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PENSION BENEFIT GUARANTY CORPORATION

Improvements Needed to Address Financial and Management Challenges

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Education, Workforce, and Income Security

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Highlights

Highlights of GAO-08-1162T, a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

PENSION BENEFIT GUARANTY CORPORATION

Improvements Needed to Address Financial and Management Challenges

Why GAO Did This Study

The Pension Benefit Guaranty Corporation (PBGC) insures the retirement future of nearly 44 million people in more than 30,000 private-sector defined benefit pension plans.

In July 2003, GAO designated PBGC's single-employer pension insurance program—its largest insurance program—as "high risk," including it on GAO's list of major programs that need urgent attention and transformation. The program remains on the list today with a projected financial deficit of just over $13 billion, as of September 2007.

Because Congress exercises oversight of PBGC, GAO was asked to testify today on 1) the critical role PBGC plays in protecting the pension benefits of workers and how PBGC is funded, 2) the financial challenges facing PBGC, and 3) the PBGC's governance, oversight and management challenges.

To address these objectives, we are relying on our reports from the last several years that, as part of our designation of PBGC's single-employer program as high-risk, explored the financial and management challenges facing the agency. GAO has made a number of recommendations and matters for Congressional consideration in these past reports. PBGC generally agreed with these past recommendations and is implementing many of them. No new recommendations are being made as part of this testimony.

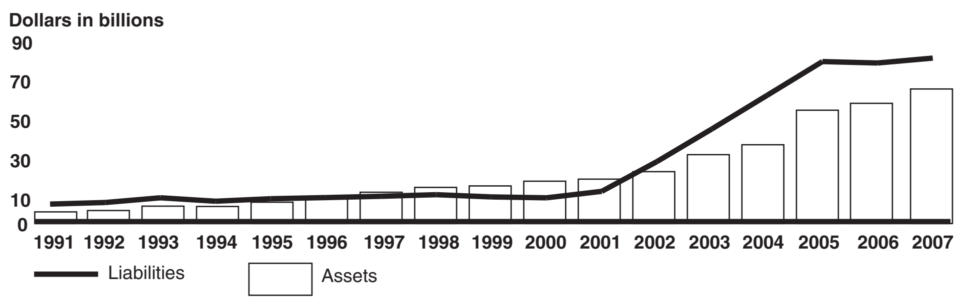
To view the full product, including the scope and methodology, click on GAO-08-1162T. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

What GAO Found

PBGC administers the current or future pension benefits for a growing number of participants of plans that have been taken over by the agency—from 500,000 in fiscal year 2000 to 1.3 million participants in fiscal year 2007. PBGC is financed by insurance premiums set by Congress and paid by sponsors of defined benefit (DB) plans, investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for those trusteed plans; PBGC receives no funds from general revenues. The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. Ultimately this budget treatment can be confusing--especially in the short-term—as on-budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC's single-employer program faces financial challenges from a history of weak plan funding rules that left it susceptible to claims from sponsors of large, severely underfunded pension plans. PBGC had seen recent improvements to its net financial position due to generally better economic conditions and from statutory changes that raised premiums and took measures designed to strengthen plan funding and PBGC guarantees. However, certain improvements have only just begun phasing-in and the changes did not completely address a number of the risks that PBGC faces going forward. Further, PBGC just began implementing a new investment policy that, while offering the potential for higher returns, also adds significant variability and risk to the assets it manages. Also, changing economic conditions could further expose PBGC to future claims.

PBGC Assets and Liabilities, Fiscal Year 1991 to 2007



Source: GAO's analysis of PBGC annual report data.

Improvements are needed to PBGC's governance structure and to its strategic approach to program management. PBGC's three member board of directors is limited in its ability to provide policy direction and oversight. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January. In addition, PBGC lacks a strategic approach to its acquisition and human capital management needs. Three-quarters of PBGC's administrative budget is spent on contractors, yet PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the financial and operational challenges facing the Pension Benefit Guaranty Corporation (PBGC). PBGC operates two pension insurance programs that protect the retirement income of nearly 44 million workers in over 30,000 private-sector defined benefit pension plans. In July 2003, GAO designated PBGC's single-employer pension insurance program—its largest insurance program—as "high risk," including it on GAO's list of major programs that need urgent attention and transformation.[1] The program remains on the list today with a projected financial deficit of just over $13 billion, as of September 2007.

PBGC was created as a self-financing, wholly owned government corporation by the Employee Retirement Income Security Act of 1974 (ERISA).[2] PBGC is managed by a presidentially-appointed, Senate-confirmed director, and governed by a three-member board of directors, consisting of the Secretaries of the Treasury, Labor, and Commerce, that is charged with providing policy direction and oversight of PBGC's finances and operations. PBGC's primary responsibilities are to collect premiums from the sponsors of defined benefit plans to insure against default and to assume administration of underfunded plans that terminate. In the event of a plan default, PBGC assumes control of plan assets (including amounts due and payable from the plan sponsor), calculates benefit amounts due plan participants, and pays recipients as benefits are due.

My statement is based on our prior work assessing PBGC's long-term financial challenges, and several reports that we have published over the past two years on PBGC governance and management. Specifically, my statement will discuss the (1) critical role PBGC plays in protecting the pension benefits of workers and how PBGC is funded, (2) financial challenges facing PBGC, and (3) PBGC's governance, oversight and management challenges.

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[1] GAO, *Pension Benefit Guaranty Corporation Single-Employer Insurance Program: Long-Term Vulnerabilities Warrant "High Risk" Designation*, GAO-03-1050SP (Washington, D.C.: July 23, 2003).

[2] Pub. L. No. 93-406, 88 Stat. 829. (Sept. 2, 1974)(codified, as amended, at 29 U.S.C. § § 1001-1461).

In summary, PBGC administers the current or future pension benefits for a growing number of participants of plans that have been taken over by the agency—from 500,000 in fiscal year 2000 to 1.3 million participants in fiscal year 2007. PBGC is financed by insurance premiums set by Congress and paid by sponsors of defined benefit (DB) plans,[3] investment income, assets from pension plans trusteed by PBGC, and recoveries from the companies formerly responsible for those trusteed plans; PBGC receives no funds from general revenues. The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. This budget treatment can be confusing—especially in the short-term—as on-budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC's insurance programs, and specifically the single-employer program, face financial challenges from a history of weak plan funding rules that left it susceptible to claims from sponsors of large, severely underfunded pension plans. We designated PBGC's single-employer insurance program as "high risk" in 2003, because of its longstanding financial challenges. PBGC had seen recent improvements to its net financial position due to generally better economic conditions and from statutory changes that raised premiums and took measures designed to strengthen plan funding and PBGC guarantees. However, certain improvements have only just begun phasing-in and the changes did not completely address a number of the risks that PBGC faces going forward. Further, PBGC just began implementing a new investment policy that, while offering the potential for higher returns, also adds significant variability and risk to the assets it manages.

Improvements are needed to PBGC's governance structure, to oversight of the corporation, and to its strategic approach to program management. PBGC's three-member board of directors is limited in its ability to provide policy direction and oversight. The three cabinet secretaries who comprise the board have numerous other responsibilities, and are unable to dedicate consistent and comprehensive attention to PBGC. With only 3 members, PBGC's board may not be large enough to include the knowledge needed

[3]Employers may voluntarily sponsor DB plans, defined contribution (DC) plans, or both for their employees. DB plans promise to provide a benefit that is generally based on a formula that typically includes an employee's salary and years of service. Under a DC plan, such as a 401(k) plan, employees have individual accounts to which the employee, employer, or both make contributions, and benefits are based on contributions along with investment returns (gains and losses) on the accounts.

to direct and oversee PBGC. According to corporate governance guidelines, the board of directors should be large enough to provide the necessary skill sets, but also small enough to promote cohesion, flexibility, and effective participation. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January, limiting the board's institutional knowledge of the corporation. In addition, we found that PBGC lacks a strategic approach to its acquisition and human capital management needs. Although three-quarters of PBGC's administrative budget is spent on contractors, PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities. PBGC also lacks formal, comprehensive human capital policies, programs and practices and does not routinely target workforce data to understand its current and future workforce needs.

