value of its liabilities by $10 billion. But by the end of 2004, the agency's estimated liabilities were $23.5 billion more than the value of its assets.

As attention focuses on that situation, the Congressional Budget Office (CBO) has prepared this paper, which aims to provide a basic understanding of federal pension insurance, the operations of PBGC, and the financial condition of and the outlook for the agency over the next 10 years. In accordance with CBO's mandate to provide impartial analysis, the paper makes no recommendations.

Geoffrey Gerhardt of the Budget Analysis Division wrote the paper under the supervision of Paul Cullinan, Bob Sunshine, and Peter Fontaine. Bruce Vavrichek, Marvin Phaup, Wendy Kiska, and Arlene Holen provided valuable comments.

John Skeen edited the paper, and Janey Cohen proofread it. Allan Keaton prepared the paper for publication. Lenny Skutnik produced the printed copies of the paper, and Annette Kalicki and Simone Thomas produced the electronic version for CBO's Web site (www.cbo.gov).



Douglas Holtz-Eakin
Director

September 2005

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A Guide to Understanding the Pension Benefit Guaranty Corporation

Summary and Introduction

The Pension Benefit Guaranty Corporation (PBGC) is a wholly owned government corporation that insures the pension benefits of more than 44 million people. Established by the Employee Retirement Income Security Act (ERISA) in 1974, PBGC insured more than $1.7 trillion worth of pension benefits by the end of 2004. That year, it paid $3 billion in benefits to more than 514,000 annuitants whose single-employer pension plans had been terminated, and the agency is responsible for making payments to another 440,000 individuals when they retire. In addition, PBGC provided financial assistance to multiemployer plans that made payments to approximately 100,000 beneficiaries.

Since the enactment of ERISA, the sponsors of tax-deferred, defined-benefit pension plans have been required to have their plans insured by PBGC. Such plans provide retirement annuities based on a formula that usually depends on participants' length of service and salary history. Sponsors are supposed to contribute enough to the plans to ensure that promised benefits, which are deferred compensation, can be paid; the participants are usually not required to make contributions.

PBGC administers two distinct insurance programs: one for single-employer plans and one for multiemployer plans, in which the benefits usually are negotiated as part of a labor agreement. For the single-employer program, PBGC collects premiums from active plans. When plans have been terminated because they do not have enough assets to cover their pension liabilities, PBGC assumes all of their assets, pays participants' retirement benefits within statutory limitations, and is responsible for benefits to vested employees and former employees when they reach retirement age. When plans with adequate assets are terminated, PBGC oversees that process but does not pay the pension benefits. For the multiemployer program, PBGC collects premiums from covered plans and provides financial support (mostly in the form of loans) to financially troubled plans.

Although PBGC has been providing pension insurance for nearly 30 years, the agency's financial situation has been particularly volatile during the past decade and has deteriorated significantly during the past several years. At the end of 2000, the total value of assets held by PBGC exceeded the estimated present value of its liabilities by $10 billion. But by the end of 2004, the agency's estimated liabilities were $23.5 billion more than the value of its assets (see Figure 1).

The sharp deterioration in PBGC's financial health can be attributed mainly to the fact that, over the past several years, the agency has assumed responsibility for, or "trusteed," numerous large pension plans that were significantly underfunded—primarily from the airline and steel industries. From 2001 through 2004, PBGC's single-employer program took on more than $13 billion in claims, which constitutes over 71 percent of all claims assumed by the agency. (Claims are the net cost of terminating a pension plan—the gap between its assets and its liabilities.)

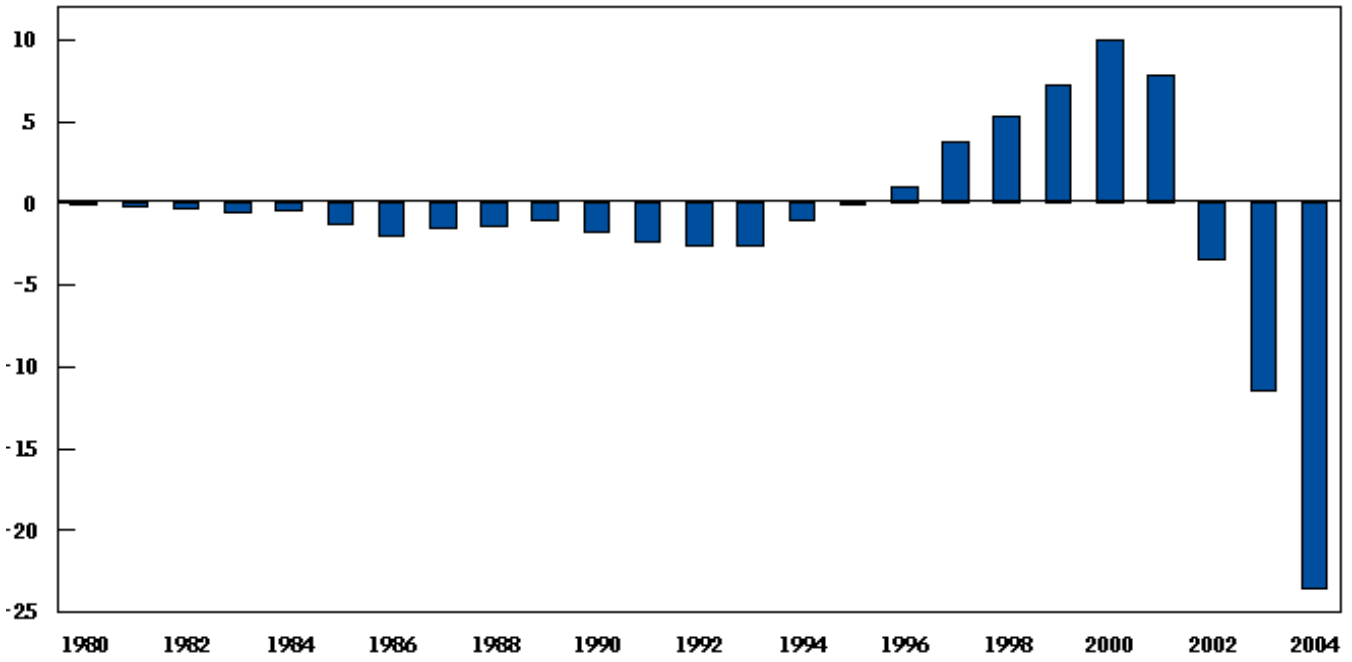
PBGC's liabilities have been growing much faster than its income from premiums. In some cases, those liabilities have been the result of bankruptcies. In others, struggling companies have shifted their plans' liabilities to PBGC in an effort to lower costs. In addition, the drop in the value of stocks after 2000 caused many well-funded pension plans to become seriously underfunded and more costly to PBGC at their termination. Finally, increases in life expectancy mean that PBGC is paying benefits to retirees for a longer period of time.

PBGC depends on premiums paid by the sponsors of defined-benefit plans to cover the shortfall between assets

Figure 1.

PBGC's Net Financial Position, 1980 to 2004

(Billions of dollars)



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

and liabilities of terminated plans. But those premiums are set in statute and are not adjusted to compensate for either changes in plans' participation or for PBGC's claims experience.

PBGC also is facing challenges arising from long-term, systemic changes to the pension system itself.[1] Many employers have come to consider the defined-benefit plans that PBGC insures to be costly and cumbersome to maintain. Instead, employers are increasingly turning to defined-contribution plans as an alternative form of retirement benefits for their workers. Under defined-contribution plans, employers and/or employees make deposits to individual accounts, and the benefits depend on the total assets accrued at the time of retirement—instead of promised amounts established up front by formula.

Background

For more than 30 years, PBGC has provided pension insurance to thousands of privately sponsored defined-benefit pension plans. Over the period, it has paid out more than $17 billion in benefit payments and is obligated to pay billions more in the future.

The Enactment of the Employee Retirement Income Security Act

ERISA was signed into law in September 1974 by President Gerald Ford. Before then, the funding of retirement benefits and pension plans' operations were largely left up to the discretion of individual employers. If an employer did not adequately fund its pension plan and then went out of business, the firm's employees and retirees could be left with little, if any, pension benefits. The most notable instance occurred in 1963, when the Studebaker Company failed and more than 4,000 employees lost 85 percent of their pension benefits.[2] By enacting ERISA, the

1. For a discussion of the financial risks and costs posed by PBGC, see Congressional Budget Office, *The Risk Exposure of the Pension Benefit Guaranty Corporation* (September 2005).

2. See Steven E. Schanes, "ERISA Insights: Voices from the Early Days" (Brookfield, Wisc.: International Foundation of Employee Benefit Plans, 2001).

Congress moved to protect workers' financial interests in the retirement system.

Although ERISA covers several types of employee benefits, it is primarily designed to protect participants in and beneficiaries of private-sector pension plans. Employers are not required to provide their employees with pension benefits, but if they do, ERISA requires the employers to purchase insurance from PBGC and establishes funding standards for the plans. In addition, the law specifies who must be covered by the plans and how long employees must work before qualifying for benefits. It operates in conjunction with sections of the tax code that also regulate contributions to employer-sponsored pension plans and their operations. To make tax-deferred contributions to a pension plan, employers must meet the requirements of both ERISA and the tax code. Pension plans that meet the requirements of both are often referred to as "qualified."

The Basics of Pension Insurance

By insuring retirement benefits, PBGC provides a minimum level of pension benefits to participants in a qualified defined-benefit pension plan in the event that the plan cannot pay benefits. PBGC shares regulatory and enforcement responsibilities over private-sector pension plans with the Internal Revenue Service in the Treasury Department (concerning participation, vesting, and funding standards) and the Department of Labor (concerning fiduciary standards and reporting and disclosure requirements). If a plan's sponsor does not meet its obligations to pay premiums to PBGC or fails to meet the minimum funding standards contained in ERISA, PBGC has the power to place a lien on the sponsor's assets. PBGC's activities are limited to defined-benefit plans; the agency does not insure or regulate defined-contribution pension plans.

The most common defined-benefit plans are those sponsored by a single employer. A particular employer may sponsor several different plans, but each of those plans is considered a single-employer plan. In contrast, under a multiemployer plan, several employers who are involved in the same type of business collectively bargain with a union to provide a pension plan for employees who work for those firms. Multiemployer plans are most common among certain industries in which workers often move from firm to firm, such as the construction and transportation industries.

