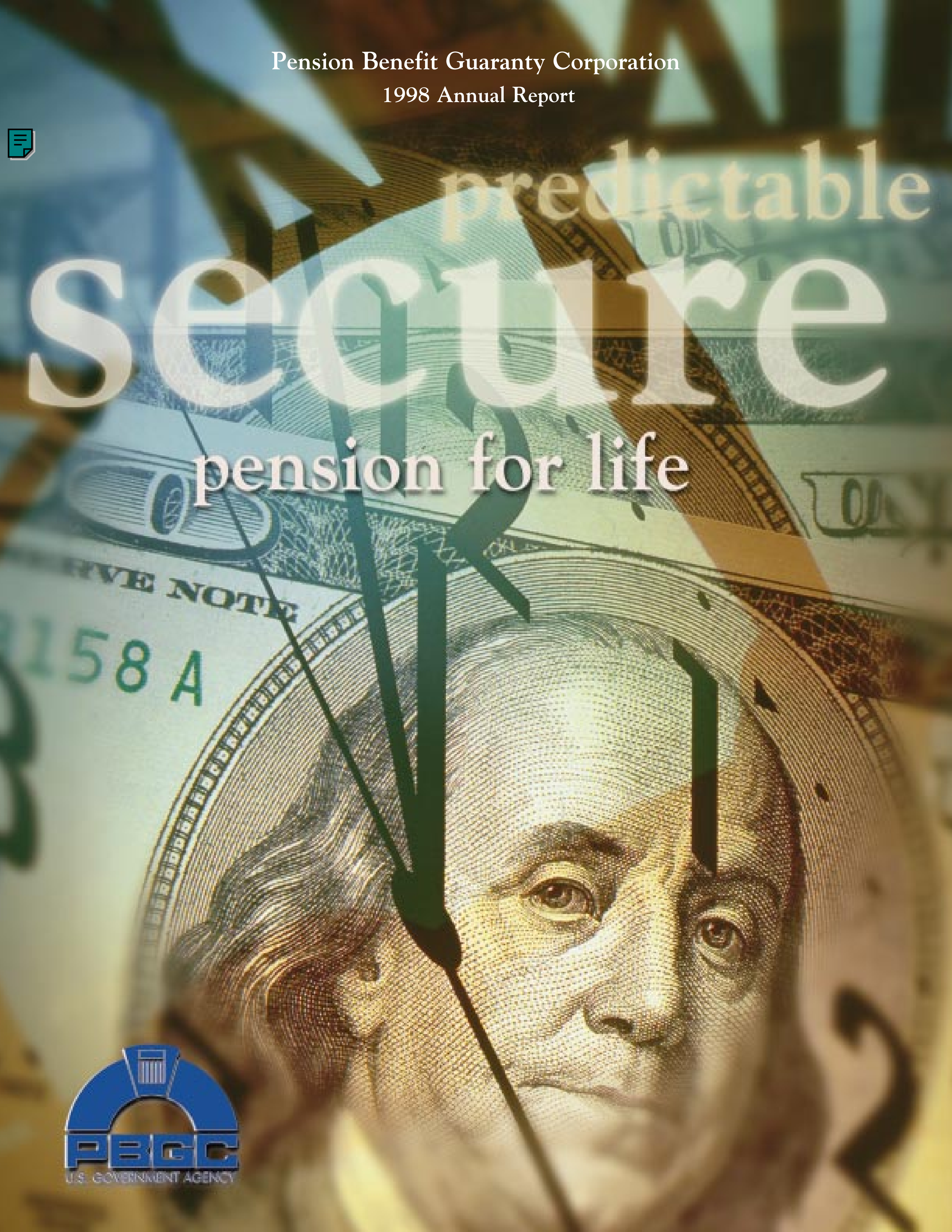
Pension Benefit Guaranty Corporation

1998 Annual Report



mission

The Pension Benefit Guaranty Corporation protects the pensions of about 42 million working men and women in more than 44,000 private defined benefit pension plans, including about 2,000 multiemployer plans. These pension plans provide a specified monthly benefit at retirement, usually based on salary or a stated dollar amount and years of service. The Employee Retirement Income Security Act of 1974 established PBGC as a federal corporation.

PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by the Congress and paid by sponsors of defined benefit plans, investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for the trusteed plans.

PBGC's mission is to operate as a service-oriented, professionally managed agency that protects participants' benefits and supports a healthy retirement plan system by:

- encouraging the continuation and maintenance of private pension plans,
- protecting pension benefits in ongoing plans,
- providing timely payments of benefits in the case of terminated pension plans, and
- making the maximum use of resources and maintaining premiums and operating costs at the lowest levels consistent with statutory responsibilities.

Highlights

The single-employer insurance program improved its net financial position as assets exceeded liabilities by more than $5 billion at yearend, largely as a result of earnings on fixed-income investments and moderate losses from plan terminations.

Investments met or exceeded the performance targets set under the agency's five-year strategic plan, as investment income totaled about $2.3 billion.

Premium income declined by $100 million (about 10 percent) as variable-rate premium payments fell for the second year in a row. Variable-rate payments were affected in part by a provision of the Retirement Protection Act of 1994 that increased the interest rate used to value plan benefit liabilities.

PBGC paid $848 million in benefits to 209,300 people during the year. Another 263,000 people will receive benefits when they retire in the future. The agency issued final benefit determinations significantly sooner than in the past and exceeded its strategic planning target.

PBGC has or will become trustee of 2,665 underfunded pension plans, including 160 terminated during the year.

The multiemployer program ended the year with a net financial position of $341 million, the largest surplus in the program's history.

With its financial position improving, PBGC made strengthening and expanding the defined benefit system its highest priority.

(Dollars in millions)	1998	1997
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Summary of Operations		
Premium Income	$ 989	$ 1,090
Loss from Plan Terminations	$ 584	$ 489
Investment Income	$ 2,251	$ 2,755
Actuarial Charges	$ 815	$ 487
Insurance Activity		
Benefits Paid	$ 848	$ 824
Retirees	209,300	205,800
Total Participants in Terminated and Multiemployer Plans	472,000	465,000
New Underfunded Terminations	160	165
Terminated/Trusteed Plans (Cumulative)	2,665	2,510
Financial Position		
SINGLE-EMPLOYER PROGRAM		
Total Assets	$17,631	$15,314
Total Liabilities	$12,619	$11,833
Net Income	$ 1,531	$ 2,612
Net Position	$ 5,012	$ 3,481
MULTIEMPLOYER PROGRAM		
Total Assets	$ 745	$ 596
Total Liabilities	$ 404	$ 377
Net Income	$ 122	$ 95
Net Position	$ 341	$ 219

Alexis M. Herman
Secretary of Labor
Chairman of the Board

chairman's message

"We now must build on **PBGC's** encouraging progress to ... assure a **secure** retirement for ... working Americans."

As we approach the 21st century, we are living in a time of opportunity. Our economy is the healthiest in a generation. Unemployment is the lowest in 25 years. Inflation is in check. But where there is opportunity, there is also challenge. One of those challenges is to provide retirement security for America's working men and women. Too many people have no pension, and too few have adequate savings. Social Security was never intended to provide enough by itself for retirees to live on.

The Pension Benefit Guaranty Corporation has taken important steps to strengthen the defined benefit system. From a deficit of nearly $3 billion just five years ago, PBGC has built a strong insurance program and solid financial foundation through hard work and sound management. We now must build on PBGC's encouraging progress to increase private pension coverage so that we can assure a secure retirement for this and future generations of working Americans.

Alexis M. Herman
Secretary of Labor
Chairman of the Board

David M. Strauss
Executive Director

executive director's message

"...we are working to... **strengthen** and expand the **defined benefit** system."

I am happy to report that, for the third consecutive year, the Pension Benefit Guaranty Corporation's insurance programs generated an accounting surplus. Because of low claims, good investment performance, and adequate premium revenues, PBGC is financially healthier than ever before. But I am also very mindful that it was not so very long ago that PBGC's financial condition was precarious. As the U.S. General Accounting Office stated in its recent evaluation of PBGC, "While PBGC's financial condition has significantly improved, risks to the long-term financial viability of the insurance programs remain." We remain vigilant.

PBGC's improving financial position has allowed me to focus my efforts on strengthening and expanding the defined benefit system. We face an enormous challenge in helping to provide retirement security for the baby boom generation and others nearing retirement. If we are to achieve the goal of retirement income security for our aging workforce, I believe the solution must include defined benefit plans. Defined benefit plans provide a predictable, secure pension for life, and even small monthly benefit amounts can make a large difference in a retiree's standard of living.

I believe that the defined benefit system is in trouble. Both the number of plans and the number of workers whose primary pension is a defined benefit plan have declined dramatically. To remedy this, I asked a PBGC team to work with pension professionals and other stakeholders to find out what can be done to make defined benefit plans more attractive. We have received a lot of good ideas and we are working to develop them to strengthen and expand the defined benefit system. That will be my primary objective in 1999. It is important that we succeed. The retirement security of millions depends on our efforts.

David M. Strauss
Executive Director

Strategic Planning

PBGC continued to follow the five-year strategic plan first developed in 1997. The plan established four broad goals that form the framework for PBGC to structure both its short-term and long-term plans. PBGC's goals are to:

(1) protect existing defined benefit plans and their participants and encourage new plans,
(2) provide high-quality services and accurate and timely payment of benefits to participants,
(3) strengthen financial programs and systems to keep the pension insurance system solvent, and
(4) improve internal management support operations.

The strategic plan establishes performance measures through which PBGC assesses its progress toward each of its strategic goals. The performance measures track specific results that are significant to PBGC's customers and gauge PBGC's solvency and customer service accomplishments. PBGC will periodically review its performance measures for necessary adjustments as circumstances change and program performance reporting capabilities improve.

1998 PBGC Corporate Performance Measures

Measure	Applicable Goal	1998 Milestone		1998 Result		Baseline (1997)	
Pension Loss Prevention (total value of loss prevention as compared to total underfunded vested benefits)	Goal #1	*		100%		88.5%	
Achieve 90% participant satisfaction regarding responses to inquiries	Goal #2	81%		available in 3/99		79%	
Provide post-audit estimated benefits to new retirees that are within 5% of final benefits in clear, understandable language	Goal #2	to be established in 1999		93.5%		90%	
Provide final accurate benefit determinations to participants within 3-5 years of plan trusteeship	Goal #2						
a) age of pretrusteeship inventory		no more than 4 years		98.6%≤ 4 years		not available	
b) timeliness of final benefit notifications		7-8 years		5.39 years		5.95 years	
Collect 97% of total pension insurance premiums due	Goal #3	95%		99%		97%	
Approximate comparable 5-year investment indices for PBGC's portfolio investment	Goal #3	*		PBGC	Index	PBGC	Index
			Equities	18.1%	17.6%	20.6%	20.6%
			Fixed-Income	9.2%	9.2%	10.9%	8.9%

* not projected — determined annually based on actual results

promoting defined benefit pensions

Providing **retirement** income **security** for those nearing retirement is one of the most compelling domestic **challenges** facing the country.

predictable, secure benefits

Providing retirement income security for the baby boom generation and others nearing retirement is one of the most compelling domestic challenges facing the country. The problem is becoming increasingly urgent because of the huge number of people affected and the short time left to deal with this issue. There are 25 million people between ages 53 and 62 who are now close to the end of their working careers, and right behind them are 78 million "baby boomers," 18 million of whom are already at least 48 years old.

People are not saving enough, early enough in life, to meet their retirement needs. Many low-income workers have no savings at all, and most older workers have not saved very much either. Half of America's households headed by people between ages 55 and 64 have wealth of less than $92,000, the bulk of which is equity in their homes. Nor is the savings situation likely to improve soon. Even those with a 401(k) plan are not saving enough. An Employee Benefit Research Institute study of 6.6 million 401(k) participants shows that the average 401(k) balance is only $37,000, and that nearly half of these participants have less than $10,000 in their accounts. Many low-income workers do not make enough to contribute anything to their 401(k) accounts. President Clinton has taken an important step to address this problem by proposing to establish universal savings accounts to give all Americans the opportunity to save.

Not only are workers not saving enough on their own, but many have no pension plan. Half of the private-sector workforce is not covered by any employer-sponsored retirement plan, and only 20 percent of the workers in small businesses have any retirement plan. Among low-wage workers, only 8 percent have a plan.