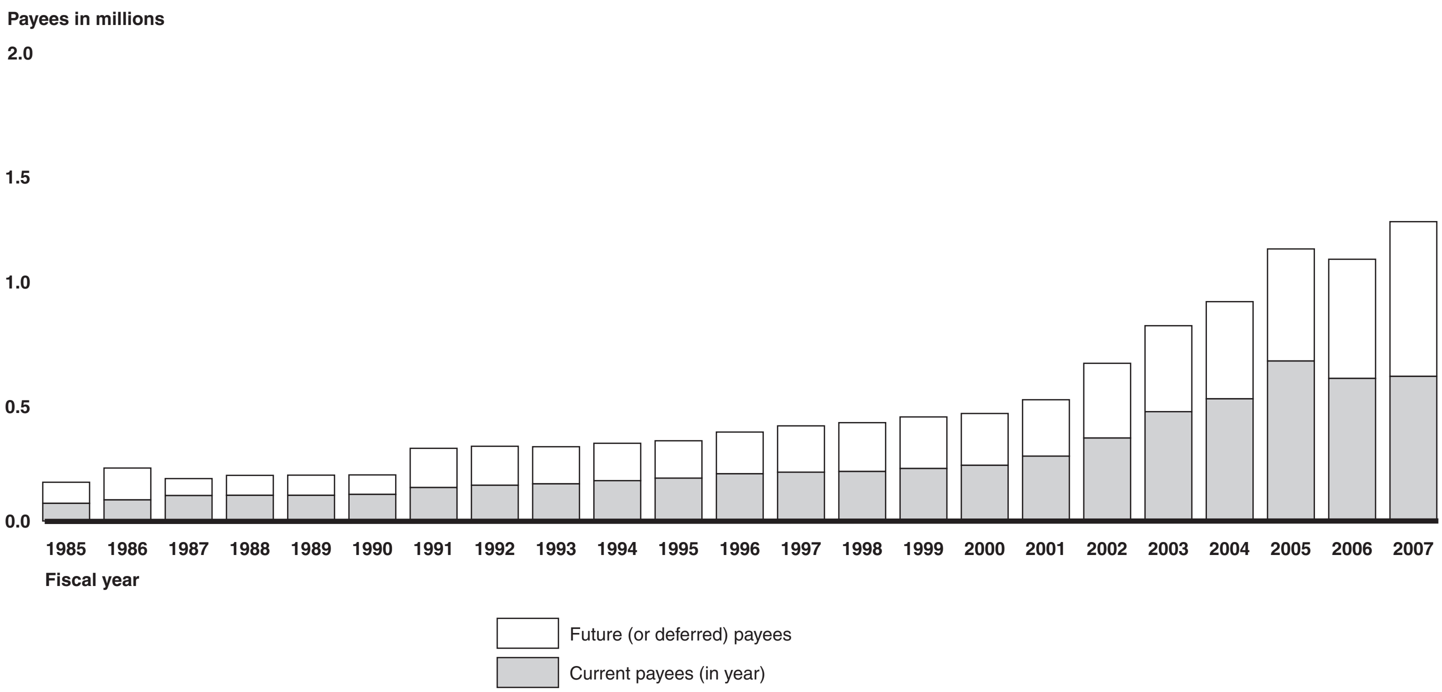
PBGC Guarantees Pension Benefits for Millions and is Funded by Premiums and Assets of Terminated Plans

PBGC plays a critical role in protecting the pension benefits of private sector workers—it is responsible for administering current or future pension benefit payments to just over 1.3 million plan participants. Its budget operations flow through two accounts, one that appears in the federal budget and one that does not. PBGC's budget can be confusing, especially in the short-term, as apparent federal budget gains may be offset by long-term liabilities that are not reported to on-budget accounts.

PBGC Plays a Critical Role in Protecting Pension Benefits

PBGC plays a critical role in protecting the pension benefits of private sector workers. PBGC administers current or future pension benefit payments to a growing number of plan participants, from just under one-half million in fiscal year 2000 to 1.3 million in fiscal year 2007. Figure 1 shows the breakdown of recipients of benefit payments from PBGC's single-insurance program.

Figure 1: Number of Payees Receiving Current or Future Single-Employer Program Benefits from PBGC, fiscal year 1985-2007



Source: PBGC's Pension Insurance Data Book 2006 (table S-20), PBGC's Pension Insurance Data Book 2001 (table S-3), and preliminary data.

PBGC benefits are insured up to certain limits—up to $51,750 per year (about $4300 per month) for participants aged 65, with lower benefits for younger participants.[4] While the actual annual benefits paid to participants are not adjusted for inflation, the initial maximum levels are set by law and are indexed for inflation. Covered benefits include pension benefits accrued at normal retirement age, most early retirement benefits, and survivor and disability benefits. PBGC pays these benefits when a plan is terminated and the plan has insufficient assets to pay all benefits accrued under the plan up to the date of plan termination. In 2006, PBGC paid over 622,000 people a median benefit of about $296 per month.

The vast majority of the participants in PBGC-trusteed plans receive all the benefits they were promised by their plan. Benefits for some participants may be reduced if 1) their benefits exceed PBGC's maximum guarantee

[4]The limit is reduced if the benefit is not paid as a single-life annuity. For example, the limit is reduced if the benefit is paid as a joint-and-survivor annuity.

limit, 2) a benefit increase occurred (or became payable due to a plant shutdown) within five years of the plan's termination, or 3) a part of their benefit is a supplemental benefit.[5] In addition to paying guaranteed benefits, PBGC may pay certain non-guaranteed benefits in limited circumstances involving asset recoveries from employers.

PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income of assets from pension plans trusteed by PBGC ($4.8 billion in investment income from $68.4 billion in assets for its combined programs in 2007) and recoveries from the companies formerly responsible for the plans. Under current law, other than statutory authority to borrow up to $100 million from the Treasury Department (sometimes referred to as a $100 million line of credit), no substantial source of funds is available to PBGC if it runs out of money.[6] In the event that PBGC were to exhaust all of its holdings, benefit payments would have to be drastically cut unless Congress were to take positive action to provide support.

In 2007, PBGC received over $1.5 billion in premium income. An insured plan in the single employer program was required to pay PBGC a yearly premium of $31 per participant for pension benefit insurance coverage in 2007. This per-participant premium rate is adjusted annually to wage inflation. Plans that are underfunded as specified by ERISA must pay PBGC an additional premium of $9 per $1,000 of underfunding. Some terminating plans have to pay an "exit" premium of $1,250 per participant per year for three years if they undergo a distress or PBGC-initiated plan termination on or after January 1, 2006.

PBGC also insures multiemployer defined benefit pensions through its multiemployer program. Multiemployer plans are established through collective bargaining agreements involving two or more unrelated employers and are common in industries such as construction, trucking, mining, the hotel trades, and segments of the grocery business. The

[5]Additional guarantee restrictions apply if the plan's termination date occurred while the employer was in a bankruptcy proceeding that began on or after September 16, 2006, or if the plan is a commercial passenger airline plan or airline catering plan that elected the 17-year funding relief under the Pension Protection Act of 2006, Pub. L. No. 109-280, § 402, 120 Stat. 780, 922-28 (Aug. 17, 2006)(reprinted in 26 U.S.C. § 430 note).

