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PBGC: IS STRONGER MANAGEMENT AND OVERSIGHT NEEDED?

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE PENSION BENEFIT GUARANTY CORPORATION, FOCUSING ON MANAGEMENT AND OVERSIGHT

DECEMBER 1, 2010

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C O N T E N T S

STATEMENTS

WEDNESDAY, DECEMBER 1, 2010

ADDITIONAL MATERIAL

PBGC: IS STRONGER MANAGEMENT AND OVERSIGHT NEEDED?

WEDNESDAY, DECEMBER 1, 2010

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 10:04 a.m. in Room SD–430, Dirksen Senate Office Building, Hon. Tom Harkin, Chairman of the committee, presiding.

Present: Senators Harkin, Murray, Casey, Hagan, Franken, Manchin, Enzi, and Isakson.

OPENING STATEMENT OF SENATOR HARKIN

The CHAIRMAN. The committee, as I said, will resume its sitting. I'd like to thank everyone for being here for the second hearing in a series focusing on retirement security in America. Today, we are going to take a hard look at the management and administration of the Pension Benefit Guaranty Corporation and see if we need to take steps to modernize this agency.

In this climate of uncertainty, PBGC's role is more important than ever. The Great Recession has taken a toll on workers all over the country. I often talk to people who are struggling just to make ends meet. They worry a lot about just having a job, putting food on the table, and getting their kids in school. The last thing they need to do is lose sleep about whether or not they're going to have their pensions when they retire.

That's why PBGC was created in 1974, providing workers with a safety net so they can rest assured that even if the company's pension plan fails, they'll get a retirement benefit. Forty-four million American workers and their families rely on PBGC to insure their hard-earned pensions. The agency is responsible for making sure that $467 million in benefits get to 801,000 retirees every single month; and that responsibility is growing. Last year alone, PBGC assumed responsibility for the pensions of 109,000 people. For PBGC, those are individuals and families that would have been left with next to nothing.

Unfortunately, the future of this valuable agency is at risk. The deficit rose again this year. Moreover, PBGC's annual report indicates that there's a very real chance that some very large plans could become insolvent in the near future. This could increase PBGC's deficit tenfold and pose a significant administrative burden.

In light of these challenges, strong and effective leadership is crucial for the future viability of PBGC. The Inspector General just recently released a report that raises serious concerns about whether PBGC would be able to cope with a sudden influx of pensions brought on by a new economic crisis.

PBGC has also been needlessly distracted by scandals such as those under former director Charles Millard. Mr. Millard's inappropriate contacts with vendors and bad decisions jeopardized the security of PBGC and cast a dark shadow over the agency during one of the worst economic crises in our Nation's history. Worse yet, Mr. Millard eroded the public's trust in the agency and in the defined benefit pension system as a whole.

Now, we're certainly starting to see some positive changes under Mr. Gotbaum's leadership, but we need to examine whether the agency has structural problems that a new director alone cannot solve.

For example, the board of directors has often been disengaged, acting as little more than a rubber stamp. Even during the height of the recent economic crisis, when the agency was most at risk, the board barely met. I think we ought to take a look at the construction of the board and the number of the board members on PBGC.

Senator Kohl of Wisconsin has put some ideas on the table. I commend him for that.

This is, again, a matter on which I hope we can put aside partisanship and work collaboratively to improve PBGC and strengthen America's pension system. This hearing today is an important step toward that goal. They have problems, but I don't think they're insurmountable.

I thank all of you for being here today to discuss this important issue.

I now yield to my friend from Wyoming, Senator Enzi.

STATEMENT OF SENATOR ENZI

Senator ENZI. Thank you, Mr. Chairman. Few people realize that the Pension Benefit Guaranty Corporation sends nearly half a billion dollars each month to retirees whose companies' pensions have gone away. The magnitude of this statistic shows how important the operation and management of PBGC is to today's and tomorrow's retirees.

Back in 2008 the vast majority of single-employer pension plans were nearly 100 percent funded; however, because of the economic downturn we've seen a greater number of single-employer pension plans taken over by the PBGC. In addition, the Government Accountability Office, GAO, states that approximately 400 of the 1,500 multiemployer pension plans are less than 80 percent funded.

Clearly, the PBGC is facing some rough waters and will continue to face them in the future.

The corporate structure of the PBGC is unlike any other in the Federal Government. It has three cabinet secretaries on the board of directors; former Secretary of Labor Elaine Chao recognized the need for greater corporate governance of the PBGC and implemented reforms, including updating and revising the agency's by-laws.

Today, we'll hear from our witnesses to see whether further improvement is necessary, and recommendations on how to improve communication between the PBGC and its board of directors. Enlarging it can be a very difficult task—but not as difficult as it was with the private sector which had to follow Sarbanes-Oxley Act, and the liability that could come to the private sector directors.

However, with the shape that the PBGC is in, it may be difficult to get people to participate on the Board.

Mr. Chairman, I'm open to legislation to improve the PBGC corporate governance—governance similar to the reforms Congress sought in the private companies in that Sarbanes-Oxley Act; however, we must undertake reforms that strengthen the PBGC and our retirement system and stay away from the so-called reforms that might politicize or minimize the agency's ability to do its job. In addition, I'm looking forward to hearing from the business community about their interactions with the PBGC.

As we all know, our retirement benefit system is built upon a voluntary partnership of companies and their employees. In order to strengthen the defined benefit system, we need a PBGC that can respond and work with the business community. Otherwise, the business community will decline to participate in the defined benefit retirement system and switch to the 401(k) plans.

Mr. Chairman, I thank you for holding this hearing, and I look forward to the testimony of the witnesses.

The CHAIRMAN. Thank you very much, Senator Enzi.

Just to respond, I was looking at the board, and you're right. There are three members of the board. They're all cabinet secretaries, so I've got to believe they don't have much time to go to board meetings.

Comparing it to other agencies that have even less responsibility, if I can put it that way, some of these other agencies have boards that have 7 members, 9 members—one has 15 members. They set up subcommittees—like a board of any company would do—and then they have these different committees that take different parts of the agency, and they're responsible for it.

I'd like to discuss that with you. I'm sure we're going to have some talk today about that, too, from our witnesses.

We have two panels. On the first panel is Joshua Gotbaum, Director of the Pension Benefit Guaranty Corporation, responsible for the agency's management, personnel, organization, budget and investments.

Immediately prior to his appointment, Mr. Gotbaum was an operating partner at Blue Wolf Capital, where he managed and advised public, private, and nonprofit institutions.

Then on our second panel we have Barbara Bovbjerg, director of education, workforce and income security issues at the U.S. Government Accountability Office; and, also, Rebecca Anne Batts, the Inspector General of the PBGC; and Ken Porter, Actuarial and International Benefits Consultant, at the American Benefits Council.

That will be our second panel.

Mr. Gotbaum, welcome to the committee. If I'm not mistaken, I think this may be your first appearance before this committee.

Mr. GOTBAUM. Yes, sir, Mr. Chairman, it absolutely is.

The CHAIRMAN. Welcome. I read your testimony last evening, and your testimony will be made a part of the record in its entirety. I'd ask if you could sum it up in several minutes so we have more chance for an exchange with the Senators. I would appreciate it very much.

Mr. Gotbaum, welcome, and please proceed.

STATEMENT BY JOSHUA GOTBAUM, DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION (PBGC), WASHINGTON, DC

Mr. GOTBAUM. Mr. Chairman, Senator Enzi, members of the committee, I want to start, frankly, by thanking you for supporting my nomination. I understand very well, the consequences of elevating the PBGC Director to a presidential appointment subject to Senate confirmation. It changes the job.

I hope that you will conclude that having done so facilitates the very management and oversight that are the subjects of this hearing.

I also, frankly, want to thank you for holding this, which is my first oversight hearing—I believe in oversight; I think it's an important part of the process—and giving me a chance to fulfill my commitments to the committee to come back and give my impressions.

Since the PBGC has just turned out its annual report, copies of which have been sent to you all and provided to your staff, I can't go chapter and verse over everything that gets done; and frankly, after only 4 months on the job, I can't pretend to be an expert on the workings of everything that we do.

I'd like to report my first impressions, and just make four points: one, is that in light of the complex tasks that ERISA has given the agency, the PBGC performs them surprisingly well. It has paid benefits reliably for 36 years, and despite the incredibly complex rules it has to follow to figure out what those benefits are, surprisingly accurately.

When a plan fails, our first priority is to make sure that benefit payments continue without interruption. Last year newly terminated plans covered 40,000 people. Forty thousand people were getting checks every month from their plan that was terminated; and every one of those 40,000 people was transferred to PBGC's payment systems without a hitch.

I brought these charts—which I admit are hard to read—and put them in the testimony as a reminder of how complicated the benefit determination process is.

PBGC starts by paying an estimate of what benefits are, and then it follows the many steps that are necessary to figure out the legal benefit payable under ERISA. The good news is that despite this incredibly complicated process, 90 percent of the estimated payments are within 10 percent of the number that is finally determined to comply with ERISA.

The bad news is that following this complicated process can take years, and during that period of time, people are uncertain.

Second point: that for PBGC, preserving plans is just as important as replacing them when they fail. The most visible part of the agency's actions are when the agency steps in after a plan fails. First, however, the agency tries to preserve plans, and keep pension promises in the hands of the employers that made them.

Our view of it is that every plan that is kept by its employer and not terminated is better for the employees, and the pensioners, and better for the PBGC.

Last year our staff negotiated with dozens of companies, both in bankruptcy and through our Early Warning Program, to preserve their plans. And, partly as a result of that, last year companies came out of bankruptcy and kept their plans; and, included in those plans were a quarter of a million people.

As a result of those efforts, a quarter of a million people had their companies go through bankruptcy and came out, but kept their plans. We think that's important.

Third point: the staff of the PBGC is, I'm pleased to report, knowledgeable, compassionate, and committed, and I think that's very important, because they have to meet very high standards of stewardship and accountability.

The agency measures its performance in many ways: we measure customer service by how quickly benefits are determined, and by independent performance surveys; we measure investment performance by comparison with professional, private sector benchmarks; we meet financial reporting standards by having, we're pleased to say, for almost two decades received a clean opinion on the PBGC's financial statements.

That does not mean that there isn't a heck of a lot more to be done. Like too many institutions, both in and out of government, our IT systems are just plain not up to snuff; they don't meet today's standards for connectivity; they don't meet standards for security.

Like many other government agencies, we rely on contractors without having enough sufficiently skilled contract managers and sufficient procedures in place to manage them as well as we should. This is a challenge for the PBGC; it's a challenge for other agencies; it's one that we think is important, and we're working on it.

My fourth and last point is about pensions and retirement security generally. As this committee knows, as the Chairman and Mr. Enzi have both mentioned, there are broad challenges to the PBGC's insurance program and to the defined benefit system itself.

In one sense we've been fortunate. Despite the greatest financial turmoil in decades, fewer plans were terminated than anyone had expected. Nonetheless, the facts are that many sponsors remain weak; many plans remain underfunded; and, I would have to say, the multiemployer system in particular, is especially worrisome.

That there are challenges is undeniable; that's not undeniable. What I believe is also undeniable is that time and again, since ERISA was enacted some 36 years ago, the Congress and the executive branch have worked together to deal with them. More than a dozen times in PBGC's history, Congress has modified ERISA to enable the agency to continue to do its job. It made changes in who we insure, the benefits we pay, the premiums we charge.

Congress has also undertaken other actions that affect the pension insurance system, such as changes in funding requirements.

ERISA charges the PBGC with being an advocate in discussions about retirement security. Given the history of nonpartisan co-operation to meet these challenges, we hope that that active partnership will continue.

I want to thank the committee again for its patience, and also for your support, and I very much look forward to hearing your views and answering your questions.

[The prepared statement of Mr. Gotbaum follows:]

PREPARED STATEMENT OF JOSHUA GOTBAUM

Good morning Chairman Harkin, Ranking Member Enzi, and other committee members. Let me begin by expressing my thanks to you and the other committee members for considering and supporting my nomination.

I also want to thank you for holding this, my first oversight hearing. It comes at an appropriate time, for PBGC has recently issued its Fiscal Year 2010 Annual Report. When this committee held a hearing on my nomination, I promised, if confirmed, to return and share my views once I had an opportunity to develop them. Thank you for providing that opportunity.

Today, I would like to describe and discuss how PBGC performs the complex tasks that ERISA has given the agency:

- Trying to preserve pension plans,
- Stepping in to pay benefits when plans fail,
- Working to recover what is owed those plans, and
- Maintaining high standards of stewardship and accountability.

Of course, PBGC also works with Congress and the Administration to implement and improve pension laws.

All these activities are described in the Annual Report and so my testimony is intended primarily to highlight them, to put them in context, and to answer your questions. I think it is important to add my own opinion: that the PBGC performs these complex tasks quite well.

As this committee knows only too well, in these difficult times there are broad challenges to the pension insurance program and to the defined benefit system itself. I would hope that the Administration and Congress can find ways to strengthen them. Nonetheless, it is important to reassure pensioners that PBGC continues to protect and insure pension plans, that we are continuing to pay billions in benefits if plans fail, and that our $80 billion in assets is more than sufficient to continue to do so for the foreseeable future.

PBGC OVERVIEW

In 1974, Congress passed the Employee Retirement Income Security Act (“ERISA”) which, among other pension protection measures, created PBGC to insure pensions earned by American workers under private-sector defined benefit (“DB”) plans. PBGC now guarantees payment of basic pension benefits earned by more than 44 million American workers participating in more than 27,000 private-sector defined benefit pension plans. Those benefits are financed by insurance premiums, by the assets from terminated plans and by funds recovered from their sponsors, and by investment income. PBGC receives no funds from general tax revenues and by law its obligations are not backed by the full faith and credit of the U.S. government.

PBGC operates two separate programs. The single-employer program protects nearly 34 million workers, retirees, and beneficiaries in about 26,000 pension plans. The smaller multiemployer program—which covers collectively bargained plans that are maintained by two or more unrelated employers—protects more than 10 million workers, retirees, and beneficiaries in about 1,500 multiemployer plans.

Originally, responsibility for managing PBGC was held by the Secretary of Labor, who delegated that responsibility to an executive director. In 2006, the Pension Protection Act (“PPA”) placed the executive responsibility in the newly created position of Director, who is appointed by the President and confirmed by the Senate, and acts in accordance with policies established by the board. The Secretary of Labor continues to chair PBGC’s three-person board whose other members are the Secretaries of Commerce and the Treasury.

The work of the PBGC is performed by some 2,300 people, of whom about 900 are Federal employees and about 1,400 are contractors. I have found the staff to be impressive. They are both knowledgeable and committed.

WHAT PBGC DOES

Working with companies to keep their pension plans. The most visible part of PBGC's efforts occurs when the agency steps in after plans fail. First, however, the agency tries to preserve plans and keep pension promises in the hands of the employers who make them. Every plan retained by its sponsor is a victory both for the plan's participants and for PBGC.

Last year, the agency continued to respond to the wave of corporate bankruptcies by stepping up its work to protect plans. PBGC staff negotiated with dozens of companies, both in bankruptcy and through our Early Warning Program, to preserve their plans.

Under the Early Warning Program, PBGC monitored more than 1,000 companies to identify transactions that could threaten a company's ability to pay pensions, and negotiated protections for the plans. When major layoffs or plant closures threaten a plan's viability, PBGC can step in and negotiate protection for the pension plan, including a guarantee, posting of collateral or contributions to the plan. In this way, last year PBGC secured an additional $250 million for participants in 20 pension plans.

When companies do enter bankruptcy, we encourage them to keep their plans intact. During fiscal year 2010, the agency worked with debtors and creditors to help 38 companies who were reorganizing in bankruptcy keep their plans. As a result, approximately 250,000 workers and retirees continue to enjoy their full pension benefits, while continuing to be protected by PBGC insurance coverage. This is almost 2½ times the number of participants in plans that failed.

When plans do fail, we step in and make sure benefits are paid. In fiscal year 2010, PBGC paid $97million in financial assistance to 50 multiemployer pension plans, up from the $86 million to 43 plans in 2009. Last year, PBGC also helped seven small insolvent multiemployer plans close out through the purchase of annuities or payment of lump sums for participants' guaranteed benefits. Also in fiscal year 2010, PBGC acted to partition the Chicago Truck Drivers, Helpers & Warehouse Workers Union (Independent) Pension Fund. That action extends the solvency of the Chicago Truck Drivers' plan and preserves full benefits for about 3,700 workers and retirees. PBGC expects that the number of insolvent plans will more than double over the next 5 years.

With regard to single-employer plans, despite PBGC's efforts to preserve pensions, in fiscal year 2010, 147 underfunded single-employer plans did terminate, most often in bankruptcy. PBGC took up responsibility for an additional 109,000 workers, retirees, and beneficiaries.

For the past 36 years, PBGC has stepped in to pay benefits—on time, every month, without interruption. Last year, PBGC paid nearly $5.6 billion to about 800,000 retirees. We are also responsible for future benefit payments to 700,000 workers who have not yet retired. The agency is responsible for pension benefits owed to 1.5 million people in 4,150 failed plans.

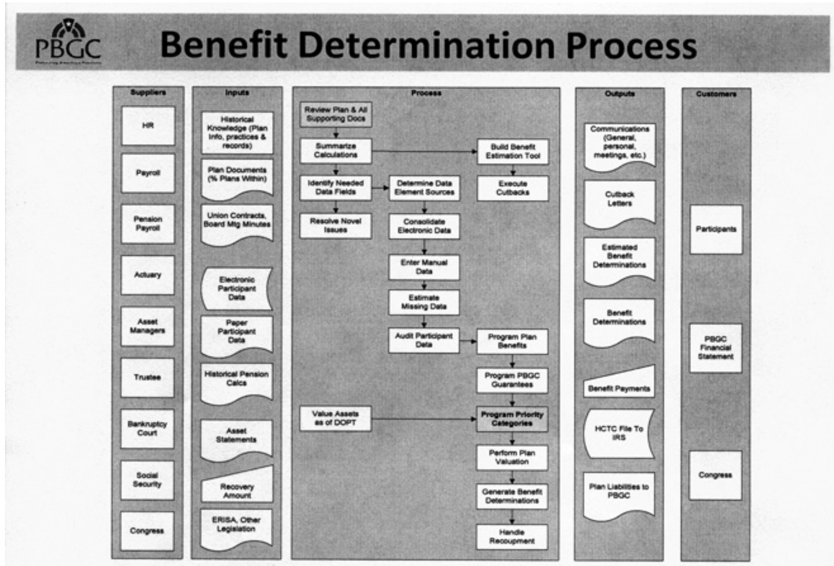
When a plan fails, PBGC's first priority is to make sure that benefit payments continue without interruption. Newly terminating plans in fiscal year 2010 covered nearly 40,000 participants already receiving monthly checks. PBGC transferred every one of them to our payment systems without interruption. Because a participant's final benefit amount has not been calculated when PBGC begins paying benefits, the agency pays estimated benefits. Historically, more than 90 percent of estimated payments are within 10 percent of the final benefit amounts.