While the number of plans covered by PBGC has fallen substantially over the past 20 years, the number of participants in those plans has grown modestly (see Figure 2). In 1980, PBGC covered more than 95,000 single-employer plans and 2,244 multiemployer plans, whereas in 2004, those figures had dropped to fewer than 30,000 and 1,600, respectively. Despite the decline in the number of plans, the number of participants in single-employer plans grew from about 27.5 million to more than 34 million, and in multiemployer plans, from about 8 million to 9.8 million.[3]

The sharpest decline in the number of defined-benefit plans has been among small firms. In 1980, plans covering fewer than 100 participants accounted for about 76,000 of the more than 95,000 single-employer plans covered by PBGC. In 2003, those small plans made up 18,000 of the 29,500 single-employer plans. Similar declines also occurred in plans with between 100 and 1,000 participants. In contrast, the number of large pension plans and the participation in them grew. Between 1980 and 2003, the number of single-employer plans with 5,000 or more participants grew from 714 to 1,133. At the same time, overall participation in those plans roughly doubled, from about 13 million to nearly 26 million.

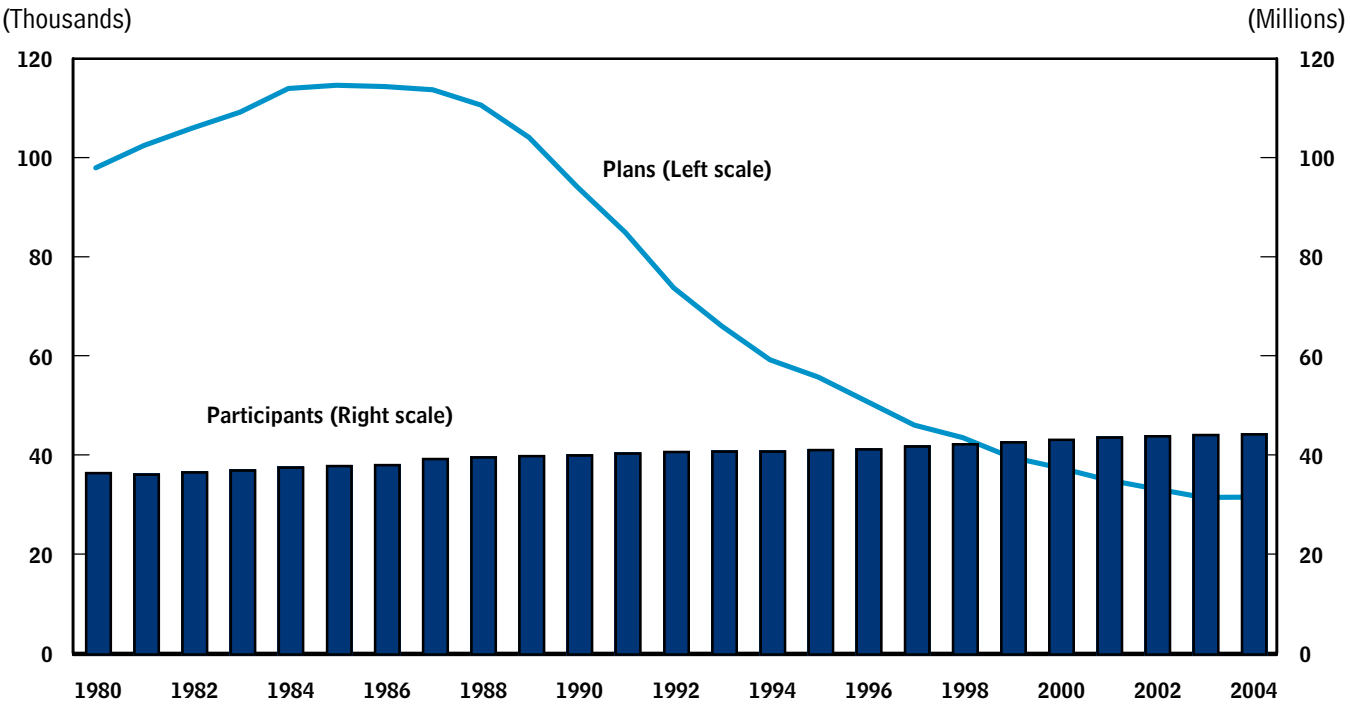
The fall in the number of plans is most easily explained by the general shift that is occurring between defined-benefit and defined-contribution pension plans. A growing number of firms have replaced their traditional defined-benefit plans with defined-contribution plans, and most new firms choose to establish defined-contribution plans.[4] The reasons behind those decisions vary from firm to firm, but some cite the growing costs of financing future benefits, the administrative burdens of

3. Participants include current workers who are vested and former employees who will someday receive a deferred benefit, as well as all retirees, spouses, and survivors who are currently receiving benefits.

4. See Leslie Papke, "Are 401(k) Plans Replacing Other Employer-Provided Pension? Evidence from Panel Data," *Journal of Human Resources*, vol. 34, no. 2 (1999), pp. 346-368. ERISA provides several ways for employers to voluntarily terminate a defined-benefit plan and replace it with either a defined-contribution plan or no pension plan at all.

Figure 2.

The Number of Pension Plans and Participants Insured by PBGC, 1980 to 2004



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

complying with ERISA, and the increased mobility of the American workforce.

In recent years, many employers have attempted to deal with those issues by converting their traditional defined-benefit plans into what are referred to as cash-balance plans. Under cash-balance plans, also called hybrid plans because they share certain characteristics with defined-contribution plans, employers make regular contributions to hypothetical accounts on behalf of their employees. Individual account statements track employers' contributions and hypothetical interest earnings for each participant. In actuality, however, contributions to cash-balance plans are not deposited into individual accounts and remain the property of the sponsors. Technically, the plans are considered a type of defined-benefit plan (and are subject to ERISA in the same ways that other defined-benefit plans are), but converting traditional defined-benefit plans into cash-balance plans has raised legal challenges. The main issue is whether such conversions violate age discrimination laws in how they treat the benefits of long-time employees. Given the disagreement over their legality, further conversions to cash-balance plans are effectively on hold.

The number of participants in single-employer plans covered by PBGC who were not actively employed by the sponsoring firms almost tripled from 1980 to 2001, growing from 6 million to almost 17 million. So while about 78 percent of PBGC's covered participants were active employees in 1981, just 51 percent were in 2001 (see Figure 3). That trend does not present problems to plans that are fully funded because benefits for current and future retirees have been fully paid in advance. But it can present significant financial challenges to underfunded plans.

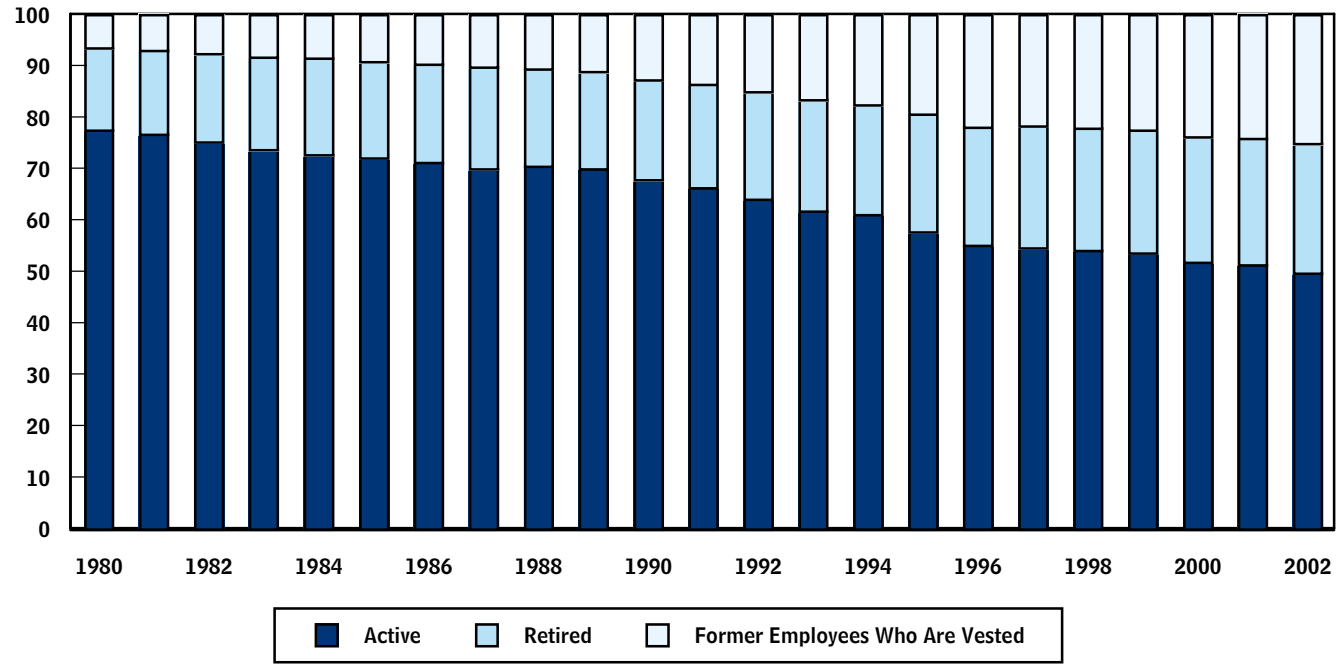
Funding Requirements for Pension Plans

Both ERISA and the tax code require that qualified plans meet minimum funding standards, which are designed primarily to protect the interests of both plans' participants and PBGC. The standards are intended to ensure that each employer-sponsored plan has enough assets to pay promised benefits in the event that the sponsor voluntarily terminates it or the sponsor is unable to continue making deposits toward the plan. ERISA and the tax code also establish limits on the tax-deductible contributions that sponsors may make to their plans. Many of the

Figure 3.

Work Status of Participants in Single-Employer Plans Covered by PBGC, 1980 to 2002

(Percentage of total participation)



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

funding rules are intended to minimize volatility in the funding requirements for sponsors and to limit losses of federal revenues. The net result of current funding rules is that many plans have become badly underfunded over the past several years, thus exposing PBGC to substantial potential losses.

Minimum Funding Standards. The rules that govern plans' funding begin with a concept known as a funding standard account (FSA). Each plan has an FSA, which is an accounting mechanism used to determine whether the pension plan is adequately funded. In general, if the value of a plan's assets equals the present value of its current liabilities, the plan has an FSA balance of zero.[5] Each year, that balance is adjusted to reflect any increases or decreases in the plan's assets and liabilities.