Historically, the defined benefit plan has provided adequate benefits for low-income workers who cannot afford to save and for older workers who failed to start saving early enough.

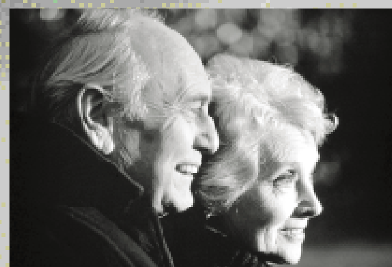
Yet, despite the value of defined benefit plans, the number of plans insured by PBGC has decreased from 114,000 in 1985 to 44,000 today, with most of the decline among smaller plans. The number of active workers in all plans has dropped from 29 million in 1985 to fewer than 25 million in 1994.

To encourage more employers to offer defined benefit plans, the Administration proposed a simplified defined benefit plan called SMART (Secure Money Annuity or Retirement Trust) for small businesses with

100 or fewer employees. SMART combines many of the best features of defined benefit and defined contribution plans. The plan would provide coverage for all eligible workers, and employers would have predictable funding based on conservative assumptions that would keep earned benefits fully funded at all times. SMART would guarantee a minimum annual retirement benefit for participants that employers could increase if the return on plan investments exceeded specified conservative assumptions, and PBGC would protect their benefits.

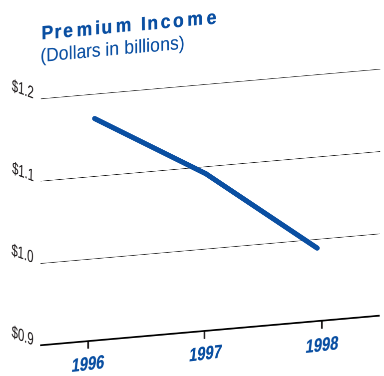
SMART is an important step. More could be done for businesses of all sizes. At the request of the Executive Director, a PBGC team is working with employer and employee groups, pension professionals, and consultants who market pension plans to determine the reasons defined benefit plans are less prevalent today.

PBGC's efforts to promote defined benefit plans in 1998 laid the groundwork for future action. In 1999, PBGC will continue to work with stakeholders to develop ideas to strengthen and expand the defined benefit system.



safeguarding solvency

PBGC marked another year of **progress** toward its strategic goal... to keep the pension insurance system **solvent**.



PBGC reported further improvement in its financial condition, marking another year of progress toward its strategic goal of strengthening its financial programs and systems to keep the pension insurance system solvent. Fixed-income investments, in particular, recorded dramatic gains. The Early Warning Program produced numerous settlements that protected the insurance program and hundreds of thousands of workers and retirees from pension losses. The agency also continued to meet legal challenges in courts across the country.

Year 2000 Readiness Disclosure

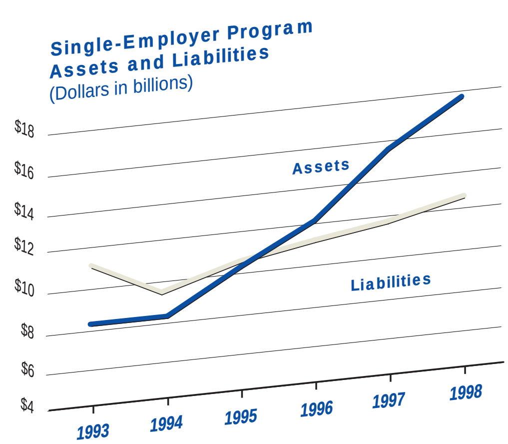
PBGC instituted a comprehensive review of its information systems, operations, and third-party relationships to assess its readiness for the Year 2000. Under the leadership of the Chief Financial Officer, PBGC formed a cross-functional team to formulate the agency's Y2K plans.

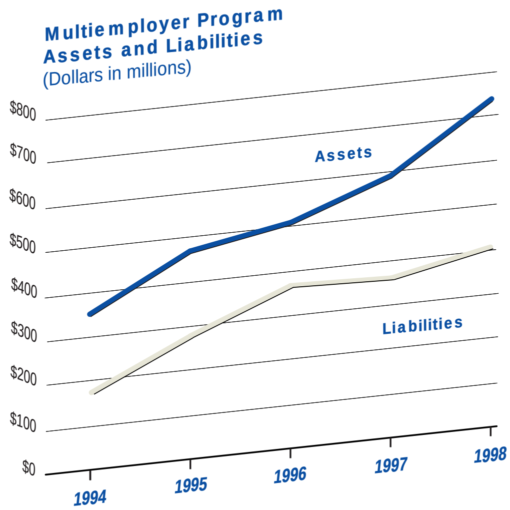
PBGC expects new automated systems implemented during 1998 to be century-date-change ready and all systems requiring changes to become ready and to complete independent verification in 1999. PBGC is also working with its business partners to address their readiness for the Year 2000, but PBGC cannot ensure that other entities will be Y2K-compliant.

This information is PBGC's Year 2000 Readiness Disclosure for the purpose of the Year 2000 Information and Readiness Disclosure Act.

Financial Management

Both PBGC insurance programs again posted significant financial gains due mainly to investment earnings. Investments of the larger single-employer program produced income of more than $2.1 billion. Premium income totaled $966 million, $100 million less than in 1997 and nearly $200 million less than the record level reached in 1996. PBGC collected 99 percent of the premiums due, exceeding the target of 95 percent set under its strategic plan. However, companies' premium payments continued to decline because of reduced risk-based premium obligations. The investment earnings enabled the single-employer program to record net income of more than $1.5 billion, increasing the program's net surplus to more than $5 billion.





The multiemployer program also continued to be financially strong, with net income of $122 million almost exclusively from investment income and an end-of-year net surplus of $341 million. At September 30, the program had assets of $745 million and liabilities totaling $404 million primarily for nonrecoverable future financial assistance. Both the net income and net surplus represent record levels for the multiemployer program.

PBGC's financial statements have received their sixth straight unqualified opinion from the agency's auditors. The 1998 audit was again performed by PricewaterhouseCoopers LLP under the direction and oversight of PBGC's Inspector General.

After the year ended, the U.S. General Accounting Office issued a report, "Pension Benefit Guaranty Corporation: Financial Condition Improving, But Long-Term Risks Remain," which cited PBGC's "significantly" improved financial condition. However, GAO also noted that long-term risks to the insurance program remain, many of which are beyond PBGC's control. These risks include continued underfunding among some large plans, downturns in the economy, problems in certain sectors of the economy, a significant decline in the stock market, and a substantial drop in interest rates. As the report stated, "An economic downturn and the termination of a few plans with large unfunded liabilities could quickly reduce or eliminate PBGC's surplus." The GAO report provided independent validation that PBGC needs to be vigilant in managing its risks and cautious about changes that could affect liabilities or revenues.

Investment Program: The Corporation's investable assets consist of premium revenues accounted for in the Revolving Funds and assets from terminated plans and their sponsors accounted for in the Trust Funds. By law, PBGC is required to invest the Revolving Funds in fixed-income securities; current policy is to invest these funds only in Treasury securities. The agency has more discretion in its management of the Trust Funds, which it invests primarily in high-quality equities. The asset allocation is designed to provide sound long-term performance.

PBGC has structured its investment portfolio to improve the agency's financial condition in a prudent manner. The Revolving Fund assets are invested to earn a competitive return and partially offset changes in its benefit liabilities. The agency's investment in equities provides overall portfolio diversification and a higher long-term expected return, within prudent levels of risk. PBGC uses institutional investment management firms to invest its assets subject to PBGC oversight. PBGC continually reviews its investment

strategy to ensure that the agency maintains an investment structure that is consistent with its long-term objectives and responsibilities.

As of September 30, 1998, the value of PBGC's total investments, including cash, was approximately $18.1 billion. The Revolving Fund's value was $11.6 billion and the Trust Fund's value was $6.5 billion. PBGC's fund allocation shifted toward fixed income and cash during 1998 due primarily to strong fixed-income returns. Cash and fixed-income securities represented 66 percent of the total assets invested at the end of the year, as compared to 61 percent at the end of 1997, while the equity allocation stood at 33 percent of all investments compared to 38 percent one year earlier. A very small portion of the invested portfolio remains in real estate and other financial instruments.

Fiscal year 1998 was positive for capital market investments and PBGC's investment program. For the year, PBGC's fixed-income program returned 22.8% while its equity program advanced 2.1%. PBGC's five-year returns equalled or exceeded their comparable market indices, surpassing the requirements of the agency's strategic plan. For the year, PBGC reported income of more than $2.1 billion from fixed-income investments and $121 million from equity investments.

INVESTMENT PROFILE

	September 30, 1998	September 30, 1997
Fixed-Income Assets		
Average Quality	**AAA**	AAA
Average Maturity (years)	**21.3**	21.0
Duration (years)	**11.3**	10.5
Yield to Maturity (%)	**5.1**	6.4
Equity Assets		
Average Price/Earnings Ratio	**19.7**	26.0
Dividend Yield (%)	**1.6**	1.6
Beta	**1.04**	1.04

INVESTMENT PERFORMANCE

(Annual Rates of Return)

	September 30, 1998	September 30, 1997	Five Years Ended September 30, 1998
Total Invested Funds	**14.4%**	21.9%	11.9%
Equities	**2.1**	37.6	18.1
Fixed-Income	**22.8**	13.5	9.2
Trust Funds	**2.1**	35.6	16.2
Revolving Funds	**22.4**	13.3	9.1
Indices			
Wilshire 5000	**3.3**	38.0	17.6
S&P 500 Stock Index	**9.2**	40.4	19.9
Lehman Brothers Long Treasury Index	**22.1**	13.2	9.2

Single-Employer Program Exposure

PBGC's "expected claims" are dependent on two factors: the amount of underfunding in the pension plans that PBGC insures (i.e., exposure), and the likelihood that corporate sponsors of these underfunded plans encounter financial distress that results in bankruptcy and plan termination (i.e., the probability of claims).

Over the near term, expected claims result from underfunding in plans sponsored by financially weak firms. PBGC treats a plan sponsor as financially weak based upon factors such as whether the firm has a below-investment-grade bond rating. PBGC calculates the underfunding for plans of these financially weak companies using the best available data, including the annual confidential filings that companies with large underfunded plans are required to make to PBGC under Section 4010 of ERISA.

For purposes of its financial statements, PBGC classifies the underfunding of financially weak companies as "reasonably possible" exposure, as required under generally accepted accounting principles. As of December 31, 1997, PBGC's estimated "reasonably possible" exposure ranged from $15 billion to $17 billion.

Over the longer term, exposure and expected claims are more difficult to quantify either in terms of a single number or a limited range. Claims are sensitive to changes in interest rates and stock returns, overall economic conditions, the development of underfunding in some large plans, the performance of some particular industries, and the bankruptcy of a few large companies. Large claims from a small number of terminations and volatility characterize the agency's historical claims experience and are likely to affect PBGC's potential future claims experience as well.

"Although PBGC's financial condition has **significantly improved** over the past few years, risks remain..."

Despite the exceptional economic conditions of recent years, it is not reasonable to assume that future experience will be as favorable to PBGC. PBGC has had a surplus for only three years after running a deficit for more than 20 straight years. Furthermore, with premium changes built into the reforms of the Retirement Protection Act of 1994, PBGC expects its variable-rate premium revenues to decline substantially after the year 2000.

After reviewing PBGC's financial situation, the U.S. General Accounting Office concluded on October 16, 1998, that: "Although PBGC's financial condition has significantly improved over the past few years, risks remain from the possibility of an overall economic downturn or a decline in certain sectors of the economy, substantial drops in interest rates, and actions by sponsors that reduce plan assets. These risks could threaten the long-term viability of the insurance programs. Further, PBGC has only a limited ability to protect itself from risks to the insurance programs."

Methodology for considering long-term claims: No single underfunding number or range of numbers — even the reasonably possible estimate — is sufficient to evaluate PBGC's exposure and expected claims over the next ten years. There is too much uncertainty about the future, both with respect to the performance of the economy and the performance of the companies that sponsor the insured pension plans.