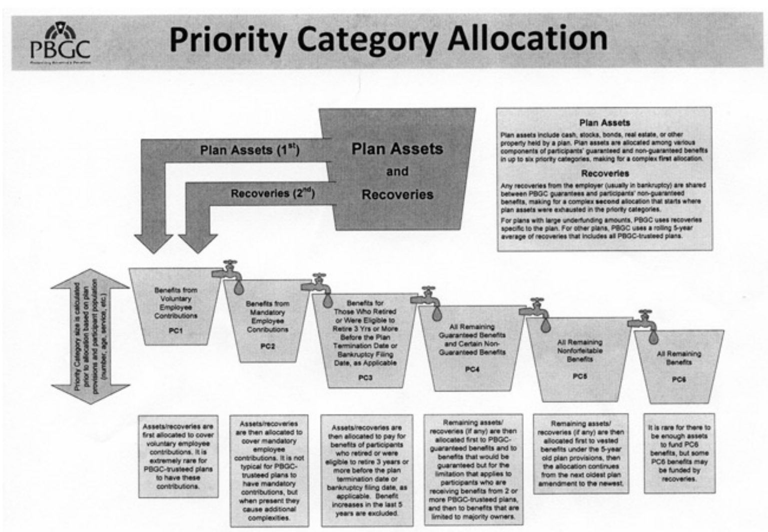
In addition to participants who were already retired when PBGC assumed responsibility for their plans, we also process about 3,000 benefit applications per month for new retirees. Nearly 85 percent of applicants receive their first payments within 45 days after PBGC has their completed applications. Over 80 percent receive their benefits by electronic direct deposit.

When PBGC becomes responsible for a terminated plan, we must determine the benefits owed to each plan participant. Each participant is entitled to the greater of the guaranteed benefit amount or the benefit amount funded by plan assets and recoveries from plan sponsors.

PBGC calculates benefits using a process spelled out in Federal law. Actuaries calculate each participant's benefit according to the plan's provisions; then they must apply statutory and regulatory rules to determine how much the agency can pay. Finally, when the benefit determination is complete, PBGC sends each participant a letter presenting the benefit amount and how it was calculated.

By law, this benefit determination process is complex and customized, requiring a unique calculation for each participant. As depicted in the charts below, PBGC analyzes plan provisions, collects participant data, and values plan assets and recoveries from plan sponsors. After determining each participant's benefit, plan assets and recoveries are then allocated across priority categories according to a complex calculation to determine the maximum amount legally payable.





We work to recover assets for retirees. When pension plan sponsors cannot maintain their plans, PBGC does more than just assume responsibility for benefit payments. We also take over the assets of those plans, and fight in court on behalf of participants and other stakeholders to recover the maximum possible amount from sponsors of those plans. These recoveries are then shared with participants as provided by law. In fiscal year 2010 PBGC assumed $1.8 billion in assets from failed plans, and recovered additional assets of $246 million from plan sponsors to help pay for unpaid contributions and unfunded benefits. In its role as trustee of terminated plans, PBGC also files other claims on behalf of the plan, such as claims against fiduciaries for breach of their duty.

We implement pension laws and work with the Administration and Congress to improve them. In addition to working to preserve plans and paying benefits to retirees and beneficiaries, PBGC also works with the Administration and with Congress to draft and implement pension laws. In fiscal year 2010, we worked with both the private sector and other government agencies to implement the funding provisions established under the Pension Protection Act of 2006.

To date, PBGC has published seven final rules implementing PPA changes that deal with premiums (two rules), disclosure (two rules), multiemployer withdrawal liability, annual financial and actuarial information reporting, and PBGC by-laws. We have also published two PPA proposed rules—reportable events and benefits in plans that terminate while the sponsor is in bankruptcy—that we expect to finalize in 2011. PPA proposed rules on cash balance plans, shutdown benefits, and missing participants are far along in development or external clearance and are expected to be issued in 2011.

In addition to implementing the PPA changes, in fiscal year 2010 PBGC published a final regulation ensuring that benefits for re-employed service members will be guaranteed for periods they served in the armed forces. We also issued a proposed rule that provides guidance on reporting requirements and liability under section 4062(e) when employers have substantial cessations of operations.

PBGC is also an important source of information on defined benefit pension plans and retirement issues generally. During fiscal year 2010, PBGC provided expertise, in legal and actuarial analysis, and simulation modeling, to analyze the issues affecting multiemployer plans, and we provided technical assistance to Congress, other ERISA agencies, the Administration, and GAO.

We are a careful steward of our resources and investments. In fiscal year 2010, PBGC collected $2.18 billion in premiums, assumed assets of $1.8 billion from failed pension plans, and recovered assets of $246 million from sponsors of failed plans. As of September 30, 2010, PBGC had an investment portfolio of $66.8 billion.

As you know, our benefits are not paid for or backed by taxpayers. We have an obligation to be an active and thoughtful steward of our assets to ensure that funds are available to fulfill our obligations.

As it has since its inception, the agency contracts with professional private sector investment management firms to manage the investment of its assets. These firms make investment decisions within the parameters of PBGC's investment policy and they are subject to PBGC oversight. We measure the performance of these managers by comparison with negotiated benchmarks. In fiscal year 2010, the investment firms we chose outperformed their total fund benchmarks over 1-, 3-, and 5-year periods. For the fiscal year, PBGC realized a 12.1 percent annualized return on total invested funds compared with the agency's total fund benchmark return of 11.0 percent.

As this committee knows, one of the first actions of the new PBGC board in 2009 was to order a review of the investment practices and policies of the past, while putting in place a temporary policy. When I joined PBGC this July, the Board appropriately asked me to undertake my own review and develop my own views of investment policy and practice. I am still in the process of doing so, but I hope and expect to complete my review this month after which the PBGC Board will complete its review and adopt a permanent policy.

Throughout fiscal year 2010, PBGC was also a careful steward of the agency's other resources. We increased attention to IT security, infrastructure improvements and system performance, and documentation of our asset valuation and benefit calculation processes to improve accountability; we continued to streamline operations; and we attained our 18th consecutive unqualified audit opinion on financial statements. Much remains to be done, but I believe that PBGC is making real progress, and doing so in a way that meets the standards we expect for an agency that handles billions of dollars and the retirement security of millions.

OPERATIONS & FINANCIAL POSITION OF THE PBGC

In fiscal year 2011, PBGC expects to pay $6.7 billion in benefits to about 800,000 retirees and beneficiaries. We also expect premium receipts in the range of $2.4 billion to $2.7 billion and expect to have an investment portfolio greater than $76 billion. As I noted earlier, we can and will pay benefits for the foreseeable future. However, over the long term our liabilities exceed our assets.

In 2011, significant factors beyond PBGC's control (including changes in interest rates, the financial markets, plan contributions made by sponsors, and recently enacted statutory changes) will continue to influence PBGC's underwriting income and investment gains or losses. No reasonable estimate can be made of 2011 terminations, effects of changes in interest rates, or investment income.

At the close of fiscal year 2010, the single-employer and multiemployer programs reported deficits of $21.6 billion and $1.4 billion, respectively, roughly the same as last year. As explained in more detail in the Annual Report, the obligations ("liabilities") that we have and will pay in the decades to come exceed the assets currently available to pay them. We had single-employer assets totaling $77.8 billion, an increase of $10.2 billion from the close of the previous fiscal year. Our single-employer liabilities (measured in present value though they will be paid over decades) totaled $99.4 billion; this compares to total liabilities of $88.7 billion in 2009. The net of these positions is a single-employer deficit of $21.6 billion, an increase of $500 million from the prior year. Likewise, the multiemployer insurance program experienced a $600 million decline, bringing its fiscal year 2010 deficit to $1.4 billion, with $1.6 billion in assets to cover about $3 billion in liabilities.

In part, PBGC's financial position is the result of inadequate plan funding and misfortunes that have befallen plan sponsors. In part, it is a result of the fact that the premiums the agency charges are insufficient to pay for all the benefits that PBGC insures, and other factors. Because our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future. However, neither program at present has the resources to fully satisfy PBGC's obligations in the long run; we cannot ignore PBGC's future financial condition any more than we would that of the pension plans we insure.

ASSESSING THE RISK OF FUTURE PLAN FAILURES

When considering PBGC's financial condition, we often separate the obligations we already have from those that we may have in the future.

In our view, the greatest challenge may well be posed by those plans that have not yet failed, but may do so in the future. For this reason, we analyze and report on PBGC's exposure to potential obligations in the future.

Both the single-employer and multiemployer program exposures are substantial. At year-end, PBGC's estimate of its single-employer exposure from underfunding by plan sponsors whose credit ratings were below investment grade or that met one or more financial distress criteria totaled approximately $170 billion, slightly up from $168 billion in 2009. The agency classifies these sponsors' underfunded plans as reasonably possible terminations.

PBGC's estimate of its multiemployer reasonably possible exposure increased significantly from $326 million in 2009 to $20 billion in 2010. The agency classifies these multiemployer plans as reasonably possible of requiring future financial assistance. The significant increase in fiscal year 2010 from prior years is due to the addition of two large plans to the reasonably possible inventory. The sponsor of one plan, with net liability of $15.0 billion, is in the "transportation, communication, and utilities" industry category; the other, with net liability of $4.8 billion, is in the "agriculture, mining, and construction" industry category.

These estimates are measured as of December 31 of the previous year. PBGC's exposure to loss may be less than these amounts because of the statutory guarantee limits on insured pensions, but this estimate is not available because it is difficult even to estimate prospectively the extent and effect of the guarantee limitations.

The significant volatility in plan underfunding and sponsor credit quality over time makes long-term estimates of PBGC's expected claims highly uncertain. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized the agency's experience to date and will likely continue. Factors such as economic conditions affecting interest rates, financial markets, and the rate of business failures will also influence PBGC's claims going forward.

Multiemployer plans present a different and more immediate challenge. Multiemployer plans are different and more complicated than single-employer plans, and PBGC's multiemployer pension insurance works very differently from our single-employer program. For decades, multiemployer plans were in relatively good health, even in the face of industry decline. Unfortunately, for many multiemployer plans, that is no longer true. By fiscal year 2010, many multiemployer plans had become substantially underfunded.

This will, of course, increase PBGC's obligations with respect to such plans. However, our focus now is on what measures might preserve them. It is not yet clear what those measures will be, but PBGC has begun developing the tools to analyze them. In fiscal year 2010, we developed and introduced a new multiemployer version of our simulation Pension Insurance Modeling System ("PIMS"). We have also begun discussions with multiemployer plans and others to secure the information about such plans that will be necessary to develop potential solutions.

STRENGTHENING PENSION INSURANCE

In one sense, we've been fortunate. Despite the greatest financial turmoil in many decades, fewer plans were terminated than many observers had expected.

In part, this may be due to the PBGC's own efforts. We continued to respond to the recent wave of corporate bankruptcies by stepping up and stepping in. The agency worked tirelessly to convince companies, both in and out of bankruptcy, to preserve their plans. In many instances, this approach worked.

However, underfunding in plans sponsored by financially weak companies remains high.

The agency's single-employer program remains on the General Accountability Office's (GAO's) "high-risk" list. GAO's high-risk designation for PBGC does *not* reflect concerns primarily about the agency's management. Rather, GAO is focused on structural problems in the private-sector defined benefit system that pose serious risks to PBGC. The structural problems—large amounts of underfunding in the pension system, especially among weak firms, the decline in PBGC's premium base, and our limited tools to encourage plan preservation—are outside the agency's control.

More than a dozen times in the PBGC's history, Congress has modified ERISA to enable the agency to continue to do its job, with changes in whom we insure, the benefits we pay, and the premiums we charge. Congress has also undertaken other actions that affect the pension insurance system, principally changes in funding requirements. That active partnership should continue. We do not, and the Administration does not, have any policy recommendations at this time. We do hope, in the months ahead, for an active discussion about what options might make sense for consideration in the future.

ERISA charged PBGC, among others, to serve as an advocate in the discussions of the issues facing retirement security. It is an obligation we take very seriously, and I look forward to working with our colleagues in the Administration, with this committee, and the Congress as a whole to do so.

Thank you again for holding this hearing. I look forward to hearing your views, to answering your questions, and, I hope, in some way to help preserve and protect the retirement security that Americans deserve.

The CHAIRMAN. Thank you very much, Mr. Gotbaum, for a very forthright statement.

I'll start off with 5-minute rounds. It'll be me, then Senator Enzi, of course, then Senator Murray, Senator Isakson, then Senator Manchin, Senator Franken, Senator Bingaman, Senator Casey and Senator Hagan.

Mr. Gotbaum, on page 8 of your testimony you said, "However, neither program at present has the resources to fully satisfy PBGC's obligations in the long run."

I read that last night, and I circled it and I said, "What is the 'long run?' "

What's the long run? You referred to that a couple times in your written testimony, saying that things are OK now, but in the long run you may not have issues. What's the long run? Two years? Five years?

Mr. GOTBAUM. Let's start by talking 20 years. The PBGC has reported a financial deficit for 30 of its 36 years. What does that mean? It means that when you compare the cash we have on hand with the obligations that we're going to pay over the next 30 years—plus, minus—discounted at present value, the obligations are bigger than the cash we have. That's a deficit. Time and again what has happened is, Congress has stepped in, in some way, shape or form, and said, "maybe your premiums are too low; maybe you need to change something" and etc. As a result, we have continued to pay benefits for all of those 36 years, on time, reliably.

Now, the deficit: as the PBGC gets larger, as its obligation gets larger, the deficit gets larger, too. One of the things I did is—the PBGC has a very talented group of forecasters, and they are making something which they would call simulations, and which I would call as very well-educated guesses about the future.

I said to them, "OK, let's take the program as we have now, the law as we have now, the practices we have now, and run your simulations over the future for the next 20 years with different economic scenarios and collapse, and so on and so forth; and then tell me, for all your scenarios, over the 20-year period, in how many percentages of them do we run out of money by the end of 20 years."

And they came back and said, "well, it depends in part on what your investment practice is going to be."

If you look at the PBGC's historical investment practice and project forward 20 years, if Congress does nothing, maybe there is a less than 5 percent chance that the PBGC runs out of money 20 years from now.

The fact is, Mr. Chairman, Congress has never done nothing. There has always been an engagement and an interaction to make sure the PBGC has the resources it needs.

So, my view is, Senator, this is not to diminish that there are real challenges in the system; there absolutely are, and we ought to take them seriously. I don't think we should act because we fear that the PBGC is imminently going to run out of money; it's not.

The CHAIRMAN. Well later, on that page you say that, "PBGC's estimate of its multiemployer reasonably possible exposure increased significantly from $326 million in 2009 to $20 billion in 2010."

Is that a typo?

Mr. GOTBAUM. No, sir. One of the things that the PBGC does, as part of its role is, it watches the pension system. The tools we have for doing so are not perfect, but I think they're pretty good, and I think the people that do it are very, very committed.

One of the things they do, time after time, is make estimates as to which plans they think are likely, over the next decade, to get into trouble; to get into trouble enough so that they would become the PBGC's business.

They make several kinds of guesses: one, is, which plans we think are likely to get into trouble; and those we put on the PBGC's books. In other words, we say, that's something we think is going to be liable. And, the history is, by the way, that when we say something is likely, there's about an 80 percent chance that we are going to end up having to deal with it directly; about 80 percent.

We also keep track of things that it's possible, not more likely than not, but possible. As I mentioned in my testimony, and as this committee knows, I know very well, when you look in the multiemployer world, the multiemployer systems work pretty well for a very long period of time. In recent years, a combination of the economics of the industries that they're in, and the investment practices there have been, for a whole combination of ingredients, they are now in a more serious condition; and we're watching them.

So, as a result, because we keep account of the ones which might get into trouble—not that we think it's likely, but might get in trouble, and increasingly, some big ones are—that's why we say, our potential exposure has gone up by a lot.

Does that make sense?

The CHAIRMAN. Sort of. I think I've got it.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman. I thank you, Mr. Gotbaum, for serving, and I thank you for your passion. I know you've only been there 4 months, and I know you had a long wait, because I know that my colleagues across the aisle had a hold on your confirmation for quite a while. I know your job is very challenging, so I thank you for your willingness to serve.

Now that you've been there for a few months, what steps would you take to ensure that the board of directors is fully engaged in the agency's activities, and what recommendations do you have to improve the communication with the PBGC and the board?

Mr. GOTBAUM. A very good question, sir. I've worked in a lot of institutions in my life, in government and outside, and I've worked with large boards and small boards. I ran a charity, the September 11 Fund; I had 27 board members. When I ran Hawaiian Airlines, I basically had a board member of one; a bankruptcy court judge.

I've worked with a range of them; and what I find is, what matters more than structure is engagement in communication. And, I will tell you that this board take their job very seriously.

I can't speak for previous administrations; I can't speak for previous boards. I am very well aware of the fact that in the past there were very long periods of time when the board didn't meet at all, but I have to tell you, that isn't this board.

I've been on the board for 4 months, right? We've already had two board meetings, and, we have another one next week. The board has a set of senior officials, the board reps, who are very actively engaged. I meet with them or talk with them at least monthly, and communicate by phone, and sit down more often than that, and send them memos.

I actually think there is, now, very extensive communication—very extensive communication. I am very well aware of the fact that in the past, that has not been the case. I do think it's important for the committee to know what's going on right now.

Senator ENZI. Thank you.

Several months ago, Senators Harkin, Backus, Grassley and I sent to PBGC a letter regarding a misunderstanding between companies and the PBGC. In the company's filings, the company had checked one box on the PGA form to select an alternative funding formula, but unfortunately, inadvertently, did not check the second box that would have reaffirmed the alternative funding formula.

The PBGC took a very hard line on those companies. I'm glad the matter was resolved in a good common-sense manner; however, it did show that the relationship between the PBGC and the business community was not healthy.

As I mentioned in my opening statement, companies can drop their defined benefit plans in favor of 401(k) plans; and I want to know what you're doing to help build a relationship between the agency and the business community so there aren't more of these misunderstandings.

Mr. GOTBAUM. Good question; important question. As a person who's been in the business community myself—been on both sides—and recognizing that the defined benefit pension insurance system is a partnership, I take that very seriously.

I can't speak for previous directors. I can tell you what I've done since I've come on: I've met repeatedly with the organized business organizations that affect pensions, the American Benefits Council, the U.S. Industry Committee, SEBA and others.

I have made sure that the very professional staff of the PBGC understands that part of our job is to interact and communicate. Whether we can do something or not, it's important that we communicate.

Now, as you mentioned the issue regarding the mistake in checking, and I think that's a perfectly good example, sir.

As I mentioned in my testimony, what we do is pretty complicated, and that's kind of in the nature of pensions; and so it turned out to be the case that there were a number of companies who, not intending to play fast and loose, just made a mistake. As it happens, in those instances, there was sufficient other evidence that we had that it really was an honest mistake; nobody was playing fast and loose, etc.

What we said is, "OK, in that case, let's recognize it's an honest mistake and allow them to correct it." That's what we did.

That's the sort of thing that I think we need to keep doing.

Senator ENZI. Thank you.

My time has expired. I have some other questions; if we don't go a second round, I'll submit them in writing for an answer.

Thank you.

The CHAIRMAN. Thank you, Senator Enzi.

Senator Murray.

STATEMENT OF SENATOR MURRAY

Senator MURRAY. Thank you very much Mr. Chairman. I just have a couple of questions.

I know that the PBGC doesn't get any general tax revenues, and its obligations aren't backed by the U.S. Government, but I do feel obligated to make sure that stewardship and accountability of our contract workers, who are about two-thirds of PBGC, are met when we have a lot of government contractors today who are under investigation; we're talking about a wage freeze for government employees.

I wanted to ask you what PBGC is doing now, to address the issue that the GAO found in their 2008 report, that PBGC's workforce management lacked a strategic approach to determining the mix of contract and Federal workers.