Charges to an FSA include normal accruals of benefits and investment losses on the plan's assets, as well as amendments to the plan's benefit structure and changes in actuarial assumptions that result in higher liabilities. Credits include normal contributions by the employer, investment gains on the plan's assets, and changes to the plan's benefit structure and actuarial assumptions that reduce liabilities. Most of the charges or credits are amortized over a period of time, depending on the particular item. For instance, gains or losses on a plan's assets are amortized over five years, and changes in a plan's actuarial assumptions that result in an increase or decrease in liabilities may be amortized over 10 years. Although amortizing decreases volatility in the funding requirements, it can also lead to a mismatch between assets and liabilities in the short term.

A sponsor of a plan that has a large balance in its FSA is generally not required to make additional contributions. However, the presence of such a balance does not preclude underfunding because balances in an FSA do not reflect current market values. If a plan had a balance because of past overpayments but the assets representing those overpayments had since lost value, the loss in value would not affect the FSA's balance. But under those cir-

5. Current liabilities reflect benefit obligations that are based on current pay and service to date.

cumstances, the plan could be underfunded, and the sponsor would not be required to make additional contributions.

ERISA also provides a method for obtaining a funding waiver in the event of business hardship. The Secretary of the Treasury may waive the normal funding requirements for a period of one year for a sponsor who can demonstrate that it is experiencing a temporary hardship and that requiring normal contributions would be "adverse to the interests of plan participants." A hardship waiver cannot be granted for more than three out of 15 consecutive years, and the sponsor is required to make up any missed payments in later years. For multiemployer plans, 10 percent of the participating sponsors must demonstrate business hardship, and the waivers cannot be granted for more than five out of 15 consecutive years.

Deficit Reduction Contributions. In single-employer plans with more than 100 participants, when the value of assets compared with current liabilities (known as the funding ratio) falls below 90 percent, sponsors are required to make additional payments. Amortization periods for such "deficit reduction contributions" (DRCs) vary depending on when the liabilities were incurred and the degree to which the plan is underfunded. A plan with unfunded liabilities that were incurred prior to 1988 has 18 years to amortize those liabilities. A plan with unfunded liabilities incurred after that date must contribute enough to reduce the underfunding by 30 percent annually. The 30 percent annual payment is reduced by 0.4 percent for every percentage point that the plan's funding ratio is above 60. Therefore, a plan that has an 80 percent funding ratio must reduce its unfunded liabilities at a rate of 22 percent annually.

Although deficit reduction contributions are intended to ensure that badly underfunded plans return to adequate funding levels over a reasonable period of time, they often fall short of that goal. No plan that has a funding ratio of 90 percent or higher must make a DRC. The rules further exempt plans that have a funding ratio of between 80 percent and 89 percent and have been above 89 percent for two consecutive years of the previous three years. In addition, balances built up in a plan's FSA are applied to any required DRCs. Because such balances are not valued at current market prices, a plan that has built up large balances in past years but has become underfunded in subsequent years can remain underfunded without being required to make those payments. Finally, the Pension Funding Equity Act of 2004, or Public Law 108-218, also temporarily eased DRC requirements for sponsors of plans in the passenger airline and steel manufacturing industries for plan years 2004 and 2005.

Full-Funding Limit. The full-funding limit (FFL) specified in ERISA places a cap on the contributions that employers are required to make. Once at the limit, sponsors are not required to make any additional contributions, even if they might otherwise be required to do so. Specifically, the FFL is the actuarial value of a plan's accrued liabilities minus the lesser of the market value of the plan's assets or the actuarial value of its assets.[6] The law gives sponsors some flexibility to determine the interest rate used to discount their accrued liabilities in calculating their FFL. Choosing a lower interest rate will act to increase the value of a plan's liabilities, thus raising its FFL, while choosing a higher interest rate will act to reduce the plan's FFL.

The law also provides for an alternative calculation whereby the FFL cannot be less than 90 percent of current liabilities minus the actuarial value of the plan's assets. The FFL is based on the larger of the two calculated amounts (see Box 1). Unlike the first method of calculating the FFL, the alternative method provides for discounting current liabilities using interest rates that are spelled out in statute. With the exception of plan years 2004 and 2005, when the specified interest rates are based on a composite rate for long-term corporate bonds, the rate used to discount current liabilities is based on the 30-year Treasury rate. In general, the interest rates used to discount current liabilities are lower than those used to discount accrued liabilities, often resulting in a situation in which a plan's current liabilities are higher than its accrued liabilities.

Maximum Deductible Contributions. In addition to requirements designed to ensure a minimal level of funding, the law also places an upper limit on the annual tax-deductible contributions that employers may make to

6. Accrued liabilities reflect total benefit obligations, including projected increases in benefits from anticipated salary increases and other factors. In accordance with ERISA, depending on the purpose, PBGC uses different measures of a pension plan's liabilities: current liabilities and accrued liabilities.

Box 1.

How Plans' Full-Funding Limit Is Calculated

The following examples show how the full-funding limit (FFL) is calculated for two different pension plans. These examples assume that the market value of assets is equal to the actuarial value of assets and at first assume that the plans do not have a balance in their funding standard account (FSA).

Plan A:

Assets	$27,000
Accrued Liabilities	$27,000
Current Liabilities	$31,000
90 Percent of Current Liabilities	$27,900

Using the plan's assets and its accrued liabilities, Plan A's full-funding limit would be zero because the two values equal each other. However, using an alternative calculation—known as the full-funding-limit override—which subtracts assets from 90 percent of current liabilities, the plan has a full-funding limit of $900 ($27,900 minus $27,000). Because the FFL is based on the larger of the two calculated amounts, the FFL for Plan A is $900.

Plan B:

Assets	$27,000
Accrued Liabilities	$28,000
Current Liabilities	$32,000
90 Percent of Current Liabilities	$28,800

Using the plan's assets and its accrued liabilities, Plan B's full-funding limit is $1,000 ($28,000 minus $27,000). Subtracting the plan's assets from 90 percent of the plan's current liabilities ($28,800 minus $27,000) yields a result of $1,800; thus, the full-funding-limit override applies, and the FFL for Plan B is $1,800.

Balances in FSAs also play a role in determining FFLs. Plans use the total value of their assets including the balance in their FSA to calculate the full-funding-limit override but do not include that balance to calculate accrued liabilities.

Assume that Plans A and B both have an FSA balance of $900, bringing the total value of each plan's assets to $27,900.

Assets Without FSA Balance	$27,000
FSA Balance	$900
Total Assets	$27,900

Under the full-funding-limit override, Plan A's original FFL was $900 because 90 percent of its current liabilities minus its assets equaled $900. But including the FSA balance of $900 boosts the value of its assets to the point that it equals 90 percent of current liabilities. Under the other method of calculating the FFL, the plan's accrued liabilities still equal the value of its assets not including the FSA balance. Thus, both calculations yield an FFL of zero for Plan A.

In the original example, Plan B had an FFL of $1,800 based on the fact that 90 percent of its current liabilities was $1,800 more than its assets, whereas its accrued liabilities were $1,000 more than its assets. Including the FSA balance of $900 increases the value of the plan's assets so that it is just $900 less than 90 percent of the plan's current liabilities. However, the plan's assets excluding the FSA balance remain $1,000 less than its accrued liabilities. Thus, Plan B's FFL now stands at $1,000.

their plans. Once at the limit, an employer may continue to make contributions but has to pay regular taxes on those contributions plus a 10 percent excise tax.

In general, sponsors are allowed to deduct all contributions needed to cover the normal costs of plans, plus required amortization payments on unfunded liabilities. Sponsors may also deduct all contributions that bring plans' assets up to 100 percent of current liabilities, even if those contributions are greater than the required contributions.

Interest Rates. The interest rates used to calculate the present value of a plan's liabilities must be within a specified range above or below the weighted average of the interest rates on 30-year Treasury bonds for the previous four-year period.[7] That range is normally 90 percent to 105 percent of the weighted average, but the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) temporarily increased the upper bound of the range to 120 percent for plan years 2002 and 2003. It is to sponsors' advantage to use a higher interest rate when calculating funding levels because a higher rate lowers the present value of plans' future liabilities.

The Pension Funding Equity Act of 2004 went a step further by temporarily changing the interest rates used to determine the present value of liabilities. The law replaces the interest rates on 30-year Treasury bonds with a composite rate on long-term investment-grade corporate bonds, as chosen by the Secretary of the Treasury. The rates on such corporate bonds are typically 50 to 100 basis points higher than those on 30-year Treasuries, so the substitution should reduce the present value of pension liabilities below what it would have been otherwise.[8] However, the change is in effect only for plan years 2004 and 2005, after which the rates on 30-year Treasuries will again apply.

The Operations of PBGC

In some respects, PBGC operates like a private insurance provider. In exchange for payments of premiums from plans' sponsors, it underwrites certain retirement benefits if the plans fail. Sponsors must pay the agency a flat-rate premium, depending on how many participants the plans cover. Single-employer plans that are not considered fully funded pay an additional premium calculated according to the extent of their underfunding. In the event that a plan is no longer able to pay benefits and PBGC must assume its liabilities, the plan forfeits all of its assets to the agency. In addition to collecting premiums and forfeited assets, PBGC also receives income from interest payments, dividends, and capital gains on the assets it holds (see Figure 4).

Although it resembles a private insurer in some ways, PBGC is different in key respects. Unlike a private insurance provider, PBGC does not enter into contracts with individual plans but is required to cover all qualified defined-benefit plans, just as sponsors of all such plans are required to have their plans insured by the agency. PBGC cannot refuse coverage for a plan that it believes is overly risky, nor does the law provide PBGC a way to adjust either the benefits it provides or the premiums it charges.

Premiums

Under ERISA, both the flat-rate premium and the premium charged to underfunded single-employer plans are set by the Congress in statute. Both are payable to a revolving fund administered by PBGC.

The flat-rate premium is tied directly to the number of participants a plan has, including active workers, deferred annuitants, and current beneficiaries. The payment itself is calculated once a year by multiplying the premium rate by the number of participants in the plan, and it is due within three months of the start of each plan year. When ERISA was enacted, the flat-rate premium for single-employer plans was $1 per participant, but it has been increased legislatively to its current level of $19 per participant. The flat-rate premium for multiemployer plans started at $0.50 per participant and now stands at $2.60. In 2004, PBGC collected $677 million in flat-rate premiums from single-employer plans and $25 million from multiemployer plans.