The proper way to assess future claims is with advanced analytic tools such as stochastic models, which incorporate random events. PBGC has developed a stochastic model to evaluate its exposure, the Pension Insurance Modeling System (PIMS), and, with this report, the agency is adopting this model for its forecasts.

PIMS portrays future underfunding under current funding rules as a function of a variety of economic parameters. The model recognizes that all companies have some chance of bankruptcy and that these probabilities can change significantly over time. The model also recognizes the uncertainty in key economic parameters (particularly interest rates and stock returns). The model simulates the flows of claims that could develop under thousands of combinations of economic parameters and bankruptcy rates.

Under the model, median claims over the next ten years will be about $600 million per year (expressed in today's dollars); that is, half of the scenarios show claims above $600 million per year, and half below. The mean level of claims (that is, the average claim) is much higher, more than $900 million per year. The mean is higher because there is a chance under some scenarios that claims could reach very high levels. For example, under the model, there is a ten percent chance that claims could exceed $2.1 billion per year. Despite PBGC's recent favorable experience, the financial condition of the agency could seriously deteriorate.

PIMS projects PBGC's potential financial position by combining simulated claims with simulated premiums, expenses, and investment returns. The mean outcome is an $8.8 billion surplus in 2008 (in present value terms). However, the model also shows the potential for significant downside outcomes. In particular, there is nearly a 20 percent chance that the agency could return to a deficit in the next ten years and a ten percent chance that the deficit could exceed $6.3 billion in 2008 (in present value terms). These outcomes are most likely if the economy performs poorly, in which case PBGC may experience large claims amounts and investment losses. PBGC is continuing to analyze the best way to manage and reduce the risk of insolvency.

Comparison to the Previous Forecast Method: PBGC's past methodology for the ten-year forecasts relied on an extrapolation of the agency's claims experience and the economic conditions of the past two decades. Although PBGC is now using a new method for forecasting its future financial condition, the agency also prepared forecasts using the old methodology for comparison with PIMS.

Forecast A is based on the average annual net claims over PBGC's entire history ($527 million per year) and assumes the lowest level of future losses. Forecast A projects steady improvement in PBGC's financial condition, resulting in a surplus of $11.5 billion at the end of 2008 ($6.6 billion in present value terms for comparison to PIMS).

Forecast B, which assumes the mid-level of future losses, is based upon the average annual net claims over the most recent 11 fiscal years ($611 million per year). Forecast B projects net income levels that, while lower than Forecast A, still lead to a surplus of $10.5 billion at the end of 2008 ($6.0 billion in present value terms).

Forecast C reflects the potential for heavy losses from the largest underfunded plans by assuming that the plans that represent the reasonably possible exposure will terminate uniformly over the next ten years in addition to a modest number of lesser terminations each year. This forecast assumes $1.5 billion of net claims each year and projects a $2.5 billion deficit in ten years ($1.4 billion in present value terms).

Technical Notes: Forecasts A, B, and C share several assumptions. Average annual net claims and projected claims are in 1998 dollars. PBGC calculated the present value of future benefits using an interest rate of 5.71% and other actuarial assumptions that are consistent with assumptions used to value the present value of future benefits in the financial statements as of September 30, 1998. PBGC's assets are projected to earn 5.71% annually. Benefits for plans terminating in the future are assumed to grow at 3.81% annually until termination. Plan funding ratios are assumed to increase at 1.5% per year from historical averages and recoveries from plan sponsors are assumed to be constant at 10% of plan underfunding. The number of participants in insured single-employer plans is assumed to remain constant. The flat-rate portion of the single-employer premium is assumed to remain constant at $19 per participant. Receipts from the variable-rate portion of the premium are projected on the basis of a constant 30-year U.S. Treasury bond rate of 5.2%. Assumed administrative expenses are consistent with PBGC's 1999 President's Budget submission.

Loss Prevention

Under its Early Warning Program, PBGC continued to monitor more than 500 companies with pension plans underfunded by at least $5 million in order to identify transactions that could jeopardize pensions and to arrange suitable protections for those pensions and the pension insurance program. During 1998, PBGC negotiators reached agreements valued at nearly $1.1 billion with 35 companies, including Pepsico, Fruit of the Loom, Sunbeam, Pillowtex, and Inland Steel Company. These agreements provided contributions, security, and other protections for the pensions of about 257,000 workers and retirees. Loss prevention is PBGC's principal performance measure for its strategic goal of protecting existing defined benefit plans and their participants; with regard to these agreements, PBGC is able to report a loss prevention rate of 100 percent for 1998.

Litigation

PBGC continues to face challenges in courts across the country, a number of which threaten to impair the agency's ability to recover its losses for underfunded plans from the employers responsible for those plans. At the end of the year, PBGC had 132 active cases in state and federal courts and 830 bankruptcy cases.

"**Loss prevention** is PBGC's principal performance measure for its **strategic** goal of protecting existing defined benefit plans..."

Several of the most significant cases concerned the priority and value of PBGC's claims for losses from plan terminations:

Copperweld Steel Company: PBGC continued to pursue bankruptcy claims to recover amounts due PBGC and Copperweld's three terminated pension plans, which covered about 3,000 workers and retirees. The company's liquidation trustee contests whether PBGC's claims for unpaid minimum funding contributions in excess of $1 million are entitled to tax priority, and whether the assumptions PBGC prescribes in its regulations appropriately measure PBGC's claims for unfunded benefit liabilities. These issues are central to PBGC's ability to recover its losses from employers in bankruptcy. In December 1997, the bankruptcy court ruled for the liquidation trustee's position on both issues. PBGC and the liquidation trustee negotiated an agreement that will expedite PBGC's appeal of these two programmatic issues to the district court.

CF&I Steel Corporation: PBGC continued to pursue its claims against the reorganized CF&I for a CF&I plan that was underfunded by about $221 million when terminated in March 1992. In August 1998, the Tenth Circuit Court of Appeals adversely decided PBGC's appeal regarding the treatment of its claims in bankruptcy. The court found that PBGC valuation of its claim for unfunded benefit liabilities conflicts with the Bankruptcy Code and affirmed lower court decisions reducing PBGC's claim to about $123 million. The court also found that PBGC's claim for unpaid minimum funding contributions is not entitled to tax priority and that only a small portion of this claim is entitled to administrative priority. PBGC's subsequent petition for rehearing by the full appeals court was denied in October 1998. PBGC is considering whether to seek further review.

PBGC v. Skeen (In re Bayly Corporation)
Just after yearend, PBGC received an adverse ruling from the Tenth Circuit Court of Appeals in this case of first impression. The court rejected PBGC's argument that a portion of its unfunded liability claim is entitled to tax priority under the Bankruptcy Code. The appeals court therefore affirmed the decisions of the lower courts denying priority to this claim.

Other major cases in 1998 included:

Hughes Aircraft Company v. Jacobson: On January 25, 1999, the U.S. Supreme Court unanimously ruled that the Hughes pension plan was not terminated merely because it was amended. The Court expressly stated that the provisions of Title IV of ERISA "constitute[ ] the sole avenues for voluntary termination" of a pension plan. Hughes had amended its ongoing plan in 1991 to create a non-contributory benefit structure. Prior to the amendment, the plan, which was reportedly overfunded by $1 billion, had been funded by contributions from both employees and the employer. A group of retirees filed suit for a share of the plan's alleged surplus, claiming that the amendment created a new pension plan and terminated the old one. A district court dismissed the suit but was reversed on appeal. PBGC, along with the Department of Labor and the Internal Revenue Service, filed a "friend-of-the-court" brief urging the Court to reverse the Ninth Circuit decision. On the issue of most concern to PBGC, the government argued that the appeals court seriously misconstrued the plan termination requirements of Title IV in ruling that the plan amendment had "constructively" terminated the plan even though the plan had not been terminated in accordance with Title IV, and the Court agreed.

Pineiro, Brooks, and Beaumont v. PBGC: In 1991, PBGC became trustee of three Pan Am pension plans underfunded by $914 million. Three former employees of Pan American World Airways later filed suit asking a district court to replace PBGC with an independent trustee. The court dismissed virtually all of the allegations as meritless, leaving open only an allegation concerning the timeliness of PBGC's notice of benefits to the Pan Am participants. The plaintiffs filed

an amended complaint in January 1998 realleging PBGC delays in issuing benefit determinations as well as most of the dismissed allegations. PBGC's motion to dismiss the amended complaint was pending action by the district court at yearend. Despite the exceedingly poor condition of company records and the difficulties caused by Pan Am's protracted bankruptcy proceedings, PBGC has been paying benefits to Pan Am retirees continuously since taking over the plans and has completed benefit determinations for more than 44,000 of the 53,000 former Pan Am workers and retirees. The agency expected to complete most of the remaining benefit determinations by the end of calendar year 1998.

White Consolidated Industries, Inc.: The district court's decision was pending at yearend on PBGC's claims for the estimated $120 million underfunding in pension plans that White transferred to Blaw Knox Corporation in 1985. PBGC alleges that a principal purpose of White in entering into the transaction was to evade pension liabilities. PBGC took over all the Blaw Knox plans either because they ran out of money or because they would have been abandoned after Blaw Knox ceased business in 1994.

providing

high-quality

service

Our customers **deserve**

our **best** effort as well as

our **respect** and **courtesy.**

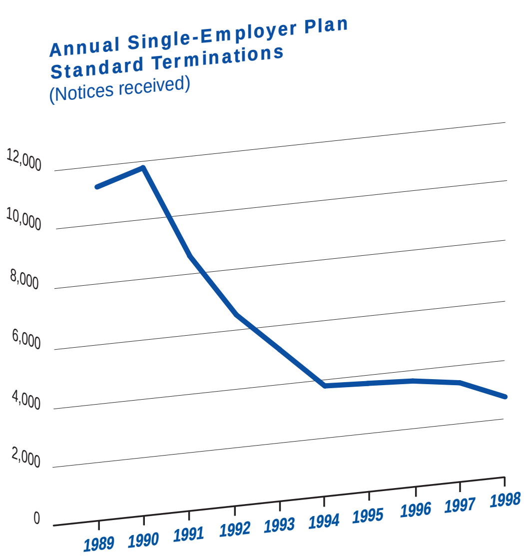
Listening to customers is an essential ingredient to premier customer service, to which PBGC management and staff are committed. PBGC continued its outreach to plan sponsors, plan participants, and pension professionals as it searched for ways to further improve its service.

Single-Employer Program Results

Through its single-employer program, PBGC oversees terminations of fully funded plans and guarantees payment of basic pension benefits when underfunded plans must be terminated. The single-employer program covers about 33 million workers and retirees in more than 42,000 plans.

Standard Terminations of Fully Funded Plans: The number of standard terminations continued to decline from their peak of about 11,800 in 1990, with 2,475 submitted to PBGC in 1998. Most of these plans had 50 or fewer participants.

PBGC audits a statistically significant number of completed terminations to confirm compliance with the law and proper payment of benefits. These audits generally have found few and relatively small errors in benefit payments, which plan administrators are required to correct. The errors arise primarily from use of incorrect interest-rate assumptions in valuing lump-sum distributions to plan participants. Due to PBGC's audits, in 1998 some 5,800 participants (about 4 percent of all participants in audited plans) received about $2.75 million of additional benefits.



Distress and Involuntary Terminations of Underfunded Plans: During 1998 the agency completed the termination of 160 underfunded plans, the vast majority of which were involuntary terminations by PBGC. In most cases termination was necessary because the sponsoring employer had gone out of business. Many of these plans had been under consideration for termination for a period of time and their actual termination dates occurred in earlier years, when the circumstances leading to their termination first arose.

Trusteed Plans: PBGC generally becomes trustee of a plan after the plan has been terminated, although not necessarily in the same year the plan was terminated. During 1998, PBGC became trustee of 187 single-employer plans covering 41,000 people. At yearend, the agency was in the process of trusteeing an additional 58 plans terminated in 1998 or earlier. In all, including 10 multiemployer plans previously trusteed, a total of 2,665 terminated plans were trusteed or were being trusteed as of the end of the year. (This total also reflects the elimination of five single-employer plans included in last year's total, which no longer required PBGC to become trustee.)

When PBGC trustees a large plan, the agency organizes informational meetings with plan participants to allay their concerns and to explain about PBGC's insurance. In 1998, the agency held 21 such sessions across the country that reached about 3,000 people. Executive Director David Strauss often attended the sessions to meet the participants and answer their questions.

