

THE PENSION BENEFIT GUARANTY CORPORATION 2004 ANNUAL REPORT: AN AGENCY FACING FINANCIAL CHALLENGES

The Pension Benefit Guaranty Corporation (PBGC) protects the pensions of 44 million workers and retirees in 31,000 private defined benefit pension plans.¹ A pension plan of this type provides a specified monthly benefit at retirement, usually based on salary or a stated dollar amount and years of service. The PBGC provides benefits to a worker in these plans if the plan is ended with insufficient funding to pay its promised benefits and the employer is in financial distress.

The PBGC provides a maximum guaranteed benefit of \$45,614 for a single life pension (payable as an annuity over the life of the participant) received at age 65 in 2005, with a reduction for benefits received earlier. In 2004, it paid annual benefits of more than \$3 billion to 518,000 people in terminated plans.

PBGC's operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, as well as investment income, assets from underfunded pension plans it has taken over, and recoveries from companies formerly responsible for the plans. The PBGC maintains separate insurance programs for single-employer defined benefit plans and for multiemployer defined benefit plans. Single-employer plans are sponsored by a single employer for its employees, while multiemployer plans are collectively bargained plans to which more than one unrelated employer contributes.

A record deficit

The 2004 Annual Report for the PBGC indicates that the agency is facing the most significant financial challenges it has confronted in more than a decade. At the end of fiscal year 2004 (September 30, 2004), the PBGC's single-employer insurance program had a record deficit of \$23.3 billion, more than doubling its record deficit of the year before. This figure compares to its total assets of \$39 billion at the end of the fiscal year.

Causes of the deficits

Claims made by companies on PBGC's pension benefit insurance are sensitive to changes in interest rates and stock returns, overall economic conditions, underfunding in some large plans, the economic performance of particular industries, such as the airlines industry, and the bankruptcy of a few large companies. The problems facing the PBGC are in part due to low interest rates that have raised pension liabilities. In 2004, PBGC's single-employer program suffered the largest losses from completed and probable pension plan terminations in its history. Terminations that have already taken place in 2005 make it possible that the record will be broken again in the current fiscal year.

The net loss for fiscal year 2004 was \$12.1 billion, which was up from \$7.6 billion in 2003 and \$11.4 billion for 2002. The two biggest factors were a \$14.7 billion loss from completed and probable pension plan terminations and a \$1.5 billion charge for actuarial

adjustments due to a change in mortality assumptions as a result of improved life expectancy. These losses were partially offset by premium income and investment income.

These large losses caused the net asset position of the PBGC to decline from its surplus of \$7.7 billion at the end of fiscal year 2001 to its deficit of \$23.3 billion at the end of fiscal year 2004 (Table 1).

Table 1. PBGC Single-Employer Trust Fund Surplus or Deficit, 2000-2004

Year	Surplus (Deficit)
2000	\$9.7 billion
2001	\$7.7 billion
2002	(\$3.6 billion)
2003	(\$11.2 billion)
2004	(\$23.3 billion)

Source: Annual Reports of the PBGC

A problem, not a crisis

Although it has a large unfunded liability, the PBGC has sufficient assets to meet its cash flow obligations for a number of years, and it thus is not facing a liquidity crisis. Its assets at the end of fiscal year 2004 of \$39 billion were far greater than the \$3 billion it paid in benefits that year. Its unfunded liability indicates that it does not have sufficient assets to pay all future benefits that it has promised. While it is not facing a liquidity crisis, it is facing a serious problem.

Events Since 2004

Since the end of the 2004 fiscal year, the financial situation of the PBGC has further deteriorated. On April 22, 2005, the PBGC reached a pension settlement with United Airlines over the termination of the company's defined benefit pension plans. Under the terms

of the agreement, which must still be approved by the bankruptcy court, the PBGC would take on an unfunded liability of \$6.6 billion for the company's four pension plans. This development considerably worsens the financial situation of the PBGC from that presented in its 2004 annual report. Concern has been raised that competitive pressures in the airlines industry may cause other airlines to declare bankruptcy and to transfer their pension plans to the PBGC. The United Airlines plan terminations highlight the weaknesses of U.S. funding regulations that permit large amounts of underfunding to occur.

The need for reforms

The PBGC argues that a comprehensive reform of the defined benefit plan funding rules must be enacted to strengthen the financial health of the defined benefit pension system. The PBGC's recent experience of plan terminations indicates that its unfunded liability has arisen in part because even when plan sponsors make required contributions, serious pension underfunding can occur.

Written by John Turner
 AARP Public Policy Institute
 601 E Street, NW
 Washington, DC 20049
 202-434-3870; E-Mail: ppi@aarp.org
 May 2005
 © 2005, AARP <http://www.aarp.org/ppi>
 Reprinting with permission only.

¹ John Gist, Laurel Beedon, Alison Shelton and Jules Lichtenstein made helpful comments. I have also benefited from discussions with Ron Gebhardtshauer.