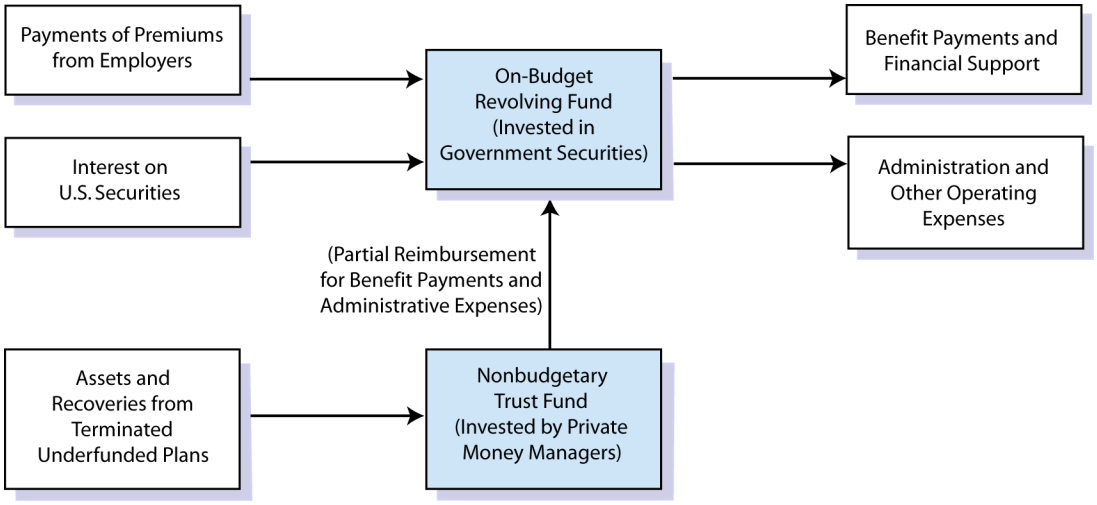
In addition to the flat-rate premium, single-employer plans that are considered underfunded must also pay a variable-rate premium. In principle, the variable-rate premium is determined by the degree to which a plan's vested liabilities exceed its assets on a net-present-value basis. In actuality, however, the formula does not require

7. The Department of the Treasury stopped issuing new 30-year bonds in 2002. In cases in which ERISA requires the use of rates on 30-year Treasuries to discount pension liabilities, current rates on outstanding 30-year Treasuries are used. The department has announced that it will again issue 30-year bonds in 2006.

8. A basis point is one-hundredth of a percentage point.

Figure 4.

PBGC's Operations



Source: Congressional Budget Office.

many plans that are actuarially underfunded to pay the variable-rate premium. For plans that owe the variable-rate premium, the payment is due to PBGC nine-and-a-half months after the start of the plan year.

In general, if a plan has reached the full-funding limit, it does not have to pay the variable-rate premium. Designed to limit the volatility of required funding and tax revenue losses, the FFL also has the effect of exempting many underfunded plans from paying a variable-rate premium. It has been estimated that the variable-rate premium was applied to only 20 percent of total underfunding in 2004, 10 percent in 2003, and 5 percent in 2002.[9]

The variable-rate premium for single-employer plans is $9 per $1,000 of underfunding. Therefore, the sponsor of a plan with $5 million in underfunding would owe $45,000 for the variable-rate premium for the plan year. Sponsors of multiemployer plans are not required to pay the variable-rate premium.

Both ERISA and the tax code specify the same measures of assets and liabilities for determining whether sponsors of plans have met the appropriate funding requirements and can continue to make tax-deductible pension contributions. ERISA uses somewhat different measures of liabilities for determining how much, if anything, sponsors owe in variable-rate premiums. Although the provisions that govern funding requirements allow sponsors to use a range of interest rates to discount current liabilities, ERISA's requirement for premiums specifies 85 percent of the 30-year bond rate for the month preceding the month in which the plan year begins.[10]

Of the $1.1 billion that PBGC collected in premiums from single-employer plans in 2004, about 40 percent was derived from the variable-rate premium. That amount was more than double the amount collected the year before. Detailed information about 2004 premiums is not yet available, but in 2003, more than 13,000 plans, representing almost half of all single-employer plans but just 17 percent of participants, were required to pay the variable-rate premium. Large plans (those with 5,000 or more participants) accounted for about half of total payments of the variable-rate premium; relatively small plans

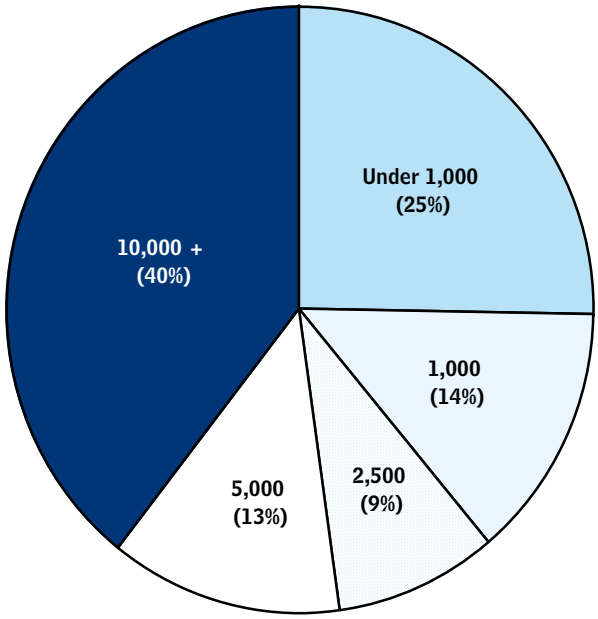
9. See Douglas J. Elliot, "PBGC: Premium Hike Possibilities," Center on Federal Financial Institutions (April 10, 2005).

10. That formula was temporarily altered by P.L. 108-218, which replaces the rates on 30-year Treasury bonds with a composite corporate-bond rate for plan years 2004 and 2005 before returning to the Treasury rate. In addition, the rate used to calculate premiums will permanently increase to 100 percent of the 30-year bond rate once the Treasury Department issues new pension mortality tables. However, those tables have been repeatedly delayed.

Figure 5.

Portion of Variable-Rate Premium Paid in 2003 by Size of Plan

(Participants)



Total Paid by All Plans: $294 Million

Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

(those with fewer than 1,000 participants) accounted for about a quarter of all such payments, even though they represented less than a tenth of all participants (see Figure 5).

Terminations of Pension Plans

Terminations of single-employer pension plans fall into one of three categories: standard, distress, and involuntary.

An employer may voluntarily terminate its pension plan provided that it gives at least 60 days' notice to participants, it ensures that the plan has enough assets to pay out all future benefits, and the termination does not violate collective bargaining agreements with the firm's employees. Ending a pension plan in that way is known as a standard termination. From 1975 through 2003, about 164,000 fully funded plans underwent standard terminations. PBGC does not become responsible for paying the benefits of such plans because their sponsors are required to purchase group annuity contracts from insurance companies or make lump-sum payments to cover all accrued benefits, and no further benefits accrue after the termination takes place.

In cases when a pension plan is underfunded and continuing to fund the plan would cause an employer to go out of business, the plan can be terminated by either the employer or PBGC. From 1975 through 2004, more than 3,400 underfunded plans were taken over by PBGC, either as distress or involuntary terminations. Over the past several years, nearly 95 percent of the plans trusteed by PBGC were the result of involuntary terminations.

A company may conduct a distress termination if PBGC determines one of the following conditions has been met:

- A petition has been filed seeking liquidation in bankruptcy court;
- A petition has been filed seeking reorganization in bankruptcy court, and the court has determined that the firm cannot be reorganized without terminating its pension plan;
- PBGC determines that the firm cannot continue to pay its creditors and remain in business unless the plan is terminated; or
- PBGC determines that continuing to contribute to the pension plan would place an unreasonable burden on the firm solely as the result of a decline in the number of employees covered by the plan.

In most cases, PBGC would prefer that terminations take place voluntarily, either through standard terminations or distress terminations. However, the law also gives PBGC the authority to conduct an involuntary termination of a pension plan under the following conditions:

- The plan has not met the minimum funding requirements;
- The plan cannot continue to pay benefits when due;
- A lump-sum payment has been made to a participant who is a substantial owner of the sponsoring company; or
- The eventual financial loss to PBGC is expected to increase unreasonably if the plan is not terminated.

Multiemployer plans generally are not terminated. If PBGC determines that a multiemployer plan is insolvent and can no longer pay its benefits, the agency provides financial assistance directly to the plan, usually in the form of a loan, so that it can continue to make payments to beneficiaries. In 2004, PBGC provided 27 multiemployer plans with financial assistance totaling about $10 million.

PBGC's Trust Funds

When an underfunded plan is terminated—either voluntarily or involuntarily—PBGC assumes control of the assets held by that plan. The total value of those assets can vary tremendously depending on the plan's number of participants and funding-to-benefits ratio.

In 2004, PBGC assumed control of 96 single-employer plans with a total of $2.8 billion in assets. In addition to the pension-related assets, PBGC received $325 million in other assets turned over by sponsors of terminated plans. Those recoveries not related to pensions, which are often the result of bankruptcy agreements, help to offset the shortfall between assets and liabilities. But such recoveries are relatively small, totaling less than 5 percent of all of the liabilities taken on by PBGC, reflecting the fact that the agency has relatively low priority in bankruptcy proceedings. Those 96 plans also added more than $5.8 billion in liabilities to the agency's balance sheet. Thus, the trusteed plans had an average funding ratio of about 49 percent when terminated.

Over its entire history, PBGC has assumed more than $22 billion in assets from terminated plans against $42.6 billion in total liabilities, providing an average funding ratio of about 52 percent.

Once a plan is terminated, assets are transferred to PBGC's control and deposited into a nonbudgetary account held at a custodian bank. Those assets do not appear on the federal balance sheet, and the transfer of such assets is not considered a receipt to the government. Assets in the nonbudgetary trust fund are commingled and no longer identified as originating with particular plans. At the end of fiscal year 2004, the assets in PBGC's nonbudgetary trust fund were valued at nearly $23 billion.

