



# Pension Benefit Guaranty Corporation (PBGC): A Fact Sheet

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## Summary

The Pension Benefit Guaranty Corporation (PBGC) is a federal government agency established in 1974 by the Employee Retirement Income Security Act (ERISA; P.L. 93-406). It was created to protect the pensions of participants and beneficiaries covered by private sector, *defined benefit* (DB) plans. These pension plans provide a specified monthly benefit at retirement, usually either a percentage of salary or a flat dollar amount multiplied by years of service. *Defined contribution* plans, such as §401(k) plans, are not insured. The PBGC is chaired by the Secretary of Labor, with the Secretaries of the Treasury and Commerce serving as board members.

The PBGC runs two distinct insurance programs for single-employer and multiemployer plans. Multiemployer plans are collectively bargained plans to which more than one company makes contributions. PBGC maintains separate reserve funds for each program. In FY2011, the PBGC insured about 27,066 DB pension plans covering 44.2 million people. The PBGC paid or owed benefits to 1.5 million people and took in 152 newly terminated pension plans. A firm must be in financial distress to end an underfunded plan. Most workers in single-employer plans taken over by PBGC receive the full benefit earned at the time of termination, but the ceiling on multiemployer plan benefits that could be guaranteed has left almost all of these retirees without full benefit protection.

In the 111<sup>th</sup> Congress, H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (P.L. 111-192) provided defined benefit pension plans sponsors some relief from funding requirements. In the 112<sup>th</sup> Congress, an amendment offered by Senate Majority Leader Harry Reid to S. 1813, Moving Ahead for Progress in the 21<sup>st</sup> Century (MAP-21), contains provisions that would address the use of excess defined benefit pension plan assets and the interest rates that defined benefit plans use to value plan liabilities.

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## Pension Benefit Guaranty Corporation

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The PBGC runs two distinct insurance programs: single-employer and multiemployer plans. Multiemployer plans are collectively bargained plans to which more than one company makes contributions. The PBGC maintains separate reserve funds for each program. In FY2011, the PBGC insured about 27,066 DB pension plans covering 44.2 million people. It paid or owed benefits to 1.5 million people and took in 152 newly terminated pension plans. A firm must be in financial distress to end an underfunded plan. Most workers in single-employer plans taken over by the PBGC receive the full benefit earned at the time of termination, but the ceiling on multiemployer plan benefits that could be guaranteed has left almost all of these retirees without full benefit protection.

### PBGC Financing

The PBGC is required by ERISA to be self-supporting and receives no appropriations from general revenue. The most reliable source of PBGC revenue is the premiums set by Congress and paid by the private-sector employers that sponsor DB pension plans. Other sources of income are assets from terminated plans taken over by the PBGC, investment income, and recoveries collected from companies when they end underfunded pension plans. The PBGC is authorized to borrow up to \$100 million from the U.S. Treasury. P.L. 96-364 requires that the PBGC's receipts and disbursements be included in federal budget totals.

### Premiums

The minimum annual premium charged for each participant in a single-employer DB plan was raised for the 2006 plan year from \$19 to \$30 by the Deficit Reduction Act (DRA) of 2005 (P.L. 109-171). This law also raised the multiemployer plan premium from a flat \$2.60 annually per participant to \$8. Because these premiums are now adjusted for inflation, the 2012 rates will be \$35 and \$9, respectively. The DRA added a new \$1,250 per participant premium for certain plans terminated after 2005. This premium is payable for the year of termination and each of the next two years. An additional premium of \$9 for each \$1,000 of "unfunded vested benefits," as newly defined by the Pension Protection Act of 2006 (PPA; P.L. 109-280), is assessed against plans that are not fully funded. Effective in 2008, the PPA also eliminated certain exemptions from this variable premium.

### Pension Benefit Guaranty

ERISA sets a maximum on the individual benefit amount that the PBGC can guarantee. The ceiling for single-employer plans is adjusted annually for national wage growth. The maximum

pension guarantee is \$55,840 a year for workers aged 65 in plans that terminate in 2012. This amount is adjusted annually and is decreased if a participant retires before age 65 or if the pension plan provides benefits in some form other than equal monthly payments for the life of the retiree. Only “basic benefits” are guaranteed. These include benefits beginning at normal retirement age (usually 65), certain early retirement and disability benefits, and benefits for survivors of deceased plan participants. Only vested benefits are insured. The median monthly benefit received in FY2009 was \$305. In 2006, PBGC indicated that 84% of PBGC recipients received their full benefits.