Benefit Processing: By the end of the year, PBGC was responsible for the current and future pension benefits of about 472,000 participants from single-employer and multiemployer plans. These include 209,300 retirees who received benefit payments totaling $848 million.

In 1998, PBGC issued more than 61,100 benefit determinations. The agency's improved automation and adjustments to basic benefit payment policies enabled PBGC staff to further reduce the amount of time needed to produce final benefit determinations. On average, PBGC issued final benefit determinations 5.39 years after the date it had trusteed the participant's plan, compared to the 8.75 year average of just two years earlier. In doing so, the agency exceeded the performance goal of 7-8 years set for 1998 under its strategic plan, which directs PBGC to issue final determinations within 3-5 years of plan trusteeship. PBGC routinely pays benefits in estimated amounts until final determinations are completed.

Appeals Processing: PBGC's Appeals Board reviews appeals of certain PBGC determinations. Most of the appeals are from people disputing their benefit determinations. Typically, about 2 percent of all benefit determinations are appealed. During 1998, the Appeals Board received 3,705 appeals, a greater percentage of benefit determinations than is usual due to a high rate of form-letter appeals relating to one large pension plan. The Appeals Board decided 779 appeals during the year, closing them within 349 days, on average, of the date received. The Board also made substantial progress toward decisions on the high number of appeals filed this year.

Pension Search Program: During 1998, the third year of operation for the missing participants clearinghouse, 552 companies terminating fully funded plans asked PBGC for assistance in finding 4,855 missing people. Of these, 3,687 were due over $6.6 million in benefits and 1,168 were covered by annuity contracts that will pay their benefits when they are found. By yearend, PBGC had confirmed addresses for 769 of the missing people and paid more than $1.5 million in benefits to 493 of them. PBGC is continuing its search for valid addresses for the remaining missing people.

The agency maintains a listing on the Internet called the Pension Search Directory as an additional means of locating people who have frustrated all previous searches by either their former employers or PBGC. Since its inception in December 1996, the Directory has enabled PBGC to find nearly 1,400 people who were owed more than $4 million in benefits plus interest. By the end of 1998, the total listing included almost 7,200 people who had worked for about 1,000 companies and were owed nearly $13 million in pension benefits. The Directory is found on the Internet at **http://search.pbgc.gov**.

Multiemployer Program Results

The multiemployer program, which covers about 8.7 million workers and retirees in about 2,000 insured plans, is funded and administered separately from the single-employer program and differs from the single-employer program in several significant ways. The multiemployer program covers only collectively bargained plans involving two or more unrelated employers. For such plans, the event triggering PBGC's guarantee is the inability of a covered plan to pay benefits when due at the guaranteed level, rather than plan termination as required under the single-employer program. PBGC provides financial assistance through loans to insolvent plans to enable them to pay guaranteed benefits.

As PBGC stated in its June 1996 report on the multiemployer program's financial condition, "The multiemployer program is financially strong. Since enactment of the current financial assistance program in 1980, the program's financial condition has improved from a deficit of $8.5 million to the current surplus ... The program has had a surplus since 1982... Projections show that the surplus should continue to grow under a wide range of economic scenarios." During 1998, PBGC updated the data used in preparing the report and found that the results remained substantially the same.

"The multiemployer **program** is financially **strong**."

Financial Assistance: The multiemployer program has received relatively few requests for financial assistance. Since 1980, PBGC has provided assistance to only 22 of the 2,000 insured plans, with a total value of approximately $38 million net of repaid amounts. In 1998, 18 of these plans were still receiving assistance of about $6 million annually.

In January, the Anthracite Health and Welfare Fund and Pension Plan, a plan for coal miners, became the first multiemployer plan to repay financial assistance from PBGC. The Fund repaid PBGC $3.2 million for financial assistance provided in the 1980's to enable the Fund to pay benefits during temporary periods of insolvency.

Legislation: The Administration has recommended that the Congress more than double the current maximum guarantee from $5,850 to $12,870. The multiemployer program's benefit guarantee has been at the same level since 1980, and inflation has cut the real value of the guarantee almost in half. Currently, less than 1 percent of all workers and retirees in insolvent multiemployer plans have all their benefits guaranteed. With the change, at least three-quarters of all plan participants in future insolvencies would receive their full benefits through PBGC's insurance. The guarantee increase would require no change in the multiemployer premium rate. The proposed increase in the guarantee has been pending before the Congress since 1996.

Customer Service

PBGC's Customer Service Center for participants in trusteed plans continued to meet higher-than-expected demands. When the center began operations three years ago, PBGC projected that it would handle about 8,000 calls per month with answer times averaging about 2 minutes. During the past year, the center handled, on average, more than 21,000 calls each month in slightly more than 2 minutes per call. Another 516,000 calls were answered through automated information.

"PBGC continued its **outreach** to plan sponsors, plan participants, and pension professionals... to further **improve** its service."

In 1998, PBGC began implementing President Clinton's plain language initiative. The agency started developing a Plain Language Guide for use by PBGC staff that includes, in part, a dictionary that defines technical terms commonly used by PBGC in more easily understandable language. The agency also began training staff in how to write in plain language. In addition, PBGC rewrote selected, frequently sent letters to customers using common everyday words and short sentences. These efforts will continue in 1999.

PBGC also completed its first "practitioner" survey of plan administrators and pension professionals to determine their level of satisfaction with the agency's services. The results, together with those of the agency's third survey of plan participants conducted in 1997, were heartening and instructive. Both practitioners and participants found that PBGC's service was improving, with 79 percent of the surveyed participants and 54 percent of the practitioners rating PBGC's overall customer service as "above average" or "outstanding." Under its five-year strategic plan, one of PBGC's goals is to satisfy 90 percent of participants by the year 2002 — the agency intends to set a satisfaction goal for practitioners after it reviews the results of its second practitioner survey, during the second quarter of 1999.

The practitioner survey suggested that PBGC could raise the overall satisfaction level simply by improving the timeliness, responsiveness, and follow-up to inquiries. Those surveyed made it clear they want their calls returned promptly and their questions resolved within three to five days and with only one or two calls. Many of these issues

PBGC's Customer Service Standards

Our customers deserve our best effort as well as our respect and courtesy.

On the first call from you, we will say:

- what we can do immediately and what will take longer,
- when it will be done, and
- who will handle your request.

We will call you if anything changes from what we first said, give you a status report and explain what will happen next.

We will have staff available from 8:00 a.m.-5:00 p.m. Eastern time to answer your calls. If you leave a message, we will return the call within one workday.

We will acknowledge your letter within one week of receipt.

also surfaced in the participant surveys. As a result, PBGC revised its Customer Service Standards to reflect the type of service requested by its customers.

In response to the surveys, PBGC formed several cross-departmental teams of employees late in the year to develop recommendations for improvements in specific areas of service, including participant communications and billings for underpaid premium payments. The intensive effort, termed Reach for Excellence and Customer Happiness, allowed team members to tap each other's knowledge about different areas of the agency in identifying and addressing barriers to good customer service. The teams had wide discretion to propose solutions. Ultimately, many of the teams' recommendations were accepted, including toll-free telephone numbers for employers, plan administrators, and pension professionals and expansion of PBGC's website to include more information for plan participants. The agency was beginning to implement the recommendations as the year ended.

PBGC initiated a number of changes in part to address issues raised by the surveys and to improve customer service. Of these, perhaps the most significant involved the extension of the premium filing due date by one month. Plan administrators and pension professionals have frequently expressed concern about the requirement that plans file their final premium payment one month earlier than the final due date for the Form 5500 annual information report they must file with the Internal Revenue Service. Some of the information needed to compute the PBGC premium is reported on the plan's Form 5500. The premium due date also coincided with the last day a company may contribute to its plan for the prior year, leading to problems in the calculation of a plan's funding level. The change in due date, effective for plan years beginning on or after January 1, 1999, will ease a substantial burden on plan administrators.

The agency introduced an electronic version of its reportable events forms on its Internet website. Software on the website now allows employers and plan administrators to complete the form and submit it to PBGC by e-mail. In addition, PBGC issued a new publication, the "Small Business Guide," to

help small businesses with PBGC-insured plans understand the operation and requirements of the pension insurance program. The Guide summarizes all employer administrative responsibilities under the insurance program in a single, nontechnical reference publication.

PBGC also began an effort to educate workers about defined benefit plans. Through a special section on its website and the issuance of a new publication called "A Predictable, Secure Pension for Life," PBGC is providing easy-to-understand information about how traditional defined benefit plans operate and the advantages they offer.

For plan participants in PBGC-trusteed plans, PBGC changed its policy on recovery of benefit overpayments to ensure that no one ever repays more than the actual amount of the overpayment. Until 1998, if a participant did not wish to repay an overpayment in a lump sum, PBGC made the recovery through a permanent reduction (generally capped at 10 percent) in the person's future benefit payments. Now, the reduction will cease when the total amount collected matches the amount by which the person had been overpaid. In addition, PBGC increased the maximum value of a benefit it will pay in a single, lump sum from $3,500 to $5,000. A participant still has the option of receiving the benefit as an annuity instead if that person's monthly benefit at normal retirement age is at least $25. PBGC also revised its procedures for valuing its recoveries for plan underfunding and unpaid contributions, which will help reduce the amount of time needed to complete final benefit determinations.

Financial Statements

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The following discussion and analysis provide information that management believes is relevant to an assessment and understanding of the Corporation's financial condition and results of operations. The discussion should be read in conjunction with the financial statements and notes thereto.

PBGC's operating results are subject to significant fluctuation from year to year depending on the frequency and severity of losses from terminating pension plans, general economic conditions, and other factors such as changes in law. Consequently, certain traditional financial ratios and measurements are not meaningful and, therefore, not presented.

Combined Results

For 1998, PBGC's combined underwriting and financial activities resulted in a net gain of $1.653 billion on gross income of $3.250 billion. The single-employer and multiemployer programs reported a net income of $1.531 billion and $122 million respectively. By law, these two programs are separate.

Single-Employer Program

Results of Activities and Trends: The net income in 1998 was $1.531 billion compared to net income of $2.612 billion in 1997. The $1.081 billion decrease was primarily attributable to the decrease in investment income.

Underwriting Activity: The gain of $462 million in 1998 was down from a gain of $897 million in 1997. This $435 million decrease was primarily due to (1) a decrease in premium income, (2) the one-time actuarial credit taken in 1997 as a result of the change in the method of calculating expenses incurred in determining and paying a participant's benefits, to more closely match the agency's annual claims-related expenses, and (3) an increase in losses from probable terminations.

Underwriting income decreased from $1.086 billion in 1997 to $976 million in 1998. The $110 million decrease relates primarily to the decrease in variable-rate premium payments.

The Corporation's losses from completed and probable plan terminations increased from $489 million in 1997 to $584 million in 1998. Although there were no major plan terminations in 1998, losses are unpredictable.

Operating costs remained level at $143 million.

Financial Activity: Investment income exceeded actuarial charges in 1998, resulting in a $1.069 billion gain versus a $1.715 billion gain in 1997. The total return on investments was 14.4% in 1998, compared to 21.9% in 1997. Fixed-income investments experienced higher returns in 1998 than in 1997 while equity investment returns were lower. PBGC, in accordance with generally accepted accounting principles, marks its assets and liabilities to market.

Actuarial charges primarily resulted from the aging of the present value of future benefits and from changes in interest rates. In 1998, the select interest rate assumption decreased from 6.2% at September 30, 1997, to 5.7% at September 30, 1998, while the ultimate rate increased from 5.5% to 5.75%. The passage of time and change in the interest rates resulted in an actuarial charge of $1.034 billion in 1998, compared to an actuarial charge of $960 million in 1997.

Liquidity and Capital Resources: The single-employer program's net position improved in 1998 to approximately $5.0 billion primarily because of a strong return on fixed-income investments. Approximately $17.5 billion (99 percent) of the program's total assets of $17.6 billion are in marketable assets.

PBGC's primary sources of cash are from premium receipts and investment activities. If funds generated from these sources are insufficient to meet fixed charges in any period, the Corporation has available a $100 million line of credit from the U.S. Treasury for liquidity purposes. PBGC did not use this borrowing authority in 1997 or 1998 and has no plans to use it in the near future.