PBGC has broad authority to oversee and administer pension assets held in its trust fund. In a legal sense, those assets are treated as nonpublic in nature, and PBGC is free to invest and expend the funds as if it were a private fiduciary of the trust fund's holdings. PBGC can invest the assets in whatever way it chooses, as long as it acts in the best financial interest of beneficiaries.

In addition to the nonbudgetary trust fund, PBGC has several on-budget revolving funds. Payments of premiums and transfers from the trust fund for both benefit payments and administrative expenses are deposited to the revolving funds. Unlike the trust fund, the revolving funds appear on the federal government's balance sheet and provide PBGC with permanent spending authority to carry out its activities. ERISA specifies the various programs and activities for which PBGC may use its revolving funds and the types of income that may be credited to each fund. Although technically there are seven revolving funds, PBGC uses only three, and their activities are combined into one fund for reporting purposes. Any assets held in the revolving fund that are not used to pay benefits are considered unobligated balances and are available for expenditure in the next year. By law, all assets in the revolving fund must be held in Treasury securities and can earn interest income, which totaled $1.2 billion in 2004. As of the end of 2004, the unobligated balance of the revolving fund was $17 billion.[11]

PBGC transfers funds from the nonbudgetary trust fund (that is, the accumulated assets of terminated plans) to its on-budget accounts to pay a portion of retirement annuities and certain administrative costs. Such transfers are referred to as reimbursements and are recorded as offsetting collections (that is, offsets to outlays) in the budget. Generally, the proportion of benefit payments that is reimbursed from the trust fund depends on the aggregate funding level among the plans that PBGC has taken over and is adjusted periodically. In other words, if the average funding ratio of all plans taken over by PBGC is 50 percent, then half of all benefit payments originate from the nonbudgetary fund. Assets in the trust fund are liquidated and transferred to the revolving fund by PBGC from time to time, depending in part on market conditions. Transfers from the nonbudgetary trust fund can be irregular and often do not match when benefit payments are actually made. For example, the trust fund will eventually cover about half of the benefit payments made in 2004, but the reimbursements actually made during the course of the year covered less than 30 percent of benefits.

11. PBGC also has a $100 million line of credit with the Treasury Department, which it has drawn on only once—to cover the agency's startup costs—and quickly repaid.

In addition to financing benefits, proceeds from liquidated trust fund assets are also transferred to the revolving fund to pay for PBGC's administrative expenses related to terminations. Those expenses can include the cost of valuing, collecting, and managing plans' assets, paying legal expenses related to plans' terminations, and determining benefit payments for plans' participants. PBGC's other administrative expenses are currently paid directly from its revolving fund.[12]

Benefits Paid by PBGC

In the event that a single-employer pension plan undergoes either a distress or involuntary termination and PBGC becomes responsible for that plan, the accrual of all additional benefits, vesting, and the plan's other regular obligations cease. PBGC pays benefits according to the provisions of each individual pension plan up to the limits of the guarantee specified in law. To ensure that ongoing benefit payments are not interrupted, PBGC pays active annuitants an estimated benefit while the agency examines the plan. Those estimated payments sometimes result in overpayments or underpayments, which the agency reconciles once it makes its final determination about benefit levels.

PBGC's guarantees cover basic retirement benefits, most early-retirement benefits, disability benefits (when the disability occurred before the plan was terminated), and certain survivor benefits. In most cases, participants in a terminated plan receive all of the benefits that they were promised under the plan. However, ERISA places a cap on how much each participant in a terminated plan can receive, so some annuitants does not receive their full benefits. In other instances, PBGC is able to recover enough assets during a termination so that annuitants whose plan entitled them to benefits above the cap are able to collect more than the maximum guarantee.

For plans assumed by PBGC in 2005, the statutory limit on guaranteed benefits in the single-employer program is $45,614 ($3,801 monthly) for a single-life annuity beginning at age 65. The maximum guarantee is adjusted downward for those who retire before the age of 65 and upward for those who retire later. For example, the maximum guarantee for a participant who retires at age 62 is $36,035 a year (or $3,003 a month) for a single-life annuity—a reduction of roughly 20 percent. For a person who retires at age 70, the maximum guarantee is $75,719 a year (or $6,310 a month). For a beneficiary who is already retired, the age used to determine the maximum amount guaranteed is the participant's age as of the date of the plan's termination. The maximum is adjusted each year for wage growth, but once PBGC determines an individual's benefits, they remain constant.

As specified in ERISA, PBGC places some additional limits on benefits. For instance, changes to a plan that increased benefits and that were made within five years of the plan's termination are not fully guaranteed. Generally, the larger of 20 percent or $20 per month of the increased benefits is guaranteed for each full year that the increased benefits were in effect. In addition, benefits paid by PBGC are not adjusted for inflation, even if the original plan called for such increases. (Few defined-benefit plans provide for automatic inflation adjustments.) Although PBGC pays survivor benefits, they may be less generous than those promised by a plan.

Benefits themselves are normally paid on a monthly basis, unless the monthly benefit is $50 or less, in which case it is paid annually. If the net present value of pension benefits is less than $5,000, the payee usually receives a lump-sum payment, which can be rolled over into a defined-contribution pension account.

All in all, restrictions on benefits normally affect more highly paid workers and early retirees the most. PBGC estimates that about 90 percent of payees in the single-employer program receive all of the benefits that they were promised by their former plan.

In 2004, the average benefit payment in the single-employer program was $475 per month for more than 530,000 annuitants. In total, the single-employer program paid out $2.9 billion in benefit payments in 2004, up from $2.4 billion the year before.

The Multiemployer Program

The smaller multiemployer program provides insurance coverage for 9.8 million participants in about 1,600 plans. The construction and trucking industries represent about 60 percent of all insured plans and nearly 40 percent of participants in the multiemployer program. The

12. Prior to 2004, administrative expenses not directly related to terminations were paid from appropriations, which were then reimbursed by the revolving fund. Legislation enacted in 2003 eliminated the distinction between moneys covering administrative expenses related to terminations and those unrelated to terminations; now, all administrative spending is considered direct spending from the revolving fund.

vast majority of participants are in plans with more than 10,000 people, although data on multiemployer plans are limited.

As required by ERISA, PBGC's multiemployer program is legally distinct from the single-employer program. Cross-subsidization between the two programs, including mixing assets and premiums, is not permitted. Originally under ERISA, the single-employer and multiemployer plans received similar treatment by PBGC. However, the Multiemployer Pension Plan Amendments Act of 1980 (P.L. 96-364) recognized that the two types of pension plans are fundamentally different.

The funding rules that govern single-employer plans generally apply to multiemployer plans as well, but multiemployer plans are allowed to amortize increases in liabilities over longer periods of time than single-employer plans. Contribution levels for multiemployer plans are usually set through collective bargaining, which means sponsors of such plans usually have less flexibility to change contributions than sponsors of single-employer plans do. ERISA establishes a special set of rules for firms that wish to discontinue their cosponsorship of a multiemployer plan. Employers must pay a "withdrawal liability," which represents the sponsors' pro rata share of the plan's unfunded liabilities.

Because multiemployer plans are sponsored by several distinct companies, they are more diversified than single-employer plans and have historically been less likely to encounter financial difficulty. For the 10 multiemployer plans that failed prior to 1980, PBGC pays benefits directly to beneficiaries, much as it does in the single-employer program. In 2004, the agency paid benefits to a total of 320 beneficiaries from multiemployer plans, down from 1,300 beneficiaries in 1995.

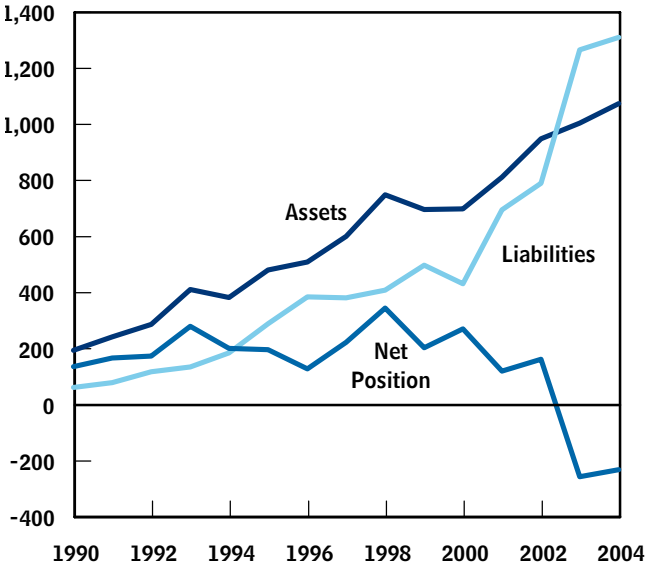
Plans that develop financial difficulty are required to pay full benefits until they run out of assets. When a multiemployer plan becomes insolvent, benefit payments can be reduced or suspended in accordance with PBGC's benefit guarantees.[13] PBGC then provides financial assistance to the plan, usually in the form of loans, which the plan uses to continue to pay benefits. Those loans continue until the plan recovers or until all vested benefits have been paid. If the plan recovers from insolvency, it is required to repay all outstanding loans, including interest, to PBGC according to "reasonable terms" set by the agency. In most cases, however, the plan never recovers, and PBGC writes off the loans. In 2004, PBGC provided $10 million worth of financial assistance to 27 multiemployer plans.

As mentioned, the multiemployer program is financed through a premium that is currently $2.60 per participant. Multiemployer plans paid a total of $25 million in premiums in 2004. Unlike the single-employer program, the multiemployer program does not require a separate premium based on the adequacy of a plan's funding. Although smaller, the multiemployer program is experiencing some of the same problems facing the single-employer program. The net position of the multiemployer program has declined rapidly over the past several years, from a surplus of $341 million in 1998 to a deficit of $236 million in 2004 (see Figure 6).

Figure 6.

The Multiemployer Program's Assets and Liabilities, 1990 to 2004

(Millions of dollars)



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

13. The current monthly guaranteed benefit for participants in multiemployer plans is up to $11 per month multiplied by the total years of service under the plan, plus 75 percent of the next $33 per month multiplied by the total years of service. That guarantee level is not indexed to inflation.