Mr. GOTBAUM. This is, as I mentioned in my testimony, one of the challenges that the PBGC faces. Actually, I think, having worked in a bunch of other government agencies, and in private business, it's a challenge that everybody faces, which is, how do you choose who ought to be a government employee; when do you rely on contractors; how do you rely on contractors, etc.

What we do, and what we are doing—and frankly, I can't take credit for this; the agency started doing this before I joined the agency—is to do several things, Senator; one is, you need to have in place, a process for actually planning and thinking about, in advance, what your contracting is; what your procurement is, etc.

The agency did that, if at all informally, before. We're now putting in place—actually saying what contracts we're going to have, etc. That's one thing you do.

Another thing you do is to ask yourself, OK, do I have the adequate contractor base? Do they have the competence I need? Are they going to be around? Et cetera.

That's a separate process you engage in; that's a process we're starting.

A third thing you do is, you look at your actual contracts and say, does this contract hold people's feet to the fire in a way that makes sense? Does a contract require performance and pay them for performing, not for just showing up?

And, I've got to be honest with you, Senator, we're starting that. In other words, what we are doing is, we are looking at our contracts and saying—and some of our contracts, by the way, do that right now. Some of our contracts say, we're hiring you as a contractor, and we expect you to meet this performance standard, but we want you to do better, so we'll pay you more if you do better.

Others of our contracts don't. We are in the process of trying to move to that where we can.

Those are the sorts of things we're doing.

Another thing which I should mention—I'm not going to go into the same detail about it—is that the procurement process—in other words, the process by which you do contracts—is different in government than it is outside government. So one of the things you have to do is make sure that your procurement process is up to snuff; that it meets the standards that you have.

Our procurement process was not. We have been working on it, and made very real progress. We now have procedures in place that we just plain didn't have. We're now building the team to follow them, but we're still doing it.

This is an area where it's a necessary part to actually get to, sensible contractor management, and we're working on it. We're not there yet, but we are working on it.

Senator MURRAY. OK, I really appreciate that candid response and look forward to your recommendations, and to watch where you're going with that.

The other thing I wanted to ask you real quickly is to summarize what kind of changes, legislatively, you think we need to make in the pension insurance system, as we look at legislation like the Pension Benefit Guaranty Corporation Governance Improvement Act of 2009.

Mr. GOTBAUM. Senator, one of the defects of having been on the job only 4 months is that I don't, at this point, have opinions, much less opinions that I can say the administration as a group agrees with.

What I hope will be the case is that—one of the things I have seen that impresses me enormously, and it's part of the reason I felt comfortable taking the job, is that pensions are so complicated that the only progress comes when it is nonpartisan; not even bipartisan; nonpartisan, where there is a consensus; we ought to do this; it's a good governmental thing to do.

I mentioned the menu of things that have come in the past; premiums, benefits, funding requirements, etc. Those are clearly things that you've undertaken and that we've implemented in the past; and those are probably the sorts of things that are going to be on the agenda in the future.

I don't have an opinion at this point as to what the right thing is. I do hope that, as you are facing them—we obviously want to work with you, and reach that same kind of active partnership that pension security has had for 36 years.

Senator MURRAY. OK, very good. I look forward to hearing your opinion as we work forward, then. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Murray.

Senator Isakson.

STATEMENT OF SENATOR ISAKSON

Senator ISAKSON. Thank you, Mr. Chairman. Mr. Gotbaum, thank you for being here today.

The last exchange between Senator Murray and yourself was the most important of this hearing so far, because it is going to be critical for you to make recommendations to us, in terms of what we need to do in the immediate future, I think, in terms of pension legislation, because PBGC would already have gone broke had we not done the Pension Protection Act of 2005 and the amendments by Senator Cardin and myself earlier this year that changed the parameters of assumptions in terms of amortization of obligation to ease and smooth the contributions of the corporations and not take all the cash out of corporate America to put it in a pension fund and cost even more jobs than we have.

We still are not there yet—you got a great record and a great history, and 4 months is not a long time. But, I would hope you would take her question to task, and your answer.

I'll pledge to you to work in a bipartisan way, because it does have to—those acts were both bipartisan; but we need some good recommendations, and we need them quicker rather than later, I think, from my standpoint.

Mr. GOTBAUM. Message received, Senator. We look forward to doing exactly that.

Senator ISAKSON. Because we can avoid a catastrophe, avoid a collapse of PBGC, not by making irrational assumptions, but by looking at reality, because the problem we have today is none of your forecasters saw—in 2006, 2007, 2008, and 2009—it coming. Nobody made assumptions that we were going to be in that kind of market.

Second, who manages your assets?

Mr. GOTBAUM. The PBGC, ever since it started—actually, I think it started fully in 1975—ever since it started, the assets are managed, intentionally, by outside professional managers.

Senator ISAKSON. Good.

Mr. GOTBAUM. About a quarter of our assets are in deposit in the Treasury, so that's obviously held by the Treasury. About three-quarters of them are managed by outside professionals. The reason for that is really simple. We think it is important that the PBGC not be mucking around and making choices about investments and not be mucking around and making choices about which stocks or bonds to buy or not to buy. So, we don't.

We have an investment policy which is set by the board; and then we implement it by picking managers and saying, go do your job.

Senator ISAKSON. I think that is important, and I appreciate the answer.

Looking at the GAO chart on page four of their report, between 2006 and 2010 your assets have increased by 33 percent. I assume that's more because of defaulted plans and less because of the growth in assets; is that right?

Mr. GOTBAUM. Yes, sir. I'm sure that—I can't tell you for certain, but that would be my guess, too.

Senator ISAKSON. I was going to say, if that's not the reason, somebody's done a good job of investment advice; I'd like to know who they are, so we can call them up.

And last, on Senator Harkin's remarks, I appreciate Secretary Solis and Mr. Geithner and the others who are on your board, but I do think we ought to look seriously at working with you to come up with a board structure that makes sense in the challenging times ahead, because you can give good people more work than they can handle, and something ends up falling through the cracks. I think you need that kind of support as well.

We demonstrated with TVA, and this committee did it, that you can change board structure, and you can change outcomes for the better by just giving the person responsible for running the agency the support they need in terms of professional advice.

I'd love to work with you on suggestions like that; and I appreciate Senator Harkin bringing that up.

That's all the questions I have.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Manchin.

STATEMENT OF SENATOR MANCHIN

Senator MANCHIN. Thank you, Mr. Chairman, Senator Harkin and Senator Enzi, thank you. It's a great honor to represent the people of West Virginia.

I just found the button. I'm brand new here.

[Laughter.]

I want to thank you so much for being here; and also it's my honor to represent the great people of West Virginia.

As you know, it's a hard-working State, and we have a work ethic that's one of the best in the Nation. They do the heavy lifting, and they work in the mine and the factories; and they've done it for years, and years, and years. They don't ask for much, just an opportunity to be able to provide for their families. Then when they give a lifetime of work, they want to make sure they're able to have a pension that's rewarding to the work they've given. Unfortunately, that hasn't always happened.

If I can reflect back on Weirton Steel. I went through a situation there that was just devastating, and it just took a tremendous toll on people's lives.

I have a hard time understanding how this can happen, when a company goes through a bankruptcy and are able to shed all of its liabilities, and then it still has value to it, and it's bought by another company that comes in, completely with the slate clean and leaves people without the pensions they were guaranteed and worked for.

And, because of their age—and they might have started very young, at 18–20 years of age or 50, and now they're 50, 55 years of age—they can't find a job, and they put 30 years in. They were devalued, their assets, to the point to where they just had to take a meaningless entry job, if you will, at a very minimum wage, and they try to survive. It's just not fair.

With the program that you have in place here—I don't know what types of checks and balances you have—if that would have been foreseen, that the collapse of that company, and they weren't in shape in order to take care of their employees, why was that not caught?

I know you've just been there a short time, too.

As a former governor from my State I have pensions in every State. OPEB liabilities is something that we're all dealing with, and it's going to wreak havoc on every one of our States. We have so many States that cannot fulfill their obligations. And, what happens is, it's because the benefits continue to change; there's no money going in to match, and it just doesn't add up. So, you have to really come to grips with the hard decisions.

When do you freeze those? Also, basically, when we have a downturn of the market that wasn't anticipated, with that being said, was any adjustments made on the benefit so that we could keep it solvent; or did it go into insolvency to where, basically, people lost everything?

What I'm trying to find out is, how do we prevent that?

You all were in place when Weirton—when it hit the skids, if you will, and so many people were left without. A few people got close to what their pensions would be, but many of them got very little. Can that be prevented?

Do you all have checks and balances in place now?

Mr. GOTBAUM. Yes. I don't know if you know this, Senator, but after I left the Carter White House, my first job was as an investment banker working for the divisional management and the union of Weirton Steel; and I spent a year and a half walking through every part of that mill, talking with everyone; helped build the ESOP; working with then-Governor Rockefeller.

Senator MANCHIN. Right. That was back in the 1980s.

Mr. GOTBAUM. So, the people of Weirton are close to me. I've talked to them even as recently as a month ago.

It is undeniably a tragedy, and nobody can sugarcoat that.

As I mentioned in my testimony, and described more in my further testimony, one of the things that we really try to do is, we try to get companies—even when they go into bankruptcy—not to terminate their plans. We do that by saying, if you terminate your plan, we become a creditor.

Unlike most creditors, the PBGC financial analyst lawyers are very, very good, and they're very, very tough, and they throw their weight around on behalf of retirees.

However, they have, within bankruptcy, a limited priority. You know, we are mostly general creditors. It is the case that if we'd had more room maybe in the bankruptcy we could have said, yes, you're in bankruptcy, but you can—and maybe pass on the ownership deal without——

Senator MANCHIN. If I could ask just one question. I looked when all this thing took place and I was not governor at the time—there should have been a deal to keep them whole, and the value was there to keep them whole, but they allowed this to go into bankruptcy to where the people were left with nothing.

The people that came in and bought it had no liability whatsoever, and was able to shed all that. I don't know enough about our bankruptcy laws or pension laws to prevent that from happening again. I don't want any State, or any employer, or any employee in any State to go through what our people had gone through. Do you know how devastating this has been?

Mr. GOTBAUM. Oh, yes, I do. If I can, this is the sort of thing that is not really a question for the record kind of thing.

Senator MANCHIN. Right.

Mr. GOTBAUM. With your permission, if some members of the PBGC staff would talk with your staff, we could explain the background.

Senator MANCHIN. I'd love to. I hope that no other Senator ever—I can share this at a later time—but I hope you never have to go through this.

The CHAIRMAN. I would like to know more about the facts and the data on that. It's always occurred to me, too, that I've seen other places, plants that go under; somebody that comes in and they buy up all the assets and they assume liabilities, but they don't assume this liability.

Senator MANCHIN. The bankruptcy court, Senator, somehow, allows them to escape the responsibility; and there's still value there. They can still make this an ongoing concern. This company still—there's another company there now; it's a foreign company that owns this, but the people in West Virginia, the people that worked there all their lives, got left with nothing.

The CHAIRMAN. That's right. Was the question then, how do we prevent this?

Senator MANCHIN. Well, basically, I'll meet with their staff; and then I'll come back and report to you and Senator Enzi and tell you what we find.

The CHAIRMAN. Fine. I'm sure my staff would like to know. I'd like to know, personally, too.

Senator MANCHIN. OK.

The CHAIRMAN. Senator Franken.

STATEMENT OF SENATOR FRANKEN

Senator FRANKEN. Thank you, Mr. Chairman, for helping address this issue vital to 44 million of our country's workers and retirees, whether PBGC has the adequate structure and the resources to perform its job.

The PBGC's task was preserving pension plans, paying benefits when plans fail, maximizing payments in the failed plans, and being highly accountable to our pensioners.

There are some areas in which the PBGC has truly excelled. Everyone here should be impressed that the PBGC has been making uninterrupted, on-time monthly payments to beneficiaries for decades. With some exceptions, PBGC has made relatively prudent investment decisions and yielded satisfactory returns under difficult conditions, especially over the past few years.

One area that concerns me is the level of accountability to our pensioners. When I talk with pensioners in Minnesota, especially when I'm up on the Iron Range, I hear their accounts of working with the PBGC; I hear the frustration in their voices when they explain that their benefit determinations have taken years to process.

Some of them have told me that it's been years since they've even heard from the PBGC about their determination.

This is extremely painful and disruptive for them and their families. It's impossible for them to plan for their futures; and I think that our pensioners deserve better than that.

I understand that much of today's focus is going to be on a small select group of people—the board—how they should be appointed, what numbers, members is ideal.

Those are all good questions; we need to tackle them, but we need to keep the focus today on the people that the PBGC serves: our Nation's pensioners, our workers, and our retirees.

I wanted to ask a question about the board. I think Senator Enzi got to this, but, I'm sorry, I had to go to a Judiciary Committee hearing—but, I read somewhere that between 1983 and 1992 there was not one meeting of the board; is that correct?

Mr. GOTBAUM. Fortunately, for me, I was not associated with the PBGC during that period, but I know that the GAO has in their testimony included a graph that shows the board meetings; and, I do know that in the past there were long periods of time when the board just plain didn't meet.

Senator FRANKEN. Well, that kind of underscores part of the problem, I think, which is that, obviously, this board, being comprised of cabinet secretaries, may not have enough time to meet. I know a number of entities have studied this and said that we have to have a bigger board and have members who aren't cabinet secretaries and who can dedicate more time to this.

That's the intention here?

Mr. GOTBAUM. One of the things we're trying to understand—members of the administration have actually met with the committee staff to try to understand what is trying to be achieved by this.

Senator FRANKEN. OK.

Mr. GOTBAUM. As you might expect, Senator—and as I mentioned in my testimony—from my perspective, one of the most important changes in the governance of the PBGC was the one that this committee and this Congress made in 2006, which was to take the director and say, "you're running the agency; you're going to be appointed by the President; you're going to be subject to Senate confirmation, which means you're going to come back and report to this committee." I think that's an important change in governance.

I also said in my testimony, or in response to the Chairman's questions, I can't speak to what the boards in the past did. I can tell you that this board takes their job seriously. They meet more frequently than any board has—than the PBGC has since it was founded in more than 30 years ago.

Senator FRANKEN. Do you think you'd be helped by having some board members who aren't cabinet secretaries, who would have more time to spend on this job in all sorts of areas, in addressing all the problems that you face, and addressing the preventing pensions from going belly up, and figuring out what to do about the deficits you have; about all the different problems that you have, don't you think that a few more members who are dedicating more of their time and effort to this would be helpful?

Mr. GOTBAUM. As I said in response to the Chairman's question, I've worked with lots of different board structures, and can work with them. I can work with the current structure just fine—and have and will.

My concern, if you will, is that, beyond the questions of boardrestructuring,there are some very real and central issues that PBGC faces, that defined benefit pension plan's face. And I would especially hope—you're the committee, in some respects; you're the functional board—but what I would hope is that there is the attention to those challenges, because I think those are the real challenges we face.

Senator FRANKEN. Yes. Well, my time's up.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Casey.

STATEMENT OF SENATOR CASEY

Senator CASEY. Thank you, Mr. Chairman. Thank you for holding this hearing, I should say, on an issue that is particularly of concern to folks in any economy, but especially when the economy is in rough shape; just the concern that people have about retirement security.

I have a specific question. I want to step back for a moment and think about the grave concerns that people have about their own retirement security; and I'm thinking about two categories, really: one category of folks are those who have worked and put those years in as Governor Manchin talked about, and then have an expectation of having that security.

Also, we've got to be concerned about folks who are still in the workforce, much younger workers who are looking down the road; and in some ways, I think we have to—if we're going to strike a bargain with workers—say, "if you stay, if you get a good education, and you work hard, and you study hard, if you continue to improve your skills over time, our end of the bargain is we're going to try to do everything we can to help you on health care"—and that's a promise yet unfulfilled—"but, we're also going to provide you some retirement security."

If that's the deal, you get educated, you keep your skills up to be able to compete in the world economy, and we'll help you with health care and retirement security.

That's kind of the goal and the ultimate good bargain for workers and for our economy.

To get there we have to do a lot of the basics, the fundamentals, what the football players would call the blocking and tackling.

Senator Franken raised, and others have raised, the benefit determination process, and I could ask you some questions about that, and maybe I will in written form.

The one question I had was on the investment policy. You said you're working on one, and you don't have it completed yet. But, I'm wondering if you can do one of two things, or both: either give us a preview of that, where you think that is headed, in terms of what determinations you'll make as it relates to investment policy; or if not, can you give us a sense of how your—what are the considerations you're weighing and developing, or what is the guidance you're using to develop that investment policy; because the return that you'll get is going to be very helpful in meeting that ultimate goal: giving workers some peace of mind.

Mr. GOTBAUM. I'm happy to answer questions for the record, or with staff, etc. on benefit determinations; I think that's really important, as you can tell from the fact I put this chart up.

On investment policy: investment policy has been—first of all, it's important to know that investment policy is something which, although the director of the PBGC has always been involved in making recommendations, is decided by the board at the PBGC. When I came on, in July, the board said: "OK, we've been thinking about this for a while; why don't you do your review and come to your own views, and then talk with us about what you think; and then a decision will be made."

We have a board meeting next week where I hope we'll—we're planning to have a discussion on that. So, I don't want to presage that, and it would be inappropriate for me to prejudge it. I think it ought to be pretty clear, what are the major considerations that have always been part of the investment policy decision.

One of them has been, you need to invest in a way that covers, as much as possible, the benefits that PBGC is obligated to pay, and reduces the pressure to raise premiums; so, partly you invest to maximize returns.

Another thing you do is, since the PBGC, although it uses professional managers, is nonetheless, a government agency—you want to make sure that the PBGC doesn't take unnecessary or inappropriate risks.

There are plenty of people—some of whom I've invested in myself—who can take risks that it would be inappropriate for the PBGC to take. We're more conservative than that; we don't do that.

The third thing that I also think matters is that whatever the policy is, it needs to be something that we can implement in a way that is so clean that our Inspector General, and the GAO, and, frankly, me—because my standards, my ethical standards, I don't think, are any lower than either of theirs—can come to this committee and say, we can do this in a manner that is clean.

That's what we're looking for. And, having had some discussions already, I'm pretty confident that that's what we'll end up with.

Senator CASEY. I appreciate that. I'm out of time, but thank you for that answer.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Casey.

Senator Hagan.

STATEMENT OF SENATOR HAGAN

Senator HAGAN. Thank you, Mr. Chairman. I, too, appreciate this hearing today.

Mr. Gotbaum, congratulations on your nomination and confirmation; and I know 4 months into the job you've got a lot on your plate.

Mr. GOTBAUM. Thank you.

Senator HAGAN. An incredible amount. Thanks for your testimony.

In your testimony you stated that PBGC's financial position is a result of inadequate planned funding and misfortunes that have befallen plan sponsors; and in part, it's a result of the fact that premiums the agency charges are insufficient to pay for all of the benefits that PBGC insures.

I know we were just talking a little bit about the premiums, but what does PBGC charge in premiums, and when was the last time that the premiums were evaluated; and tell me about your thoughts on recalculating them.

Mr. GOTBAUM. Let me summarize it at my 4-month-on-the-job level of add detail on the record.

When the PBGC was started out, they really had no idea what level of premiums made sense, and so they guessed.

Senator HAGAN. This was 30 years ago?

