Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

March 30, 2007

MEMORANDUM

TO: Terrence Deneen
Chief Insurance Program Officer

FROM: Luther Atkins
Assistant Inspector General for Audits

SUBJECT: Final Report: PBGC has Opportunities to Reduce Multiemployer Administrative Costs (2007-4/PA-0031)

The Office of Inspector General's final report resulting from our audit of Administrative Costs of Multiemployer Plans is attached. The overall purpose of this audit was to review the administrative costs of paying pension benefits for the smallest insolvent multiemployer plans and to identify options for reducing the overall cost of administering these plans.

We thank the staff of the Multiemployer Program Division and the Standard Termination and Compliance Division for their outstanding cooperation and efforts during the audit. If there are any questions or concerns needing further discussion, please contact me at ext. 3928.

Attachment

cc: Vince Snowbarger, Interim Director
Stephen Barber, Chief Management Officer
Marty Boehm, Director, CCRD

Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

PBGC Has Opportunities to Reduce Multiemployer Administrative Costs

March 30, 2007

2007-4/PA-0031

Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

March 30, 2007

MEMORANDUM AUDIT REPORT

TO: Terrence Deneen
Chief Insurance Program Officer

FROM: Luther Atkins
Assistant Inspector General for Audits

SUBJECT: PBGC has Opportunities to Reduce Multiemployer Administrative Costs (2007-4/PA-0031)

In November 2006, you requested that the Office of Inspector General (OIG) examine the administrative costs paid by PBGC for operations of certain insolvent multiemployer plans. You were concerned that the administrative costs for the smallest plans were high considering the amount paid as pension benefits. Based on the request, OIG initiated an audit in December 2006 to review the administrative costs of paying pension benefits for the smallest insolvent multiemployer plans and to identify options for reducing the overall costs of administering these plans.

Results in Brief

We concluded that the administrative costs for the smallest insolvent multiemployer plans that receive financial assistance were disproportionate, when compared to the benefits paid by these plans. We identified two options for PBGC to reduce administrative costs for these plans:

- Close the plans by funding the purchase of annuities or lump sum payments for each participant; or
- Consolidate the administration similar to what is done with field benefit administrators of single employer plans.

Based on our review of a legal opinion issued by the Office of the General Counsel which analyzed the financial assistance statutes, we concluded that PBGC can implement either of these above stated options. After considering the merits of both options, we recommend that PBGC close the plans by funding sufficient amounts for the plan administrator to purchase annuities or to make lump sum payouts for each participant. We estimate that PBGC would save about $1.9 million over the life of these plans by purchasing annuities.

The Chief Insurance Program Officer agreed with our finding and recommendation.

Background

Multiemployer plans are defined benefit plans that are maintained by two or more employers and are collectively bargained. They are usually within the same or related industries. Participants in a typical multiemployer plan receive benefits based on a flat dollar amount for each year of service covered by the plan.

Under the Employee Retirement Income Security Act of 1974 (ERISA), as amended, single employer and multiemployer plans are treated very differently when they can no longer pay benefits to their participants. For single-employer plans, PBGC terminates and trustees the plan, assumes administration of the plan and pays benefits directly to the participants. In contrast, if a multiemployer plan meets the insolvency tests established by statute, then it can apply to receive financial assistance from PBGC (see ERISA § 4245, 29 U.S.C. § 1426). The financial assistance consists of the total amount of benefit payments that are due to participants plus administrative expenses, such as attorney's and actuary's fees and the plan's other costs. Once the multiemployer plan requests financial assistance from PBGC and is approved, PBGC then transfers the funds to the plan, of which the plan administrator continues to administer the plan and pay the participants' benefits. The plan requests and receives financial assistance payments on a cyclical basis.

The Multiemployer Program Division (MEPD) handles oversight and monitoring of the 1600 active multiemployer plans, as well as the 33 insolvent plans. The MEPD is responsible for opening cases involving Notices of Termination and Notices of Insolvency. Once the Notice of Insolvency is filed with MEPD, the case is referred to the Standard Termination Compliance Division who assigns an audit supervisor to lead an initial audit and review the cyclical financial assistance requests.