[6]PBGC has used this "line of credit" only once—to cover the agency's startup costs—and quickly repaid.

multiemployer program is far smaller than the PBGC single employer program, insuring about 10 million participants in about 1,530 plans. Like the single employer program, PBGC collects premiums from sponsoring employers and insures multiemployer participant benefits up to a limit, although both the level of premiums and the maximum insured limit are far lower than those for the single employer program.[7] Further, unlike the single-employer program, a multiemployer plan termination does not trigger the PBGC benefit guarantee. A terminated multiemployer plan continues to pay full plan benefits so long as it has sufficient assets to do so.[8]

PBGC's Budget Only Partly Flows through the Federal Government

The treatment of PBGC in the federal budget is complicated by the use of two accounts—an on–budget revolving fund and a non-budgetary trust fund. Some activities flow through the federal budget and other activities are outside the federal budget. Not only is PBGC's budget structure complex, it can also result in confusing signals about the financial health of PBGC and create unintended policy incentives.

PBGC's receipts and disbursements are required by law to be included in the federal budget.[9] These cash flows are reported in the budget in a single revolving fund account.[10] The cash flows include premiums paid, interest income on federal securities, benefit payments, administrative expenses, and reimbursements from PBGC's non-budgetary trust fund. The non-

[7]Multiemployer DB plans must pay PBGC a yearly premium of $8.00 per participant for pension benefit insurance coverage in 2007. Like the single employer program, the PBGC multiemployer premium rate is adjusted annually to changes in the national average wage index and then rounded to the nearest whole dollar. However, there is no underfunding or exit premium for multiemployer plans. For multiemployer plan participants, the maximum insured benefit is about $12,870 for a participant with 30 years of service. Unlike the single employer program, the maximum insurable benefit limit for multiemployer participants is not indexed to wage inflation and has not changed since December 2000.

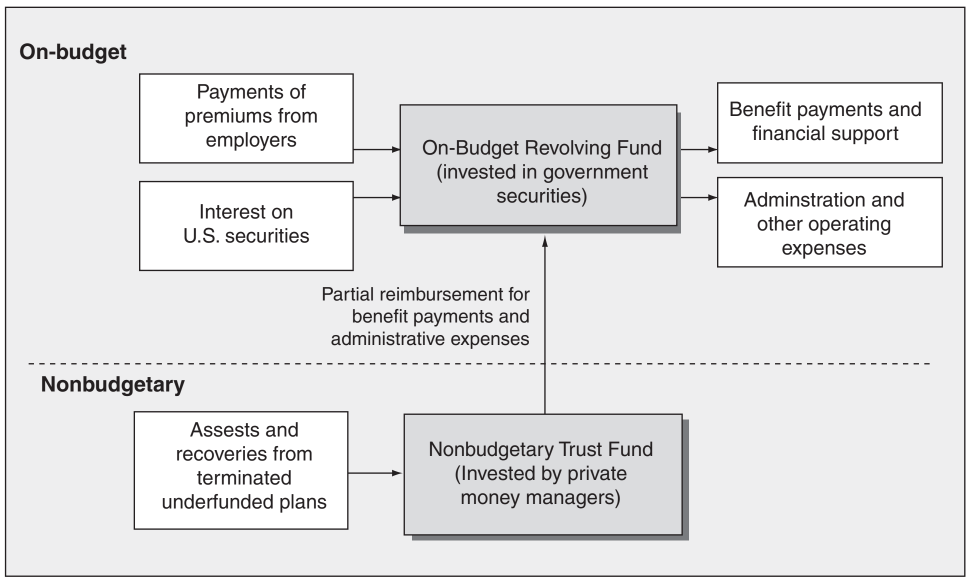
[8]PBGC permits multiemployer plans that cannot pay full benefits to pay reduced benefits equal to the PBGC guarantee. For plans that become insolvent, PBGC will typically loan the plan an amount necessary to pay guaranteed benefits and administrative expenses. In the past, few plans receiving financial assistance from PBGC have recovered sufficiently to repay all the monies lent to them and PBGC typically does not expect the loans to be repaid. An allowance has been established on PBGC's financial records to account for financial assistance that is not expected to be repaid.

[9]29 U.S.C. § 1302(g)(2).

[10]29 U.S.C. § 1305. Although technically there are seven revolving funds, PBGC uses only three, and their activities are combined into one fund for reporting purposes.

budgetary trust fund includes assets obtained from terminated plans and is managed by private money-managers. Because the trust fund is a non-budgetary account, the transfer of assets from terminated plans to PBGC is not considered a receipt to the government. Likewise, the liabilities PBGC incurs when it takes over an underfunded plan or other changes in PBGC's assets and liabilities are not reflected in the budget. Figure 2 provides an overview of PBGC's budgetary and non-budgetary cash flows.

Figure 2: PBGC's cash flows



Source: Congressional Budget Office.

When an insured pension plan is terminated, assets are transferred to PBGC's non-budgetary trust fund. Neither these assets nor the benefit liabilities appear on the federal balance sheet and PBGC's net loss is not recorded in the federal government's income statement. Assets in the non-budgetary trust fund are commingled and no longer identified with particular plans. PBGC has broad authority to oversee and administer pension assets held in its trust fund and is free to invest and expend the funds as if it were a private fiduciary of the trust fund's holdings. PBGC can invest the assets in whatever way it chooses, as long as it acts in the best financial interest of beneficiaries.

In addition to the non-budgetary trust fund, PBGC has an on-budget revolving fund. Premium income and transfers from the trust fund for both benefit payments and administrative expenses are deposited to the revolving funds as offsetting collections (that is, offsets to outlays). Unlike the trust fund, the revolving fund appears on the federal government's balance sheet and provides PBGC with permanent spending authority to carry out its activities. In years that premium income and trust fund reimbursements exceed benefit payment and administrative costs, the revolving fund would show negative outlays, thus improving the overall fiscal balance of the federal government. Any funds that are not used to pay benefits or expenses are considered unobligated balances and are available for expenditure in the next year. By law, unobligated funds in the revolving fund must be held in Treasury securities and earn interest income.

PBGC transfers funds from the non-budgetary trust fund to its on-budget revolving fund to pay a portion of retirement annuities and certain administrative costs. Such transfers are referred to as reimbursements and are recorded as offsetting collections in the budget. Generally, the proportion of benefit payments that is reimbursed from the trust fund depends on the aggregate funding level of the plans that PBGC has taken over and is adjusted periodically. In other words, if the average funding ratio of all plans taken over by PBGC is 50 percent, then half of all benefit payments originate from the non-budgetary trust fund. In addition to financing benefits, trust fund assets are also transferred to the revolving fund to pay for PBGC's administrative expenses related to terminations. PBGC's other administrative expenses are paid directly from the revolving fund.[11]

Insurance programs with long-term commitments, such as PBGC, may distort the budget's fiscal balance by looking like revenue generators in years that premium collections exceed benefit payments and administrative expenses because the programs' long-term expected costs are not reported. For example, in 2004 when PBGC's losses measured on an accrual basis ballooned and its deficit grew from $11 billion to $23 billion, PBGC's cash flow reported in the budget was positive and reduced the federal government's budget deficit.

[11]Prior to 2004, administrative expenses not directly related to terminations were paid from appropriations, which were then reimbursed by the revolving fund. Legislation enacted in 2003 eliminated the distinction between moneys covering administrative expenses related to terminations and those unrelated to terminations; now, all administrative spending is considered direct spending from the revolving fund.