In contrast, the ceiling on guaranteed benefits for multiemployer plans is not adjusted annually. The amount set in 1980 did not change until the Consolidated Appropriations Act, 2001 (P.L. 106-554) became law in December 2000. These plans determine benefits by multiplying a flat dollar rate by years of service, so the benefit guaranty ceiling is tied to this formula. The new ceiling equals 100% of the first \$11 of monthly benefits per year of service plus 75% of the next \$33 of monthly benefits per year of service.

## Current Financial Picture

**Table 1** provides information on the net financial position from FY2002 through FY2011. In 1996, the PBGC showed a surplus in its single-employer program for the first time in its history. That surplus peaked at \$9.7 billion in 2000, helped by the strong performance of the equity markets in the 1990s.

**Table 1. PBGC Single and Multi-Employer Insurance Programs: Net Financial Position, FY2002 -FY2011**

(billions of dollars)

Fiscal Year	Single Employer Program	Multi-Employer Program	Total PBGC Deficit
2002	-3.6	0.2	-3.5
2003	-11.2	-0.3	-11.5
2004	-23.3	-0.2	-23.5
2005	-22.8	-0.3	-23.1
2006	-18.1	-0.7	-18.9
2007	-13.1	-1.0	-14.1
2008	-10.7	-0.5	-11.2
2009	-21.1	-0.9	-21.9
2010	-21.6	-1.4	-23.0
2011	-23.3	-2.8	-26.0

Source: PBGC.

The weakness in the economy in 2001, particularly in the steel and airline industries, led to large and expensive plan terminations that eliminated the surplus. By the end of 2004, the single-employer program had a deficit of \$23.3 billion. The deficit was \$13.1 billion at the end of 2007 and \$10.7 billion at the end of FY2008. The deficit increased to \$21.1 billion at the end of FY2009, \$21.6 billion at the end of FY2010, and \$23.3 billion at the end of FY2011. The

multiemployer program had a surplus from 1982 to 2002, but the PBGC reported that it had a deficit of \$473 million at the end of FY2008, \$869 million at the end of FY2009, \$1.4 billion at the end of FY2010, and \$2.8 billion at the end of FY2011.

## **Defined Benefit Pension Funding**

To ensure that sufficient money is available to pay promised pension benefits to participants and beneficiaries, ERISA sets rules that require plan sponsors to fully fund the pension liabilities of defined benefit plans. The funding requirements of ERISA recognize that pension liabilities are long-term liabilities. Consequently, plan liabilities need not be funded immediately, but instead can be amortized (paid off with interest) over a period of years.

The assets of the pension plan must be kept in a trust that is separate from the employer's general assets. Assets in the pension trust fund are protected from the claims of creditors in the event that the plan sponsor files for bankruptcy. ERISA requires employers that sponsor defined benefit plans to fund the pension benefits that plan participants earn each year. This is referred to as funding the target normal cost of the plan. In addition, the funding obligation for plan sponsors may be affected by the following:

- Pension benefits granted to employees for past service, but for which no monies were set aside.
- Increases in the level of benefits by plan amendment.
- Changes in the present value of future benefit obligations as a result of interest rate changes. Because DB pension benefits are generally paid as a stream of payments over several years in the future, the plan calculates a current value of the benefits by discounting the future cash flows using a specified interest rate. Changes in the interest rate cause the value of future benefit obligations—and the amount that plans must set aside to meet them—to change.
- Changes in the value of investments. Since many pension plans invest a least a portion of their assets in equities and other financial assets like bonds, changes in the stock market and other financial markets cause changes in the value of pension plans' assets. Decreases in value of investments must be made up by increases in plan sponsor contributions while increases in the value of investments may be used to offset future funding obligations.

Pension plan underfunding has increased in recent years. An analysis by Milliman found that the average funding by the 100 largest corporate DB plans has been less than 100% since July 2008 and was 72.4% as of December 31, 2011.<sup>1</sup>

## **Funding Relief Enacted in the 111<sup>th</sup> Congress**

The funding obligations for pension plans increased sharply in 2008 as a result of the economic recession that began in December 2007. Three factors have contributed to the increase in DB

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<sup>1</sup> Details of the analysis are available at <http://www.milliman.com/expertise/employee-benefits/products-tools/pension-funding-index/>.

pension plans sponsors' funding obligations: (1) the PPA changed some of the methods that plan sponsors use to value plan assets and liabilities; (2) the decline in the stockmarket in 2008 caused the value of pension plan assets to decrease because many pension plans hold part of their portfolios in equities; and (3) the decline in interest rates caused the value of pension plan benefit obligations to increase. In addition, the economic downturn may have hurt the ability of some pension plans to pay for their funding obligations. Some have suggested that monies that plan sponsors would use to fund their benefit obligations would be better spent on other, more immediate company priorities.