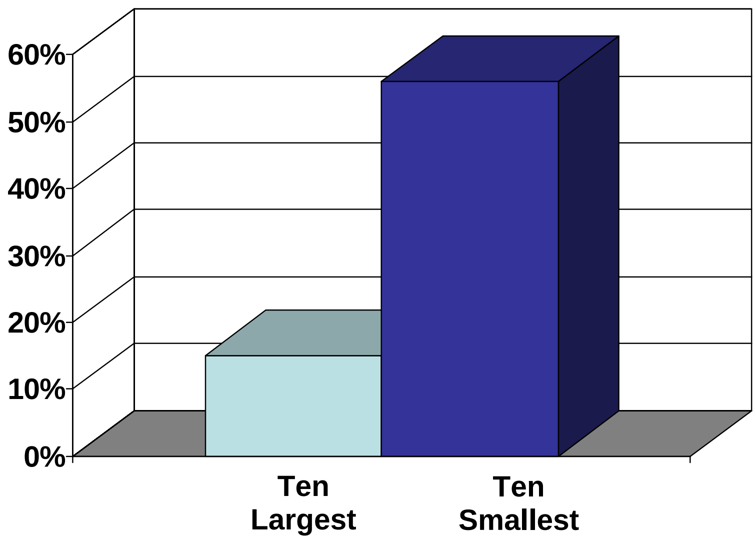
The need to reduce expenditures is especially acute today in light of the deficit in PBGC's net position in the multiemployer program: -$739 million reported in the FY 06 Financial Statements (see PBGC's FY 2006 Annual Management Report). Included in this deficit is a $5.4 million liability for ten of this program's smallest plans. If PBGC funds the purchase of annuities or lump sum payouts, its liability will be paid in a single year. However, all administrative costs are eliminated for future years.

To conduct our audit, we reviewed financial assistance requests from 10 of the smallest plans. In addition, we interviewed program staff from the Multiemployer Program Division and auditors from the Standard Termination and Compliance Division. This audit was conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States, *Government Auditing Standards*, 2003 Revision.

Disproportionate Administrative Costs

Administrative costs for small multiemployer plans that receive financial assistance were disproportionate when compared to the benefits paid to plan participants. PBGC relies on the plan administrators to control the administrative costs, some of which relate to required work by accountants and actuaries. There may be several reasons for the disproportionate administrative costs, including that the smallest plans cannot achieve the same economy of scale as large plans. When comparing the costs of administering the smallest insolvent plans to the largest ones, the average administrative cost is much greater as a percentage of benefits paid for the smallest plans compared to the largest plans. In 2005, administrative costs were approximately 14 percent of benefits paid by the ten largest plans and 56 percent for the ten smallest plans.

Administrative Costs as Percent of Benefits Paid
Insolvent Multiemployer Plans



After comparing the benefits paid by the smallest plans to the plans' administrative costs, we concluded that the administrative costs were disproportionate when compared to the benefits paid to participants. For most of the 10 plans we reviewed, the administrative costs represented a significant amount of the financial assistance PBGC pays to the plan (see Table I). For example:

- In 3 of the 10 plans, the cost of administering the plan far exceeds the amount paid to retirees. For one plan, PBGC paid $83,934 in administrative costs for $32,897 of the benefits, which is 2 ½ times the benefits paid to retirees.
- In another 4 plans, the administrative costs ranged from 27% to 63% of the retirees' benefit payments.
- In 2005, for these 10 smallest plans, PBGC paid a total of $425,658 in benefits and $240,162 in administrative expenses. This means that PBGC paid approximately 56% of the benefits costs for plan administration expenses.

As the amount of financial assistance PBGC provided to multiemployer plans grew from $14 million in FY 05 to $70 million in FY 06, the costs of administering these insolvent plans could be a significant expenditure out of the multiemployer trust fund. PBGC needs to identify an overall strategy to reduce the costs of administration, which does not rely on plan administrators of the smallest plans to control costs, and achieves the same economy of scale as large plans.

Options for Reducing Administrative Costs

PBGC can achieve financial benefits by adopting a different model for paying participants in the smallest insolvent multiemployer plans. Under the current financial assistance program, PBGC will continue to fund the plan's operations, until the final participant or beneficiary in the plans dies, which can be many years. These costs are unavoidable, unless specific steps are taken to reduce or eliminate the costs.

Option 1 - Purchase Annuities. PBGC could close the plans by funding sufficient amounts for the plan administrator to purchase annuities or pay lump sums to each participant in these insolvent plans. This would eliminate: (1) all plan administrative costs in future years and (2) PBGC's operations costs for staff assigned to monitor the insolvent plans and review the periodic applications for financial assistance. According to a recent report prepared by the Actuarial Services Division, the present value of future plan administrative costs is $1,086,969. Thus, PBGC could avoid spending this amount by funding the purchase of annuities or lump sum payouts for the participants in the 10 identified plans (see Table I).