GAO has reported previously that the cash-based federal budget, which focuses on annual cash flows, does not adequately reflect the cost of pension and other insurance programs.[12] Generally, cost is only recognized in the budget when claims are paid rather than when the commitment is made. Benefit payments of terminated plans assumed by PBGC may not be made for years, even decades, because plan participants generally are not eligible to receive pension benefits until they reach age 65. Once eligible, beneficiaries then receive benefit payments for the rest of their lives. As a result, there can be years in which PBGC's current cash collections exceed current cash payments, regardless of the expected long-term cost to the government.

PBGC Continues to Face Financial Challenges

PBGC's single-employer program faces financial challenges both from past claims resulting from bankruptcies and plan termination, which have been concentrated in a few industrial sectors, and structural problems such as weak plan funding rules and a premium structure that does not fully reflect the various risks posed by plans. Because of these financial challenges, GAO designated the single-employer program as "high risk" in 2003, and it remains so today. PBGC has seen recent improvements to its net financial position and recent legislative changes have raised premiums, changed certain plan funding rules and limited PBGC guarantees. However, the legislation has only been recently implemented and it did not completely address a number of the risks that PBGC faces going forward. Further, PBGC has recently implemented a new investment policy which adds significant variability and risk to the assets it manages.

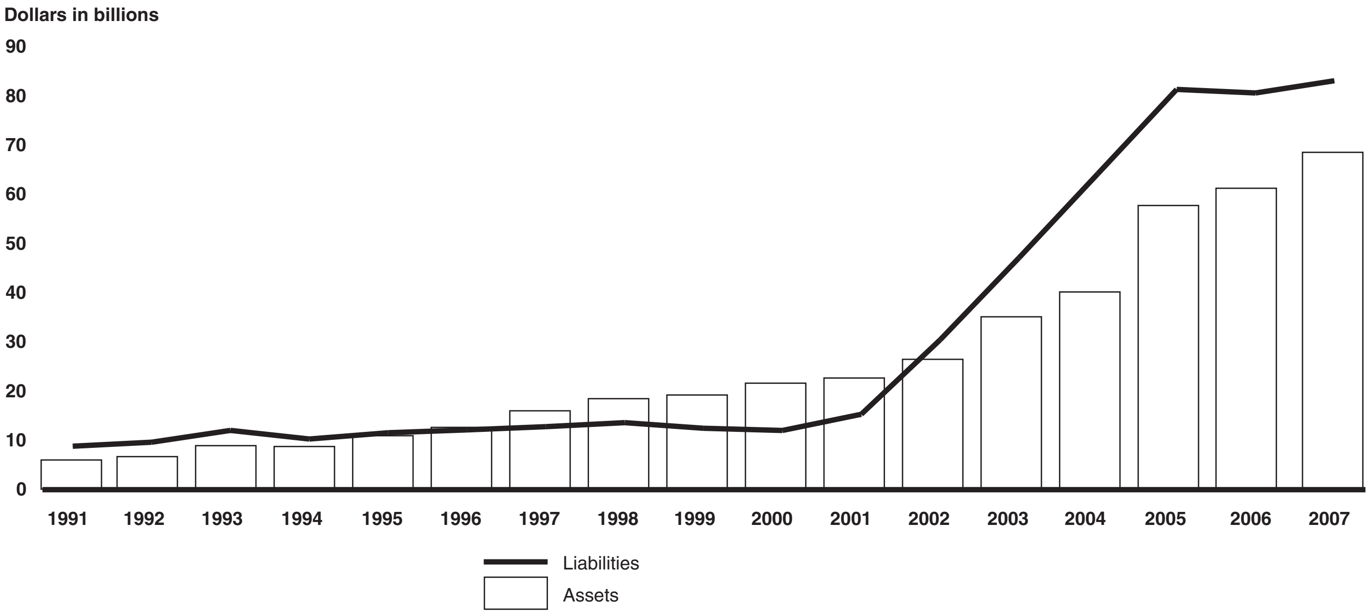
PBGC's net deficit for the single-employer program, which is currently $13.1 billion, reached a peak of $23.3 billion (or $23.5 billion for both insurance programs combined) in 2004 largely as a result of a number of realized and probable claims that occurred during that year.[13] See figure 3 for the difference between PBGC assets and liabilities for both insurance programs from 1991 to 2007. GAO has generally focused its work on the single-employer pension insurance program with respect to PBGC's

[12]GAO, *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/AIMD-97-16 (Washington D.C.: Sept. 30, 1997).

[13]Claims are the net cost of terminating a pension plan—the gap between its assets and its liabilities.

overall financial challenges. This is because the single-employer program represents nearly all of the assets and liabilities held by PBGC.[14]

Figure 3: PBGC Assets and Liabilities, Fiscal Year 1991 to 2007



Source: GAO's analysis of PBGC annual report data.

Note: Figure includes assets and liabilities of single-employer program and multi-employer program. The single-employer program accounts for over 95 percent of all assets and liabilities within each year over this period.

The assets and liabilities that PBGC accumulates from taking over, or "trusteeing," plans has increased rapidly over the last 5 years or so. This is largely due to the termination, typically through bankruptcies, of a number

[14]As noted earlier, the multiemployer program is a much smaller program. For example, the current liabilities of the multiemployer program represent less than 3 percent of PBGC's total liabilities for both its insurance programs. Despite its smaller size, we have reported on the unique financial challenges that the program faces and we will continue to monitor developments. See GAO, *Private Pensions: Multiemployer Plans Face Short- and Long-Term Challenges*, GAO-04-423 (Washington, D.C.: March 26, 2004).

of very large, underfunded plan sponsors.[15] In fact, eight of the top 10 largest firms that have presented claims to PBGC did so from 2002 to 2005. (See table 1).

Table 1: Top 10 Firms Presenting Claims (1975-2006) Single-employer Program

Top 10 firms	Number of plans	Fiscal year(s) of plan terminations(s)	Claims (by firm)	Vested participants	Claim per vested participant	Average percent of total claims (1975-2006)
1. United Airlines	4	2005	$7,484,348,482	122,541	$61,076	22.9%
2. Bethlehem Steel	1	2003	3,654,380,116	97,015	37,668	11.2%
3. US Airways	4	2003, 2005	2,690,222,805	59,778	45,004	8.2%
4. LTV Steel	6	2002, 2003, 2004	2,136,698,831	83,879	25,474	6.5%
5. National Steel	7	2003	1,275,628,286	35,580	35,852	3.9%
6. Pan American Air	3	1991, 1992	841,082,434	37,485	22,438	2.6%
7. Weirton Steel	1	2004	690,181,783	9,196	75,052	2.1%
8. Trans World Airlines	2	2001	668,377,106	34,257	19,511	2.0%
9. Kaiser Aluminum	3	2004	600,009,879	17,591	34,109	1.8%
10. Kemper Insurance	2	2005	568,417,151	12,221	46,512	1.7%
Top 10 total	**33**	**-**	**$20,609,346,871**	**509,543**	**$40,447**	**63.2%**
All other total	**3,640**	**-**	**12,017,433,400**	**1,194,479**	**10,061**	**36.8%**
Total	**3,673**	**-**	**$32,626,780,271**	**1,704,022**	**$19,147**	**100.0%**

Source: PBGC's Pension Insurance Data Book 2006 (table S-31).