Benefit payments and administrative expenses should again approximate $1 billion in 1999. Due to significant factors beyond PBGC's control (e.g., fluctuations in interest rates, contributions made to PBGC-insured plans by sponsors, etc.), it is difficult to project premium revenue with a high degree of certainty.

The Corporation is subject to litigation that could have considerable impact on its financial condition. Also, the total underfunding in large plans that are sponsored by companies with below-investment-grade bond ratings ranges from approximately $15 billion to $17 billion. Losses from these plans are not probable at this time but generally accepted accounting principles require the exposure to be disclosed in the footnotes of the financial statements. This exposure is primarily in the steel, airline, communications, and transportation equipment industries.

The single-employer program's positive net position of approximately $5.0 billion at yearend will help provide the financial foundation needed to support the Corporation's long-term responsibilities under the Employee Retirement Income Security Act. A properly managed insurance program must have the resources to provide for unforeseen losses from terminating pension plans.

Multiemployer Program

Results of Activities and Trends: The multiemployer program reported a net gain of $122 million in 1998 compared to a net gain of $95 million in 1997. The $27 million increase in net gain was primarily due to the increase in investment income. Premium income remained constant at $23 million. Investment income increased from $68 million in 1997 to $133 million in 1998. Of the program's assets, 95.6 percent and 94.1 percent were invested in Treasury securities in 1998 and 1997, respectively.

Liquidity and Capital Resources: As the multiemployer program has a positive net position and most assets are highly liquid Treasury securities, PBGC has sufficient resources to meet its liquidity requirements now and in the long-term future. In 1999, premium receipts will approximate $22 million, while benefit payments and financial assistance will be about $20 million.

Federal Managers' Financial Integrity Act Statement

Management controls in effect in 1998 provided reasonable assurance that assets were safeguarded from material loss and that transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations. Furthermore, PBGC management controls provided reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds.

PBGC has not identified any new material weaknesses. The Corporation will correct the last previously identified financial management system weakness by integrating the new revolving fund system in 1999.

MANAGEMENT REPRESENTATION

PBGC's management is responsible for the accompanying Statements of Financial Condition as of September 30, 1998 and 1997, the related Statements of Operations and Changes in Net Position, and the Statements of Cash Flows for the years then ended. PBGC's management is also responsible for establishing and maintaining systems of internal accounting and administrative controls that provide reasonable assurance that the control objectives — preparing reliable financial statements, safeguarding assets, and complying with laws and regulations — are achieved.

The Inspector General engaged PricewaterhouseCoopers LLP (PwC) to conduct the audit of the Corporation's 1998 and 1997 financial statements. In its opinion on PBGC's financial statements, PwC reported that the Statements of Financial Condition as of September 30, 1998 and 1997, and the Statements of Operations and Changes in Net Position and Statements of Cash Flows for the fiscal years ended September 30, 1998 and 1997, were fairly stated in all material respects.

In the opinion of management, the financial statements present fairly the financial position of PBGC at September 30, 1998, and September 30, 1997, and the results of operations and cash flows for the years then ended, in conformity with generally accepted accounting principles (GAAP) and actuarial standards applied on a consistent basis.

Estimates of probable terminations, nonrecoverable future financial assistance, amounts due from employers, and the present value of future benefits may have a material effect on the financial results being reported. In addition to litigation that has been properly disclosed and reported in accordance with GAAP, other litigation may have an effect on the financial condition of the Corporation.

As a result of the aforementioned, these statements are based, in part, upon informed judgments and estimates for those transactions not yet complete or for which the ultimate effects cannot be precisely measured, or for those that are subject to the effects of any pending litigation.

David M. Strauss
Executive Director

N. Anthony Calhoun
Deputy Executive Director
and Chief Financial Officer

January 15, 1999

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
	1998	1997	**1998**	1997	**1998**	1997
ASSETS						
Cash and cash equivalents	**$ 693**	$ 553	**$ 21**	$ 20	**$ 714**	$ 573
Investments, at market (Note 3):						
Fixed maturity securities	**10,530**	8,340	**712**	561	**11,242**	8,901
Equity securities	**6,048**	5,974	**3**	4	**6,051**	5,978
Real estate and real estate investment trusts	**39**	83	**0**	0	**39**	83
Other	**35**	38	**0**	0	**35**	38
Total investments	**16,652**	14,435	**715**	565	**17,367**	15,000
Receivables, net:						
Sponsors of terminated plans	**21**	52	**0**	0	**21**	52
Sponsors of restored plans (Note 4)	**55**	56	**0**	0	**55**	56
Premiums (Note 11)	**53**	59	**1**	1	**54**	60
Sale of securities	**23**	33	**0**	0	**23**	33
Notes receivable (Note 5)	**2**	3	**0**	0	**2**	3
Investment income	**123**	114	**8**	7	**131**	121
Other	**5**	4	**0**	3	**5**	7
Total receivables	**282**	321	**9**	11	**291**	332
Furniture and fixtures, net	**4**	5	**0**	0	**4**	5
Total assets	**$17,631**	$15,314	**$745**	$596	**$18,376**	$15,910

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)

	Single-Employer Program September 30,		Multiemployer Program September 30,		Memorandum Total September 30,	
	1998	1997	**1998**	1997	**1998**	1997
LIABILITIES						
Present value of future benefits, net (Note 6):						
Trusteed plans	**$10,446**	$ 9,994	**$ 6**	$ 7	**$10,452**	$10,001
Terminated plans pending trusteeship	**90**	147	**0**	0	**90**	147
Settlements and judgments	**319**	248	**0**	0	**319**	248
Claims for probable terminations	**1,426**	1,108	**0**	0	**1,426**	1,108
Total present value of future benefits, net	**12,281**	11,497	**6**	7	**12,287**	11,504
Present value of nonrecoverable future financial assistance (Note 7)			**389**	361	**389**	361
Unearned premiums (Note 11)	**266**	271	**9**	9	**275**	280
Accounts payable and accrued expenses (Note 8)	**72**	65	**0**	0	**72**	65
Commitments and contingencies (Notes 9, 10, and 16)						
Total liabilities	**12,619**	11,833	**404**	377	**13,023**	12,210
NET POSITION	**5,012**	3,481	**341**	219	**5,353**	3,700
Total liabilities and net position	**$17,631**	$15,314	**$745**	$596	**$18,376**	$15,910

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

(Dollars in millions)

	Single-Employer Program For the Years Ended September 30,		Multiemployer Program For the Years Ended September 30,		Memorandum Total For the Years Ended September 30,	
	1998	1997	**1998**	1997	**1998**	1997
UNDERWRITING:						
Income:						
Premium (Note 11)	**$ 966**	$1,067	**$ 23**	$ 23	**$ 989**	$1,090
Other	**10**	19	**0**	0	**10**	19
Total	**976**	1,086	**23**	23	**999**	1,109
Expenses:						
Administrative	**143**	143	**0**	0	**143**	143
Other	**6**	29	**0**	0	**6**	29
Total	**149**	172	**0**	0	**149**	172
Other underwriting activity:						
Losses from completed and probable terminations (Note 12)	**584**	489	**0**	0	**584**	489
Losses (gains) from financial assistance (Note 7)			**34**	(3)	**34**	(3)
Actuarial adjustments (Note 6)	**(219)**	(472)	**0**	(2)	**(219)**	(474)
Total	**365**	17	**34**	(5)	**399**	12
Underwriting income (loss)	**462**	897	**(11)**	28	**451**	925
FINANCIAL:						
Investment income (Note 13):						
Fixed	**1,994**	1,000	**133**	67	**2,127**	1,067
Equity	**121**	1,679	**0**	1	**121**	1,680
Other	**3**	8	**0**	0	**3**	8
Total	**2,118**	2,687	**133**	68	**2,251**	2,755
Expenses:						
Investment	**15**	12	**0**	0	**15**	12
Actuarial charges (Note 6):						
Due to passage of time	**621**	654	**0**	1	**621**	655
Due to change in interest rates	**413**	306	**0**	0	**413**	306
Total	**1,049**	972	**0**	1	**1,049**	973
Financial income	**1,069**	1,715	**133**	67	**1,202**	1,782
Net income	**1,531**	2,612	**122**	95	**1,653**	2,707
Net position, beginning of year	**3,481**	869	**219**	124	**3,700**	993
Net position, end of year	**$5,012**	$3,481	**$341**	$219	**$5,353**	$3,700

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

(Dollars in millions)

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
	1998	1997	**1998**	1997	**1998**	1997
OPERATING ACTIVITIES:						
Premium receipts	**$ 967**	$ 1,047	**$ 24**	$ 24	**$ 991**	$ 1,071
Interest and dividends received, net	**673**	597	**41**	36	**714**	633
Cash received from plans upon trusteeship	**67**	29	**0**	0	**67**	29
Receipts from sponsors	**48**	25	**0**	0	**48**	25
Other receipts	**9**	8	**3**	0	**12**	8
Receipts of notes receivable	**1**	79	**0**	0	**1**	79
Benefit payments – trusteed plans	**(839)**	(792)	**(1)**	(1)	**(840)**	(793)
Financial assistance payments			**(6)**	(4)	**(6)**	(4)
Settlements and judgments	**(40)**	(5)	**0**	0	**(40)**	(5)
Payments for administrative and other expenses	**(148)**	(154)	**0**	0	**(148)**	(154)
Net cash provided by operating activities (Note 15)	**738**	834	**61**	55	**799**	889
INVESTING ACTIVITIES:						
Proceeds from sales of investments	**7,537**	3,680	**214**	23	**7,751**	3,703
Payments for purchases of investments	**(8,135)**	(4,635)	**(274)**	(82)	**(8,409)**	(4,717)
Net cash used in investing activities	**(598)**	(955)	**(60)**	(59)	**(658)**	(1,014)
Net increase (decrease) in cash and cash equivalents	**140**	(121)	**1**	(4)	**141**	(125)
Cash and cash equivalents, beginning of year	**553**	674	**20**	24	**573**	698
Cash and cash equivalents, end of year	**$ 693**	$ 553	**$ 21**	$ 20	**$ 714**	$ 573

The accompanying notes are an integral part of these financial statements.

Note 1 — Organization and Purpose

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and is subject to the provisions of the Government Corporation Control Act. Its activities are defined in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980, the Single-Employer Pension Plan Amendments Act of 1986, the Pension Protection Act of 1987, and the Retirement Protection Act of 1994. The Corporation insures pensions, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans that meet the criteria specified in Section 4021 of ERISA.

ERISA requires that PBGC programs be self-financing. The Corporation finances its operations through premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA as amended, and investment income. In addition, PBGC may borrow up to $100 million from the U.S. Treasury to finance its operations. The Corporation did not use this borrowing authority during the years ended September 30, 1998, or September 30, 1997, nor is use of this authority currently planned. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

Under the single-employer program, PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by PBGC is generally equal to the present value of the future benefits (including amounts owed under Section 4022(c) of ERISA) less (1) the amounts that are provided by the plan's assets and (2) the amounts that are recoverable by PBGC from the plan sponsor and members of the plan sponsor's controlled group, as defined by ERISA.

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from PBGC to allow the plan to continue to pay participants their guaranteed benefits. PBGC recognizes assistance as a loss to the extent that the plan is expected to be unable to repay these amounts from future plan contributions, employer withdrawal liability, or investment earnings.

Note 2 — Significant Accounting Policies

PBGC has reclassified certain items on the 1997 financial statements to conform with present year classifications.

Revolving and Trust Funds: PBGC accounts for its single-employer and multiemployer programs' revolving and trust funds on an accrual basis. Each fund is charged its portion of the benefits paid each year. The revolving and trust funds have been combined for presentation purposes in the financial statements. The single-employer and multiemployer programs are separate programs by law and, therefore, are reported separately.

ERISA provides for the establishment of revolving funds to be used by PBGC in carrying out its duties. The revolving funds support the operational and administrative functions of PBGC and fund any deficits incurred by PBGC in trusteeing plans or providing financial assistance. Premiums collected from ongoing plans are accounted for through the revolving funds. The Pension Protection Act of 1987 created a single-employer revolving fund that is credited with all premiums in excess of $8.50 per participant, including all penalties and interest charged on these amounts, as well as investment income. This fund may not be used to pay PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

The trust funds reflect accounting activity associated with: (1) trusteed plans — plans for which PBGC has legal responsibility, (2) plans pending trusteeship — terminated plans for which PBGC has not become legal trustee by fiscal yearend, and (3) probable terminations — plans that PBGC determines are likely to terminate and be trusteed by PBGC. PBGC cannot exercise legal control over a plan's assets until PBGC becomes trustee, which may be several years after the date of plan termination.