Purchasing annuities or making lump sum payouts would also eliminate the costs of monitoring insolvent plans and reviewing periodic applications for financial assistance. PBGC routinely conducts on-site evaluations of insolvent multiemployer plans. In addition, when the plan requests financial assistance, PBGC auditors review financial statements, expenditures and supporting documentation (such as invoices and check registers). The purpose of these reviews is to verify that the costs are reasonable and applicable to the plan. Based on estimates of the cost to conduct evaluations and the time required to process requests for financial assistance, we estimate that PBGC would avoid $832,000 in operating costs over the next ten years.

Option 2 - Consolidate Operations. Another option for reducing administrative costs is for PBGC to consolidate the administration of insolvent multiemployer plans under one administrator. This option would be similar to what occurs when PBGC trustees a single-employer plan. PBGC trustees the plan and hires a contractor to administer the plan and pay benefits to participants. A similar approach for the smallest multiemployer plans would achieve economies of scale by consolidating the administration of the plans. This would reduce the cost of administration, but PBGC would continue to incur cost to monitor and oversee the plans. This option would eliminate more than $1 million of future administrative costs for the ten insolvent plans, but savings would be offset by the cost of consolidating the oversight, administration and benefit payments of the plans. Because we were unable to reasonably estimate these costs, we were unable to estimate the potential savings of consolidating operations.

Legal Issues

At the outset of this audit it was unclear if PBGC had the statutory authority to do anything other than to fund multiemployer plans on a continual basis until the participants and beneficiaries were all deceased. In January 2001, the Office of the General Counsel (OGC) issued a memorandum to the OIG analyzing the financial assistance statutes in ERISA. OGC concluded that the ERISA financial assistance provisions were broadly drafted, giving PBGC flexibility to administer payments to insolvent multiemployer plans.

We note that, over a course of years, PBGC has closed-out selected insolvent multiemployer plans in several ways, one of which was through funding the purchase of annuities.[1] PBGC had concluded it had the legal authority to close-out insolvent plans rather than continuing to pay financial assistance, however, they had not established an alternative program. The program officials believed the cost/benefit for purchasing annuities would be favorable, but the data had not been analyzed. Hence, the request for an independent and objective audit to analyze the data and report on the potential options.

Based on our review of OGC's legal opinion, we concur that PBGC has the legal authority to establish options, other than financial assistance, to pay participants' benefits in insolvent multiemployer plans.

Conclusion

After considering the available options and the related legal implications, we concluded that the best option for reducing the overall cost of administering the smallest insolvent plans is to fund sufficient amounts for the plan administrator to purchase annuities or pay lump sums to each participant. This would eliminate over $1.9 million in future administrative costs and the costs of in-house monitoring of insolvent plans.

Recommendation

We recommend that PBGC close the 10 smallest plans by funding sufficient amounts for the plan administrator to purchase annuities or make lump sum payouts to participants. **(IPD-3)**

Other Matters

During the audit, we identified two issues that did not directly relate to our objective but warranted the attention of the Standard Termination Compliance Division (STCD). Among the functions of STCD is conducting initial audits, when a multiemployer plan is determined to be insolvent, and processing financial assistance requests from insolvent multiemployer plans.

[1] Recently, PBGC facilitated the close out of the smallest plan in this audit by funding the purchase of annuities.

1. No formal audit program

The initial audits are extremely valuable in accounting for assets, liabilities, income, expenses and, most importantly, the participants. The initial audit is conducted by a team of two or more auditors lead by an audit supervisor who has many years of PBGC audit experience. A review of the work papers from two initial audits shows that the audits thoroughly cover financial and participant data of the insolvent multiemployer plan and the work was well documented. However, the audits are performed without a written audit program to guide the auditor. Without a written audit program there is a risk that audits will not be consistent among the auditors and that important steps could be overlooked.

STCD recently hired a contractor to write an audit program for the initial audits of insolvent multiemployer plans. Although the contract does not specify a due date for the audit program, STCD expects it to be completed by September 30, 2007.

2. No requirement for continuing professional education

Although STCD auditors perform a variety of duties, much of their work requires auditing and accounting skills. However, once hired, the auditors are provided very little continuing education or training in their field of study. The training records of five STCD auditors showed that they had not taken any accounting or auditing courses during the past two years. There are similar trends for years going further back and for most auditors in STCD. Continuing professional education is important for skill, proficiency and growth for those designated as GS-0511 auditors; further, it is mandatory for those who are licensed certified public accountants.