These top 10 claims alone currently account for nearly two-thirds of all of PBGC's claims and are concentrated among firms representing the steel and airline industries. Overall, these industries account for about three-

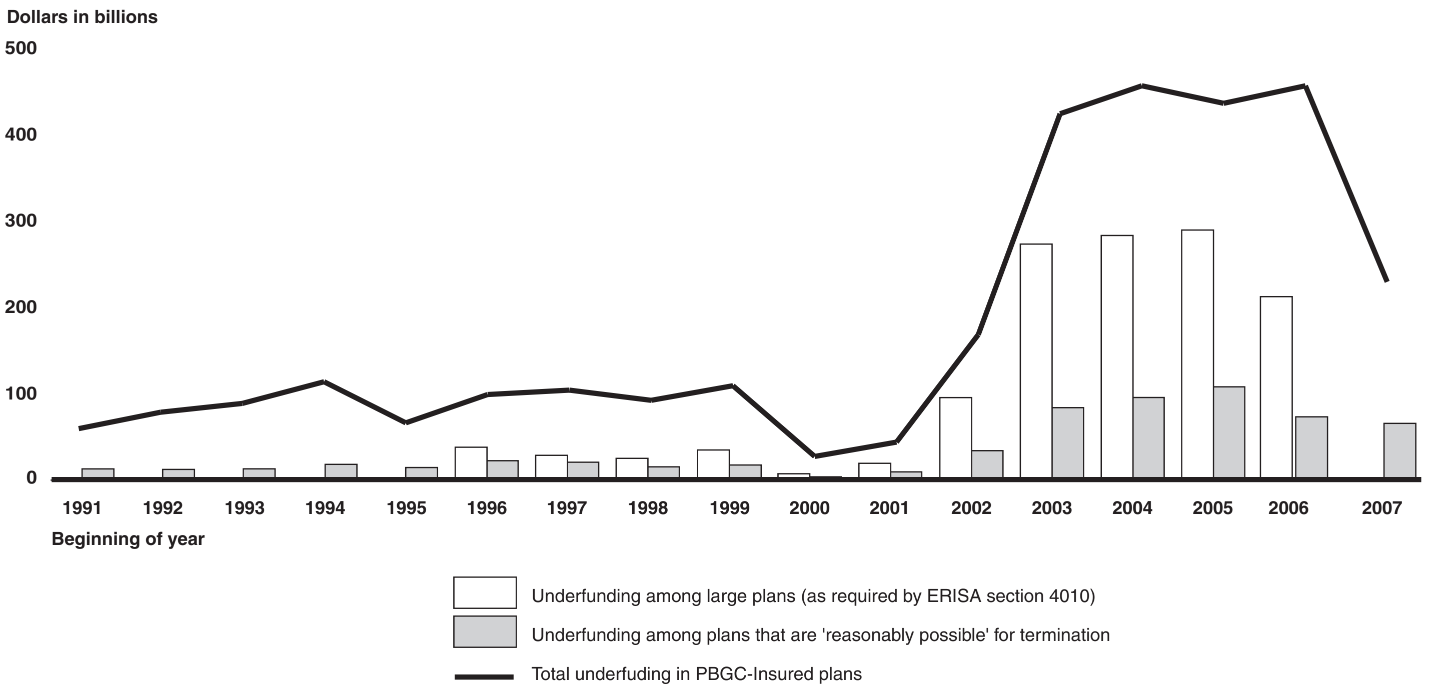
[15]The termination of a fully funded DB plan is called a standard termination. Plan sponsors may terminate fully funded plans by purchasing a group annuity contract from an insurance company, under which the insurance company agrees to pay all accrued benefits, or by paying lump-sum benefits to participants if permissible. The termination of an underfunded plan, termed a distress termination, is allowed if the plan sponsor requests the termination and the sponsor satisfies other criteria. Alternatively, PBGC may initiate an "involuntary" termination. PBGC may institute proceedings to terminate a plan if the plan has not met the minimum funding standard, the plan will be unable to pay benefits when due, a reportable event has occurred, or the possible long-run loss to PBGC with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. See 29 U.S.C. § 1342(a).

quarters of PBGC's total claims and total single-employer benefit payments in 2006.

While the claims presented by the steel and airline industries were due in some part to restructuring and competitive pressures in those industries, it is important to recognize other economic and regulatory factors affected PBGC and DB plan sponsors as a whole. For example, when we reported on airline pension plan underfunding in late 2004 we noted that several problems contributed to the broad underfunding of DB plans.[16] These problems included cyclical factors like the so called "perfect storm" of key economic conditions, in which declines in stock prices lowered the value of pension assets used to pay benefits, while at the same time a decline in interest rates inflated the value of pension liabilities. The combined "bottom line" result was that many plans were underfunded at the time and had insufficient resources to pay all of their future promised benefits. Figure 4 shows the underfunding of PBGC's single-employer plans from 1991 to 2007.

[16]GAO, *Private Pensions: Airline Plans' Underfunding Illustrates Broader Problems with the Defined Benefit Pension System*, GAO-05-108T (Washington, D.C.: Oct. 7, 2004)

Figure 4. Underfunding of PBGC Single-Employer Insured Plans Using Alternative Measures, 1991-2007



Source: PBGC's Pension Insurance Data Book 2006 (table S-47), 2007 Annual Management Report, and preliminary data.

Note: 'Underfunding among large plans' is from data obtained under Section 4010 of ERISA, which, prior to the Pension Protecton Act of 2006 (PPA) required that companies annually provide PBGC with information on their underfunded plans if the firm's aggregate underfunding exceeds $50 million or there is an outstanding lien for missed contributions exceeding $1 million or an outstanding funding waiver of more than $1 million and underfunding is reported based on an estimate of vested benefits. Section 4010 data was not required or reported prior to 1996, and is not yet reported for 2007 due to changes from PPA. 'Underfunding among plans that are reasonably possible for termination' is among plan sponsors with less than investment-grade bond ratings and is based on an estimate of vested benefits. 'Total underfunding in PBGC-insured plans' includes the universe of PBGC single-employer insured plans and estimated total liabilities are based on all plan liabilities, whether vested or not.

In 2003, GAO designated PBGC's single-employer program as high-risk, or as a program that needs urgent Congressional attention and agency action. We specifically noted PBGC's prior-year net deficit as well as the risk of the termination among large, underfunded pension plans, as reasons for the programs high-risk designation.[17] As part of our monitoring of PBGC as a high-risk agency we have highlighted additional challenges faced by the single-employer program. Among these concerns were the serious weaknesses that existed with respect to plan funding rules[18] and that PBGC's premium structure and guarantees needed to be re-examined to better reflect the risk posed by various plans.[19] Additionally the number of single-employer insured DB plans has been rapidly declining, and, among the plans still in operation, many have frozen benefits to some or all participants. [20] Additionally the prevalence of plans that are closed to new participants seems to imply that PBGC is likely to see a decline in insured participants, especially as insured participants seem increasingly likely to be retired (as opposed to active or current) workers.

There have been a number of developments with respect to PBGC's situation since we issued our most recent high risk updates in 2005 and 2007. At least until fairly recently, key economic conditions have been generally favorable for DB plan sponsors and plan funding has generally improved. In addition, major pension legislation was enacted which addressed many of the concerns articulated in our previous reports and testimonies on PBGC's financial condition. The Deficit Reduction Act of 2005 (DRA) was signed in to law on February 8, 2006 and included

[17]The condition of the single-employer program has been a longstanding concern of both the Congress and GAO. In 1990, as part of our effort to call attention to high-risk areas in the federal government, we noted that weaknesses in the single-employer insurance program's financial condition threatened PBGC's long-term viability. We stated that minimum funding rules still did not ensure that plan sponsors would contribute enough for terminating plans to have sufficient assets to cover all promised benefits. In 1992, we also reported that PBGC had weaknesses in its internal controls and financial systems that placed the entire agency, and not just the single employer program, at risk. Three years later, we reported that legislation enacted in 1994 had strengthened PBGC's program weaknesses and that we believed improvements had been significant enough for us to remove the agency's high-risk designation—though we continued to monitor PBGC's situation.