Allocation of Revolving and Trust Funds: PBGC allocates revolving and trust fund assets, liabilities, income, and expenses to each program's revolving and trust funds to the extent that such amounts are not directly attributable to a specific fund. Revolving fund income is allocated on the basis of each program's average cash available for investment during the year while the expenses are allocated on the basis of each program's present value of future benefits. Revolving fund assets and liabilities are allocated on the basis of the yearend equity of each program's revolving funds. The plan assets acquired by PBGC and commingled at PBGC's custodian bank are credited directly to the appropriate fund while the earnings and expenses on the commingled assets are allocated to each program's trust funds on the basis of each trust fund's value, relative to the total value of the commingled fund.

Valuation Method: Consistent with generally accepted accounting principles outlined in Statements of Financial Accounting Standards Nos. 35 ("Accounting and Reporting by Defined Benefit Pension Plans"), 60 ("Accounting and Reporting by Insurance Enterprises"), and 87 ("Employers' Accounting for Pensions"), PBGC reports its assets and liabilities at fair value. A primary objective of PBGC's financial statements is to provide financial information that is useful in assessing PBGC's present and future ability to ensure that defined benefit pension plan beneficiaries receive benefits when due. PBGC believes that measuring its assets and liabilities at fair value provides the most relevant information to the reader.

Cash and Cash Equivalents: Cash includes cash on hand and demand deposits. Cash equivalents are securities with a maturity of one business day.

Investment Valuation and Income: Fair values are based on the last sale of a listed security, on the mean of the "bid-and-asked" for nonlisted securities, or on a valuation model in the case of fixed-income securities that are not actively traded. These valuations are determined as of the end of each fiscal year. Purchases and sales of securities are recorded on the trade date. Investment income is accrued as earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are calculated using an average cost basis. Any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC (see Notes 3, 6, and 13).

Sponsors of Terminated Plans, Receivables: The amounts due from sponsors of terminated plans or members of their controlled group represent the settled claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for uncollectible amounts. PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. The Corporation will report any such future amounts realized in the period in which they accrue or are received.

Premiums: Premiums receivable represent the earned but unpaid portion of the premiums for plans that have a plan year commencing before the end of PBGC's fiscal year and past due premiums deemed collectible, including collectible penalties and interest. Unearned premiums represent an estimate of payments received during the fiscal year that cover the portion of a plan's year after the Corporation's fiscal yearend. Premium income represents revenue generated from self-assessments from defined benefit pension plans as required by Title IV of ERISA (see Note 11).

Present Value of Future Benefits (PVFB): The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay with respect to trusteed plans and terminated plans pending trusteeship. This liability is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and members of their controlled group and the assets of terminated plans pending trusteeship. PBGC also includes the estimated liabilities attributable to probable future plan terminations as a separate line item in the PVFB (net of estimated recoveries and assets). To measure the actuarial present value, PBGC used assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). PBGC also included anticipated expenses to settle the benefit obligation in the determination of the PVFB.

(1) Trusteed Plans — represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trusteed by PBGC prior to fiscal yearend.

(2) Terminated Plans Pending Trusteeship — represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated but have not been trusteed by PBGC prior to fiscal yearend.

(3) Settlements and Judgments — represents estimated liabilities related to settled litigation.

(4)Net Claims for Probable Terminations — includes reasonable estimates of the losses, net of plan assets and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in a future year. These estimated losses are based on conditions that existed as of PBGC's fiscal yearend. It is likely that one or more events subsequent to PBGC's fiscal yearend will occur, confirming the fact of the loss.

PBGC's benefit payments to participants represent a reduction to the PVFB (see Note 6).

Present Value of Nonrecoverable Future Financial Assistance: In accordance with Title IV of ERISA, PBGC provides financial assistance to multiemployer plans, in the form of loans, to enable the plans to pay guaranteed benefits to participants and reasonable administrative expenses. These loans, issued in exchange for interest-bearing promissory notes, constitute an obligation of each plan.

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by PBGC in the future to multiemployer plans that will not be able to meet their benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future guaranteed benefits and expenses and the market value of plan assets, including the present value of future amounts expected to be paid by employers, for those plans that are expected to require future assistance. The amount reflects the rates at which, in the opinion of management, these liabilities (net of expenses) could be settled in the market for single-premium nonparticipating group annuities issued by private insurers (see Note 7).

Other Expenses: These expenses represent a current period estimate of the net amount of receivables deemed to be uncollectible. The estimate is based on the most recent status of the debtor (e.g., sponsor), the age of the receivables, and other factors that indicate the element of uncollectibility in the receivables outstanding.

Losses from Completed and Probable Terminations: Amounts reported as losses from completed and probable terminations represent the difference as of the date of plan termination between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 12). In addition, the plans' net income from date of plan termination to the beginning of the fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to PBGC's inventory of terminated plans.

Actuarial Adjustments and Charges: PBGC classifies actuarial adjustments related to changes in method and the effect of experience as underwriting activity. Actuarial charges related to changes in interest rates and passage of time are classified as financial activity. These adjustments and charges represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 6).

Depreciation: PBGC calculates depreciation of its furniture and equipment on a straight-line basis over the estimated useful lives of the assets. The useful lives range from 5 to 10 years. Routine maintenance and leasehold improvements (the amounts of which are not material) are charged to operations as incurred.

Note 3 — Investments

Premium receipts are invested in securities issued by the U.S. Government.

The trust funds include assets PBGC acquires or expects to acquire with respect to terminated plans and investment income thereon. These assets generally are held by custodian banks.

The basis and market value of the investments by type are detailed below. The basis indicated is cost of the asset if acquired after the date of plan termination or the market value at date of plan termination if the asset was acquired as a result of a plan's termination. Realized and unrealized gains and losses, in addition to interest and dividends earned on these investments, are disclosed in Note 13.

INVESTMENTS OF SINGLE-EMPLOYER REVOLVING FUNDS AND SINGLE-EMPLOYER TRUSTEED PLANS

(Dollars in millions)

	September 30, 1998		September 30, 1997	
	Basis	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$ 9,145**	**$10,516**	$ 7,710	$ 8,122
Certificates of deposit	**0**	**0**	1	1
Corporate bonds	**13**	**14**	195	217
Subtotal	**9,158**	**10,530**	7,906	8,340
Equity securities	**4,070**	**6,048**	3,443	5,974
Real estate and real estate investment trusts	**31**	**39**	73	83
Other:				
Insurance contracts	**39**	**33**	44	36
Mortgages	**1**	**2**	2	2
Total	**$13,299**	**$16,652**	$11,468	$14,435

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

(Dollars in millions)

	September 30, 1998		September 30, 1997	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	$620	$712	$532	$561
Equity securities	2	3	2	4
Total	$622	$715	$534	$565

NOTE 4 — RECEIVABLES, NET: SPONSORS OF RESTORED PLANS

The $55 million receivable consists of the original $48 million, 8 1/2% interest-bearing note from the LTV Corporation that matures on December 31, 2020.

NOTE 5 — RECEIVABLES, NET: NOTES RECEIVABLE

In fiscal year 1997, PBGC received $73 million from Continental Airlines to liquidate 10 secured notes with a face value of $82 million. There are four remaining 12% secured notes that mature in 1999. These notes had a net present value of $2 million at September 30, 1998, and a net present value of $3 million at September 30, 1997; in all, the 14 notes had a net present value of $86 million at September 30, 1996.

NOTE 6 — PRESENT VALUE OF FUTURE BENEFITS

The following table summarizes the actuarial adjustments, charges, and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 1998 and 1997.

PBGC used a 25-year select interest rate of 5.7% followed by an ultimate rate of 5.75% for 1998 and a 25-year select interest rate of 6.2% followed by an ultimate rate of 5.5% for 1997. These rates were determined to be those needed to continue to match the survey of annuity prices provided by the American Council of Life Insurance. PBGC's regulations state that both the interest rate and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in the opinion of management, the liabilities (net of expenses) could be settled in the market at September 30, for single-premium nonparticipating group annuities issued by private insurers. These rates are impacted by many factors including Federal Reserve policy.

In 1997, PBGC adopted the 1994 Group Annuity Mortality (GAM) Static Table (with margins), set forward two years and projected 12 years to 2006 using Scale AA, based on the recommendation of a study conducted by an outside consultant.

The reserve for administrative expenses in the 1998 and 1997 valuation was assumed to be 1.3 percent of benefit liabilities plus additional reserves for cases whose plan asset determinations, participant database audits, and actuarial valuations were not yet complete. The factors to determine the additional reserves were based on case size, number of participants, and time since trusteeship. In 1997, PBGC modified the expense formula used to calculate the PVFB to more accurately reflect its claims-related expenses, as determined by a study conducted by an outside consultant.

The present values of future benefits for trusteed multiemployer plans for 1998 and 1997 reflect changes due to benefit payments, change in interest assumption, passage of time, and effect of experience.

The resulting liability represents PBGC's best estimate of the measure of anticipated experience under these programs.

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 1998 AND 1997

(Dollars in millions)

	September 30,			
	1998		1997	
Present value of future benefits, at beginning of year — Single-Employer, net		**$11,497**		$10,760
Estimated recoveries		**12**		36
Assets of terminated plans pending trusteeship, net		**103**		119
Present value of future benefits at beginning of year, gross		**11,612**		10,915
Settlements and judgments		**(248)**		(62)
Net claims for probable terminations, prior year		**(1,108)**		(955)
Actuarial adjustments — underwriting:				
Changes in method and assumptions	**$ (174)**		$ (454)	
Effect of experience	**(45)**		(18)	
Total actuarial adjustments — underwriting	**(219)**		(472)	
Actuarial charges (credits) — financial:				
Passage of time	**621**		654	
Change in interest rates	**413**		306	
Total actuarial charges — financial	**1,034**		960	
Total actuarial charges		**815**		488
Terminations:				
Current year	**414**		870	
Changes in prior year	**(61)**		(177)	
Total terminations		**353**		693
Benefit payments*		**(847)**		(823)
Estimated recoveries		**(12)**		(12)
Assets of terminated plans pending trusteeship, net		**(29)**		(103)
Settlements and judgments		**319**		248
Net claims for probable terminations:				
Future benefits**	**3,309**		2,593	
Estimated plan assets and recoveries from sponsors	**(1,883)**		(1,485)	
Total net claims, current year		**1,426**		1,108
Present value of future benefits, at end of year — Single-Employer, net		**12,281**		11,497
Present value of future benefits, at end of year — Multiemployer		**6**		7
Total present value of future benefits, at end of year, net		**$12,287**		$11,504

* The benefit payments of $847 million and $823 million include $8 million in 1998 and $31 million in 1997 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $3,309 million and $2,593 million for fiscal years 1998 and 1997, respectively, include $119 million and $120 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $3,190 million and $2,473 million, respectively, in net claims for specifically identified probables.

ASSETS OF SINGLE-EMPLOYER TERMINATED PLANS PENDING TRUSTEESHIP, NET

(Dollars in millions)

	September 30, 1998		September 30, 1997	
	Basis	**Market Value**	Basis	Market Value
U.S. Government securities	**$ 2**	**$ 2**	$ 19	$ 19
Corporate bonds	**10**	**10**	27	27
Equity securities	**13**	**14**	35	35
Insurance contracts	**2**	**2**	6	6
Other	**0**	**0**	5	5
Cash and cash equivalents	**1**	**1**	11	11
Total, net	**$28**	**$29**	$103	$103

Net Claims for Probable Terminations: Factors that are presently not fully determinable may be responsible for these claim estimates differing from actual experience. Included in net claims for probable terminations is a provision for future benefit liabilities for plans not specifically identified.

The values recorded in the following reconciliation table have been adjusted to the expected dates of termination.