Mr. GOTBAUM. That's 30, 36 years ago now, ma'am, yes. they said, for single employer plans it will be $1.00 for participant per year, and for multiemployer plans it will be 50 cents. They didn't know. They just needed to start with something.

Then what's happened over the years, because for most of the PBGC's time, there has been a deficit, meaning the premiums we take in, the cash that we have, is less than the obligations, Congress has, time and again said, "we're going to change—we're going to raise premiums; we're going to change premiums." There's a basic flat rate premium, and then there's a premium that relates to the degrees of underfunding

One of the issues that has been raised in the past is whether or not, in addition to underfunding, premiums ought to be based on the risks that the plan terminates; not just how underfunded it is, but what the risk is, etc.

The average premium—and if I get this way wrong, I'll correct the record—but from that kind of $1.00 per participant per year is now, round numbers, about $80.00 per participant per year.

That gives you an idea by how much premiums——

Senator HAGAN. What about recalculating that; and what about evaluating that, moving forward; what's your plan?

Mr. GOTBAUM. Oh, that is something which has been on the agenda a bunch of times. I'm too new on the job even to have an opinion as to what happened. It is precisely the sort of thing that the committee, the PBGC, the administration have worked and discussed.

The last time I believe it was changed was in 2006 as part of the Pension Protection Act. My hope and expectation would be, as we get there, as to what the options are—that, that discussion can be part of the mix.

Senator HAGAN. As the director, are you not concerned about wanting to move forward when you're looking at these huge deficits that you've been talking about?

Mr. GOTBAUM. It's funny. No one's asked the question exactly that way. Senator, what I have learned in my 4 months on the job, and having watched the decisionmaking, is that pension policy has to be consensual. Pensions are mind-bendingly complicated, and the fact is, we don't make progress unless we work it and guessed it.

From my perspective, what is much more important than that we move fast, is that we engage enough so that there is a consensus; so that nobody thinks somebody's playing fast and loose.

The other thing is, I mentioned in my response to Chairman Harkin is, we have $80 billion in assets. Last year we paid out about $6 billion. We took in about $3 billion in premiums and recoveries and other things like that, etc; so, we had a negative cash flow of about three, but we had $80 billion in cash.

From my perspective, there is no danger that PBGC is going to run out of cash—when I say the foreseeable future, my very careful and punctilious Inspector General, and folks who worry about accounting, get nervous when I say, "the foreseeable future," but guess what? We are not going to run out of cash in the foreseeable future. That's not my concern.

My concern is that, in the same way that the Congress always has worked and talked and figured out what's the right solution, that we do that, and that there's enough time to do that.

That's something which we would like to engage in.

Senator HAGAN. I was just curious: do you have a number in the private-industry market that would compare to your $80 premium?

Mr. GOTBAUM. No, Senator, we don't, because one of the things that happens when the government takes over an insurance function, is that most folks in the private sector don't do that insurance function. There's no ready standard.

Most academic studies suggest that the average premium ought to be considerably higher.

Senator HAGAN. Yes.

Mr. GOTBAUM. Most academic studies suggest that the premium ought to take the risk—what the benefit actually is, into account, and what the risk is, etc; and that's stuff which we don't do.

It's clearly something which has been part of the discussion in the past, and I hope will be part of the discussion in the future.

Senator HAGAN. You've used the term, "foreseeable future." I mean, I am very concerned about it; but what's your definition of "foreseeable future"?

Mr. GOTBAUM. Oh.

Senator HAGAN. Have we already asked that? Oh, sorry.

Mr. GOTBAUM. No, but it's a very important question.

My definition of foreseeable future is 20 years. In other words, one of the things we did—since I have this question, let me just summarize and say, I asked the best people I know, who are the people who work in the PBGC, who, every day estimate what our cash flows are, what our obligations are, etc; and I said, assume Congress does nothing, and the PBGC does its job, what are the odds that 20 years from now, we'll run out of money?

They said you hold investment policy about where it is—maybe less than 5 percent. A less than 1 in 20 chance that we run out of money; and that's if there's no discussion, no engagement, no change in premiums, no nothing; etc.

My view is, for the foreseeable future, let's just say that I expect not only to retire, but to leave this earth before the PBGC runs out of money.

Senator HAGAN. Well, when I think about all the people who are counting on it, I think the foreseeable future needs to have a very short definition so that we can plan appropriately and effectively for these retirees.

Mr. GOTBAUM. If I mis-spoke, Senator, then I apologize.

What I'm trying to say is, I think——

Senator HAGAN. Yes.

Mr. Gotbaum, people who get benefits from the PBGC ought not to worry about the benefits they're getting from the PBGC; they're going to get them.

Senator HAGAN. You talked a little bit about the governing structure; and I, too, am concerned about the small size of the board. There's also the oversight functions, the advisory committee; do you think the advisory committee should have statutory authority to conduct audits and case reviews? Tell me about how you'd utilize the advisory committee.

Mr. GOTBAUM. Well, thank you, Senator, because from my perspective that's actually an important question, because the advisory committee—as with boards in the past, advisory committees have done different things in the past, with your permission, I'd like to tell you how I——

Senator HAGAN. I just realized I'm over time. I apologize.

Mr. GOTBAUM. I'll be brief. My view of the advisory committee is, this is a group of knowledgeable, committed people who, every 8 weeks, come to Washington and spend a day walking through, with the director of the PBGC and the staff, talking about issues; they talk about investment policy issues; they talk about the issues involving multiemployer plans; they talk about questions of politics, etc.

My view is, this is a group of people who I can talk to, who have a broad range of backgrounds. I think they do a good job, and frankly, I like working with them.

The CHAIRMAN. Thank you very much. Mr. Gotbaum, the ERISA gives PBGC three things they've got to do: No. 1, insure pensions; No. 2, collect premiums; and No. 3, encourage the continuation of defined benefit pension plans.

OK, insure pensions, check, you've done that; collect premiums, check, you've done that; No. 3, encourage the continuation of defined benefit pension plans, we've been losing them ever since PBGC has come into being; can I assume that you're failing on No. 3?

Mr. GOTBAUM. I think no one can deny, Mr. Chairman, that there's clearly real challenges and trouble in the defined benefit world.

The CHAIRMAN. Why?

Mr. GOTBAUM. Well, I'm sufficiently new at this, Mr. Chairman, so I don't want to pretend that I'm definitive on this, because I'm not, OK, but it's pretty clear to me that part of this is that plan sponsors, companies, businesses, etc, have decided that they don't want to offer defined benefit plans; and for whatever reason, their employees are satisfied with defined contribution plans, or no plan at all, or whatever, etc.

That is clearly something which is more than the PBGC can, in my view, affect or change by its program. I do think there is something——

The CHAIRMAN. Yes, but you're supposed to encourage the continuation of defined benefits.

Mr. GOTBAUM. I think we are. I think we are in a couple of senses.

The CHAIRMAN. But we're losing them all the time.

Mr. GOTBAUM. We are, but it is still the fact, Mr. Chairman, that there are some 40-plus million people who are protected by defined benefit plans, and I mentioned in my testimony—and I think this part is important—that from my perspective, part of the mandate's preserved plans is what we do when we try to convince companies not to terminate their plans.

Part of that mandate is, when we go into a company in bankruptcy and say, "are you sure you want to terminate your plan, because if you do, you're going to have to deal with us." I think that is part of the way we fulfill that mandate.

The other way that we can fulfill that mandate is to engage in the broader discussions about, how do we make sure that whatever the form of retirement security is, it's adequate, it's understood, and it's widely available.

The CHAIRMAN. Well, but what about a company that doesn't go into bankruptcy; they just want to get rid of their defined benefit pension plan?

Mr. GOTBAUM. If a company does that?

One of the things that happens is, we have tools that we can take action on, and we do. We have an Early Warning Program and we have authorities that you have given us to engage with companies that, when they take steps, corporate transactions, shutdowns, closures, even sales, that we can say to the company, we're nervous about what this does to your pension plan; we think you should do something to shore up the pension plan.

The thing we can't do, Senator, is if a company legally decides it's going to terminate its plan, and it terminates it according to ERISA, according to the law—which means it buys annuities for all of the participants—ERISA permits a company to do that. The PBGC has no authority to tell them not to.

If they follow ERISA, and decide not to do a DB plan, that's not something that we can do, except to make sure—and we do, by the way—that when they do a standard plan termination, that they do it according to ERISA, according to the rules; that it's done by the book. But, we can't stop them from doing it.

The CHAIRMAN. One last thing, Do you believe that, or do you have any opinion that you would like to voice on whether or not in bankruptcy law, that the status of a defined benefit plan participant should be higher on the pecking order, the list of creditors that need to be satisfied, if a plan goes into bankruptcy. Do you have any opinion on that?

Mr. GOTBAUM. Not an informed opinion, Senator. With your permission, let me think about it, find out the facts and circle back.

The CHAIRMAN. Because there is some legislation here, pending to do that; and I just didn't know if you had any thought on that at all, but I'll give you the benefit of thinking about it and get back to us on it. I appreciate it very much. OK, thank you.

Senator Enzi has some follow-up questions. Anybody else have any other questions?

Mr. GOTBAUM. Mr. Chairman, I'm told that I have misremembered the average premium; that the average premium works out to be in the 30-plus dollar range. I will if you'll permit me to put in the record a more detailed response, so that I can give you the full range and what the figures actually are, I'll be grateful.

The CHAIRMAN. Mr. Gotbaum, thank you very, very much. I appreciate your testimony and your leadership and look forward to working with you in the future. Through my staff, I may be sending some additional questions to you. Obviously, other Senators can submit questions for 10 days. I know Senator Enzi has some also.

Thank you very much, Mr. Gotbaum.

[The information referred to may be found in Additional Material.]

The CHAIRMAN. Now, we'll turn to our second panel. Our second panel is Barbara Bovbjerg of the GAO, and Rebecca Anne Batts, who is the Inspector General of the PBGC, and Mr. Ken Porter of the American Benefits Council.

All of your testimonies will be made a part of the record in their entirety, and I would ask, again, that if you will just go down the line in order of which I introduced people, we'll start with Ms. Bovbjerg. Do I say "Bovberg" or "Bobverg"?

Ms. BOVBJERG. It's Bovbjerg, Mr. Chairman.

The CHAIRMAN. Bovbjerg.

Ms. BOVBJERG. I have to say that my in-laws, who are Bovbjergs, are proud residents of Iowa City. So, Bovbjerg. Important constituents.

The CHAIRMAN. That's a recognizable name in Iowa, I got to tell you, Bovbjerg.

[Laughter.]

I should have known better. Anyway, we'll start with Ms. Bovbjerg and go on down the line.

Ms. Bovbjerg, if we could all just sum it up in 5 or 7 minutes, I'd appreciate it.

Ms. BOVBJERG. I'll do that.

STATEMENT OF BARBARA D. BOVBJERG, MANAGING DIRECTOR, EDUCATION, WORKFORCE, AND INCOME SECURITY, GOVERNMENT ACCOUNTABILITY OFFICE (GAO), WASHINGTON, DC

Ms. BOVBJERG. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Ms. BOVBJERG. Senator Enzi, members who stayed, thank you. I'm really grateful to be invited here today to talk about the need for improved governance and management of the PBGC.

As we've said, PBGC insures the pensions of 44 million workers, yet it faces an accumulated deficit of $23 billion. With the growth of large plants under its trusteeship, PBGC's responsibilities have increased significantly since its creation in 1974, and its financial portfolio is one of the largest of any government corporation.

My testimony today discusses the PBGC's need for a strong board structure, and for improved management of its contracts and benefit determination processes.

My statement is based upon our prior work on these topics, many of it for this committee.

First, the board: PBGC needs strong policy direction and oversight in the face of its current financial condition and the long-term or foreseeable structural challenges.

Our prior work has highlighted a number of limitations with the statutory structure of the board, starting with its size and its composition.

No other government corporation's board is as small as PBGC's, which is comprised of three cabinet secretaries. This is too small to allow the establishment of standing oversight committees, which are commonly used on other boards; and its members' other responsibilities limit the time they have to focus on the PBGC's business.

In addition, this board's structure is vulnerable to disruptive transitions. At each change of presidential administration, the entire board, and the PBGC director, leaves with the departing administration, not only limiting continuity of PBGC, but also leaving no board-level leadership in the event of immediate policy challenges.

For example, amid the turbulent economic times between February 2008 and February 2010 the board did not meet at all.

GAO has previously recommended that Congress consider expanding the PBGC board, and we suggest it be changed to include additional members who possess knowledge and expertise useful to PBGC's mission, and that their terms be overlapping to assure an active board at all times.

Other Federal corporations have boards structured this way; and these steps can improve the continuity and strength of the PBGC oversight.

I'm pleased that this committee is now considering legislation that would bring about such a change.

I'd like to turn now to some management issues at the PBGC. Over the years, GAO has focused regularly on contracting in the corporation, both in the use of contract staff and in contract management. Since the mid-80s PBGC has had contracts covering a wide range of services; and as its workload has grown, has come to rely heavily on contractors to supplement its workforce.

The PBGC has taken some steps to improve its workforce management. The corporation still lacks a strategic approach to optimize the mix of Federal and contract workers.

Also, PBGC continues to focus its strategic management attention almost entirely on its own Federal workforce rather than the performance of the contractors.

Our previous work has found weaknesses in PBGC's overall contract management, as well. We found, repeatedly, that most of PBGC's contracts lack performance incentives or other methods to hold contractors accountable for results.

The corporation has also relied heavily on labor-hour payment arrangements rather than the fixed-price contracts that we and others recommend.

Further, the corporation declined to take our recommendation to elevate procurement in corporate strategic planning and decision-making, despite the importance of this function to PBGC operations.

We currently have additional work underway on this important topic, and we'll be reporting that next year.

We've also made recommendations regarding PBGC's benefit determination processes, which were, in fact, the topic of a hearing here the last time I appeared before this committee.

When PBGC takes over a terminated plan, it must calculate the benefits owed the participants of the plan using the structure that was in the picture, in Mr. Gotbaum's testimony.

A small number of large and complex plans account for most of the lengthy delays and inaccurate payments to participants. Although the corporation has recently adopted several of our recommendations for improvement, it has not yet incorporated the performance measurement that we believe is necessary.

Improvements like these could help reduce the benefit determinations that are so troubling to beneficiaries, and unnecessarily add to their stress.

In conclusion, PBGC has become ever more essential to American workers and retirees during the recent downturn; yet, even with the increased attentiveness of the current board, the body structure will leave PBGC leaderless at times, as it did most recently in 2008 and 2009.

Engaging in more strategic management will help PBGC better weather the storms of the future, but still, it can't overcome the weak system of governance that we have today.

That is why the bill you're considering, that would address these issues, is so important. Although I have to say, even though improving the governance and oversight of PBGC doesn't by itself solve PBGC's financial problems, actions like those would be critical to helping PBGC manage them as they arise, which they surely will.

I'm available for questions. That concludes my statement. Thank you.

[The prepared statement of Ms. Bovbjerg follows:]

PREPARED STATEMENT OF BARBARA D. BOVBJERG

SUMMARY—WHY GAO PREPARED THIS TESTIMONY

The Pension Benefit Guaranty Corporation (PBGC) is a self-financing government corporation that insures the pensions of 44 million workers in more than 27,000 private sector defined benefit pension plans. Yet, PBGC faces financial instability that could pose a future threat to this source of protection for Americans' retirement income. As fewer sponsors pay premiums for fewer participants in defined benefit plans, and as the underfunding of large defined benefit plans increases, the risks to PBGC's financial future also increase. As of September 2010, PBGC's net accumulated financial deficit was $23 billion. GAO has designated PBGC and the pension insurance programs it administers as "high risk" areas in need of urgent attention and transformation to address economy, efficiency, or effectiveness changes.

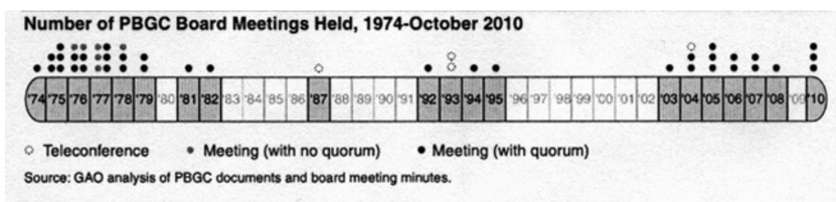
In this testimony, GAO discusses its recent work regarding PBGC. Specifically, this statement focuses on needed improvements to PBGC's governance structure and strategic management based on GAO's prior work in these areas. GAO is making no new recommendations in this statement, but continues to believe that Congress should consider expanding PBGC's board of directors and that PBGC should implement recommendations from prior reports that have not yet been implemented, such as those concerning strategic workforce management and benefit determination process performance measures for large, complex plans.

IMPROVEMENTS NEEDED TO STRENGTHEN GOVERNANCE STRUCTURE AND STRATEGIC MANAGEMENT

WHAT GAO FOUND

PBGC requires a strong governance structure and strategic management to ensure that it can meet its future financial challenges. Companies who pay annual premiums to PBGC and the millions of employees whose retirement benefits are under PBGC's protection are owed greater stewardship of the corporation and its funds.

By law, PBGC is governed by a three-member board of directors composed of the Secretaries of the Treasury, Commerce, and Labor. Because of their numerous responsibilities in their roles as cabinet-level secretaries, the board members have historically been unable to dedicate consistent attention to PBGC matters. In fact, since 1980, the board has met only 23 times. During a critical 2-year period between February 2008 and February 2010, amid turbulent economic times and congressional investigations of certain procurement practices, the board did not meet at all. While the current PBGC board is meeting more frequently than in prior years, its members still have little time to devote to PBGC governance and the board remains vulnerable to disruptive transitions during future changes of administration.



In addition, although PBGC management has taken steps in recent years to strengthen its operations, recommendations from GAO's prior work concerning how the corporation could improve its strategic workforce management and the benefit determination process have yet to be fully implemented. PBGC's contract workers comprise about two-thirds of its workforce, yet GAO found that workforce management lacked a strategic approach for determining the mix of contract and Federal workers, and PBGC did not include procurement decisionmaking in corporate-level strategic planning. Also, GAO found that management of PBGC's benefit determination process did not provide for separate reporting of performance measures for large, complex plans, yet these plans are responsible for most long delays in processing and most cases with overpayments. Measures that reflect averages across all plans do not provide sufficient incentive to improve the processing of these plans. The need for a more strategic approach in managing both the contract workforce and the benefit determination process is essential to ensure that PBGC is operating efficiently and effectively.

Improvements to PBGC's governance and strategic management cannot correct structural weaknesses in its financial design, but it can better position PBGC for the challenges that lie ahead.

Mr. Chairman and members of the committee, I am pleased to be here today to discuss the need for improved governance and strategic management of the Pension Benefit Guaranty Corporation (PBGC). PBGC operates two pension insurance programs—the single-employer program and multiemployer program—that insure the pensions of 44 million private-sector workers and retirees in more than 27,000 defined benefit pension plans.[1] With the growth in number of large plans under its

[1] A defined benefit plan is a pension plan that generally provides monthly retirement benefits based on a formula that combines salary and years of service to the company. 29 U.S.C. §1002 (35). In contrast, a defined contribution plan is a pension plan that generally provides retirement benefits based on the balance available in an individual's account that has received contributions from the employee, employer, or both, during the employee's years of service to the company. U.S.C. §1002 (34).

trusteeship, PBGC's responsibilities for administering plans and managing assets have increased significantly since its creation in 1974, and its financial portfolio is now one of the largest of any Federal Government corporation.[2] While PBGC has sufficient assets to pay retirees promised benefits in the near future, PBGC has maintained an accumulated financial deficit for a number of years. In fact, we first designated PBGC's largest insurance program—the single-employer program—as "high risk" in 2003 due to PBGC's prior-year net deficit, as well as the increased likelihood of large, underfunded pension plan terminations.[3] Since that time, the single-employer program has remained high risk because of its continued deficit and the structural challenges that pose a risk for future losses. In 2009, we designated the multiemployer program as high risk as well.[4] At the end of fiscal year 2010, PBGC's deficit for both programs combined was approximately $23 billion.