Congress provided funding relief to DB pension plan sponsors in 2010 in H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (P.L. 111-192), which was introduced by Representative John Dingell on October 29, 2009. The bill passed the House on November 7, 2009, and did not contain any pension funding relief provisions. On June 18, 2010, an amended bill passed the Senate. The Senate approved bill contains funding relief provisions. The House passed the Senate's amendment to H.R. 3962 on June 24, 2010. The president signed the bill into law on June 25, 2010.<sup>2</sup>

### **Single-Employer Funding Relief**

Changes to a pension plan's funding level that result in increased required funding by a plan sponsor may be amortized over a period of seven years. P.L. 111-192 allowed pension plan sponsors to amortize their funding shortfalls either over nine years, with the first two years of payments consisting of interest only on the amortization charge and the next seven years consisting of interest and principal, or over 15 years.

P.L. 111-192 contained provisions that required plan sponsors that chose one of these amortization schedules to make additional contributions to the plan if the plan sponsors pays excess compensation or declares extraordinary dividends.

Specifically, the provisions required additional contributions to the plan from plan sponsors that

- provided more than \$1 million in compensation to any employee;<sup>3</sup> and
- (1) paid dividends or redeem company stock greater than the value of a company's net income for the prior year or (2) paid dividends greater than the sum of a company's dividends in the previous five years.

### **Certain Other plans**

A provision allowed funding relief to plans that would otherwise be ineligible. Certain rural cooperatives and defense contractors were allowed to delay the implementation of the funding

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<sup>2</sup> Section 202 of the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA; P.L. 110-458) allowed some firms to delay the implementation of increased funding requirements that were required by the PPA. For more information on this provision, see CRS Report R40171, *The Worker, Retiree, and Employer Recovery Act of 2008: An Overview*, by Jennifer Staman.

<sup>3</sup> The following are exempted from the calculation of compensation: (1) amounts set aside for paying deferred compensation as part of a nonqualified deferred compensation arrangement; (2) compensation for services performed before March 1, 2010; and (3) payments for certain types of compensation as a result of a contract that was in effect prior to March 1, 2010.

requirements of the PPA. PBGC settlement plans were not subject to any of the provisions of the PPA. These plans would otherwise be ineligible for the funding relief provisions currently under consideration. P.L. 111-192 allows these plans to choose either the nine year amortization period (with the first two years of payments consisting of interest only on the amortization charge) or the 15-year amortization period.

### **Plans Run by Charities**

A credit balance is an amount of a plan sponsor's contributions to a pension plan that exceed the minimum funding requirement. Under current law, plans that are funded in excess of 80% may apply previous years' credit balances to offset the current year's required funding. P.L. 111-192 allowed charities as described in 26 U.S.C. 501(c)(3) to use prior years' credit balances if the plan was least 80% funded in the plan year that ended prior to September 1, 2008.

### **Multiemployer plans**

Multiemployer plans may currently amortize their investment losses over a 15-year period. Under the DB funding provisions passed in P.L. 111-192, multiemployer plans can

- elect to amortize their net investment losses over 30 years if the plan sponsor can certify the plan's solvency over the amortization period; and
- use asset valuation methods that result in asset values that range from 80% to 130% of market value. They could use these valuation methods for up to 10 years.

Multiemployer plans that elect to use either of these funding relief methods are not be allowed to increase plan benefits for two years unless the benefit increases are funded by additional contributions to the plan.

### **Pension Funding Legislation Introduced in the 112<sup>th</sup> Congress**

The funding obligations for pension plans continue to be a concern for some policymakers. Some have argued that because of the low interest rates of recent years, the valuation of pension plan liabilities is much higher than is necessary to ensure that pension plans are able to pay current and future benefits to plan participants.<sup>4</sup> They feel that allowing pension plans sponsors to contribute less than current law requires would allow plan sponsors to invest funds in their businesses that they would otherwise have to contribute to their pensions.<sup>5</sup> Although funding relief would allow companies to divert funds for investment purposes, plan sponsors may be reluctant to use funding relief if restrictions were attached to the use of funds saved.<sup>6</sup> Others disagree. A recent article

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<sup>4</sup> For example, in testimony to the House Subcommittee on Health, Employment, Labor, and Pensions Subcommittee of the House Education and Workforce Committee, Ken Porter called current interest rates "artificially low." His testimony is available at [http://edworkforce.house.gov/UploadedFiles/02.02.12\\_porter.pdf](http://edworkforce.house.gov/UploadedFiles/02.02.12_porter.pdf).

<sup>5</sup> See, for example, Hazel Bradford, "Pension Funding Changes Could Offer Some Relief," *Pensions&Investments*, March 19, 2012, available at <http://www.pionline.com/article/20120319/PRINTSUB/303199978/pension-funding-changes-could-offer-some-relief>.