OIG Evaluation of Agency Comments

Overall, PBGC agreed with the report. However, since PBGC does not trustee multiemployer plans they commented that when closing out a plan it would be more efficient to have the current plan administrator, rather than PBGC, arrange the purchase of annuities or payouts of lump sums to participants. A complete copy of PBGC's response is at Appendix A.

Analysis of Administrative Costs and Benefit Payments for 10 Small Multiemployer Plans

Multiemployer Plan Name	Year	Benefit Payments	Administrative Costs	Administrative Expenses as a % of Benefit Payments
Hotel and Restaurant Employee Union Local 18 Pension Plan	2005	$4,632	$4,898	105.74%
Painters Local 1042 Pension Plan	2005	$3,528	$2,229	63.18%
Trustee for Tilesetters and Marble Masons Local Union 2	2005	$10,357	$5,184	50.05%
Graphic Art Pressroom Retirement Fund	2005	$51,807	$14,485	27.96%
Textile Foreman's Pension Plan	2005	$49,654	$6,691	13.48%
Luggage Workers Union of Phil. and Vicinity Local 61 Retirement Plan	2005	$36,552	$60,679	166.01%
Brewery Workers Local 1149 Pension Plan	2005	$60,519	$2,659	4.39%
Retail Clerks Union District Council No. 12 Variety and Department Store Pension Plan	2005	$73,682	$9,986	13.55%
Local 144 Funeral Directors Pension Plan	2005	$102,030	$49,417	48.43%
Division 1181-1061 ATU Long Island Employees Pension Fund and Plan	2005	$32,897	$83,934	255.14%
TOTALS		**$425,658**	**$240,162**	**56.42%**

Table II

Administrative Costs as a Percentage of Benefit Payments for a Three Year Period			
Multi Employer Plan Name	**2005**	**2004**	**2003**
Hotel and Restaurant Employee Union Local 18 Pension Plan	105.74%	35.12%	12.21%
Painters Local 1042 Pension Plan	63.18%	107.23%	119.79%
Trustee for Tilesetters and Marble Masons Local Union 2	50.05%	31.99%	21.39%
Graphic Art Pressroom Retirement Fund	27.96%	17.26%	33.34%
Textile Foreman's Pension Plan	13.48%	17.61%	9.27%
Luggage Workers Union of Phil. and Vicinity Local 61 Retirement Plan	166.01%	116.23%	104.32%
Brewery Workers Local 1149 Pension Plan	4.39%	14.24%	3.40%
Retail Clerks Union District Council No. 12 Variety and Department Store Pension Plan	13.55%	13.54%	11.92%
Local 144 Funeral Directors Pension Plan	48.43%	41.80%	35.81%
Division 1181-1061 ATU Long Island Employees Pension Fund and Plan	255.14%	201.61%	178.62%

PBGC
Protecting America's Pensions
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

March 28, 2007

MEMORANDUM

To: Luther L. Atkins
Assistant Inspector General for Audits

From: Terrence Deneen
Chief Insurance Program Officer

Subject: Draft Report on Multiemployer Plans

Thank you for the opportunity to comment on your "Draft Report on Administrative Costs of Multiemployer Plan" (dated March 12, 2007). I have reviewed the Draft with great interest, and I have solicited comments from the staff of the Office of Chief Counsel ("OCC") and the Multiemployer Plans Division ("MPD"). I have also had the opportunity to discuss certain of the financial information with Mr. Novak of your staff.

We agree with the substantive conclusions reached in your report about the burden of administrative costs associated with PBGC's provision of financial assistance to small, insolvent multiemployer plans. Your Draft outlines several options that might reduce both costs associated with small plans, as well as "free up" our limited professional resources to deal with PBGC's growing inventory of large insolvent plans. MPD plans to implement these options in the current and next fiscal years.

We do have a comment about one specific point at page 4 of the Draft Report. As a result of the statutory framework embodied in the 1980 Multiemployer Act, PBGC will rarely (if ever) become trustee of a multiemployer plan, and PBGC has not trusteed a multiemployer plan since 1980. Accordingly, when closing out a plan–either through the purchase of annuities or payments of lump sums–it seems more efficient, when feasible, to have the current plan administrator and consulting professional actuary take the steps necessary to value benefits and obtain annuity bids. Likewise, if plans are consolidated for administrative purposes, it is probably more efficient to place plans under the charge of an existing private sector trustee.

We appreciate the professional, efficient manner in which you and Mr. Novak prepared this important Draft Report.

Cc: Messrs. Rae, Boehm, Goldowitz, Foster, and Novak