My statement will focus on steps PBGC could take to help meet the challenges of its unstable financial condition and increasing workloads. Specifically, I will discuss PBGC's need for (1) a stronger board structure and (2) a more strategic approach to managing its contract workforce and benefit determination process. My statement is based on our prior work assessing PBGC's long-term financial prospects, and various reports we have published over the past several years on PBGC governance and management. Our prior work was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

BACKGROUND

PBGC was created by the Employee Retirement Income Security Act of 1974 (ERISA)[5] to pay benefits to participants in private defined benefit pension plans in the event that an employer could not.[6] PBGC may pay benefits up to specified limits, if a plan does not have sufficient assets to pay promised benefits and the sponsoring company is in financial distress. As of September 2010, PBGC was paying monthly retirement benefits to more than 800,000 retirees in about 4,200 terminated pension plans.[7]

PBGC receives no funds from general tax revenues. Instead, the corporation finances its activities from three main sources of funds: (1) insurance premiums in amounts set by Congress and paid by defined benefit plan sponsors, (2) assets acquired from plans that have been terminated and trusteed by PBGC, and (3) investment income earned on these assets. Under current law, the corporation has no substantial source of funds available to it if it were to exhaust its assets, except for the ability to borrow up to $100 million from the Department of the Treasury.[8] The U.S. Government is not liable for any obligation or liability incurred by the corporation.[9]

PBGC's deficit fluctuates due to various factors, including changes in interest rates, investment performance, and losses from completed and probable plan terminations. PBGC's deficit improved during fiscal year 2008, but then worsened the next year with the severe market downturn. As of September 2010, PBGC held approximately $79.5 billion in assets and approximately $102.5 billion in liabilities—for an accumulated deficit of $23.0 billion, more than double the deficit from 2 years earlier (see fig. 1). This growth in its deficit was due largely to an increase in plan terminations and a decline in interest rates used to value PBGC's liabilities. As a

[2] Federal Government corporations are corporations owned or controlled by the Federal Government. 5 U.S.C. §103. In addition to PBGC, other examples of Federal Government corporations include the Federal Deposit Insurance Corporation and the Export-Import Bank of the United States.

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

[4] GAO, *High-Risk Series: An Update*, GAO–9–271 (Washington, DC: January 2009).

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

[6] 29 U.S.C. §1302(a)(2).

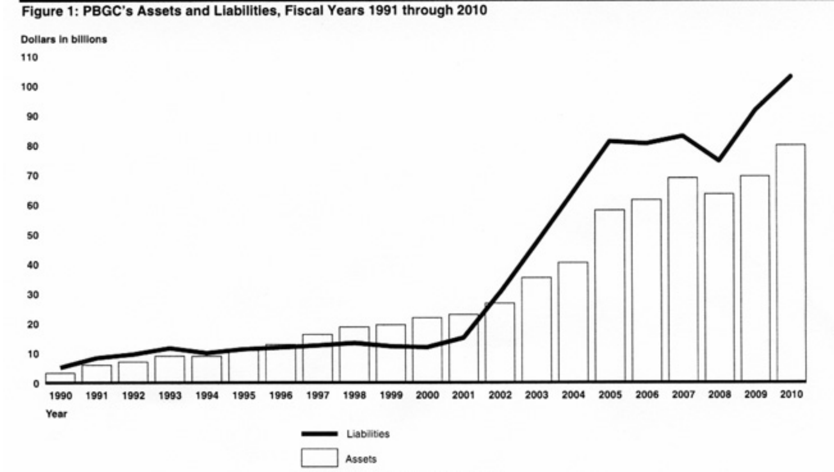
[7] A single-employer plan is established and maintained by one employer. Single-employer plans can be established unilaterally by the sponsor or through a collective bargaining agreement with a labor union. 29 U.S.C. §1002(41). A multiemployer plan is a collectively bargained arrangement between a labor union and a group of employers in a particular trade or industry. Management and labor representatives must jointly govern multiemployer plans. 29 U.S.C. §1002(37).

[8] 29 U.S.C. §1305(c).

[9] 29 U.S.C. §1302(g)(2).

result of these plan terminations, PBGC became directly responsible for the pensions of more than 200,000 additional participants in fiscal year 2009, the third highest annual total of new participants in PBGC's history. During this time, the corporation trusteed plans of companies such as Lehman Brothers, IndyMac Bank, Circuit City, Nortel, and Delphi Corporation. In addition, as of September 2010, PBGC estimated future losses from underfunded multiemployer plans that are unable to repay financial assistance provided by PBGC at about $3.0 billion—up from $1.8 billion 2 years earlier.

Figure 1: PBGC's Assets and Liabilities, Fiscal Years 1991 through 2010



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

PBGC currently has sufficient assets to make scheduled benefit payments for a number of years, given that benefits are paid monthly and spread over participants' and beneficiaries' lifetimes. However, in the long term, PBGC is likely to remain at financial risk due, in part, to several structural challenges that limit PBGC's ability to manage its risk.[10] For example, statutorily prescribed pension funding requirements specify how much a sponsor must contribute to its defined benefit plans each year.[11] However, these funding rules are based on assumptions about future liabilities that may differ from a plan's actual payouts of benefits over time. Similarly, PBGC's premium structure is specified in law for both single- and multiemployer defined benefit plans.[12] This structure limits the corporation's ability to manage its financial risk because, unlike private insurers, PBGC cannot decline to provide insurance coverage or adjust premiums in response to actual or expected claims exposure. Meanwhile, PBGC's premium base has been shrinking as the number of defined benefit pension plans and active plan participants has been declining rapidly. In fiscal year 2010, PBGC insured about half the number of plans it insured 15 years earlier.

Legislation enacted over the past 5 years has taken steps to address these concerns, but the extent to which these steps may reduce PBGC's risk of future losses is still unknown. For example, the Deficit Reduction Act of 2005 included provisions to raise flat-rate premiums and create a new, temporary premium for certain terminated single-employer plans.[13] In addition, the Pension Protection Act of 2006

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

[11] Funding requirements for employer plans are generally codified at 26 U.S.C. §§412, those specific to single-employer plans at 26 U.S.C. §430 and multiemployer plans at 26 U.S.C. §431 and 432.

[12] 29 U.S.C. §1306. The flat-rate premium is a per-participant premium that plans pay to PBGC each year. In 2009, the rate for the flat premium was $34 per participant in insured single-employer plans. For multiemployer plans the flat rate premium was $9 per participant.

[13] Pub. L. No.109–171, §8101, 120 Stat. 4, 181–83 (2006). The new temporary premium was not to apply to any plan terminated after December 2010. Congress recently provided temporary funding relief through the enactment of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, which allows plan sponsors to amortize funding gaps over a longer period of time than is currently allowed and provides funding relief for up to 2 years. Pub. L. No. 111–192, §§201 and 202, 123 Stat. 1280, 1283–99.

(PPA)[14] included a number of provisions aimed at improving plan funding and PBGC finances through such measures as raising the funding targets defined benefit pension plans must meet, reducing the period over which sponsors can "smooth" reported plan assets and liabilities, and restricting sponsors' ability to substitute "credit balances" for cash contributions.[15] However, in response to the recession, Congress enacted legislation in 2008 to help companies better weather the economic downturn by granting funding relief to certain sponsors and delaying implementation of certain PPA provisions.[16] Thus, the overall impact of PPA remains unclear.

PBGC's insurance programs are in need of urgent congressional attention and agency action. We first designated the single-employer insurance program as "high risk" in 2003 after it moved from a $9.7 billion accumulated surplus in fiscal year 2000 to a $3.6 billion accumulated deficit in fiscal year 2002.[17] Since that time, the net financial position of PBGC has significantly worsened due, in part, to the declines in certain industries that led to PBGC having to assume responsibility for several large underfunded plans, and to the steep downturn in the financial markets. We added the high risk designation to the multiemployer program in 2009 in light of the increased risk of future losses in that program as well.[18] As of September 2010, PBGC's estimated financial deficit for both programs combined was $23.0 billion—more than double its deficit from 2 years earlier.

PBGC'S BOARD STRUCTURE NEEDS STRENGTHENING

PBGC needs strong policy direction and oversight in the face of its current financial condition and long-term structural challenges, yet the board's structure as established by law limits the board's ability to provide such policy direction and oversight. ERISA specified that PBGC is to have a three-member board of directors consisting of the Secretaries of the Treasury, Commerce, and Labor. The Secretary of Labor serves as the Chairman of the Board.[19] The board is required to direct and oversee the corporation, in part, by approving all policy decisions affecting American employers and workers as well as reviewing and approving its budget, strategic plans, and financial performance. Each board member can designate an official to serve on his or her behalf in most instances.[20] This designee is referred to as the board member's "representative." In addition, ERISA established an Advisory Committee, whose seven members are appointed by the President to represent the interests of labor, employers, and the general public. The committee has an advisory role but has no statutory authority to set PBGC policy or conduct formal oversight.[21]

Our prior work has highlighted a number of limitations with this statutory governance structure, starting with the size and composition of the board. According to corporate governance guidelines published by The Conference Board,[22] 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 corporation. We found that other government corporations' boards averaged about 7 members, with one having as many as 15 (see table 1). None had a board as small as PBGC's. In addi-

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[14] Pub. L. No. 109–280, §§101–221, 120 Stat. 780, 784–919.

[15] For further discussion of these provisions, such as "smoothing" and use of "credit balances," see Patrick Purcell and Jennifer Staman, *Summary of the Employee Retirement Income Security Act* (ERISA), Congressional Research Service (Washington, DC, May 19, 2009).

[16] The Worker, Retiree, and Employer Recovery Act of 2008, Pub. L. No 110–455, 122. Stat. 5036. It also provided multiemployer plans with temporary relief from PPA requirements by allowing plans to temporarily freeze their funded status at the previous year's level. §204, 122. Stat. 5118–20.

[17] GAO–03–1050SP.

[18] GAO–09–271.

[19] 29 U.S.C. §1302(d).

[20] The board representatives hold the rank of assistant secretary or above. The organizational level of a PBGC board representative can vary depending upon whom each secretary selects. As part of recent bylaw revisions, the board of directors more clearly defined the roles and responsibilities of its members, representatives, and director. *Bylaws of the Pension Benefit Guaranty Corporation*. 73 Fed. Reg. 29,985 (May 23, 2008). For example, the new bylaws state that the board is responsible for establishing and overseeing the policies of the corporation. The new bylaws explicitly outline 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. 29 CFR §4002.3(a)(3) (2009). In addition, the new bylaws explicitly define the role and responsibilities of the director and the corporation's senior officer positions. 29 CFR §4002.9 (2009).

[21] 29 U.S.C. §1302(h).

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

tion, the size of PBGC's board also prevents the members from establishing standing oversight committees, which are commonly used by both government corporations and private corporate boards. For example, other government corporations, such as the Overseas Private Investment Corporation (OPIC) and the Federal Deposit Insurance Corporation have established standing committees to conduct oversight of certain functions, such as audits and case file reviews.

Table 1.—Board Membership of Selected Government Corporations with a Similar Mission

Government corporation	Members	Description of key provisions
Commodity Credit Corporation; 15 U.S.C. §714g(a).	8	Board of directors consists of seven members, in addition to the Secretary, who are appointed by the President, with the advice and consent of the Senate. Board is subject to the general supervision and direction of the Secretary of Agriculture, who is an ex-officio member and chairperson.
Export-Import Bank of the United States; 12 U.S.C. §635a(c).	5	Board of directors consists of the bank's president (as chairman), the bank's first vice president (as vice chairman), and three others. All members of the board are appointed by the President with the advice and consent of the Senate and serve staggered 4-year terms.
Federal Crop Insurance Corporation; 7 U.S.C. §1505(a).	10	Board of directors consists of the manager of the corporation (serving as a nonvoting ex officio member), the Department of Agriculture under secretary responsible for crop insurance, an additional department under secretary, the department's Chief Economist, and six private sector members appointed by and holding office at the pleasure of the Secretary of Agriculture (including one experienced in the crop insurance business, one experienced in reinsurance, and four active producers, who are policy holders, from different geographic areas and represent a cross-section of agricultural commodities). Board selects its own chair and private sector members serve staggered 4-year terms.
Federal Deposit Insurance Corporation; 12 U.S.C. §1812(a) –(c).	5	Board of directors consists of the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and three citizens (including one with State bank supervisory experience) appointed by the President with the advice and consent of the Senate. Chairperson and vice chairperson are designated by the President with the advice and consent of the Senate. Each member appointed for 6-year term and, if vacancies occur, others are appointed only to complete unfinished terms.
Overseas Private Investment Corporation; 22 U.S.C. §2193(a) and (b).	15	Board of directors consists of eight members from the private sector and seven from the Federal Government. At least two of the private sector directors must be experienced in small business, one must represent organized labor, and another must have experience in cooperatives. Government members include the President of the Corporation, the Administrator of the Agency for International Development, the U.S. Trade Representative or Deputy U.S. Trade Representative, and four additional members who are principal government officers, including at least one from the Department of Labor. All members appointed by the President, with advice and consent of the Senate and serve staggered 3-year terms.
Pension Benefit Guaranty Corporation; 29 U.S.C §1302(d).	3	Board of directors consists of the Secretaries of Labor (as chairman), Commerce and the Treasury.

Source: GAO Analysis of U.S. Code.

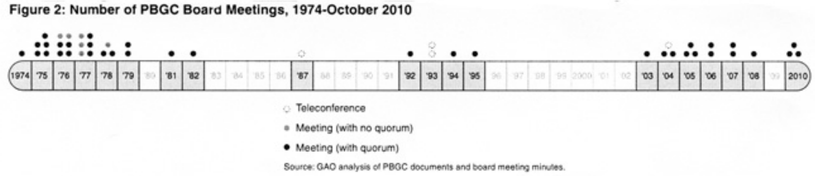
PBGC's governance structure is also vulnerable to disruptive transitions with each administration change. The board, its representatives, and the director typically change with each presidential transition, thus limiting the board's institutional knowledge of the challenges facing the corporation.[23] Other government corporations have board structures with staggered terms for their directors, which arguably avoid gaps in their organization's institutional knowledge. For instance, OPIC's directors

[23] GAO, *Pension Benefit Guaranty Corporation: Governance Structure Needs Improvement to Ensure Policy Direction and Oversight*, GAO–07–808 (Washington, DC: July 2007).

may be appointed for a term of no more than 3 years, and the terms of no more than 3 of the 15 directors can expire in any given year.[24]

Our prior work has also found that PBGC's board members often have limited time and resources to dedicate to PBGC matters given their numerous other responsibilities in their roles as cabinet secretaries.[25] 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. However, we found that since PBGC's inception, the board has met infrequently, even when pressing strategic and operational issues were at play. In 2003, after several high-profile pension plan terminations, PBGC's board began meeting twice a year (see fig. 2). But PBGC officials have told us that it is a challenge to find a time when all three cabinet secretaries are able to meet, and when they do meet, the meetings generally only last about an hour. The current board has recently begun to meet more frequently, meeting three times since February 2010. However, prior to that time, the board had not met since February 2008, despite pending terminations of several pension plans sponsored by large automakers and congressional investigations into certain procurement practices.

Figure 2: Number of PBGC Board Meetings, 1974-October 2010



Because PBGC's board members have generally been unable to dedicate consistent attention to PBGC, they have relied on their board representatives to conduct much of the work on their behalf. The board also relies on PBGC's Inspector General and management oversight committees to ensure that PBGC is operating effectively. However, we have found that communications between these entities and the board may be limited and the board may not always be sufficiently aware of PBGC's activities. For example, PBGC's bylaws require the board to review any reports that the Inspector General deems appropriate,[26] and the Inspector General reports to the board through the Chair.[27] However, there is no formal protocol requiring the Inspector General to routinely meet with the board of directors or their representatives. Moreover, PBGC's oversight committees are not independent of the PBGC director nor required to formally report all matters to the board. Under this structure, it remains unclear if the board members would be aware of the Inspector's General findings or of significant actions taken by PBGC management.

We have also noted that the PBGC Advisory Committee does not have formal access to the board members, potentially limiting the board members' knowledge of the committees' concerns and recommendations. PBGC's Advisory Committee typically reports only to the director, although officials said that the committee can submit concerns to the board if it believes it is warranted. In contrast, the advisory boards or committees of other government corporations—such as the Federal Deposit Insurance Corporation and Export-Import Bank—are required to submit formal reports to their board chair and directors.[28]

To address these weaknesses in PBGC's governance structure, we believe that Congress should consider expanding the board of directors to include additional members with diverse backgrounds who possess knowledge and expertise useful to PBGC's mission.[29] PBGC hired a consulting firm to review governance models and provide a background report to assist the board in its review of alternative corporate

[24] 22 U.S.C. §2193.
[25] GAO, *Pension Benefit Guaranty Corporation: Need for Improved Oversight Persists*, GAO–0908–1062 (Washington, DC: September 2008) and GAO–07–808.
[26] 29 CFR §4002.3(a)(3)(ix) (2009).
[27] 29 CFR §4002.3(a)(2) (2009).
[28] In some instances, government corporations' advisory committees are subject to the Federal Advisory Committee Act, which defines how Federal advisory committees operate, including open meetings, chartering, public involvement, and reporting for such entities. Pub. L. No. 92–463, 86 Stat. 770 (1972) (codified as amended at 5 U.S.C. app. 2). According to PBGC officials, the corporation is exempt from the Federal Advisory Committee Act because of the proprietary nature of its work.
[29] GAO–07–808.

governance structures. While the report did not advocate any particular governance option, the consulting firm's final report corroborated our findings and described the advantages and disadvantages of governance practices of other government corporations and selected private sector companies. The report concluded that there are several viable alternatives for strengthening PBGC's governance structure and practices, some of which are now being put forth in pending legislation.[30]

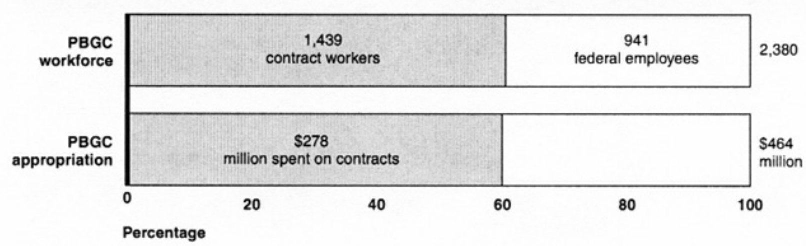
PBGC NEEDS MORE STRATEGIC MANAGEMENT OF ITS CONTRACT WORKFORCE AND BENEFIT DETERMINATION PROCESS

Contract Workforce Management

Although PBGC management has taken steps in recent years to strengthen its operations, our prior work has identified ways that the corporation could be more strategic in its management of its contract workforce and the benefit determination process. The need for a strategic approach in these areas is essential to ensure that PBGC is operating as efficiently and effectively as possible to manage its increasing workload.