[18]GAO, *Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules*, GAO-05-294 (Washington, D.C.: May 31, 2005)

[19]GAO, *Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks*, GAO-04-90 (Washington, D.C.: Oct. 29, 2003)

[20]A plan freeze is an amendment to the plan to limit some or all future pension accruals for some or all plan participants. See GAO, *Defined Benefit Pensions: Plan Freezes Affect Millions of Participants and Pose Retirement Income Challenges*, GAO-08-817 (Washington, D.C.: July 21, 2008) and GAO, *Private Pensions: Timely and Accurate Information Is Needed to Identify and Track Frozen Defined Benefit Plans*, GAO-04-200R (Washington, D.C.: Dec. 17, 2003).

provisions to raise flat-rate premiums[21] and created a new, temporary premium for certain terminated single-employer plans.[22] Later that year the Pension Protection Act of 2006 (PPA) was signed into law and included a number of provisions aimed at improving plan funding and PBGC finances. However, PPA did not fully close plan funding gaps, did not adjust premiums in a way that fully reflected risk from financially distressed sponsors and provided special relief to plan sponsors in troubled industries, particularly those in the airline industries. PBGC's net financial position improved from 2005 to 2006 because some very large plans that were previously classified as probable terminations were reclassified to a reasonably possible designation as a result of the relief granted to troubled industries. Since this provision has only been implemented for a few years, it is still too early to determine how much risk of new claims these reclassified plans still represent to PBGC. As many of the provisions in PPA are still phasing-in, we will continue to monitor the status of the single-employer program with respect to PPA and will be updating our high risk series in early 2009.

GAO recently reported on a newly developing financial challenge facing PBGC due to the recent change to its investment policy.[23] While the investment policy adopted in 2008 aims to reduce PBGC's $14 billion deficit by investing in assets with a greater expected return, GAO found that the new allocation will likely carry more risk than acknowledged by PBGC's analysis. According to PBGC the new allocation will be sufficiently diversified to mitigate the expected risks associated with the higher expected return. They also asserted that it should involve less risk than the previous policy. However, GAO's assessment found that, although returns are indeed likely to grow with the new allocation, the risks are

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[21]The flat-rate premium is a per-participant premium that plans pay to PBGC each year. In 2008, the rate for the flat premium is $33 per participant in insured single-employer plans. For multiemployer plans the flat rate premium is $9.00 per participant. These rates are adjusted annually by an average-national-wage index.

[22]Pub. L. No. 109-171, § 8101, 120 Stat. 4, 180-83 (codified at 29 U.S.C. § 1306). The legislation created a new premium for sponsors of plans that are terminated on an involuntary or distressed termination basis. The required payment is $1,250 per plan participant, per year, for three years after the termination. For sponsors whose plans were terminated while the program was being reorganized under chapter 11 of the bankruptcy code, the premium would be levied after the sponsor emerges from bankruptcy. Under DRA the premium would not apply to firms that are liquidated by a bankruptcy court or to terminations after December 2010.

[23]GAO, *PBGC Assets: Implementation of New Investment Policy Will Need Stronger Board Oversight*, GAO-08-667 (Washington, D.C.: July 17, 2008)

likely higher as well. Although it is important that the PBGC consider ways to optimize its portfolio, including higher return and diversification strategies, the agency faces unique challenges, such as PBGC's need for access to cash in the short-term to pay benefits, which could further increase the risks it faces with any investment strategy that allocates significant portions of the portfolio to volatile or illiquid assets.

Improvements Needed to PBGC's Governance, Oversight and Management

Improvements are needed to PBGC's governance structure, to oversight of the corporation, and to its strategic approach to program management. PBGC's three member board of directors is limited in its ability to provide policy direction and oversight. According to corporate governance guidelines, the board of directors should be large enough to provide the necessary skill sets, but also small enough to promote cohesion, flexibility, and effective participation. PBGC may also be exposed to challenges as the board, its representatives, and the director will likely change with the upcoming presidential transition in January, limiting the board's institutional knowledge of the corporation. In addition, Congressional oversight of PBGC in recent years has ranged from formal congressional hearings to the use of its support agencies, such as GAO, the Congressional Budget Office, and the Congressional Research Service. However, unlike some other government corporations, PBGC does not have certain reporting requirements for providing additional information to Congress. Finally, we found that PBGC lacks a strategic approach to its acquisition and human capital management needs.

PBGC's Governance Structure Needs Improvement

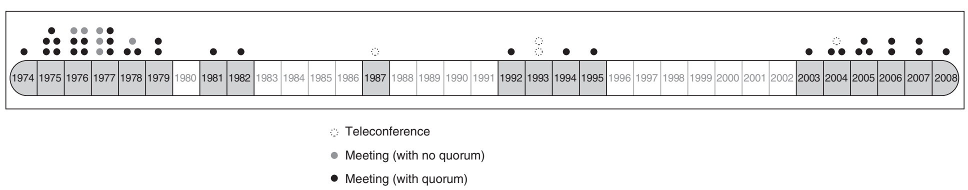
PBGC's board has limited time and resources to provide policy direction and oversight and had not established comprehensive written procedures and mechanisms to monitor PBGC's operations.[24] PBGC's three-member board, established by ERISA, includes the Secretary of Labor as the Chair of the Board and the Secretaries of Commerce and Treasury. We noted that the board members have designated officials and staff within their respective agencies to conduct much of the work on their behalf and relied mostly on PBGC's management to inform these board members' representatives of pending issues. PBGC's board members have numerous

[24] GAO, *Pension Benefit Guaranty Corporation: Governance Structure Needs Improvements to Ensure Policy Direction and Oversight*, GAO-07-808 (Washington, D.C.: July 6, 2007).

other responsibilities in their roles as cabinet secretaries and have been unable to dedicate consistent and comprehensive attention to PBGC.

Since PBGC's inception, the board has met infrequently. In 2003, after several high-profile pension plan terminations, PBGC's board began meeting twice a year (see figure 5). PBGC officials told us that it is a challenge to find a time when all three cabinet secretaries are able to meet, and in several instances the board members' representatives officially met in their place. While the PBGC board is now meeting twice a year, very little time is spent on addressing strategic and operational issues. According to corporate governance guidelines, boards should meet regularly and focus principally on broader issues, such as corporate philosophy and mission, broad policy, strategic management, oversight and monitoring of management, and company performance against business plans.[25] However, our review of the board's recorded minutes found that although some meetings devoted a portion of time to certain strategic and operational issues, such as investment policy, the financial status of PBGC's insurance programs, and outside audit reviews, the board meetings generally only lasted about an hour.

Figure 5: Number of PBGC Board Meetings 1974 to September 2008



Source: GAO analysis of PBGC documents and board meeting minutes.

The size and composition of PBGC's board does not meet corporate governance guidelines. According to corporate governance guidelines published by The Conference Board,[26] corporate boards should be structured so that the composition and skill set of a board is linked to the corporation's particular challenges and strategic vision, and should include a mix of knowledge and expertise targeted to the needs of the

[25]Matteo Tonello and Carolyn K. Brancato, *Corporate Governance Handbook, 2007: Legal Standards and Board Practices*, Research Report R-1405-07-RR, The Conference Board (New York, New York: 2007).

