



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

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## **Contents**

Pension Benefit Guaranty Corporation .....	1
PBGC Financing .....	1
Premiums .....	1
Pension Benefit Guaranty .....	1
Current Financial Picture .....	2
Defined Benefit Pension Funding .....	2
Funding Relief .....	3
Single-Employer Funding Relief .....	4
Certain Other plans .....	4
Plans Run by Charities .....	4
Multiemployer plans .....	5

## **Contacts**

Author Contact Information .....	5
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## **Pension Benefit Guaranty Corporation**

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 Treasury and Commerce serving as board members.

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 FY2009, the PBGC insured about 27,900 DB pension plans covering 33.6million people. It paid benefits to 1.3 million people, took in 144 newly terminated pension plans, and had about 201,000 new participants. 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 2008 rates will be \$33 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 (PPA) of 2006 (P.L. 109-280), is assessed against plans that are not fully funded. Effective in 2008, the PPA also eliminates certain exemptions from this variable premium that are presently available.

### **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 \$54,000 a year for workers aged 65 in plans that terminate in 2009. 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 FY2008 was \$289.

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**

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. The weakness in the economy, particularly in the steel and airline industries, has led to large and expensive plan terminations that have eliminated the surplus and left the single-employer program with a deficit of \$18.1 billion at the end of FY2006. The deficit decreased to \$10.7 billion at the end of FY2008 and increased to \$21.1 billion at the end of FY2009. 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 and \$869 million at the end of FY2009. For more information on PBGC finances, see CRS Report RL33937, *The Financial Health of the Pension Benefit Guaranty Corporation (PBGC)*, by William Klunk.

## **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

- 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 78.6% as of May 31, 2010.<sup>1</sup>

## **Funding Relief**

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 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.

Several bills in the 111<sup>th</sup> Congress would provide funding relief to DB pension plan sponsors.

Representatives Earl Pomeroy and Paul Tiberi introduced H.R. 3936, the Preserve Benefits and Jobs Act of 2009, on October 27, 2009. Many of the funding relief provisions in this bill have been incorporated in subsequent bills that include provisions for DB funding relief.

H.R. 4213 was introduced in the House by Representative Charles Rangel on December 7, 2009, as the Tax Extenders Act of 2009. H.R. 4213 passed the House on December 9, 2009, and did not include pension funding relief provisions. On March 10, 2010, the Senate passed an amendment that provided for DB funding relief. On May 28, 2009, the House passed the American Jobs and Closing Tax Loopholes Act of 2010, an amended bill that included DB funding relief and also included provisions from H.R. 2989, the 401(k) Fair Disclosure and Pension Security Act of 2009. As of June 23, 2010, the Senate has not acted on the most recent House-passed bill. Senator Baucus has offered a substitute amendment that would maintain the DB funding relief provisions

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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/>.

but would remove the provisions related to H.R. 2989. As of June 23, 2010, the Senate has not acted on Senator Baucus' amendment.

H.R. 3962, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, 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.

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

Changes to a pension plans funding level that result in increased required funding by a plan sponsor may be amortized over a period of seven years. H.R. 3962 allows 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.

H.R. 3962 contains provisions that would require plan sponsors that choose 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 require additional contributions to the plan from plan sponsors that

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

### **Certain Other plans**

A provision in the funding relief proposals apply to plans that would otherwise be ineligible. Certain rural cooperatives and defense contractors were allowed to delay the implementation of the funding 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. H.R. 3962 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

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<sup>2</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.

apply previous years' credit balances to offset the current year's required funding. H.R. 3962 allows 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 H.R. 3962, 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.

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