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. As PBGC's workload grew in response to the significant number of large pension plan terminations, PBGC has come to rely on contractors to supplement its workforce. About two-thirds of PBGC's workforce consists of contract workers (see Fig. 3).

Figure 3: PBGC Overall versus Contractor Personnel and Spending, Fiscal Year 2010



Source: PBGC.

Note: The number of contract workers is as of June 30, 2010; the number of federal employees is as of July 9, 2010; and the amount spent on contracts is for fiscal year 2010 as of September 30, 2010.

Over the years, PBGC has taken steps to improve its workforce management. For example, in response to a recommendation we made in 2000, PBGC agreed to conduct a comprehensive review of its future human capital needs and to use this review to better link contracting decisions to PBGC's long-term strategic planning process.[31] After commissioning this review, PBGC developed a human capital strategic plan that called for aligning human capital programs with the corporations' strategic goals and mission. However, in 2008, we found that the corporation still lacked a strategic approach to identifying the optimal mix of Federal versus contract workers and ensuring that the performance of its contract workforce contributes to the corporation's mission.

As a matter of general best practice, our 2008 work noted that a strategic plan should incorporate an understanding of how acquisitions will be used to assist an agency in achieving its mission.[32] This is especially true of PBGC with its large contract workforce. Yet, our 2008 work found that although PBGC had made efforts to improve its acquisition infrastructure, it had not developed a strategic approach to its contracting process as envisioned in our 2000 report. Moreover, PBGC's human capital strategic plan focused almost exclusively on its Federal workforce. We rec-

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[30] For example, the Pension Benefit Guaranty Corporation Governance Improvement Act of 2009, S. 1544, proposes amending ERISA with respect to the composition of the PBGC board of directors, among other changes.

[31] GAO, *Pension Benefit Guaranty Corporation: Contracting Management Needs Improvement*, GAO/HEHS–00–130 (Washington, DC: Oct. 18, 2000).

[32] GAO, *Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management*, GAO–08–624 (Washington, DC: June 2008).

ommended that the plan do more to reflect the importance of contracting and to link staffing and contracting decisions at the corporate level. While PBGC agreed that contracting should be part of its strategic planning process, it maintained that this is already being achieved by its current process.

Since our 2008 report, PBGC has implemented new guidance and policies in a number of areas to improve its management of the contracting process and contractor oversight. In August 2009, PBGC issued guidelines for determining whether to use contractors or government employees. While useful, these procedures do not include any specific steps to ensure that such decisions are linked to the strategic planning process. Subsequently, PBGC issued its new human capital strategic plan for fiscal years 2010–14. In this plan, PBGC acknowledges the importance of contracting and the challenges of balancing their workforce between Federal and contract workers, but the plan does not provide specific actions to address such challenges and appears to continue to focus primarily on PBGC's Federal workers.

Our previous reports also found weaknesses in PBGC's efforts to ensure that the performance of its contract workforce contributes to the corporation's mission. In 2000, and again in 2008, we found that most of PBGC's contracts lacked performance incentives and methods to hold contractors accountable for performance outcomes linked to the corporation's strategic goals. In 2000, we recommended that, where appropriate, PBGC should utilize more fixed-price contracts and fewer labor-hour payment arrangements, consistent with best practices in performance-based contracting. In 2008, we recommended that to improve implementation of a performance-based approach to contracting, PBGC should ensure that future contracts measure performance in terms of outcomes, provide incentives for the accomplishment of desired outcomes, and ensure payment of award fees only for excellent performance. We also recommended that PBGC should provide comprehensive training on performance-based contracting for PBGC's procurement staff, managers, and acquisition-related workforce.

PBGC agreed with our previous recommendations to enhance implementation of performance-based contracting, and stated that the actions recommended were already under way, including: incorporating performance-based measures into its future contracts and providing comprehensive training for PBGC staff. Further, PBGC noted that the use of labor-hour contracts had been restricted. However, the move to performance-based contracting has been difficult. For example, officials attempted to use performance-based contracts when making new awards for contracts with the field benefit administration offices, but these efforts were abandoned because, according to PBGC officials, the proposals were too complicated to evaluate and more costly than expected. We are examining these issues in a study currently under way to assess how well PBGC is managing its contracting activities and the steps it is taking to ensure the integrity of its contract process. We anticipate completing this work next summer.

Although we commend PBGC for its improvements to contract management, we continue to believe that more should be done to include procurement decisionmaking in corporate-level strategic planning and to link contractor performance measures with the corporation's mission. Without a more inclusive strategic planning process that looks at the contract workforce and Federal workforce together, PBGC cannot be assured that it has the optimal mix of contractor staff and Federal employees and that it is holding its contract workforce accountable for helping meet its strategic goals.

Benefit Determination Process Management

Finally, our prior work has also found that PBGC needs a more strategic approach for determining the benefits for participants in large, complex plans that have been terminated. In our August 2009 report, we reviewed plans terminated with insufficient funds and trusteed by PBGC during fiscal years 2000 through 2008. We found that a small number of complex plans—especially those with large numbers of participants affected by limits on guaranteed benefit amounts[33]—accounted for most cases with lengthy delays and overpayments.[34] For example, PBGC completed most participants' benefit determinations in less than 3 years, but required more time—up to 9 years—to process determinations for complex plans and

[33] When single-employer plans are terminated without sufficient assets to pay all promised benefits, PBGC guarantees participants' benefits only up to certain limits, specified under ERISA and related regulations. These limits on guaranteed benefits are commonly referred to as the maximum limit, the phase-in limit, and the accrued-at-normal limit. 29 U.S.C. §1322(b)(1), (3) and (7); 29 CFR §§4022.21, 4022.23, and 4022.25 (2009).

[34] GAO, *Pension Benefit Guaranty Corporation: More Strategic Approach Needed for Processing Complex Plans Prone to Delays and Overpayments*, GAO–09–716 (Washington, DC: Aug. 17, 2009).

plans with missing data.[35] In addition, while only a small percentage of participants receive overpayments of their estimated benefits while their final benefit amounts are being determined, we found that nearly two-thirds of cases with overpayments involved participants in just 10 large, complex plans.[36]

Given these findings, we recommended that PBGC develop a better strategy for processing benefit determinations for complex plans in order to reduce delays and minimize overpayments, and that PBGC set goals for timeliness and monitor the progress made in finalizing benefit determinations for large, complex plans separately from other plans. In response, PBGC has taken a number of steps to improve its procedures for communicating with participants in large, complex plans and to reduce overpayments. In addition, officials indicated that formal process improvement efforts were under way to tailor plan processing to plan size and streamline other aspects of work in an effort to reduce process times in the future. At the same time, officials noted that they had no plans to set any performance goals separately for large, complex plans as a group. Due to the complexities and variations with each of these plans, PBGC prefers to set schedules only on an individual plan basis. However, we continue to believe that reporting performance measures that reflect averages across all plans does not provide adequate weight to large versus small plans and does not provide sufficient incentive to improve the processing times for large, complex plans.

CONCLUDING OBSERVATIONS

In these challenging economic times, PBGC has become even more essential as millions of American workers and retirees have come to rely on the corporation for protection of their retirement income. PBGC is now one of the largest Federal Government corporations with nearly $80 billion in assets, yet it continues to face a future of financial instability. Its premium base has been eroding over time as fewer sponsors are paying premiums for fewer participants. In addition, as a result of the recession, PBGC is still at risk from the increased underfunding of some large defined benefit plans. To the extent that companies are more at risk of bankruptcy, the plans that they sponsor are more at risk of termination. The fact that PBGC's board of directors has only recently begun to meet to discuss these problems is less than reassuring. Moreover, even with the increased attentiveness of the current board, the lack of staggered terms for board membership means that consistency in both policy direction and oversight is not guaranteed in the future. PBGC needs a board that can offer long-term, strategic sophistication to keep the corporation as solvent as possible for as long as possible.

Improvements to PBGC's governance and to its strategic management cannot correct the structural weaknesses of its financial design, but it can put PBGC in a better position to confront the challenges that lie ahead. It is untenable to rest the management of nearly $80 billion in assets on a corporate board architecture that can fail to meet and provide strategic direction for years at a time, and that is vulnerable to a lack of leadership during transitions to new administrations. Companies that pay annual premiums to PBGC and the millions of employees whose retirement benefits are under PBGC's protection are owed greater stewardship of the corporation and its funds.

Chairman Harkin and members of the committee, this concludes my prepared statement. I would be happy to respond to any questions.

The CHAIRMAN. Thank you very much, Ms. Bovbjerg. Now we turn to Ms. Batts. Welcome. Please proceed.

STATEMENT OF REBECCA ANNE BATTS, INSPECTOR GENERAL, PENSION BENEFIT GUARANTY CORPORATION (PBGC), WASHINGTON, DC

Ms. BATTS. Thank you. I'm Rebecca Anne Batts, and I'm the Inspector General of Pension Benefit Guaranty Corporation, Office of the Inspector General.

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[35] If the participant is already retired, or retires before the benefit determination process is complete, PBGC makes payments to the retiree based on an estimate of the final benefit amount. However, lack of certainty about their final benefit amounts can make it difficult for retirees to plan for retirement.

[36] If a retiree receives an estimated benefit amount that is greater than the final benefit amount, then the retiree is likely to have received an overpayment which must be repaid.

I appreciate the opportunity to testify today about the need for strong management and oversight in the Pension Benefit Guaranty Corporation.

The Office of Inspector General has been working diligently to address the issues most critical to ensuring that the corporation is meeting its mission and can continue to meet its mission into the future.

Many of our recent reports have been quite critical of the corporation, and in some cases, years of effort will be needed to correct persistent problems. But, despite the many challenges that PBGC continues to face, my message today is one of good news.

Director Gotbaum and I communicate with one another frequently, and I believe effectively. My office holds monthly discussions of critical issues with the representatives of PBGC's board members; and OIG benefits from the resulting support.

After meetings with the board of directors, I sit in executive sessions with the board members to address areas of particular concern or sensitivity.

I'm happy to report that PBGC is taking many of our reported concerns very seriously, and implementing corrective actions.

For example, last spring my office reported issues with PBGC's privacy program. By law, the corporation has an affirmative responsibility to protect the confidentiality, integrity and availability of personally identifiable information—names and social security numbers.

PBGC took prompt, corrective action, going above and beyond what OIG recommended, with the goal of becoming a model for handling sensitive information; and as a result of these prompt actions, the corporation is better positioned to protect the personally identifiable information of the workers it serves.

While progress has been made, much remains to be done. The corporation has committed to addressing long-standing issues, including weaknesses in contracting and information technology security; the two weaknesses that you've heard about over and over today.

PBGC depends on its contractors to protect the pensions of the American workers, historically, almost two out of every three people doing the work of PBGC contractors; and additionally, the corporation spends about two-thirds of its annual operating budget through contracts.

Our work has shown that PBGC's contractors don't always deliver goods and services as they should. Allowing a contractor to provide a deliverable at a lesser quality than is called for in a contract, constitutes a form of waste or abuse, if not outright fraud.

PBGC has recently promised to take specific actions to address long-standing problems with the integrity and effectiveness of its contracting processes. For example, when my office recently found that a PBGC contractor didn't exercise due professional care in performing audits of plan assets, and of participant information, the corporation committed to hiring a CPA firm to re-perform the work related to two of the largest single-employer programs claims in PBGC's history.

Further, the corporation is developing a plan for how contractor work will be monitored, evaluated, and accepted in the future.

In response to our recommendations in several different audits, PBGC developed a set of standard operating procedures to guide procurement activities and establish basic eternal controls over the contracting process.

The corporation has committed to a series of reviews of the staff who provide the day-to-day monitoring and supervision of PBGC's contractors with the objective of ensuring compliance with the newly-implemented policies and internal controls.

PBGC also depends on its computers. Almost every aspect of PBGC is automated, from the initial operations and the Early Warning Program through the payment of benefit checks to PBGC's retirees. If PBGC can't use its computer, the corporation simply can't do its job.

My office has identified issues with PBGC's information technology practices that we believe pose an increasing and substantial risk to PBGC's ability to carry out its mission.

The corporation has developed corrective action plans to deal with identified weaknesses, and acknowledges that the planned actions won't be completed for 3 to 5 years. OIG is closely monitoring the implementation of PBGC's plans.

You may have noticed something important about the theme of my testimony today. Much of my discussion has focused on the future, plans for corrective action and what PBGC promises to do to correct long-standing ills.

PBGC leadership, and all those that have oversight responsibility for the corporation, should make certain that PBGC is effective in executing planned corrective actions.

Mr. Chairman, that concludes my remarks, and I'd be happy to take any questions.

[The prepared statement of Ms. Batts follows:]

Prepared Statement of Rebecca Anne Batts

Summary

My testimony today is essentially "good news" testimony. In some areas, focused attention by PBGC leadership has already resulted in effective corrective action. For example, during the past year:

- PBGC implemented OIG's specific recommendations to enhance privacy processes and also made additional improvements with the stated goal of making PBGC a model for handling of sensitive information.
- PBGC initiated actions to protect the PBGC's securities on loan to other investors, including developing a method to validate revenues from securities lending to eliminate reliance on the custodian bank, and developing internal controls to better monitor the program.

In other areas, much remains to be done and full implementation of corrective action may take years.

- Sustained management attention and oversight will be needed if PBGC is to fully implement its current plans to improve the effectiveness and integrity of its contracting practices.
- While PBGC has developed corrective action plans to address serious weaknesses in information technology security, execution of the plans is scheduled to take between 3 and 5 years and many critical details have yet to be developed. During the interim, careful review by those with oversight responsibility for PBGC will be needed to ensure that the PBGC's plans stay on track to completion.
- Though the future is difficult to predict, the possibility that an increased number of plans and participants will be trusteed by PBGC is very real. Therefore, OIG concluded that PBGC should prepare strategically for the possibility of a workload surge.

CONCLUSION

We recognize PBGC's progress in addressing numerous high priority areas and support its efforts to address our related recommendations. Considering the organization-wide impact of the information technology security issues and the weaknesses in contracting practices, PBGC leadership and those with oversight responsibility should target their oversight efforts on the effective execution of the corrective action plans that have been developed. Additionally, for critical weaknesses that cannot be addressed in the near future, interim measures should be developed and adopted to minimize the associated risks. OIG will continue our monitoring activities until PBGC demonstrates that it has been fully responsive to our recommendations. In addition, we plan future audit work in the areas of highest risk to validate the effectiveness of PBGC corrective actions.

Chairman Harkin, Ranking Member Enzi, and members of the committee, thank you for inviting me here today to discuss the Pension Benefit Guaranty Corporation's (PBGC) oversight and management of its Single and Multi-employer Pension Insurance programs. PBGC protects the pensions of approximately 44 million workers and retirees in more than 27,500 private-defined benefit pension plans. Under Title IV of the Employee Retirement Income Security Act of 1974, PBGC insures, subject to statutory limits, pension benefits of participants in covered private defined benefit pension plans. To accomplish its mission, PBGC relies extensively on the use of contractors and on information technology. Internal controls over these operations are essential to ensure the confidentiality, integrity, and availability of critical data while reducing the risk of errors, fraud, and other illegal acts.

BACKGROUND

PBGC receives no funds from general tax revenues; instead PBGC is financed by insurance premiums paid by companies that sponsor defined benefit pension plans, investment income and assets from terminated plans. PBGC has been in a deficit position (where current and future commitments to participants exceed resources) for a number of years. Inadequate minimum contributions, inadequate insurance premiums, employer shift from defined benefit pension plans to defined contribution pension plans and insufficient funding of terminated plans are factors contributing to the deficit. Between the end of fiscal years 2008 and 2009, the deficit in PBGC's single-employer insurance program doubled in size from $10.7 billion to $21.1 billion. In fiscal year 2010, the single-employer program's net position declined by $.52 billion, increasing the program's deficit to $21.59 billion.

PBGC currently pays monthly retirement benefits to over 800,000 retirees in 4,150 plans. Including those who have not yet retired and participants in multiemployer plans receiving financial assistance, PBGC is responsible for the current and future pensions of more than 1.4 million people.

THE PBGC OFFICE OF INSPECTOR GENERAL

The PBGC Office of Inspector General provides an independent and objective voice that helps the Congress, the Board of Directors, and PBGC protect the pension benefits of American workers. Like all Federal Offices of Inspector General, the PBGC Office of Inspector General is charged with providing leadership and recommending policies and activities designed to prevent and detect fraud, waste, abuse, and mismanagement; conducting and supervising independent audits and investigations; and recommending policies to promote sound economy, efficiency, and effectiveness. As Inspector General, I report directly to the PBGC Board of Directors, through the PBGC Board Chair; this reporting relationship has supported OIG's ability to audit and investigate the aspects of PBGC operations that pose the highest risks for fraud, waste, abuse, and mismanagement.

During the past 2 years, my office has conducted numerous independent audits and investigations pertaining to agency programs and operations, resulting in significant improvements and changes that ultimately serve to protect America's pensions. Many of the reports have been quite critical of PBGC, in some instances placing significant stress on the relationship between the Office of Inspector General and the Corporation. Nevertheless, the PBGC Board of Directors and PBGC have responded appropriately and professionally to implement many of the improvements recommended by the Office of Inspector General.

Our ongoing audit work addresses some of the most critical issues facing PBGC. We are in the process of applying for law enforcement authority and have begun the process of enhancing the nature and sophistication of the investigations we conduct. Recent cases accepted by U.S. Attorney's Offices include significant issues such as complex multi-employer pension plan fraud. We are performing some of our investigations in concert with other agencies, including the Department of Labor OIG Office of Labor Racketeering and Fraud, and other Federal, State, and local law enforcement agencies.

Over the last 5 years, we have issued 52 reports addressing PBGC's oversight of its programs and made 359 recommendations for improvement or recovery of questioned costs. Although PBGC has responded positively to many of our recommendations, 176 recommendations, contained in 40 different reports, remain open as of today.

THE STATUS OF PBGC ACTIONS TO IMPLEMENT OIG RECOMMENDATIONS

The following are examples of some of PBGC's recent accomplishments in responding to OIG recommendations, as well as areas where additional oversight and management attention are needed.

PBGC Took Action to Protect Sensitive and Personally Identifiable Information

Last spring my office reported concerns with PBGC's privacy program. By law, PBGC has an affirmative responsibility to protect the confidentiality, integrity, and availability of personally identifiable information. PBGC's mission requires the collection, storage and transmittal of a great deal of personally identifiable information, such as the names, social security numbers, and earning histories of workers in trusteed plans. In March 2010, we reported that PBGC's Privacy Office did not properly monitor its privacy processes for quality and compliance. Further, PBGC's process for reporting personally identifiable information events was inaccurate and unverifiable. Technical controls (e.g., encryption of laptop computers) required strengthening.

To their credit, the Corporation took immediate measures to begin addressing reported concerns. Some actions directly addressed OIG's recommendations; for example, specific guidance and procedures were developed for privacy staff to follow in reporting to the U.S. Computer Emergency Readiness Team (US-CERT) security incidents involving the disclosure of personally identifiable information. PBGC's actions went well beyond the specific recommendations included in OIG's report. PBGC re-examined its privacy program with the stated intention of making PBGC a model for handling sensitive information and surveyed other Federal agencies to identify best practices. The Privacy Office then developed and implemented key guidance, including detailed record keeping instructions and a requirement that all incidents involving personally identifiable information be reported to US-CERT within 1 hour of discovery. The guidance was widely disseminated via e-mail to all PBGC employees and contractors with PBGC e-mail accounts, as well as to the contract service providers that handle or access personally identifiable information at contractor facilities. PBGC followed up by giving in-person training on privacy protection standards and reporting requirements to those PBGC employees and contractors (e.g., staff at Field Benefit Administration sites) who frequently handle sensitive information.