PBGC's Financial Condition and Outlook

PBGC's finances can be assessed in two ways. One approach is accrual accounting, which measures the total value of all assets held by PBGC and the total value of all liabilities the agency will be responsible for paying. The other approach is cash accounting, which tracks how much money the agency takes in each year versus the amount of money it spends. Accrual accounting is the norm within the pension industry and is a useful tool for projecting the adequacy of the agency's funding to cover benefits that will be paid decades in the future. However, the federal budget generally does not use accrual accounting and mainly operates on a cash basis. The budget also does not record the receipt of pension assets assumed by the nonbudgetary trust fund when pension plans terminate. The budget recognizes the receipt of those funds only when they are liquidated and transferred to the on-budget revolving fund to help pay for benefits and administrative expenses.

PBGC's Net Position

PBGC's overall fiscal health is usually measured by looking at its net financial position, which is defined as the difference between the program's assets and the present value of its liabilities. Assets include the current fair market value of all cash, bonds, equities, and other holdings of PBGC's trust fund and revolving fund. Liabilities are calculated as the estimated present value of all future benefits that PBGC is obligated to pay on behalf of terminated plans, those pending termination, and plans that PBGC identifies as likely to terminate. Calculating liabilities in present-value terms is a common practice in the pension industry and provides the most accurate long-range picture of PBGC's fiscal health.

From the time it began operations in 1975 through 1995, PBGC's net financial position was negative; that is, the total value of the assets on hand was not enough to cover projected future benefit payments. Over the 1975-1995 period, the agency's net financial position reached a low of -$2.6 billion in 1993. Starting in 1996, however, the situation changed and PBGC's net financial position became positive, reaching a peak of $10 billion in 2000. The pendulum swung back in 2002, and a record shortfall of $23.5 billion existed by the end of 2004 (see Table 1).

Fluctuations in the agency's net position arise mostly from changes in the financial condition of PBGC's single-employer program. Until recently, assets and liabilities within the single-employer program have tended to move together (see Figures 7 and 8). Both liabilities and assets jumped in the early 1990s as PBGC took over several large pension plans in the airline industry. For most of next decade, liabilities flattened as the agency took over relatively small plans. At the same time, the value of PBGC's assets, much of which was invested in the equities market, surged. The net position of the single-employer program reached a surplus of $9.7 billion in 2000.

Starting in 2001, however, liabilities began to swell rapidly as the agency took over several large pension plans in the airline and steel industries. From 2001 through 2003, PBGC took responsibility for roughly $25 billion in liabilities against $14 billion in assets and recoveries, resulting in claims against the agency of nearly $11 billion. At the same time, the stock market began to slump, eroding the value of PBGC's investment assets, while declining interest rates boosted the present value of its liabilities. The result was a $33 billion drop in the net position of the single-employer program from 2000 to 2004.

In a separate analysis released earlier this month, CBO estimated that the present value of PBGC's net costs for single-employer plans totals about $87 billion for the next 10 years—consisting of $23 billion from claims for plans that have already terminated or whose termination is imminent, and more than $63 billion of prospective losses (net of future premiums) for terminations that have not yet occurred.[14] CBO's estimate of $87 billion reflects the market value of PBGC's insurance, that is, the price that a private insurer would charge to accept the premiums and PBGC's insurance obligations for currently terminated plans and those that terminate during the 10-year period. It incorporates a charge for the cost of market risk, a cost that arises because investors demand compensation for the fact that new claims are likely to be higher in bad economic times, when more sponsoring firms fail, and the value of pension assets is depressed. The figure also includes all estimated losses on insured plans even though current law limits the government's

14. See Congressional Budget Office, *The Risk Exposure of the Pension Benefit Guaranty Corporation* (September 2005).

Table 1.

PBGC's Net Financial Position, 2000 to 2004

(Billions of dollars)

	2000	2001	2002	2003	2004
Single-Employer Program					
Total assets	20.8	21.8	25.4	34.0	39.0
Total liabilities	11.1	14.0	29.1	45.3	62.3
Net position	9.7	7.7	-3.6	-11.2	-23.3
Multiemployer Program					
Total assets	0.8	0.8	0.9	1.0	1.1
Present value of future benefits and nonrecoverable financial assistance	0.4	0.7	0.8	1.3	1.3
Net position	0.3	0.1	0.2	-0.3	-0.2

Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

liability to those that can financed by the income and assets available to PBGC.

In 2004, PBGC adopted a new investment policy designed to reduce its financial risk by better matching the duration of its assets and liabilities. The agency intends to increase the percentage of its portfolio invested in fixed-income securities and decrease its holdings in equities. Such a strategy means that any change in the value of the agency's liabilities should be closely matched by a change in the value of its portfolio. At the end of fiscal year 2004, about 30 percent of the agency's total assets were in equities. According to PBGC's new investment policy, it will eventually invest between 15 percent and 25 percent of its total assets in equities. During 2004, PBGC reported a $3.2 billion investment gain, $1 billion of which was from fixed-income securities and $2.2 billion from equities.

PBGC's Cash Flows

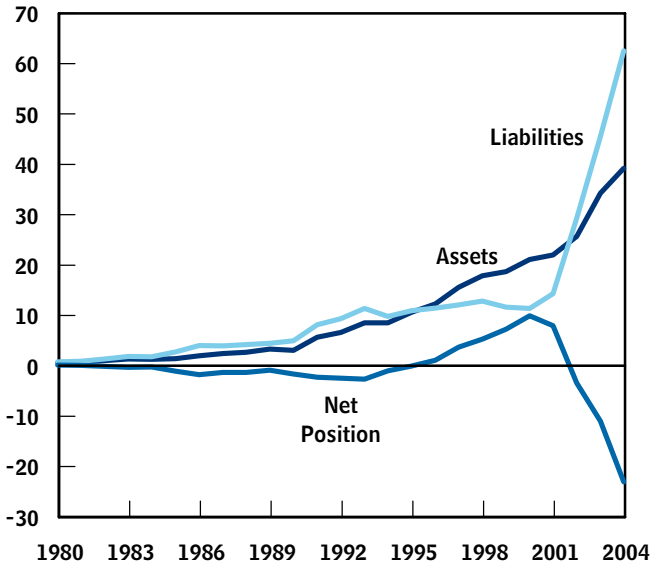
Prior to 1981, PBGC's cash flows appeared in the appendix to the federal budget but were not included in federal budget totals. Changes to ERISA enacted in 1980 mandated that PBGC's cash flows be included in the federal budget.

From its first full year of operation until 2003, PBGC took in more cash each year than it spent. According to the government's cash accounting rules, PBGC ran a cumulative on-budget surplus of more than $12 billion from 1981 through 2002. An observer looking at PBGC only on a cash basis might have concluded that it was on a firm financial footing. In running cash surpluses for so long, the agency managed to accrue substantial assets, both in the on-budget revolving fund and in the nonbudgetary fund.

Figure 7.

The Single-Employer Program's Assets and Liabilities, 1980 to 2004

(Billions of dollars)

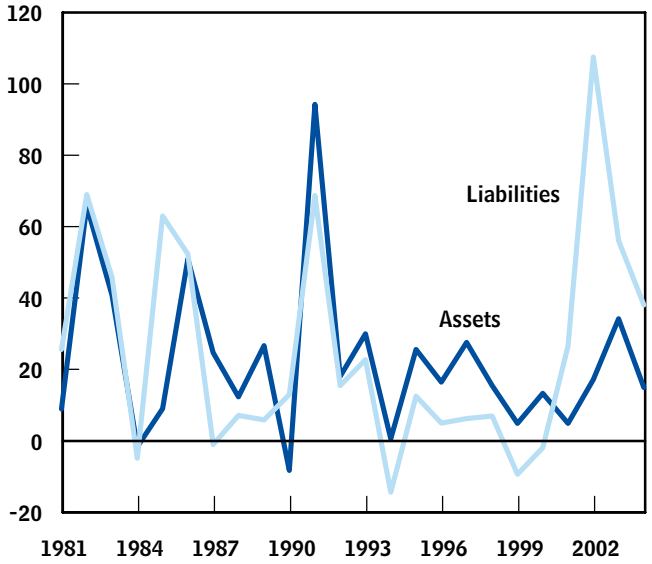


Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

Figure 8.

Annual Change in the Single-Employer Program's Assets and Liabilities, 1981 to 2004

(Percentage change)



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

In 2003, PBGC experienced its first cash deficit, spending $229 million more than it realized in receipts (see Figure 9 and Table 2). The deficit was, in part, a reflection of the fact that benefit outlays had risen by more than 250 percent over the previous three years, from $1.1 billion in 2001 to $2.9 billion in 2004. Over the same time period, on-budget receipts from the agency's various sources of income did not keep pace, increasing from $2.4 billion in 2001 to $3.4 billion in 2004. The 2003 deficit was also partly the result of an irregular pattern in the program's receipts—especially for trust fund reimbursements. In 2004, the agency once again realized a cash surplus of $247 million.

CBO's Baseline Projections

According to CBO's projections, PBGC will run cash deficits for the foreseeable future, draining its on-budget revolving fund. By CBO's calculations, that fund will run out of assets within the next 10 years.

In its baseline, CBO projects PBGC's anticipated collections and spending 10 years into the future. Those baseline projections represent CBO's best estimate as to how much money the agency will collect and spend each year over the next 10 years, under an assumption that no changes are made to the laws that govern its programs.

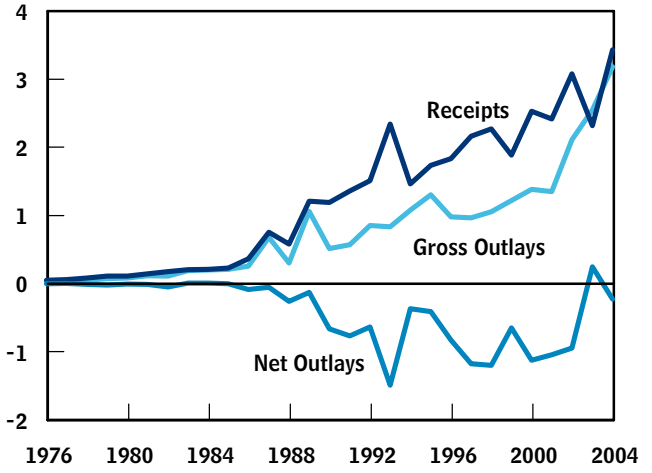
Although PBGC does not spend any federally appropriated funds, its net cash flow affects the federal budget. Because premiums, interest earnings, and other receipts are considered offsetting collections, a reduction in those receipts results in an increase in mandatory spending. If PBGC's offsetting collections are smaller than what it spends in a given year, the effect is to increase the budget deficit.