<sup>6</sup> For example, the Business Roundtable indicated that less than 5% of eligible companies elected the funding relief that became available in 2010. Their statement is available at <http://businessroundtable.org/news-center/pension-funding-stabilization-communication-to-key-senate-staff/>. The 2010 funding relief required additional pension plans (continued...)



noted that “American corporations are sitting on record amounts of cash.”<sup>7</sup> Yet others have expressed a concern that funding relief would exacerbate current pension plan underfunding.<sup>8</sup> They argue that pension plan contributions are an obligation incurred by companies and that greater underfunding could lead to greater losses for PBGC if these underfunded plans are terminated and are trusted by PBGC.<sup>9</sup>

## Interest Rate Stabilization

The Pension Protection Act of 2006 (PPA; P.L. 109-280) specified that pension plans discount their future benefit obligations using one of three discount rates. The rate to be used, called a segment rate, depends on the date on which the benefit obligation is expected to be paid and the corresponding rates on the corporate bond yield curve.<sup>10</sup> The segment rates are calculated as the average of the corporate bond yields within the segment for the preceding 24 months. The first segment is for benefits payable within five years. The second segment is for benefits payable in 5 to 15 years. The third segment is for benefits payable in 15 years or later.

S. 1813, Moving Ahead for Progress in the 21<sup>st</sup> Century (MAP-21), which passed the Senate on March 14, 2012, would, among other provisions, affect pension plan funding. The Pension Funding Stabilization provision in MAP-21 would allow for the segment rates to be adjusted if they are below or above specified (called the “applicable”) minimum and maximum percentages of the average of the rates for the preceding 25 years. Segment rates that are lower than the applicable minimum percentage of the average of the corporate bond yields for the preceding 25 years would be set to the applicable minimum percentage of the average. Segment rates that are higher than the applicable maximum percentage of the average of the segment rates for the preceding 25 years would be set at the applicable maximum percentage of the average. The minimum and maximum percentages are listed in **Table 2**. For example, the first segment rate (for benefits payable within five years) is calculated as the average of short-term corporate bond yields for the previous 24 months.<sup>11</sup> For April 2012, this first segment rate was 1.90%.<sup>12</sup> If this segment rate is less than 90% of the average of corporate bond yields for the preceding 25 years, then, for the purposes of calculating pension obligations that will be paid within five years, the

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(...continued)

contributions from plan sponsors who chose funding relief and who (1) provided excess compensation to company executives, (2) engaged in stock buybacks above specified levels, or (3) paid dividends to shareholders above specified levels.

<sup>7</sup> See, for example, Jacqueline Doherty, “Where Is All That Corporate Cash, Anyway?,” *Barron’s Online*, December 10, 2011, available at [http://online.barrons.com/article/SB50001424052748704048804577082712227921128.html#articleTabs\\_panel\\_article%3D1](http://online.barrons.com/article/SB50001424052748704048804577082712227921128.html#articleTabs_panel_article%3D1).

<sup>8</sup> See, for example, Fitch Ratings, “Pension Funding Relief May Again Prove Counterproductive,” March 8, 2012, available at <http://www.fitchratings.com/web/en/dynamic/articles/Pension-Funding-Relief-May-Again-Prove-Counterproductive.jsp>.

<sup>9</sup> See, for example, Roger Lowenstein, “Don’t Let Corporations Slash Pension Payments,” *Bloomberg*, March 11, 2012, available at <http://www.bloomberg.com/news/2012-03-11/don-t-let-corporations-slash-pension-payments-roger-lowenstein.html>.

<sup>10</sup> The yield curve is a graph that relates the maturity of a bond to the interest rate that bondholders receive for a bond of that maturity.

<sup>11</sup> See IRS Notice 2007-81 for more details on IRS calculations of the segment rates. This notice is available at [http://www.irs.gov/irb/2007-44\\_IRB/ar08.html](http://www.irs.gov/irb/2007-44_IRB/ar08.html).

<sup>12</sup> See IRS Notice 2012-28, available at <http://www.irs.gov/pub/irs-drop/n-12-28.pdf>.

segment rate would be adjusted upward until it is equal to 90% of the average for the preceding 25 years.

**Table 2. Applicable Minimum and Maximum Interest Rate Percentages of 25 Year Averages for Pension Funding in S. 1813, as Passed by the Senate**

<b>Calendar Year</b>	<b>Applicable Minimum Percentage</b>	<b>Applicable Maximum Percentage</b>
2012	90%	110%
2013	85%	115%
2014	80%	120%
2015	75%	125%
After 2015	70%	130%

**Source:** *Congressional Record*, March 13, 2012, p. S1625.

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