Earlier this fall, we reviewed PBGC's corrective actions related to PBGC's privacy program. Our testing showed that our recommendations in this important area had been effectively implemented. The Corporation's positive reaction to OIG's findings increased the likelihood that PBGC will be able to properly protect the personally identifiable information and other sensitive data with which it has been entrusted.

PBGC Initiated Actions to Protect its Securities on Loan to Other Investors

Securities lending is a small but important component of PBGC's overall investment program and is intended to obtain incremental investment return. As of September 30, 2010, PBGC had about $21 billion in securities available for lending; of this amount, about $5.7 billion in securities was actually on loan. OIG's review of PBGC's Securities Lending Program disclosed the general absence of written guidance at all levels and little documentation of the procedures used to implement, monitor, and oversee the program. Further, we reported that PBGC was unable to independently validate that the gross and net revenues earned through the program were correctly calculated by the bank with custody of PBGC's loaned assets. Upon issuance of our report, representatives of the PBGC Board of Directors and PBGC leadership responded promptly and corrective actions were initiated.

PBGC is making progress in the implementation of the 16 recommendations included in OIG's report. For example, PBGC has developed and is testing a method to validate the amount of revenue earned through securities lending. That is, PBGC will soon be capable of "checking" the calculations of its custodian to ensure the Corporation receives the full amount of earnings to which it is entitled. Reducing

PBGC's dependence on the custodial bank is an important step. Further, PBGC is in the process of implementing a number of internal controls intended to provide effective oversight and monitoring of the securities lending program. OIG continues to work diligently to support PBGC in its ongoing efforts to develop needed controls over this complex investment practice.

At the time of our review, written policies regarding the securities lending program were virtually non-existent. PBGC has begun the arduous process of drafting written policy guidance regarding the establishment, investment objectives, risk tolerance, and measurement standards and operations of the securities lending program. We have worked closely with PBGC, reviewing several iterations of PBGC's draft documents and offering suggestions and edits. Because the PBGC Board has the authority and responsibility for establishing and overseeing the investment policy and its implementation, the securities lending guidelines proposed in our report should be submitted to the Board and Board Representatives for review. Our recommendations for guidance will not be considered complete until this has been done.

PBGC is Working Toward Protection of the Corporation's Ability to Carry Out its Mission Through the use of Information Technology

OIG has focused much of its recent audit work on the serious weaknesses in PBGC's information technology practices that pose increasing and substantial risks to PBGC's ability to carry out its mission. For the past 2 years, PBGC's annual financial statement audit included an adverse opinion on internal control, based in part on systemic information technology security control weaknesses. A report on PBGC compliance with the Federal Information Security Management Act described PBGC's information systems as "a series of stovepipe solutions built upon unplanned and poorly integrated heterogeneous technologies with varying levels of obsolescence."

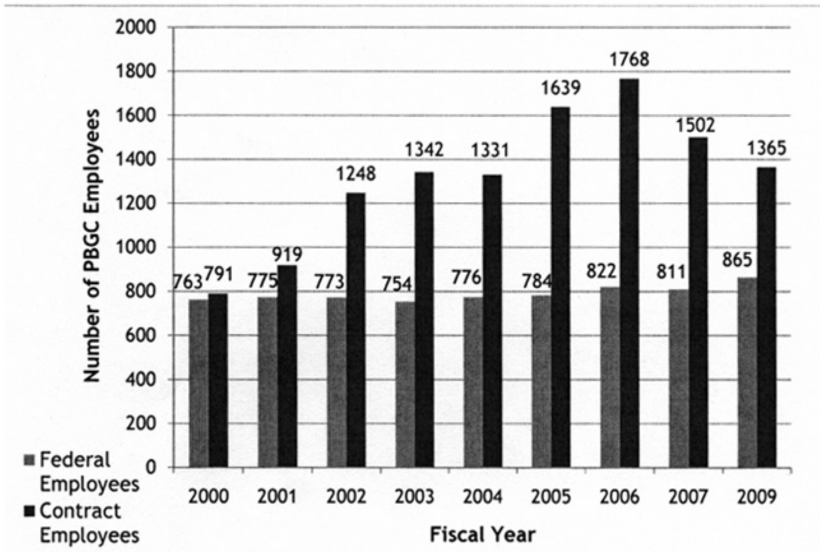
The operations of PBGC are heavily dependent on information technology. During the summer of 2008, shortly after I became Inspector General at PBGC, I learned that PBGC frequently dismissed OIG's concerns about information security. The auditors and investigators in my office worked hard to demonstrate the need to enhance attention to this crucial area. In the fall of 2009, we gave PBGC senior leadership a restricted disclosure presentation on the results of penetration testing conducted to discover weaknesses and to exploit discovered vulnerabilities. After our presentation, new leadership was assigned to enhance PBGC's security posture and to develop a long-term corrective action plan to address long-standing issues. Importantly, PBGC committed to build and manage security controls to an appropriate National Institute of Standards and Technology (NIST) standard. Further, PBGC made the decision to enter into an interagency agreement with the Bureau of Public Debt to leverage its expertise in security control. PBGC is beginning to actively address serious information technology issues and the substantial risks they pose for PBGC's ability to carry out its mission.

The Corporation has embarked on a coherent approach to resolving and correcting fundamental information technology weaknesses. PBGC has developed and is implementing multi-year corrective action plans to address security issues at the root cause level. The corrective action plans are an important first step that reflects the priority that PBGC leadership places on this critical issue. However, PBGC's realistic assessment is that a timeframe of between 3 and 5 years is needed to achieve the objectives of the PBGC's plans. According to PBGC's schedule, corrective action for many of OIG's recommendations will not be complete until 2015.

Current PBGC leadership has been straightforward in acknowledging the challenges it faces in revitalizing PBGC's information technology processes. Implementing the corrective action plans will be difficult and time-consuming. Some of PBGC's challenges, like the continuous stream of new and ever-changing Federal requirements, are shared by all Federal entities. Others are unique to PBGC. For example, PBGC still has an acting Chief Information Officer, PBGC system security expertise is still maturing, and trust-building is still a work-in-process for the office that manages PBGC's information technology. Strong leadership and effective, persistent oversight, from within the organization as well as from the outside, will be needed if PBGC is to ensure the security of the information technology systems that support the PBGC mission.

PBGC Must Ensure the Integrity of the Contracting Process

PBGC relies heavily on the services of contractors to carry out its operations, a factor that makes procurement and contracting a significant PBGC activity. PBGC reports spending about two-thirds of its annual operating budget through contracts. Historically, nearly two of every three people who do the work of PBGC are contract employees, as shown by the following table. Thus, ensuring that contractors provide the goods and services for which they are paid is critical to PBGC's ability to meet its mission.



OIG continues to devote a significant portion of its resources to audits, investigations, and reviews of PBGC's procurement and contracting activities. Forty-three open audit recommendations relate to PBGC's contracting practices; some have remained open for more than 5 years without effective resolution. Many of the most critical issues we are currently addressing have been caused or exacerbated by poor contract management. Our ongoing monitoring also shows a continued need for close management attention in this area.

While PBGC places tremendous reliance on its contractors, the Corporation has experienced serious and costly problems with the quality and utility of some of the contract deliverables for which it paid. Many of these issues could have been avoided through effective contract management, including careful contract monitoring, acceptance of deliverables and evaluation of contractor performance. PBGC senior leadership also needs to reinforce the idea that allowing a contractor to provide a deliverable of a lesser quality than called for in a contract constitutes a form of waste or abuse, if not outright fraud.

PBGC has recently committed to taking a number of important actions to improve the effectiveness of its contracting activities. For example:

- Our on-going reviews of two of the largest Single Employer program claims in PBGC's history show that a PBGC contractor did not exercise due professional care in performing audits of plan assets and of plan participant information. PBGC's oversight of the contractor was ineffective in identifying obvious and material errors and omissions in the work. To its credit, PBGC leadership is taking action to address the issues, including: (1) contracting for a Certified Public Accounting (CPA) firm to re-perform the work related to these two plan sponsors' pension plans; (2) developing a plan for how contractor work will be monitored, evaluated, and accepted; and (3) reviewing plan asset evaluations completed over the last 2 years, with the objective of using identified deficiencies to train reviewers and staff and to update procedures.
- In response to our audit recommendations, PBGC developed a set of Standard Operating Procedures (SOP) to guide procurement activities and establish basic internal controls over the contracting process. Based on our review of the document, the SOPs form a useful "first step" toward improving procurement effectiveness. However, PBGC leadership needs to develop a method to determine the degree to which those with responsibility for contracting are complying with the new procedures and to make any necessary corrections or adjustments as needed.

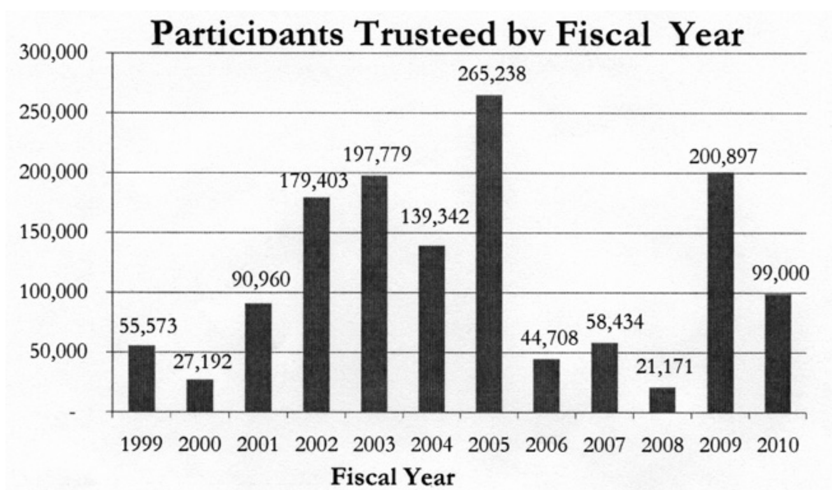
• During the course of a recent evaluation, we became aware of a reduction in the minimum qualifications for contract staff at some of PBGC's remote sites. There was no indication that PBGC sought reduced rates when staff with lesser qualifications were provided or that PBGC confirmed the contractors' assertions that fully qualified staff could not be retained. Based on our discussions with PBGC management, the Corporation solicited a contractor to provide a thorough and objective assessment of PBGC practices associated with the acquisition, planning and contract administration for the remote site contracts. The resulting report, issued on October 29, 2010, confirmed our initial observations and made 14 recommendations for improvement in PBGC's contract modification process. PBGC leadership has committed to implementing the report's recommendations.

• OIG has repeatedly expressed the need for PBGC to be more vigilant about the integrity and effectiveness of its contracting processes. A special team led by the Chief Financial Officer and the General Counsel was established to assist the Procurement Department in responding to open audit recommendations and in enhancing PBGC's ability to contract effectively and in compliance with relevant guidance. As a result, many long-standing recommendations have been closed and others are nearing completion. Additionally, plans have been made to review the actions of the contracting officer's technical representatives and the technical monitors who provide day-to-day monitoring and supervision of PBGC's contractors. PBGC leadership should ensure that these reviews are carried out carefully and that necessary corrective actions are taken if the reviews show a lack of compliance with established contracting practices.

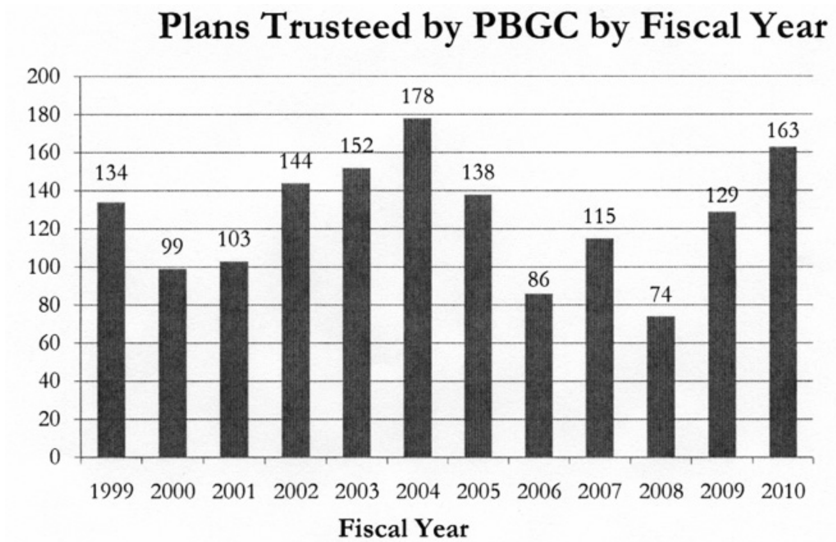
PBGC Should Prepare Strategically for the Possibility of a Workload Surge

In response to a request from the Chairman of the Senate Special Committee on Aging, OIG reviewed PBGC's planning efforts to strategically prepare for the potential influx of pension plans. In our report, issued last month, we explained our conclusion that PBGC needs to develop specific strategies and tactics to be used in the event of a serious workload surge.

The recent global economic downturn caused financial hardships for many businesses in a number of different sectors, which directly impact PBGC's operations and forecasting. The risk of numerous pension plans simultaneously terminating could cause a domino effect requiring PBGC to assume a large number of participants in a short period of time. Conversely, if the economy is strong, PBGC may only assume 20,000 or 40,000 participants in a given year (see the chart below).



The number of plans that PBGC assumes on a year-to-year basis fluctuates based on numerous factors, mainly the economic strength of the country. PBGC experienced an influx of pension plans from fiscal year 2002–5, when PBGC became responsible for paying more than 700,000 participants from plans that were terminated and trusteed, primarily from the airline and steel industries (see the next chart). PBGC is experiencing one of the busiest periods in its history. In fiscal year 2009, PBGC terminated and trusteed 129 plans with more than 200,000 participants. During fiscal year 2010, PBGC assumed responsibility for 99,000 additional workers and retirees in 163 failed plans.



The Government Accountability Office lists PBGC on its High Risk list, in part, because PBGC continues to be "exposed to the threat of terminations of large underfunded pension plans sponsored by financially weak firms." PBGC acknowledged in its fiscal year 2010 Annual Report issued last month that no reasonable estimate could be made of 2011 terminations.

The future is difficult to predict. The uncertainty about 2011 termination, when considered together with the exposure noted by GAO, provides sufficient reason for PBGC to expand and enhance its planning for possible workload surges.

To date, the Corporation has generally kept its planning activities simplistic and linear. PBGC executive leadership explained their belief that a "playbook" approach, explicitly detailing the steps to be taken, was impractical. To their view, because a workload surge could take many varied and unpredictable forms, the only practical option was reliance on the Corporation's ability to develop and implement an "ad hoc" approach, in the event that a workload surge materialized. Based on our review, we identified a number of specific activities the Corporation could take to enhance its readiness in the event of a workload surge. These activities could be best implemented as part of an overall strategic plan, an approach that we consider to be a best practice. However, even in the absence of a comprehensive Workload Surge Strategy Plan, implementing the recommendations in our report would help position the Corporation to deal with a significant workload surge.

The Chief Operating Officer responded to our report, noting PBGC's conclusion that the risk of a large influx of plans is much lower now than anticipated in fiscal year 2009. Further, his response stated management's belief that the resources needed to address the report's recommendations would be better used in other higher priority areas. Accordingly, instead of implementing OIG's recommendations as written, PBGC proposed the creation of a Large Influx Working Group (LIWG) Planning Document as a basis for alternative actions to address the recommendations. We will need to review the planning document PBGC proposes to draft before we can determine whether PBGC's proposed approach adequately addressed the report's findings.

CONCLUSION

We recognize PBGC's progress in addressing numerous high priority areas and support its efforts to address our related recommendations. Considering the organization-wide impact of the information technology security issues and the weaknesses in contracting practices, PBGC leadership and those with oversight responsibility should target their oversight efforts on the effective execution of the corrective action plans that have been developed. Additionally, for critical weaknesses that cannot be addressed in the near future, interim measures should be developed and adopted to minimize the associated risks. OIG will continue our monitoring activities until PBGC demonstrates that it has been fully responsive to our recommendations. In addition, we plan future audit work in the areas of highest risk to validate the effectiveness of PBGC corrective actions.

Mr. Chairman, that concludes my remarks. I would be happy to answer any questions that you or other members of the committee may have.

The CHAIRMAN. Thank you very much, Ms. Batts. And, now Mr. Porter, welcome. Please take a seat.

STATEMENT OF KEN PORTER, INTERNATIONAL BENEFITS AND ACTUARIAL CONSULTANT, AMERICAN BENEFITS COUNCIL, WASHINGTON, DC

Mr. PORTER. Thank you, Mr. Chairman, Ranking Member Enzi, and the members of the committee. I appreciate the opportunity to be here today.

My name, of course, is Ken Porter. I'm Actuarial and International Benefits Consultant with the American Benefits Council.

Previously, I spent 35 years with the DuPont Company, where I was the Finance Director, responsible for all corporate risk management, as well as the financial planning and actuarial responsibility for all employee benefits around the world.

There were 160,000 U.S. plan participants in the PBP Plan sponsored by the company in the United States, and about $18 billion of assets covering those participants at the time.

Our focus then, on our comments today, are on the relationship between the PBGC and defined benefit sponsor community. The American Benefits Council represents the PBGC's customer base. It's the premium payers. We're the business partners to the PBGC. We appreciate the long-standing relationship we have with the PBGC.

Throughout all of its years the PBGC has been quite open to communicating with us and hearing what our concerns are; and we openly welcome suggestions on how we can make that communication even better than it is.

I have two issues that I want to just highlight today: the first is a general observation; and we've already mentioned one of the missions of the PBGC is to encourage the continuation and maintenance of voluntary private pensions.

As a former corporate risk manager, I spent many hours negotiating with insurance companies of all kinds on all kinds of risks throughout the world; and typically, we would come up with a win-win solution where the insurance company would recognize the business needs of the insured, and the risks for the insured would be paid off and the insurance company would maintain its requirements for a profitability end, and reserves.

Once in a while an insurance company would not be able to, for one reason or another, recognize the needs of the business; and the business would have to make a decision either to find a different insurance company or to choose not to insure that particular risk.

In the case of a defined benefit pension plan, the risk manager has no choice. If they're going to have a defined benefit plan, a company must use the PBGC, and must pay the premiums that Congress ordains from time to time.

We are very concerned as plan sponsors, that the actions and the policies of the PBGC can tend to interfere with normal business transaction of plan sponsors; and as such, discourage plan sponsors from maintaining plans, in addition to a lot of other factors that have worked against the sponsorship of employee benefits.

One example of that is the recent regs on 4062(e) that the PBGC proposed. In those rules we believe that they could have significant impact—have the potential of interfering with normal business transactions of corporations even though those transactions pose no material risk to the PBGC.

We applaud Director Gotbaum's efforts in recognizing some of this. He's extended the comment period. We look very forward to working with them to help them rethink what these rules could be to achieve their goals; and at the same time, partner with the plan-sponsor-community so as not to be disruptive to normal business operations.

