



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

July 20, 2010

The Honorable George Miller  
Chairman  
Committee on Education and Labor  
U.S. House of Representatives  
2181 Rayburn House Office Building  
Washington, D.C. 20515-6100

Dear Chairman Miller:

I am writing in response to your December 14, 2009 request that our office review the circumstances surrounding the Pension Benefit Guaranty Corporation (PBGC) handling of the 2005 termination of United Airlines' (UALs) pension plans. Your request was based on your concern that the interests of airline workers and retirees, including UAL workers and retirees, be protected as far as is practical. I want to thank you and the committee members for the opportunity to provide assistance on this matter and for your patience.

Specifically, you requested the PBGC-Office of Inspector General (OIG) to:

- Determine whether worker and retiree interests were protected to the extent practical in this case and in PBGC's termination processes in general; and
- Verify that PBGC properly executed its own protocols and that those protocols remain sufficient to protect the interests of current and future beneficiaries.

### **Background**

Under the Employee Retirement Income Security Act of 1974 (ERISA), PBGC insures benefits in certain defined benefit pension plans sponsored by private sector employers. ERISA authorizes PBGC to initiate the termination of a single-employer pension plan when certain conditions occur, such as if the plan will be unable to pay benefits when they are due or the plan's future liabilities are reasonably expected to cause an unreasonably increased long-run loss to PBGC.<sup>1</sup> When a pension plan is terminated, PBGC is charged to continue an uninterrupted stream of benefits to participants, in accordance with the ERISA limitations.<sup>2</sup> PBGC receives no tax revenues; it is funded

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<sup>1</sup> ERISA section 4042(a)(2) and (a)(4); 29 U.S.C. § 1342(a)(2) and (a)(4).

<sup>2</sup> ERISA section 4002(a)(2); 29 U.S.C. § 1302(a)(2).

through premium payments, interest on its investments, the remaining assets from pension plans that are terminated, and recoveries from the companies formerly responsible for the plans. The assets of terminated plans are pooled in a trust fund. PBGC pays guaranteed benefits to participants in underfunded plans that terminate. Premium payments deposited in PBGC's revolving fund help make up the difference in the terminated plan's underfunding.

With respect to the four pension plans sponsored by UAL,<sup>3</sup> PBGC instituted proceedings to terminate each of the pension plans. At that time, PBGC estimated the cumulative underfunding of the four UAL-sponsored pension plans to be more than \$10.4 billion, i.e., the plans had only \$6.8 billion in assets to pay about \$17.2 billion in promised pension benefits. Under ERISA, PBGC determined that \$13.8 billion of benefits were guaranteed. Of that amount, about \$7 billion was unfunded.<sup>4</sup> The money to pay those guaranteed benefits that were not funded by UAL is coming from PBGC's funds. At the beginning of fiscal year when the UAL plans were terminated, PBGC's own deficit was \$23.5 billion.<sup>5</sup>

#### **Protection of Worker and Retiree Interests**

We observed from our review that PBGC officials and staff took actions and performed administrative steps that protected the worker and retiree interests. The Corporation has established procedures for termination and trusteeship of single-employer pension plans. These procedures include detailed administrative processes for PBGC's determination whether the statutory termination criteria are met for a single-employer pension plan to be terminated in either a plan sponsor-initiated distress termination or a PBGC-initiated termination.

We saw evidence that PBGC personnel determined the applicable statutory criteria, and took other actions to terminate each of the four pension plans of United Airlines and for PBGC to become trustee for each of the plans. These actions included:

- Analyzing and documenting whether the plans should be terminated and, if so, on what date.
- Subjecting the analyses and termination recommendations to multiple, higher-level reviews.
- Issuing Notices of Determinations for each of the defined benefit pension plans to the president of United Airlines.

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<sup>3</sup> United Airlines sponsored 4 single-employer plans covering (1) pilots, (2) ground employees, (3) flight attendants, and (4) management, administrative and public contact employees.

<sup>4</sup> Termination and Trustee Decision Record for each of the 4 UAL plans.