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS

(Dollars in millions)

	September 30, 1998		1997	
Net claims for probable terminations, at beginning of year		**$1,108**		$ 955
New claims	**$ 284**		$ 95	
Actual terminations	**(56)**		(127)	
Eliminated probables	**(26)**		(32)	
Change in benefit liabilities	**260**		331	
Change in plan assets	**(190)**		(198)	
Change in expected recoveries	**46**		84	
Loss on probables		**318***		153*
Net claims for probable terminations, at end of year		**$1,426**		$1,108

* See Note 12

Note 7 — Multiemployer Financial Assistance

Financial assistance is granted to multiemployer defined benefit pension plans in the form of loans. An allowance is set up to the extent that repayment of these loans is not expected. Negotiations with a multiemployer plan produced a final agreement in December 1997, under which the plan repaid $3.2 million in financial assistance in January 1998.

NOTES RECEIVABLE MULTIEMPLOYER FINANCIAL ASSISTANCE

(Dollars in millions)

	September 30, 1998	1997
Gross balance at beginning of year	**$ 35**	$ 31
Financial assistance payments—current year	**6**	4
Financial assistance repayment	**(3)**	0
Subtotal	**38**	35
Allowance for uncollectible amounts	**(38)**	(32)
Net balance at end of year	**$ 0**	$ 3

The losses (gains) from financial assistance reflected in the Statements of Operations and Changes in Net Position include annual changes in the estimated present value of nonrecoverable future financial assistance and assistance granted that was not previously accrued. The gains resulting from the repayment of financial assistance do not impact the estimated present value of nonrecoverable future financial assistance.

PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE

(Dollars in millions)

	September 30, 1998	1997
Balance at beginning of year	**$361**	$365
Changes in allowance:		
Losses from financial assistance	**34**	0
Financial assistance granted (previously accrued)	**(6)**	(4)
Balance at end of year	**$389**	$361

NOTE 8 — ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The following table itemizes accounts payable and accrued expenses reported in the Statements of Financial Condition:

ACCOUNTS PAYABLE AND ACCRUED EXPENSES

(Dollars in millions)

	September 30, 1998	1997
Due for purchase of securities	**$33**	$36
Annual leave	**4**	3
Other payables and accrued expenses	**35**	26
Accounts payable and accrued expenses	**$72**	$65

NOTE 9 — CONTINGENCIES

There are a number of large single-employer plans that may terminate. In addition, there are some multiemployer plans that may require future financial assistance. The amounts disclosed below represent the Corporation's best estimates given the inherent uncertainties about these plans.

PBGC estimated that total unfunded vested benefits on termination of single-employer plans that represented reasonably possible exposure as of September 30, 1998, ranged from $15 billion to $17 billion. This exposure was primarily in the steel, airline, communications, and transportation equipment industries. PBGC calculated this estimate as in previous years by using data obtained from filings with the government and corporate annual reports for fiscal years ending in calendar 1997. The Corporation adjusted the value reported for liabilities in the $15 billion estimate to the December 31, 1997, PBGC select interest rate of 5.4%. When available, data was adjusted to a consistent set of mortality assumptions. The Corporation eliminated plans not insured by PBGC from the data. Since these figures were generally based on the reporting requirements in the Financial Accounting Standards Board's Statement of Financial Accounting Standard No. 87 ("Employers' Accounting for Pensions"), PBGC made no provision for the possible failure of the plan sponsor to make subsequent contributions or for plan liabilities that would be incurred after that date.

PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 7) for multiemployer plans that PBGC estimated may require future financial assistance. In addition, PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of $369 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable or reasonably possible as the present value of guaranteed future benefit and expense payments as of the later of September 30, 1998, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 1998, using interest only. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts require consideration of many complex factors. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

A select and ultimate interest rate assumption of 5.7% for the first 25 years after the valuation date and 5.75% thereafter was used. The 1994 Group Annuity Mortality Static Table (with margins), set forward two years, projected 12 years to 2006 using Scale AA, was also used.

Note 10 — Commitments

PBGC leases its office facility under a commitment that began on December 11, 1993, and expires December 10, 2008. The lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, PBGC is leasing space for field benefit administrators. These leases began in 1996 and expire in 2008. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 1998, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS

(Dollars in millions)

Years Ending September 30,	Operating Leases
1999	$ 11.7
2000	12.0
2001	12.2
2002	12.4
2003	12.3
Thereafter	79.5
Minimum lease payments	$140.1

Lease expenditures were $11.7 million in 1998 and $11.3 million in 1997.

Note 11 — Premiums

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and penalties on the unpaid amount for late payment or underpayment of premiums. Late payment interest continues to accrue until the premium due is paid, while the amount of penalty that can be levied is capped at 100 percent of the premium late payment or underpayment. Annual premiums for the single-employer program are $19 per participant for a fully funded plan. Underfunded single-employer plans pay an additional variable-rate charge, previously capped at $53 per participant, based on funding levels. The multiemployer premium is $2.60 per participant. See Note 2 for further information on premium accounting policies.

Note 12 — Losses from Completed and Probable Terminations

Amounts reported as losses are the present value of future benefits (including amounts owed under Section 4022(c)) less related plan assets and the present value of expected recoveries from sponsors. The following table details the components that make up the losses:

LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS — SINGLE-EMPLOYER PROGRAM

(Dollars in millions)

	For the Years Ended September 30,					
	1998			1997		
	New Terminations	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$414**	**$(61)**	**$353**	$870	$(177)	$693
Less plan assets	**236**	**(38)**	**198**	536	35	571
Plan asset insufficiency	**178**	**(23)**	**155**	334	(212)	122
Less estimated recoveries	**1**	**(1)**	**0**	0	(24)	(24)
Subtotal	**$177**	**$(22)**	**155**	$334	$(188)	146
Settlements and judgments			**111**			190
Probables			**318***			153*
Total			**$584**			$489

* See Note 6

Note 13 — Financial Income

FINANCIAL INCOME

(Dollars in millions)

	For the Years Ended September 30,					
	1998			1997		
	Terminated Plans Pending Trusteeship	**Revolving Funds and Trusteed Plans**	**Total**	Terminated Plans Pending Trusteeship	Revolving Funds and Trusteed Plans	Total
Fixed-income securities:						
Interest earned	**$0**	**$ 675**	**$ 675**	$1	$ 596	$ 597
Realized gain	**0**	**427**	**427**	1	29	30
Unrealized gain	**0**	**1,025**	**1,025**	0	440	440
Total fixed-income securities	**0**	**2,127**	**2,127**	2	1,065	1,067
Equity securities:						
Dividends earned	**1**	**50**	**51**	1	64	65
Realized gain	**0**	**623**	**623**	1	351	352
Unrealized gain (loss)	**0**	**(553)**	**(553)**	0	1,263	1,263
Total equity securities	**1**	**120**	**121**	2	1,678	1,680
Other income	**0**	**3**	**3**	0	8	8
Total financial income	**$1**	**$2,250**	**$2,251**	$4	$2,751	$2,755

Note 14 — Employee Benefit Plans

All permanent full-time and part-time PBGC employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984 participate in CSRS unless they elected and qualified to transfer to FERS.

The Corporation's contribution to the CSRS plan, for 1998 and 1997 respectively, was 8.51 percent and 7 percent of base pay for those employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 10.7 percent and 11.4 percent of base pay for 1998 and 1997 respectively. In addition, for FERS-covered employees, PBGC automatically contributes 1 percent of base pay to the employee's Thrift Savings account, matches the first 3 percent contributed by the employee, and matches one-half of the next 2 percent contributed by the employee. Total retirement plan expenses amounted to $6 million in both 1998 and 1997.

These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to PBGC employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM accounts for federal health and life insurance programs for those retired PBGC eligible employees who had selected federal government-sponsored plans. PBGC does not offer other supplemental health and life insurance benefits to its employees.

Note 15 — Cash Flows

The following is a reconciliation between the net income as reported in the Statements of Operations and Changes in Net Position and net cash provided by operating activities as reported in the Statements of Cash Flows.

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

(Dollars in millions)

	Single-Employer Program September 30,		Multiemployer Program September 30,		Memorandum Total September 30,	
	1998	1997	**1998**	1997	**1998**	1997
Net income	**$ 1,531**	$ 2,612	**$122**	$ 95	**$ 1,653**	$ 2,707
Adjustments to reconcile net income to net cash provided by operating activities:						
Net appreciation in fair value of investments	**(1,444)**	(2,010)	**(91)**	(32)	**(1,535)**	(2,042)
Net income of terminated plans pending trusteeship	**(10)**	(36)	**0**	0	**(10)**	(36)
Loss on completed and probable terminations	**584**	489	**0**	0	**584**	489
Actuarial charges (credits)	**815**	488	**0**	(1)	**815**	487
Benefit payments-trusteed plans	**(839)**	(792)	**(1)**	(1)	**(840)**	(793)
Cash received from plans upon trusteeship	**67**	29	**0**	0	**67**	29
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
(Increase) decrease in receivables	**29**	77	**3**	(4)	**32**	73
Increase (decrease) in present value of nonrecoverable future financial assistance			**28**	(4)	**28**	(4)
Increase (decrease) in unearned premiums	**(5)**	(25)	**0**	2	**(5)**	(23)
Increase in accounts payable	**10**	2	**0**	0	**10**	2
Net cash provided by operating activities	**$ 738**	$ 834	**$ 61**	$ 55	**$ 799**	$ 889

NOTE 16 — LITIGATION

PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. PBGC estimates that resolution of other litigation matters will not have a material adverse effect on PBGC's financial position.

Actuarial Valuation

PBGC calculated and validated the present value of future PBGC-payable benefits (PVFB) for both the single-employer and multiemployer programs and of nonrecoverable future financial assistance under the multiemployer program.

Methods and procedures for both single-employer and multiemployer plans were generally the same as those used in 1997.

PRESENT VALUE OF FUTURE BENEFITS AND NONRECOVERABLE FINANCIAL ASSISTANCE — 1998

(Dollars in millions)

	Number of Plans	Number of Participants (000)	Liability
I. SINGLE-EMPLOYER PROGRAM			
A. Terminated plans			
1. Seriatim at fiscal yearend (FYE)	1,651	185	$ 5,186
2. Seriatim at DOPT, adjusted to FYE	304	45	813
3. Nonseriatim[1]	700	193	4,885
4. Rettig Settlement (seriatim)[2]	—	*	2
5. Missing Participants Program (seriatim)[3]	—	6	10
Subtotal	2,655	429	10,896
B. Probable terminations (nonseriatim)[4]	26	98	3,309
Total[5]	2,681	527	$14,205
II. MULTIEMPLOYER PROGRAM			
A. Pre-MPPAA terminations (seriatim)	10	1	$ 6
B. Post-MPPAA liability (net of plan assets)[6]	48	42	389
Total	58	43	$ 395

* Fewer than 500 participants

Notes:

1) The liability for terminated plans has been increased by $356 million for terminated plans not yet reported and for other settlements.

2) The Rettig Settlement refers to the liability that PBGC incurred due to the settlement of a class action lawsuit that increased benefits for some participants and provided new benefits to others. The remaining participants not yet paid are valued seriatim.

3) The Missing Participants Program refers to a liability that PBGC assumed for unlocated participants in standard plan terminations.

4) The net claims for probable plans reported in the financial statements include $119 million for not-yet-identified probable terminations. The assets for the probable plans, including the expected value of recoveries on employer liability and due-and-unpaid employer contributions claims, are $1,883 million. Thus, the net claims for probables as reported in the financial statements are $3,309 million less $1,883 million, or $1,426 million.

5) The PVFB in the financial statements ($12,281 million) is net of estimated plan assets and recoveries on probables ($1,883 million), estimated recoveries on terminated plans ($12 million), and estimated assets for plans pending trusteeship ($29 million), or, $14,205 million less $1,883 million less $12 million less $29 million = $12,281 million.

6) The Post-MPPAA liability includes $81 million for a settlement with a national multiemployer pension fund.

Single-Employer Program

PBGC calculated the single-employer program's liability for benefits in the terminated plans and probable terminations, as defined in Note 2 to the financial statements, using a combination of two methods: seriatim and nonseriatim. For 1,651 plans, representing about 62 percent of the total number of single-employer terminated plans (43 percent of the total participants in single-employer terminated plans), PBGC had sufficiently accurate data to calculate the liability separately for each participant's benefit — the seriatim method. This was an increase of 42 plans over the 1,609 plans valued seriatim last year. For 304 plans whose data were not yet fully automated, PBGC calculated the benefits and liability seriatim as of the date of plan termination (DOPT) and brought the total amounts forward to the end of fiscal year 1998.