According to CBO's August 2005 baseline projections, PBGC's spending on retirement benefits and financial assistance to multiemployer plans is estimated to grow from about $4 billion in 2005 to more than $10 billion in

Figure 9.

PBGC's Outlays and Receipts, 1976 to 2004

(Billions of dollars)



Source: *Budget of the United States Government*, Appendix (various years).

Notes: Net outlays represent the surplus (-) or deficit (+) experienced by the program on a cash basis.

Spikes in the program's gross outlays are mostly the result of short-term expenses related to terminations or court-ordered benefit payments. Spikes in receipts are mostly the result of changes in premium rates or plans' underfunding (which affects collections of the variable-rate premium) and the timing of reimbursements from PBGC's nonbudgetary trust fund.

Table 2.

PBGC's On-Budget Outlays and Offsetting Collections, 2001 to 2004

(Millions of dollars)

	2001	2002	2003	2004
Outlays				
Benefit payments and financial assistance	1,101	1,883	2,277	2,883
Administrative expenses	155	210	252	278
Gross outlays	1,256	2,093	2,529	3,161
Offsetting Collections				
Premiums	-850	-864	-866	-1,139
Payments received from nonbudgetary account	-946	-1,513	-624	-1,063
Interest credited to on-budget account	-598	-676	-810	-1,206
Other[a]	-4	-5	0	0
Total collections	-2,398	-3,058	-2,300	-3,408
Net Outlays	**-1,068**	**-965**	**229**	**-247**

Sources: *Budget of the United States Government*, Appendix (various years); Pension Benefit Guaranty Corporation.

Note: A negative net outlay reduces the budget deficit; a positive net outlay increases the deficit.

a. Other offsetting collections consist mainly of payments from the nonbudgetary account to the on-budget account for services rendered.

2015, or an average of about 10 percent per year (see Table 3). PBGC's administrative expenses, including spending related to terminations, and certain categories of offsetting collections, including sponsors' payments of flat-rate and variable-rate premiums, are projected to remain fairly constant over the period. The interest credited on Treasury bonds held by the on-budget revolving fund will decline as balances in the fund fall; and reimbursement payments received from the nonbudgetary fund will have to increase steadily to cover the rising benefit payments.

CBO anticipates that PBGC will record a small surplus for 2005. Starting in 2006, CBO projects, the agency will begin spending more than it collects, with cash deficits growing steadily for the next several years—attributable mainly to increases in benefit outlays for the single-employer program. By 2015, benefit payments for the single-employer program will be roughly three-and-a-half times larger than what they were in 2004, according to CBO's estimates. Over the same period, PBGC's premium income—the main form of income covering the program's unreimbursed costs—will remain basically flat.

In CBO's estimation, PBGC's on-budget revolving fund will be completely exhausted around 2013.While there is no precedent for how PBGC will proceed if the revolving fund becomes insolvent, CBO assumes that the agency will cover its expenses by increasing the percentage of benefits and other expenses being paid by the nonbudgetary trust fund, which will still be solvent through at least 2015, according to CBO's estimates. Therefore, starting in 2013, reimbursements from the trust fund will have to increase sharply in order to cover benefit payments and administrative expenses.

Projections of on-budget cash flows do not include the assets held in or income earned by the agency's nonbudgetary trust fund, except to the extent that they are transferred to the on-budget account. When a plan fails and is assumed by PBGC, the total value of the nonbudgetary trust fund tends to increase much more than the initial increase in PBGC's outlays for benefits because the transfer of the plan's assets takes place almost immediately and benefits are paid out over a long period of time. Consequently, the size of the nonbudgetary trust fund can be a misleading indicator of PBGC's financial health.

Under current law, no substantial source of funds is available to PBGC if it runs out of money. Premium rates are set by law and cannot be changed by the agency itself. Other than a $100 million line of credit with the Treasury Department, no source of additional funding for the agency exists. In the event that PBGC were to exhaust all

Table 3.

CBO's Baseline Projections for the Pension Benefit Guaranty Corporation, 2005 to 2015

(Millions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Outlays											
Benefit payments and financial assistance	3,923	5,192	5,690	6,299	6,962	7,522	8,098	8,726	9,254	9,690	10,170
Administrative expenses	353	441	455	472	487	489	486	480	463	436	407
Gross outlays	4,276	5,633	6,145	6,771	7,449	8,011	8,584	9,206	9,717	10,126	10,577
Offsetting Collections											
Premiums	-1,559	-1,284	-1,259	-1,518	-1,486	-1,430	-1,383	-1,392	-1,403	-1,414	-1,428
Payments received from nonbudgetary account	-2,070	-2,882	-3,174	-3,530	-3,921	-4,258	-4,607	-4,989	-6,387	-8,687	-9,123
Interest credited to on-budget account	-758	-714	-655	-598	-514	-409	-282	-135	-29	-25	-26
Total collections	-4,387	-4,880	-5,088	-5,646	-5,921	-6,097	-6,272	-6,516	-7,819	-10,126	-10,557
Net Outlays	**-111**	**753**	**1,057**	**1,125**	**1,528**	**1,914**	**2,312**	**2,690**	**1,898**	**0[a]**	**0[a]**

Source: Congressional Budget Office.

Note: A negative net outlay reduces the budget deficit; a positive net outlay increases the deficit.

a. According to CBO's projections, PBGC's on-budget revolving fund will be exhausted after 2013. See the discussion on page 17.

of its holdings, either benefit payments would be drastically cut or the Congress would have to enact a bailout. The Center on Federal Financial Institutions estimates that if PBGC's assets are eventually exhausted, its ongoing income would fund only about 10 percent of its annual benefit obligations.[15]

Uncertainties About PBGC's Future

PBGC is an agency that, by its very nature, faces many uncertainties. As an insurer, it bears many of the risks incurred by private pension plans. Those risks are influenced by many factors outside of the agency's control, such as investment decisions by plans' sponsors, the vagaries of the private equities market, the general state of the economy, and the financial condition of sponsors. Although large in terms of the agency's history, the $33 billion swing in PBGC's net position over the past four years is not necessarily an isolated incident, but an example of how an economic downturn, low interest rates, and the termination of several large plans can produce dramatic changes in the agency's financial picture.

During the late 1990s, the run-up in the stock market caused the value of assets held in defined-benefit pension plans to swell, so many previously underfunded plans became fully funded according to the measures specified by ERISA. In 1996, almost half of all single-employer plans were sufficiently underfunded that they had to pay the variable-rate premium; by 2000, just 28 percent of plans had to. However, as economic conditions deteriorated, the financial position of many pension plans suddenly changed for the worse. In 2003, about 55 percent of plans were required to pay the variable-rate premium.

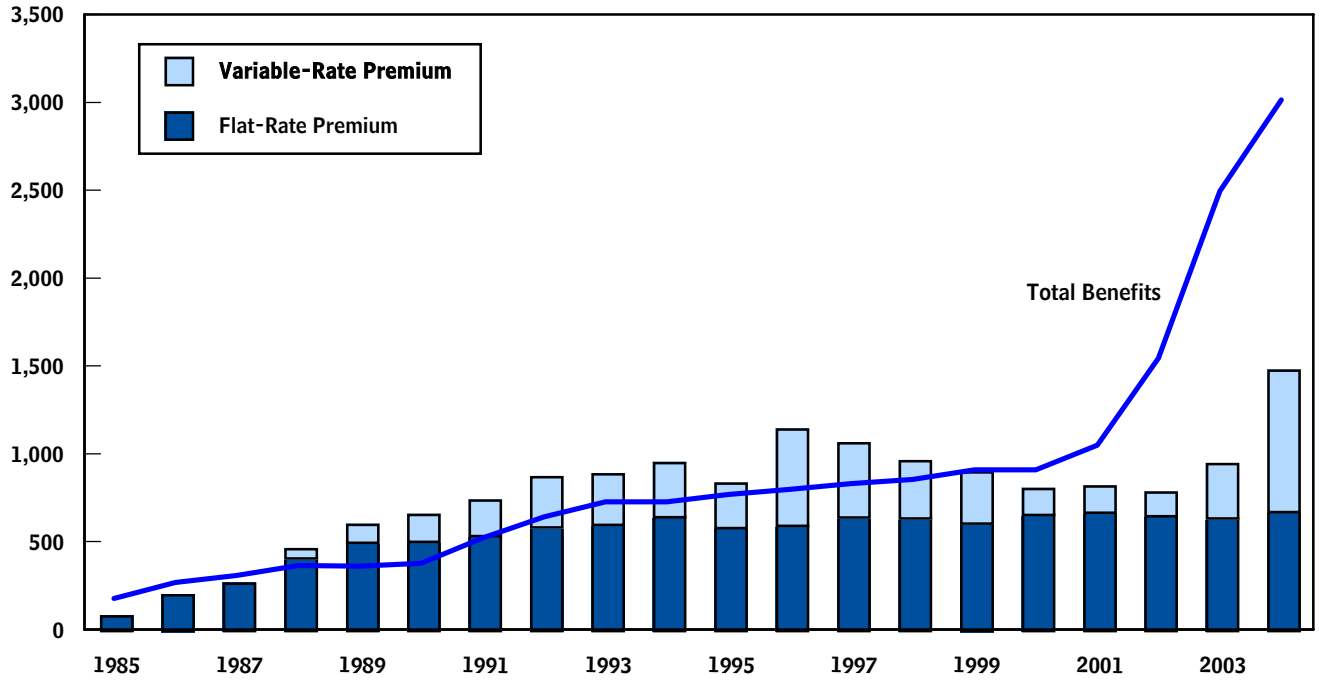
Since 2000, the extent of underfunding among PBGC-insured plans has measurably increased. Partly a function of the drop in the stock market, it is also a result of low interest rates. The extended period of low interest rates has pushed the present value of pension liabilities upward, causing more plans to become underfunded. Consequently, sponsors faced a twofold financial pressure: having to put more money into their plans to reduce

15. See Douglas J. Elliot, "PBGC: When Will the Cash Run Out?" Center on Federal Financial Institutions (September 13, 2004).

Figure 10.

Income from Premiums Compared with Total Benefit Payments in the Single-Employer Program, 1985 to 2004

(Millions of dollars)



Source: Pension Benefit Guaranty Corporation, *Pension Insurance Data Book, 2004*, no. 9 (Spring 2005).

underfunding and making variable-rate premium payments to PBGC because of their underfunding. The need to divert more money to funding their pension plans, combined with other systemic business problems, helped push some companies into bankruptcy.