[26]*Corporate Governance Handbook, 2007*, Research Report R-1405-07-RR. The Conference Board is a global business membership and research organization that creates and disseminates knowledge about management and the marketplace.

corporation. We did not identify any other government corporations with boards as small as at PBGC. Government corporations' boards averaged about 7 members, with one having as many as 15. In addition, PBGC may also be exposed to challenges as the board, board members' representatives, and the director will likely change with the upcoming presidential transition in January 2009, limiting the board's institutional knowledge of the corporation.

The recent revision of PBGC's investment policy provides an example of the need for a more active board.[27] We found that PBGC board's 2004 and 2006 investment policy was not fully implemented. While the board assigned responsibility to PBGC for reducing equity holdings to a range of 15 to 25 percent of total investment, by 2008 the policy goal had not been met. Although the PBGC director and staff kept the board apprised of investment performance and asset allocation, we found no indication that the board had approved the deviation from its established policy or expected PBGC to continue to meet policy objectives.

We previously recommended that Congress consider expanding PBGC's board of directors, to appoint additional members who possess knowledge and expertise useful to PBGC's responsibilities and can provide needed attention. Further, dedicating staff that are independent of PBGC's executive management and have relevant pension and financial expertise to solely support the board's policy and oversight activities may be warranted. In response to our finding, PBGC contracted with a consulting firm to identify and review governance models and provide a background report to assist the board in its review of alternative corporate governance structures. The consulting firm's final report describes the advantages and disadvantages of the corporate board structures and governance practices of other government corporations and select private sector companies, and concludes that there are several viable alternatives for PBGC's governance structure and practices.

Along with the board's limited time and resources, we found that the board had not established comprehensive written procedures and mechanisms to monitor PBGC's operations. There were no formal protocols concerning the Inspector General's interactions with the board,[28]

[27] GAO-08-667.

[28] PBGC's Office of the Inspector General is an independent office within PBGC established under the Inspector General Act (codified, as amended, at 5 U.S.C. appx).

and PBGC internal management were not required to routinely report all matters to the board. Even though PBGC used informal communication to inform the board, it could not be certain that it received high quality and timely information about all significant matters facing the corporation. As a result we recommended that PBGC's board of directors establish formal guidelines that articulate the authorities of the board, Department of Labor, other board members and their respective representatives. In May 2008 PBGC revised its bylaws. As part of its bylaw revision, the board of directors more explicitly defined the role and responsibilities of the director and the corporation's senior officer positions, and outlined the board's responsibilities, which include approval of policy matters significantly affecting the pension insurance program or its stakeholders; approval of the corporation's investment policy; and review of certain management and Inspector General reports.

Congress Has Overseen PBGC in Several Ways and Some other Government Corporations have Additional Reporting Requirements

Since 2002, PBGC officials have testified 20 times before various congressional committees—mostly on broad issues related to the status of the private sector defined benefit pension policy and its effect on PBGC—and, in 2007, the Senate conducted confirmation hearings of PBGC's director. PBGC must annually submit reports to Congress on its prior fiscal year's financial and operational matters, which include information on PBGC's financial statements, internal controls, and compliance with certain laws and regulations.[29] In addition, through its support agencies—GAO, the Congressional Budget Office, and the Congressional Research Service—Congress has also provided oversight and reviewed PBGC. Specifically, Congress has asked GAO to conduct assessments of policy, management, and the financial condition of PBGC. For example, we conducted more than 10 reviews of PBGC over the past 5 years, including assessments related to PBGC's 2005 corporate reorganization and weaknesses in its governance structure, human capital management, and contracting practices. Our work also raised concerns about PBGC's financial condition and the state of the defined benefit industry.

Some government corporations have additional reporting requirements for notifying Congress of significant actions. For example, the Millennium Challenge Corporation is required to formally notify the appropriate

[29]PBGC is required each year to submit to Congress and the President an annual report, which must include the actuarial assumptions and methods PBGC uses to evaluate the expected 5-year operations and status of its pension benefit guaranty funds, and a comparison of its funds' investment returns with a designated index. 29 U.S.C. § 1308.

congressional committees 15 days prior to the allocation or transfer of funds related to the corporation's activities.[30] The Commodity Credit Corporation is subject to a similar requirement.[31] These examples demonstrate how Congress has required additional reporting requirements for certain activities conducted by government corporations. PBGC generally has no requirements to formally notify Congress prior to taking any significant financial or operational actions.

A More Strategic Approach Could Improve Contracting and Human Capital Management at PBGC

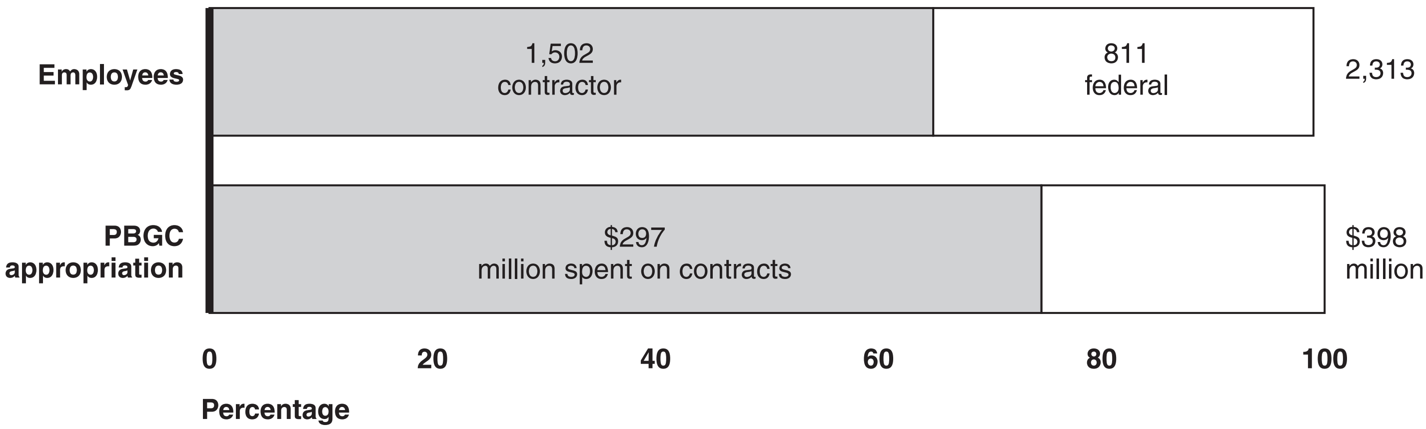
As reported in our recent work on PBGC contracting and human capital management,[32] contracting plays a central role in helping PBGC achieve its mission and address unpredictable workloads. Three-quarters of PBGC's budget was spent on contracts and nearly two-thirds of its personnel are contractors, as shown in figure 6. Since the mid-1980s, PBGC has had contracts covering a wide range of services, including the administration of terminated plans, payment of benefits, customer communication, legal assistance, document management, and information technology. From fiscal year 2000 through 2007, PBGC's contract spending increased steadily along with its overall budget and workload, and its use of contract employees outpaced its hiring of federal employees. As PBGC workload grew due to the significant number of large pension plan terminations, PBGC relied on contractors to supplement its workforce, acknowledging that it has difficulty anticipating workloads due to unpredictable economic conditions.

[30]The Millennium Challenge Corporation is a U.S. government corporation designed to work with foreign countries to reduce global poverty through the promotion of sustainable economic growth. 22 U.S.C. §§ 7701, 7703.

[31]The Commodity Credit Corporation (CCC) is a U.S. government corporation created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their distribution. 15 U.S.C. § 714.