<sup>5</sup> Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2005 and 2004 Financial Statements, <http://oig.pbgc.gov/audit/2006/pdf/FA-0014-1.pdf>

- Placing notices in major newspapers so that participants and beneficiaries had notice the plans would not continue.
- Becoming trustee of the defined benefit plans.

We further noted that a Court Order was issued to terminate the Pilots' Plan, documenting the court's approval of PBGC's termination decision and accepting the proposed termination date. The Order was upheld on appeal. PBGC's actions were also upheld in challenges to the Ground Plan and the Flight Attendants Plan. Nothing came to our attention to cause us to believe that PBGC did not perform all of the required measures and steps outlined in its termination process. However, we did not complete an audit of the termination process. If we had done so, other matters might have been disclosed during the course of our review.

PBGC also took steps intended to protect the rights of the workers and retirees in United's pension plans by contracting for analyses and calculations in support of PBGC's decisions, including:

- Financial and investment advisors to provide support in analyzing UAL's business plan for emerging from bankruptcy, their financial forecasts, capital structure, and the company's ability to obtain exit financing while maintaining pension plans;
- Contractors to conduct various actuarial analyses of the UAL pension plans; and
- Contractors to perform audits intended to establish the fair market value of plan assets at the date of plan termination.

Other than our concerns with the plan asset audit process and the participant data audit processes, as noted below, nothing came to our attention to cause us to believe that the outside contractors, including the investment advisors and actuaries, did not perform their analyses and calculations as required in their respective contracts.

Plan Asset Audits. Our review showed that the auditors charged with conducting the plan asset audits for the four UAL plans did not exercise due professional care in their work. Further, we found that PBGC did not comply with its own protocols in conducting plan asset audits of the four UAL defined benefit plans, in part because PBGC did not properly oversee the work and failed to identify or follow-up on errors and omissions in the work.

We determined that the issues surrounding the inadequate plan asset audits were so significant that additional, more detailed evaluation is warranted. As a result, within the next month, my office will issue a formal evaluation report including findings and recommendations for necessary improvements in PBGC's oversight of the plan asset audit process.



We have briefed PBGC officials on the results of our work to date addressing UAL plan asset audits. PBGC officials agree that our preliminary findings are serious and have committed to doing the additional work necessary to definitively determine any effect on the benefits of UAL workers and retirees. PBGC officials believe the need for changes to benefits is unlikely.

Participant Data Audits. Our limited review of these audit reports disclosed that PBGC did not validate certain electronic records to manual source documents. We continue to work to understand whether PBGC was able meet its audit objective through alternative audit tests and will report our conclusions as part of the evaluation report noted above.

### **Communications with UAL Workers and Retirees**

PBGC answered questions, addressed concerns, and explained the federal pension program through meetings with multiple groups of UAL pension participants and beneficiaries, and through responses to many individual letters and mass mailings. OIG received nine complaints through its Hotline, which OIG referred to PBGC for response and follow-up. During the course of this review, we learned that PBGC did not provide answers to the complainants we referred because, to PBGC's view, there was no reason to issue responses to each member of the group who had written the same letter, because the organization had already received one or more responses. Although we had requested, in writing, that PBGC advise us of the actions taken in response to the complaints we referred to them, PBGC did not do so and we did not become aware that the complaints had lingered without being answered until we began our work to respond to this Congressional request. We intend to include a copy of this letter in a future response to each of the nine complainants.

### **Adequacy of Established Protocols**

During our review, nothing came to our attention to cause us to believe that PBGC's established protocols are not adequate to protect the interests of current and future beneficiaries, as long as PBGC ensures careful execution of the protocols. However, we did note that the Corporation does not have formal procedures that mandate documentation of discussions and negotiations between PBGC and plan sponsor officials. As a result, various aspects of the UAL settlement discussions were not documented, with a resulting limitation on our ability to conduct aspects of our review. Because litigation and other settlement discussions are fluid, we concluded that, while prescriptive protocols may not be appropriate, creating a contemporaneous record of settlement discussions would create a complete record of the government's actions for the particular matter and would also preserve the facts from fading memories, differing perceptions, and lost knowledge when staff leave PBGC. Based on our review, we concluded that PBGC officials should develop and implement protocols for all meetings or discussions with plan sponsors that, at a minimum, require all meetings or discussions with plan sponsors be documented.