The prevalence of underfunding may reflect a belief held by some sponsors that the performance of their plan's investments can eventually overcome a shortfall in contributions. They may also feel that, even though contributions are tax-deductible, other activities are more valuable to their company's financial success.

Fluctuations in plans' funding levels have several effects on PBGC's cash flows. Because the agency's variable-rate premium is charged to underfunded plans, as underfunding increases, so too does income from premiums. But while greater underfunding may cause premium income to increase, it also tends to increase the size of claims to be paid by PBGC if and when underfunded plans terminate (see Figure 10).

The performance of the stock market, long-term interest rates, the pace at which sponsors fund their pension obligations, and bankruptcy rates among plans' sponsors will all play important roles in determining the future financial performance of PBGC. But it appears unlikely that the agency will be able to pay all insured benefits for terminated plans in the coming years without substantial additional financial resources.

Glossary

Accrual accounting: A way of tracking transactions at the time a liability is incurred or a receivable is promised rather than when cash is paid or received.

Annuitant/beneficiary: Someone who is actively receiving regular payments from a pension plan, including retired workers, as well as surviving spouses and children.

Asset value: Total value on the open market of all bonds, equities, and other investments held by a plan; also termed the mark-to-market value. The Employee Retirement Income Security Act and the tax code allow plans to "smooth" asset valuations to avoid fluctuations due to investment gains and losses.

Benefit accrual: The normal increase in benefits that results from an increase in covered service or salary.

Cash-balance plan: A type of defined-benefit pension plan in which the employer makes regular contributions (usually based on salary) to hypothetical individual accounts on behalf of its employees. The balance in each account grows according to interest credits determined by the sponsor. Benefits are based on the total balance in each account upon retirement. Although cash-balance plans resemble defined-contribution plans in many respects, from a legal point of view they are considered defined-benefit plans.

Cash flow: A cash receipt or outlay for a particular period of time.

Claim: A present-value measure of the cost to the Pension Benefit Guaranty Corporation for a terminated plan. It is the net difference between a plan's assets and termination liabilities.

Covered plan: A defined-benefit pension plan meeting certain criteria contained in the Employee Retirement Income Security Act and the tax code that allow contributions to the plan to be tax-deferred. Such plans are required to have their benefits insured by the Pension Benefit Guaranty Corporation.

Deferred annuitant: Someone who is entitled to receive retirement benefits from a pension plan but is no longer employed by the plan's sponsor and has not yet reached the plan's required age for collecting benefits.

Deficit reduction contributions (DRCs): Payments by sponsors of certain pension plans that are determined to be underfunded under the Employee Retirement Income Security Act and the tax code. The sponsors must make DRCs in addition to normal pension contributions for the regular accrual of benefits.

Defined-benefit plan: A type of pension plan under which benefits are based on a formula that usually depends on participants' length of service and salary history. Plans' sponsors are required to contribute enough to ensure that promised benefits can be paid. Employees are usually not required to make contributions to defined-benefit plans.

Defined-contribution plan: A type of pension plan under which deposits are made to individual accounts by

employers and/or employees and benefits depend on the total assets accrued in each account.

Discount rate: Interest rate used to determine the present value of future pension payments.

Distress termination: A termination of an underfunded pension plan initiated by a sponsor in severe economic distress or bankruptcy. In order to qualify for a distress termination and have the plan assumed by the Pension Benefit Guaranty Corporation, the sponsor must meet rules prescribed by the Employee Retirement Income Security Act.

ERISA: The Employee Retirement Income Security Act of 1974. Along with the tax code, ERISA is the law that governs employee benefits, including pensions. It established the Pension Benefit Guaranty Corporation and required sponsors of qualified defined-benefit plans to insure their pension benefits with the agency.

Flat-rate premium: An annual per-participant premium charged to both single-employer and multiemployer plans covered by the Pension Benefit Guaranty Corporation (PBGC). Single-employer plans are charged $19 per participant; multiemployer plans are charged $2.50 per participant. Those rates are set in law and cannot be altered by PBGC.

Full-funding limit: The maximum amount a sponsor is required to contribute to its pension plan in a given plan year. Plans that have reached the full-funding limit are exempt from paying the variable-rate premium.

Funding ratio: The proportion of assets to liabilities held by a pension plan. For example, a plan that has assets of $20 million and liabilities of $16 billion has a funding ratio of 125 percent.

Funding standard account: An accounting device used to determine the amount of contributions that is due from a plan's sponsor for the normal accrual of benefits as well as changes to the plan's benefit structure.

Group annuity purchase: The sale of pension liabilities to a private insurance provider. Benefits no longer accrue to the plan and the insurance provider becomes responsible for paying all remaining pension benefits.

Hybrid pension plan: A defined-benefit pension plan that has characteristics similar to those of a defined-contribution plan. Cash-balance plans are a type of hybrid pension plan.

Involuntary termination: The procedure by which the Pension Benefit Guaranty Corporation (PBGC) initiates the termination of a pension plan. For PBGC to conduct an involuntary termination, the plan must meet certain criteria specified by the Employee Retirement Income Security Act. In general, involuntary termination must occur when a plan is unable to pay benefits and may occur in cases in which PBGC determines that allowing a plan to continue will lead to unreasonable increases in unfunded liabilities.

Liability: A present-value measure of pension benefits. There are various ways to measure pension liability.

- Under the Employee Retirement Income Security Act, *accrued liability* is the present-value measure of benefits based on current service and projected pay used to determine a plan's funding; it incorporates long-term assumptions to reflect expectations about future benefits.
- Under the Employee Retirement Income Security Act, *current liability* is the present-value measure of benefits based on current pay and service used to determine a plan's funding; it incorporates assumptions to reflect the value of benefits today.

- *Termination liability* is the present-value measure of benefits at a particular date after which no more liabilities accrue and no additional contributions are made to a plan. The Pension Benefit Guaranty Corporation's termination liability is adjusted to account for any legal limitations that may apply to benefits provided by the plan.

Maximum deductible contribution: The maximum amount a sponsor can contribute to its pension plan without paying taxes on its contributions. Contributions above the maximum are subject to regular corporate taxes plus a 10 percent excise tax.

Multiemployer pension plan: A kind of defined-benefit pension plan that is sponsored by multiple firms usually in a common industry in which employees frequently switch employers (such as construction and trucking). Contributions to the plan are collectively bargained by the employing firms and union representatives; benefits are set by a board of trustees, which also administers the plan.

Net position: The difference between the Pension Benefit Guaranty Corporation's total assets and liabilities, calculated on a present-value basis. Liabilities include the claims of plans it considers probable to terminate.

Nonbudgetary trust fund: A fund in which assets, outlays, and receipts are not included in the federal budget. In the Pension Benefit Guaranty Corporation's case, assets and recoveries from terminated plans are placed in a nonbudgetary trust fund, where they are managed until they are liquidated and transferred to the agency's revolving fund.

On-budget: The status of outlays and receipts that are recorded by the federal budget.

Participant: An individual who is vested in a covered pension plan. Participants can be currently employed, vested but separated, or former employees who are collecting annuities.

Plan year: A 12-month period of time during which a pension plan is required to make certain calculations and perform certain tasks. The plan year does not necessarily correspond with the calendar year or fiscal year. For example, a particular plan might record its plan year 2005 as running from July 1, 2005, through June 30, 2006.

Present value: A method of measuring liabilities that involves discounting payments that will be made in the future back to current dollars.

Probable termination: A termination that the Pension Benefit Guaranty Corporation believes is likely in the foreseeable future. The agency uses these criteria to help identify such a plan: the plan's sponsor is in Chapter 11 bankruptcy; the sponsor has granted security to an unsecured creditor as part of renegotiation of debt; the sponsor is known to be in default on existing debt; the sponsor's unsecured debt is rated CCC+/Caa1 by Standard & Poor's or Moody's, respectively. The Pension Benefit Guaranty Corporation may also consider other factors to determine how likely a plan is to terminate.

Qualified plan: See "covered plan."

Reasonably possible termination: A termination by a plan that the Pension Benefit Guaranty Corporation believes is at high risk in the foreseeable future but that is not classified as probable. The agency uses these criteria to help identify such a plan: the plan's sponsor is in Chapter 11 bankruptcy; the sponsor has missed the minimum funding contribution; the sponsor's bond rating is below investment grade; the sponsor has no bond rating but the ratio of long-term debt plus unfunded benefit liabilities to the market value of shares is 1.5 or greater.

Recoveries: Nonpension assets that the Pension Benefit Guaranty Corporation assumes from a sponsor when its plan is terminated.

Reimbursements: Transfers of assets from the Pension Benefit Guaranty Corporation's nonbudgetary trust fund to its on-budget revolving fund. These transfers, which are recorded as offsetting collections in the budget, are used to reimburse the agency for benefit payments and certain administrative costs related to terminations.

Revolving fund: A type of federal budget account that makes outlays for a specific purpose and is regularly replenished by receipts intended for the same purpose. The Pension Benefit Guaranty Corporation (PBGC) has seven revolving funds, although only three of them are actively used. Interest may accrue on assets held in a revolving fund. For reporting purposes, PBGC combines the activities of its revolving funds.

Single-employer pension plan: A defined-benefit pension plan that is sponsored by a single firm.

Sponsor: An employer that establishes a pension plan and makes regular payments to it.

Standard termination: A termination in which a single-employer plan is voluntarily terminated by the plan's sponsor and its assets are adequate to cover its liabilities. The Pension Benefit Guaranty Corporation oversees standard terminations but does not become responsible for paying benefits. Participants can choose to take lump-sum payments or have their benefits paid through a private insurance company.

Trustee: The Pension Benefit Guaranty Corporation's status when it assumes legal and financial responsibility for the assets and liabilities of a covered pension plan.

Variable-rate premium: A premium charged annually to single-employer pension plans covered by the Pension Benefit Guaranty Corporation (PBGC). The variable-rate premium, charged only to plans that are considered underfunded under the Employee Retirement Income Security Act, is currently $9 per $1,000 of underfunding. Under certain circumstances, plans that are considered underfunded are exempt from paying the variable-rate premium. This premium is set by statute and cannot be altered by PBGC.

Vesting: The provision of retirement benefits that cannot be forfeited, occurring when a participant reaches a plan's particular service requirements and otherwise qualifies.