For 700 other terminated plans, PBGC did not have sufficiently accurate or complete data to value individual benefits. Instead, the Corporation used a "nonseriatim" method that brought the liabilities from the plan's most recent actuarial valuation forward to the end of fiscal year 1998 using certain assumptions and adjustment factors.

For the actuarial valuation, PBGC used a select and ultimate interest rate assumption of 5.70% for the first 25 years after the valuation date and 5.75% thereafter. The mortality assumptions used for the valuation were the same as for the 1997 valuation. For healthy lives, PBGC used the 1994 Group Annuity Mortality Static Table (with margins), set forward two years, projected 12 years to 2006 using Scale AA. The projection period is determined as the sum of the elapsed time from the date of the table (1994) to the valuation date plus the period of time from the valuation date to the average date of payment of future benefits. PBGC assumed an explicit loading for expenses in all terminated plans and single-employer probable terminations. The reserve for expenses in the 1998 valuation was assumed to be 1.3 percent of the liability for benefits plus additional reserves for cases whose plan asset determinations, participant database audits, and actuarial valuations were not yet complete. The factors to determine the additional reserves were based on case size, number of participants, and time since trusteeship.

For non-pay-status participants, PBGC used expected retirement ages, as explained in subpart B of the Allocation of Assets in Single-Employer Plans regulation. PBGC assumed that participants who had attained their expected retirement age were in pay status. In seriatim plans, for participants who were older than their plan's normal retirement age, were not in pay status, and were unlocated at September 30, 1998, PBGC reduced the value of their future benefits to zero over the three years succeeding normal retirement age to reflect the lower likelihood of payment.

Multiemployer Program

PBGC calculated the liability for the 10 pre-MPPAA terminations using the same assumptions and methods applied to the single-employer program.

PBGC based its valuation of the post-MPPAA liability for nonrecoverable future financial assistance on the most recent available actuarial reports, Form 5500 Schedule B's, and information provided by representatives of the affected plans. The Corporation expected 48 plans to need financial assistance because severe industrial declines have left them with inadequate contribution bases and they had either run out of assets or were expected to run out of assets in the foreseeable future.

Statement of Actuarial Opinion

This valuation has been prepared in accordance with generally accepted actuarial principles and practices and, to the best of my knowledge, fairly reflects the actuarial present value of the Corporation's liabilities for the single-employer and multiemployer plan insurance programs as of September 30, 1998.

In preparing this valuation, I have relied upon information provided to me regarding plan provisions, plan participants, plan assets, and other matters, some of which are detailed in a complete Actuarial Report available from PBGC.

In my opinion, (1) the techniques and methodology used for valuing these liabilities are generally acceptable within the actuarial profession; (2) the assumptions used are appropriate for the purposes of this statement and are individually my best estimate of expected future experience discounted using current settlement rates from insurance companies; and (3) the resulting total liability represents my best estimate of anticipated experience under these programs.

Joan M Weiss

Joan M. Weiss, FSA, EA
Chief Valuation Actuary, PBGC
Member, American Academy of Actuaries

A complete actuarial valuation report, including additional actuarial data tables, is available from PBGC upon request.

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

Office of Inspector General

To the Board of Directors
Pension Benefit Guaranty Corporation

This letter transmits the PricewaterhouseCoopers LLP report on the audit of the Fiscal Years (FYs) 1998 and 1997 financial statements of single-employer and multiemployer program funds administered by the Pension Benefit Guaranty Corporation (PBGC) and the results of the Office of Inspector General's (OIG) review thereon.

The Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576), as amended, requires PBGC's Inspector General or an independent external auditor, as determined by the Inspector General, to audit PBGC's financial statements. The audit is to be performed in accordance with *Government Auditing Standards* as issued by the Comptroller General of the United States and other applicable requirements.

PricewaterhouseCoopers issued an unqualified opinion on the FYs 1998 and 1997 financial statements of single-employer and multiemployer program funds administered by PBGC, and also issued two additional reports - an unqualified opinion on PBGC management's assertion about the effectiveness of its internal control and a report on PBGC's compliance with laws and regulations. However, the audit identified three reportable conditions in PBGC's internal control.

1. PBGC needs to integrate its financial management systems and improve its systems development life cycle methodology;
2. PBGC needs to finalize and test its plan for maintaining continuity of operations; and
3. PBGC needs to implement and improve controls surrounding the Participant Records Information Systems Management application.

To fulfill our responsibility under the CFO Act, we monitored the quality of audit work performed in accordance with *Government Auditing Standards*. Specifically, we:

- reviewed PricewaterhouseCoopers' approach and planning of the audit;
- evaluated the qualifications and independence of its auditors;
- monitored the progress of the audit at key points;
- examined its working papers and reports to evaluate compliance with *Government Auditing Standards*; and
- performed other procedures that we deemed necessary.

Based on the results of our review, the OIG determined that PricewaterhouseCoopers planned, executed, and reported the results of its audit of FYs 1998 and 1997 financial statements of single-employer and multiemployer program funds administered by PBGC in accordance with applicable standards. Therefore, in our opinion, PricewaterhouseCoopers' work generally provides a reasonable basis on which to render its January 15, 1999 opinion, and we concur with its report.

A set of PricewaterhouseCoopers' reports (99-7/23132-2) is available upon request from the PBGC's Office of Inspector General.

Sincerely,

Wayne Robert Poll

Wayne Robert Poll
Inspector General

February 16, 1999

PRICEWATERHOUSECOOPERS

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Arlington VA 22209-3195
Telephone (703) 741 1000
Facsimile (703) 741 1616

Report of Independent Accountants

To the Inspector General
Pension Benefit Guaranty Corporation

We have audited the accompanying statements of financial condition as of September 30, 1998 and 1997, of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC or the Corporation) and the related statements of operations and changes in net position and statements of cash flows for the years then ended. These financial statements are the responsibility of PBGC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC at September 30, 1998 and 1997, and the results of their operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

By law, PBGC's Single-Employer Program Fund (the Fund) must be self-sustaining and as such, its premiums must be sufficient to cover both its short and long-term obligations. The Fund is able to meet its short-term benefit obligations and internal analyses indicate that the combined effect of future premium revenue and reduced underfunding of single-employer plans may allow the Fund to meet its future obligations as well. While the Fund's statement of financial condition reports a net position (assets in excess of liabilities) of $5.0 billion at September 30, 1998, losses that are "reasonably possible" as a result of unfunded vested benefits are estimated to be in the range of $15 billion to $17 billion, as discussed in Note 9. To the extent contingent losses currently classified as "reasonably possible" become more likely, such as from deteriorating economic conditions or from insolvency of a large plan sponsor, the Fund's net position could be depleted.

The Actuarial Valuation and other supplemental information contain a wide range of data, some of which are not directly related to the principal financial statements. We do not express an overall opinion on this information. However, we compared this information for consistency with the principal financial statements and discussed the methods of measurement and presentation with PBGC officials. Based on this limited work, we found no material inconsistencies with the principal financial statements.

In addition, in accordance with *Government Auditing Standards*, we have issued reports dated January 15, 1999, on PBGC management's assertion about the effectiveness of its internal control and on its compliance with laws and regulations.

PricewaterhouseCoopers LLP

January 15, 1999
Arlington, Virginia

99-6/23132-1

Organization

Board Of Directors

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Secretary of Labor

Robert E. Rubin
Secretary of Treasury

William M. Daley
Secretary of Commerce

Executive Management

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Executive Director

N. Anthony Calhoun
Deputy Executive Director and Chief Financial Officer

Joseph Grant
Deputy Executive Director and Chief Operating Officer

John Seal
Deputy Executive Director and Chief Management Officer

Monica Healy
Senior Advisor to the Executive Director

Judy Schub
Assistant Executive Director for Legislative Affairs

James J. Keightley
General Counsel

Andrea E. Schneider
Chief Negotiator and
Director, Corporate Finance and Negotiations Department

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Communications and Public Affairs Department

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Contracts and Controls Review Department

Richard A. Ippolito
Chief Economist

Wayne Robert Poll *
Inspector General

* The Inspector General reports directly to the Chairman of the Board.

The PBGC Advisory Committee

Appointed by the President of the United States

Representing the Interests of the General Public

Milton M. Irvin, *Chairman*
President and Chief Operations Officer
Blaylock & Partners
New York, New York

Beverly Fisher White
Tallahassee, Florida

One vacancy to be filled.

Representing the Interests of Employers

Two vacancies to be filled.

Representing the Interests of Employee Organizations

Judith A. Scott
General Counsel
Service Employees International Union
Washington, DC

Teresa Ghilarducci
University of Notre Dame
South Bend, Indiana

Financial Summary

(Dollars in millions)

SINGLE-EMPLOYER PROGRAM	Fiscal Year Ended September 30, 1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Summary of Operations:										
Premium income	$ **966**	1,067	1,146	838	955	890	875	741	659	603
Other income	$ **10**	19	26	18	42	38	118	45	5	—
Investment income (losses)	$ **2,118**	2,687	915	1,956	(380)	1,538	614	860	(109)	387
Actuarial charges (credits)	$ **815**	488	632	1,561	(926)	1,680	848	905	181	362
Losses from completed and probable terminations	$ **584**	489	118	169	(249)	743	896	1,049	938	163
Loss on contingent value rights	$ **0**	0	0	0	0	96				
Administrative and investment expenses	$ **158**	155	150	138	135	107	97	71	63	45
Other expenses	$ **6**	29	3	19	0	0	0	212	162	0
Net income (loss)	$ **1,531**	2,612	1,184	925	1,657	(160)	(234)	(591)	(789)	420
Summary of Financial Position:										
Cash and investments	$ **17,345**	14,988	11,665	10,026	7,857	7,866	5,897	4,562	2,408	2,356
Total assets	$ **17,631**	15,314	12,043	10,371	8,281	8,267	6,381	5,422	2,797	3,059
Present value of future benefits	$ **12,281**	11,497	10,760	10,388	9,215	10,693	8,790	7,594	4,476	3,984
Net position	$ **5,012**	3,481	869	(315)	(1,240)	(2,897)	(2,737)	(2,503)	(1,913)	(1,124)
Insurance Activity:										
Benefits paid	$ **847**	823	790	761	719	720	634	514	369	353
Participants receiving monthly benefits at end of year	**208,450**	204,800	198,600	181,000	172,800	156,800	150,200	140,100	110,380	106,770
Plans trusteed and pending trusteeship by PBGC	**2,655**	2,500	2,338	2,084	1,961	1,848	1,760	1,644	1,558	1,501

(Dollars in millions)

MULTIEMPLOYER PROGRAM	Fiscal Year Ended September 30, 1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Summary of Operations:										
Premium income	$ **23**	23	22	22	23	23	23	23	21	20
Other income (losses)	$ **0**	0	1	0	0	(1)	1	1	1	—
Investment income (losses)	$ **133**	68	12	83	(46)	107	27	38	13	16
Actuarial charges (credits)	$ **0**	(1)	1	2	(1)	2	(1)	3	1	1
Losses (gains) from financial assistance	$ **34**	(3)	102	108	57	20	46	21	23	1
Administrative and investment expenses	$ **0**	0	0	0	0	0	0	0	2	3
Net income (loss)	$ **122**	95	(68)	(5)	(79)	107	6	38	9	31
Summary of Financial Position:										
Cash and investments	$ **736**	585	498	472	374	405	279	236	183	154
Total assets	$ **745**	596	505	477	378	407	283	238	190	161
Present value of future benefits	$ **6**	7	9	10	10	13	13	16	15	17
Nonrecoverable future financial assistance, present value	$ **389**	361	365	268	164	110	94	52	33	11
Net position	$ **341**	219	124	192	197	276	169	163	132	123
Insurance Activity:										
Benefits paid	$ **1**	1	2	2	2	2	2	2	2	3
Participants receiving monthly benefits from PBGC at end of year	**850**	1,000	1,100	1,300	1,400	1,590	1,760	1,990	2,170	2,310
Plans receiving financial assistance from PBGC	**18**	14	12	9	8	6	6	5	3	3

Pension Benefit Guaranty Corporation
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