[32]See GAO, *Pension Benefit Guaranty Corporation: Some Steps Have Been Taken to Improve Contracting, but a More Strategic Approach Is Needed*, GAO-08-871 (Washington, D.C.: August 18, 2008) and GAO, *Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management*, GAO-08-624 (Washington, D.C.: June 12, 2008).

Figure 6: PBGC Overall Versus Contractor Spending and Personnel, Fiscal Year 2007



Source: PBGC.

In 2000, we recommended that PBGC develop a strategic approach to contracting by conducting a comprehensive review of PBGC's future human capital needs and using this review to better link contracting decisions to PBGC's long-term strategic planning process. PBGC took some initial steps to implement our recommendation, and in August 2008, we reported that PBGC had recently renewed its efforts and drafted a strategic human capital plan.

In addition to drafting a strategic human capital plan, PBGC recently issued its strategic plan; however this plan does not document how the acquisition function supports the agency's missions and goals. Although contracting is essential to PBGC's mission, we found that the Procurement Department is not included in corporate-level strategic planning. Further, PBGC's draft strategic human capital plan acknowledges the need for contractor support, but does not provide detailed plans for how the contract support will be obtained. While PBGC's workload can expand and contract depending on the state of plan terminations, planning documents do not include strategies for managing the fluctuations. Based on these findings, we recommended that PBGC revise its strategic plan to reflect the importance of contracting and to project its vision of future contract use, and ensure that PBGC's procurement department is included in agency-wide strategic planning.

PBGC also needs a more strategic approach for improving human capital management. While PBGC has made progress in its human capital management approach by taking steps to improve its human capital planning and practices—such as drafting a succession management plan—the corporation still lacks a formal, comprehensive human capital strategy, articulated in a formal human capital plan that includes human capital policies, programs, and practices.[33] PBGC has initiatives for the management of human capital, such as ensuring employees have the skills and competencies needed to support its mission and establishing a performance-based culture within the corporation, and has made some progress toward these goals. However, PBGC has not routinely and systematically targeted and analyzed all necessary workforce data—such as attrition rates, occupational skill mix, and trends—to understand its current and future workforce needs.

PBGC is generally able to hire staff in its key occupations—such as accountants, actuaries, and attorneys—and retain them at rates similar to those of the rest of the federal government. However, PBGC has had some difficulty hiring and retaining staff for specific occupations and positions, including executives and senior financial analysts. PBGC has made use of various human capital flexibilities in which the corporation has discretionary authority to provide direct compensation in certain circumstances to support its recruitment and retention efforts, such as recruitment and retention incentives, superior qualification pay-setting authority, and special pay rates for specific occupations.[34] However, PBGC officials said that they had not recently explored additional flexibilities that required the approval of OPM and OMB to determine whether they would be applicable or appropriate for the corporation.

[33]According to GAO's internal control and management tool, agencies should have control activities, such as policies, procedures, techniques, and mechanisms that help ensure that management's directives to mitigate risk identified during the risk assessment process are carried out. Common categories of control activities include, in part, management of human capital. As part of human capital management, agencies should consider having a coherent overall human capital strategy that encompasses human capital policies, programs, and practices to guide the agency. GAO, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 1, 2001).

[34]Like most federal agencies, PBGC offers a wide range of employee benefits such as health benefits, life insurance benefits, paid leave and holidays, telecommuting or other flexible work schedules, transit subsidies, retirement investment options, flexible health spending accounts, long-term care insurance, student loan repayments, child care and car pool subsidies, and an on-site fitness center—most of which are available to other federal agencies.

Conclusions

PBGC clearly faces many challenges. The impact of PPA is still unclear, but in any case difficult decisions for the future still remain. While PBGC's net financial position has improved along with economic conditions that until recently had been favorable to plan sponsors, we are concerned that such conditions are changing and could leave PBGC exposed to another spate of claims from sponsors of very large severely underfunded plans. The challenges PBGC faces are acutely illustrated by its recent changes to its asset investment policy. The aim of the change to the policy is to reduce the current deficit through greater returns, but, holding all else equal, the potential for greater returns comes with greater risk. This greater risk may or may not be warranted, but the uncertain results of the policy could have important implications for all PBGC stakeholders: plan sponsors, insured participants, insured beneficiaries, as well as the government and ultimately taxpayers.

One thing that is certain: PBGC will continue to require prudent management and diligent oversight going forward. However, PBGC faces challenges with its board structure, which will only become more apparent in the coming months as the board, its representatives, and the corporation's director will likely be entirely replaced by a new president. Without adequate information and preparation, this transition could limit not only the progress made by the current board, its representatives, and director, but may also hinder the corporation's ability to insure and deliver retirement benefits to millions of Americans that rely on the corporation. As this transition highlights, an improved board structure is critical in helping PBGC manage the daunting, and in many ways fundamental, long-term financial challenges it faces, which is why we have recommended the Congress restructure the Board.

Chairman Lewis, Congressman Ramstad, and Members of the Subcommittee, this concludes my prepared statement. I would be happy to respond to any questions you may have.

Contacts and Staff Acknowledgments

For further questions about this statement, please contact Barbara D. Bovbjerg at (202) 512-7215. Individuals making key contributions to this statement include Blake Ainsworth, Charles Jeszeck, Jay McTigue, Charles Ford, Monika Gomez, Craig Winslow, and Susannah Compton.

Appendix I: List of Selected GAO Reports and Testimonies Related to the Pension Benefit Guaranty Corporation

Pension Benefit Guaranty Corporation: Need for Improved Oversight Persists, GAO-08-1062. Washington, D.C.: September 10, 2008.

Pension Benefit Guaranty Corporation: Some Steps Have Been Taken to Improve Contracting, but a More Strategic Approach Is Needed. GAO-08-871. Washington, D.C.: August 18, 2008.

PBGC Assets: Implementation of New Investment Policy Will Need Stronger Board Oversight. GAO-08-667. Washington, D.C.: July 17, 2008.

Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management. GAO-08-624. Washington, D.C.: June 12, 2008.

High Risk Series: An Update. GAO-07-310. Washington, D.C.: January 2007.

Pension Benefit Guaranty Corporation: Governance Structure Needs Improvements to Ensure Policy Direction and Oversight. GAO-07-808 Washington, D.C.: July 6, 2007.

PBGC's Legal Support: Improvement Needed to Eliminate Confusion and Ensure Provision of Consistent Advice. GAO-07-757R. Washington, D.C.: May 18, 2007.

Private Pensions: Questions Concerning the Pension Benefit Guaranty Corporation's Practices Regarding Single-Employer Probable Claims. GAO-05-991R. Washington, D.C.: September 9, 2005.

Private Pensions: The Pension Benefit Guaranty Corporation and Long-Term Budgetary Challenges. GAO-05-772T. Washington, D.C.: June 9, 2005.

Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules. GAO-05-294. Washington, D.C.: May 31, 2005.

Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks. GAO-04-90. Washington, D.C.: October 29, 2003.

Pension Benefit Guaranty Corporation Single-Employer Insurance Program: Long-Term Vulnerabilities Warrant 'High Risk' Designation. GAO-03-1050SP. Washington, D.C.: July 23, 2003.

Pension Benefit Guaranty Corporation: Statutory Limitation on Administrative Expenses Does Not Provide Meaningful Control. GAO-03-301. Washington, D.C.: February 28, 2003.

GAO Forum on Governance and Accountability: Challenges to Restore Public Confidence in U.S. Corporate Governance and Accountability Systems. GAO-03-419SP. Washington, D.C.: January 2003.

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