### **Actions in Response to OIG's Review of UAL'S Claim Sale**

Finally, as part of our work to respond to your questions, we followed up on our report, *Review of PBGC Claims Sale*, (No. 2006-11/PA-0029, August 31, 2006). This report evaluated whether the process followed by the PBGC in hiring Deutsche Bank to market and sell PBGC's rights to UAL securities upon UAL's emergence from bankruptcy was reasonable in light of PBGC's governance and industry standards for institutional investors. While the report noted that "the Sale was perceived in the market as successfully executed," in general, the report found that PBGC failed to share useful and timely information within PBGC and with the Board of Directors. OIG's recommendations addressed PBGC's investment policy, governance, and standard documentation.

At our request, PBGC provided an update on May 20, 2010 to report activities that addressed the findings and recommendations. We were unable to independently validate the effectiveness of these actions with respect to PBGC claims sales as only one additional claim sale has occurred. However, PBGC officials reported taking the following corrective actions:

- Written Weekly Significant Activity Reports sent to the Board Representatives each Friday afternoon. This confidential weekly report includes briefings on any significant developments in active cases or litigation matters occurring in the past week, or expected in the following week.
- Bi-weekly Significant Case Update meetings, in which the Insurance Programs Office (IPO) provides in person updates on the recent and upcoming significant events in IPO to the PBGC Director, the Deputy Director, the Chief Financial Officer (CFO), the General Counsel, the Chief Operating Officer, and department directors in the departments affected by the cases.
- Large case working group meetings, which are interdisciplinary meetings of agency managers and staff involved in the agency's planning and preparation for large plan termination and trusteeship.
- Bi-Weekly meetings between the General Counsel and the Chief Counsel and their senior officials to discuss matters of mutual concern, including but not limited to the potential for pre-emergence transactions. Since the UAL claims sale, the Corporation reports that it has more clearly defined the roles of the two legal offices in a written document. The Corporation states that this, together with their regular coordination, has resolved the structural issues about their roles raised in our report.

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- Written 30-60-90 reports prepared every other month by each Chief-level officer for the Director. These privileged and confidential reports describe anticipated events and significant activity that is likely to occur in the 30-day, 60-day, and 90-day time-frames. For this purpose, and for the briefing book prepared for each meeting of the Board of Directors, IPO prepares a Significant Case memo, which updates the status of active cases and litigation matters.
- An integrated, multi-disciplinary approach for evaluating potential preemergence transactions, including meetings at the earliest possible point between the CFO organization (especially the Corporate Investments Department), IPO and OGC.

PBGC officials stated that while PBGC claims sales are rare, the findings and recommendations in our report continue to be helpful as they prepare for the possibility of similar transactions in the future. Based on our review of documentation submitted by PBGC officials, there has been improvement in communications between the departments. Though PBGC did not implement some of our recommendations, the Corporation has established protocols and processes that reduce the likelihood of future communications breakdowns similar to those that occurred during the UAL claims sale.

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We appreciate the opportunity to assist your Committee as you address these important issues and would be happy to provide a detailed briefing for your staff, at your request. Alternatively, please feel free to have a member of your staff contact me at (202) 326-4000, x3437, if there is additional information that we can provide.

Respectfully Submitted,



Rebecca Anne Batts  
Inspector General

cc: The Honorable John Kline  
Ranking Member, Committee on Education and Labor

The Honorable Robert Andrews  
Chairman, Subcommittee on Health, Employment, Labor, Pensions

The Honorable Tom Price  
Ranking Member, Subcommittee on Health, Employment, Labor, Pensions

Vincent K. Snowbarger  
Acting Director, Pension Benefit Guaranty Corporation