The second example is, over the last 2 years as there was bipartisan support to provide relief for plan sponsors in funding their plans due to the simultaneous enactment—or the effective date of the Pension Protection Act, and the economic downturn. During that period of time the PBGC significantly resisted the efforts, the bipartisan efforts, to provide smoothing to the companies.

These experiences have been very difficult for plan sponsors and have sent up red flags.

Finally, the second issue is regarding the investment policy. We agree with Mr. Gotbaum's comments that they need to be well thought out and concerted. They need to take into account all of the constituents.

From a plan sponsor perspective, we look at the PBGC's deficits as reported and know that there's only two ways that they can erase those deficits: one is through investment return that exceeds their conservative measure of their liabilities; and the second is to rely on Congress to raise the premium on plan sponsors.

As the number of plan sponsors decline and if the policy for investment is too conservative, the premiums being charged through the remaining plan sponsors will become debilitating.

In conclusion it is our desire to continue working with the PBGC openly. We value the relationship we have with them. We want to be the clients as well as business partners to the PBGC; and we applaud our shared view with this committee: that the plan sponsor community needs to have the encouragement to insure that benefit security for all Americans who are covered by this plan.

Thank you.

[The prepared statement of Mr. Porter follows:]

PREPARED STATEMENT OF KEN PORTER

My name is Ken Porter and I am an Actuarial and International Benefits Consultant for the American Benefits Council (the "Council"). I also serve as Executive Director of the Council's research and education affiliate, the American Benefits Institute. Previously, I worked for 35 years for The DuPont Company, from which I retired as the Finance Director for Corporate Insurance and Global Benefits Financial Planning. I also served as Global Risk Manager and Corporate Chief Actuary with responsibilities that included DuPont's defined benefit pension plans covering more than 160,000 participants in the United States and with about $18 billion in U.S.-defined benefit plan assets. I also had actuarial oversight responsibility for defined-benefit pension plans in every other country where the company sponsored defined-benefit pension plans. In my capacity as a DuPont employee, I served on the Council's Board of Directors and I am a former Chairman of the Council's Board. Thank you very much for the opportunity to testify.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Council applauds Chairman Harkin, Ranking Member Enzi, and the members of this committee for holding this hearing to examine the management and oversight of the Pension Benefit Guaranty Corporation (the PBGC). The Council believes this is a topic that merits a full public policy discussion.

The PBGC has a very challenging mission. The PBGC needs to ensure that it has adequate funds to provide benefits to participants and beneficiaries whose plans are terminated with insufficient assets. We believe that the PBGC works hard to fulfill this part of its mission. For that, we are very grateful.

The PBGC has an additional very complementary responsibility that is critical to enabling it to meet its first goal. That is to be a champion of the defined benefit pension plan system and to encourage the continuation and maintenance of pension plans. In no way should this role be viewed as at odds with the need to have adequate funds to pay benefits to participants in terminated plans. To the contrary, the future financial integrity of the PBGC depends upon the maintenance of defined benefit pension plans.

I would like to focus my testimony on one key issue: the relationship between the PBGC and the defined benefit pension plan sponsor community. The American Benefits Council, which represents the PBGC's customers who pay the premiums that support the agency, appreciates its longstanding relationship with the PBGC and the opportunities that have been afforded to share our views on a range of issues over the years. We certainly also welcome suggestions on how we, the plan sponsor community, can more effectively communicate with the PBGC. It is very important that the relationship be strengthened and we would of course like to continue working with Congress and the PBGC in that regard, so that all parties can better understand the others' concerns. Such strengthening is critical to fulfilling the PBGC's statutory mission "to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants." We believe that this mission can be served through better communication between the PBGC and business community.

The core problem we see is that PBGC and the business community need to communicate more effectively about why employers are fleeing the defined-benefit plan system, why they are freezing their plans, and how certain well-intended PBGC policies and actions can actually threaten business viability and *increase* PBGC liability. The following examples illustrate this issue:

- The PBGC recently proposed regulations regarding various corporate transactions, including the shutdown of operations. These proposed regulations would reverse longstanding PBGC written policy and would impose potentially enormous liabilities with respect to routine transactions that involve no layoffs or shutdowns and pose no threat to the PBGC. Companies will find it extremely difficult to continue sponsoring defined-benefit pension plans if their routine business transactions trigger large liabilities unrelated to any risk to the PBGC. In our view, this regulatory project is a critical test of PBGC/business community communication. Given the depth of our concerns, we were very encouraged recently when PBGC Director Joshua Gotbaum recognized the importance of these proposed regulations and extended the comment period to receive further input. We thank the Chairman and Ranking Member of this committee for their leadership with respect to that extension. We further hope that this hearing will lead to an open dialogue among Congress, plan sponsors, and the PBGC so that the PBGC rules will encourage rather than discourage plan maintenance.
- The PBGC has not joined in the broad bipartisan support that has been evidenced in both the Senate and the House of Representatives over the past 2 years for defined benefit pension plan funding relief. Congress has wisely recognized that pension funding relief legislation is critical not only to saving jobs, but also to saving pensions by forestalling the termination of underfunded plans and thereby protecting the PBGC as well. However, the PBGC itself has resisted the efforts to help companies recover from the economic downturn and smooth out the extraordinary losses suffered by the plans. The lack of support for essential relief has understandably led long-time defined benefit plan sponsors to question their own commitment to the system. Again, better communication might help the agency and its customers (i.e. the plan sponsors who pay the PBGC premiums) be in better alignment on such a critical policy matter.
- We believe it is essential that there be a continuing and open dialogue with the PBGC about:

- The PBGC's economic modeling system, which has been actively used in public policy debates but has not been made available for public discussion.
- The PBGC's investment policy, which we believe should be based on a diversified portfolio; The investment decisions made by the PBGC affect us all, of course, but we also believe the trustees should have appropriate discretion in the selection of investments because that is an important part of their job.
- The PBGC's assumptions underlying its reported deficit. In that regard, a report was prepared for us in 2005 by former staff on the Joint Committee on Taxation that raised questions regarding the assumptions used by PBGC in determining that deficit. That report, *Promises to Keep: The True Nature of the Risks to the Defined Benefit Pension System*, is attached to this testimony and we ask that it be included in the official hearing record.*

• The PBGC has on occasion proposed that it should operate in a manner similar to a true insurance company. However, a true insurance company would balance its insurance business needs against the needs of its customers. Further, an insurance company's products would be designed to dynamically meet the changing needs of its customers. We believe that enhanced communication with the plan sponsor community is needed in order for the PBGC to function more like an insurance company in these respects.

We applaud Senator Kohl for his continuing interest in addressing PBGC governance. In our view, the theme of the Pension Benefit Guaranty Corporation Governance Improvement Act of 2009, S. 1544, as introduced by Senator Kohl, is to provide improved management of the PBGC through (1) greater involvement of private sector representatives, (2) strengthened communication among affected parties, and (3) enhanced management consistency. We believe that these are all important first steps.

The PBGC and the business community each play a critical role in the defined benefit plan system and each faces many challenges. The economic difficulties of the last several years have contributed to erosion of the most effective communication that is needed between the PBGC and the community with which it works. We all need to look for opportunities to do more, through legislation or simply through open dialogue.

Again, we thank you for the opportunity to testify and I would be happy to answer any questions the committee may have.

The CHAIRMAN. Thank you very much, Mr. Porter.

Thank you all for your fine testimony.

I want to hit on this one issue, again, of board membership.

In looking at Ms. Bovbjerg's testimony, and outlining all of the different Federal departments that we have that have boards now—the Commodity Credit Corporation—I'm familiar with that for my Agriculture Committee work, has 8 members; Export-Import Bank, 5; Federal Crop Insurance Corporation, 10; FDIC, 5; OPEC, 15; and Pension Benefit Guaranty Corporation, 3.

Also, it just seems, maybe it's odd to me, but in all my years here, I don't remember having a board that consisted simply of three appointed secretaries of departments. Usually boards are made up of people that have some expertise and background, and that continue on, so there's not this abrupt change from one administration to the next.

I'm intrigued by this. I'm going to ask you again now, for the record, just your own views from having looked at this. Mr. Porter, you, too. I want you to think about whether the boards should be expanded? I don't have a number in mind. It's important to at least get some continuity that would go from one administration to the other. I agree that everything's been said, this is one area that—not to be political, and not to be partisan—we ought to get the best people at all to be on the board; and where you would have a hold-

*The report referred to may be found at *http://help.senate.gov/imo/media/doc/Porter-Report.pdf*.

over, some rotational kind of a system so that you keep some expertise on these boards from one administration to the next.

I want your views on that, and how important is that right now for us to pay attention to this, Mr. Porter?

Mr. PORTER. Yes. Thank you, very much. Certainly I can't dictate or would not want to even begin to dictate how large it ought to be, but I agree that whatever the size of the board is, and its constituency, it needs to be a board that has longevity; it needs to have continuity.

The period of time during the economic turmoil, as was mentioned, where there was effectively no board and no executive director for a period of time, was very troubling to the business community. We would like to—whatever. We would support measures that would provide for continuity.

We look back at the investment policy and we see frequent changes to the investment policy that have not always been to the best interest in the long-term. We don't see corporate plans changing their investment strategy frequently, and yet that seems to have happened to the PBGC over time.

I'd like to see stability; and that's what we would be in favor of.

The CHAIRMAN. Ms. Batts.

Ms. BATTS. From the perspective of the Office of Inspector General, there's an additional problem when we lose continuity of the board. I might share with you—you referred to the situation—the unfortunate situation with Former Director Millard.

In February 2009 when my office confirmed former Director Millard's misconduct, the former director was gone from PBGC, but the contracts that were under question remained.

Now, I was able to speak to PBGC's acting director, once we confirmed the misconduct—and that acting director was not part of the problem. So, we had no issue.

Had the acting director also been part of the problem, PBGC, OIG would have had no one to go to, with no board members, with no confirmed Secretary of Commerce or Secretary of Labor or Secretary of Treasury, and only one confirmed board representative. That did represent an additional vulnerability for us.

Fortunately, it didn't turn into a problem, but, I think that is something else to think about in terms of ensuring continuity of the board.

The CHAIRMAN. OK. Ms. Bovbjerg.

Ms. BOVBJERG. Well, I've already talked about this a lot, so I won't take a lot of time, but the continuity point issue is really important for many of the reasons already mentioned.

I do want to say that the original board—which in our work, seems unique in the Federal Government—is there for diversity; so labor represents workers, commerce represents sponsors, treasury represents finance. And that's a really good idea, but you need more of that.

In addition to more members, you know, it would be helpful to have someone on the board who's a management expert or risk assessment expert, or a pension finance person.

You'd have to be concerned about conflicts. You appoint people who might be involved with the industry, but it would be really important to continue that tradition of diversity.

I also wanted to say that the McKinsey Report—which followed up on ours, but with regard to what boards might look like—reported that in a survey, members of corporate boards said they spend an average of 22 hours a month on their board work. I just don't see how that's possible for cabinet secretaries in the U.S. Government.

The CHAIRMAN. Thank you. Thank you all very much.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

Mr. Porter, I was interested in your reference in your testimony, to PBGC's proposed regulations imposing enormous liabilities on companies with respect to the routine business transactions that you say pose no threat to the PBGC.

Would you provide us with an example of that?

Mr. PORTER. Certainly. Thank you, Senator.

One example, and this is sort of the nature of the game as plan sponsors are freezing plans for a variety of reasons, the number of active employees participating in those plans tends to shrink over time.

You can envision many situations where the number of active participants in a plan might be a fraction of the total active participants of an employer. An employer might have, for example, 10,000 employees, but perhaps only 1,000 of them are active participants in the plan.

Under the rules, the rules impose a significant increase in the liability and the funding requirements if 20 percent of the active participants leave the plan sponsor.

You could have a situation where as few as 200 employees might be involved in a divestiture, and that would only represent 2 percent of the total workforce; but because it's 20 percent of the plan, the plan would now be subject to enormous increases in liability.

And, because it's a legacy plan, there may well be 10, 12, 15,000 retirees in that plan, not just the 1,000 active employees.

The impact on the plan sponsor would be enormous for simply having a small divestiture that involves perhaps only one or two percent of their workforce.

If that plan sponsor's plan is well-funded and the plan sponsor is strong, that really isn't a material threat to the PBGC's liability.

Senator ENZI. Thank you. That's very helpful with letting us know some of the unintended consequences, and some things we have to do or might potentially have to do. I appreciate that.

Ms. Bovbjerg, in your opinion, would the PBGC benefit from creating a standing audit board, which could not only address critical issues, which require more attention than the time allowed at board meetings, but also provide oversight to the board's interaction with the PBGC?

Also, what can be done to improve the investment board or PBGC's advisory committee?

Ms. BOVBJERG. We didn't call for a separate audit board, but at GAO we always like to see more auditing capacity.

Senator ENZI. As the only accountant in the Senate, I do, too.

Ms. BOVBJERG. Yes, so what we did think about, though, is the importance of the standing committees in the board; that we really do think there needs to be some audit committee to work with the external auditors and pay pretty concentrated attention to the finances of PBGC.

We hadn't thought about a separate board, but we certainly could consider that. I wouldn't be willing to recommend it and get myself in trouble.

You also asked about the advisory board, which is seven members appointed by the president; and they report to the director right now. Most committees and boards of that nature report directly to the board of directors, so that might be something.

That advisory group—it was called an advisory committee in the past, and it has a board. It was at one time the investment advisory boards. They were only looking at investment issues. It's changed over time, and it's been subject to what the director wants them to be, to a great extent.

I think that having them more connected to the board might be something to consider.

Senator ENZI. OK. Thank you.

Ms. Batts, you testified that the PBGC has developed corrective action plans to address serious weaknesses in information technology security and other areas; however, critical details of those plans have yet to be developed.

Would the PBGC benefit from hiring a risk management specialist to help the agency better prepare for future risks facing the agency and the retirement community?

Ms. BATTS. That's an interesting question. Certainly, PBGC has hired external expertise to help with addressing many of the areas of persistent weakness; for example, in its information technology security work.

I'm not aware of the need for such a selection, but that's not something I've thought about. I'm sorry. I just don't really have a—I know that PBGC has reached out to get the expertise that it needs, and they've reached out frequently, through contracts. There's no hesitation to reach out to get that expertise.

Senator ENZI. OK. I appreciate it. My time has expired.

The CHAIRMAN. Thank you.

Senator Franken.

Senator FRANKEN. Thank you, Mr. Chairman.

I find the reporting on the relationship with the contractors a little disturbing. I was wondering what percentage of the workforce—and this can go to anybody—is comprised of contractors.

Ms. BATTS. It's about two-thirds. Right now it's slightly less than two-thirds, but historically, it's run right at about two-thirds.

Senator FRANKEN. OK. Has there been any thought to—because I know, like in the military now, there's a tendency now to stop this dependence on contractors and go back to actually using the military to do the job, because they have a loyalty to the country and to the military; and people who are contractors have a loyalty to making a profit, and to their contractor.

Is there any thought about increasing the number of people who work for the PBGC, and less reliance on contractors?

Ms. BOVBJERG. Back, in 2000 we took a look at this issue. And, so there's arguments, sort of, on both sides. We looked at the ramp-up in contractors at PBGC in the 1990s and the 1980s.

The bankruptcy of Eastern Airlines, Pan Am, they had to get some people in place pretty quickly to process those benefits. So they did that, but that structure has essentially stayed in place.

When we were reporting on this in 2000, we said, "we think you should really review this. Do you need locations in places where there were all these Eastern Airline employees, for example?"

Maybe if you're a virtual organization it doesn't matter. But, we thought they should consider this.

We also wondered—there's an argument for ramping up with contractors when you need them, and then dropping off, which you cannot do with Federal employees. There was that argument when they thought that their workload might kind of decrease.

Senator FRANKEN. But it hasn't. The workload hasn't decreased, right?

Ms. BOVBJERG. It hasn't.

Senator FRANKEN. We're not anticipating it decreasing for a while, are we?

Ms. BOVBJERG. No. It could get much bigger.

Senator FRANKEN. OK, so, this is like when—after the Cold War ended there was going to be this peace dividend, and we reduced the size of the military, and we increased contractors as we needed them; and then found that we were in a war for 9 or 10 years, and relying so much on contractors and wasting a tremendous amount of money on the contractors; and I'm wondering if we're wasting a tremendous amount of money on the contractors who—I'm not hearing great reports on the kind of job they're doing.

Ms. BOVBJERG. OK.

Senator FRANKEN. When——

Ms. BOVBJERG. Something we think they should look at.

They shouldn't just keep going because that's what they've done before.

Senator FRANKEN. Well, there are recommendations to look at things, but who's going to look at them, if you have a board that doesn't meet and a board that's comprised of three cabinet secretaries?

We've talked about the continuity of the board. This is an institutional memory. There's no institutional memory here. How are you going to get anything done if there's no institutional memory. This seems to have to be done soon.

Ms. BATTS. Senator Franken, if I could add, our office has some very recent audit work in this area, and we do have an open recommendation that PBGC take a strategic look and include both the contract and the Federal employee workforce in its human capital planning.

To date, PBGC has provided some alternatives, but hasn't actually agreed to implement that. It's consistent with recommendations made by GAO in the past.

Senator FRANKEN. OK. Can I ask about the long-term plans, or shape of this, of the workforce of the PBGC, because, I saw in the briefings for this hearing that there's worry about, obviously, increased needs in terms of failures in pension accounts; and I know that the role of the PBGC is to encourage defined benefits, but defined benefits are going down; right, in our society?

Is there a curve that's been projected on the role of the PBGC that coincides with what defined benefits in our society, the role they're going to play; in other words, is this going to go up at a certain point and then start to come down again as defined benefits play a lower role?

I know we're trying to encourage defined benefits, but that doesn't seem to be happening. Is there some kind of actuarial look at what the future of the PBGC, in terms of its responsibilities will be, vis-á-vis what the curve of defined benefits are?

Was that clear, because I don't know if it was.

Ms. BOVBJERG. Yes. No, they're not going out that far. As defined benefits decline, there are fewer plans out there; there are still some really big plans with a lot of participants.

So, when PBGC looks at its future, it's looking at the likelihood that those plans are going to go under, and they'll be underfunded at the same time that they will have to take them.

As far as they can look out, they're still paying benefits; they're still potentially taking in underfunded plans.

Senator FRANKEN. OK.

Ms. BOVBJERG. There could be a time, but way down the road.

Senator FRANKEN. Way down the road. Then the idea of perhaps relying less on contractors and bringing more Federal employees into the PBGC as a way of saving money and getting the job done better is not such a bad idea.

Ms. BOVBJERG. It could be a really good idea. They need to consider it. At GAO we cannot tell——

Senator FRANKEN. How long do you have to consider these things? Who would consider them? Would the board consider them? Because the board is incapable of considering much of anything.

Ms. BOVBJERG. The board should. That should be an issue for the board; it's a long-term strategic issue.

Senator FRANKEN. OK.

Mr. PORTER. Senator, if I may, I would just add a point to that, from a practitioner's perspective; from a plan sponsor perspective.

Outsourcing of benefits calculations, in particular, is perhaps one of the most complicated endeavors we have in our society; it's terrible. So if there is a change from status quo to something else, whether it's from one contractor to another, or one contractor back into the government, there has to be a transition plan that may span several years; and at which time there will be duplicative cost and duplicative effort. That's one point I'd like to make.

Second point I'd like to make is that the majority of the plans that have been frozen are sponsored by healthy companies that continue to fund their plans; they're not terminated; they're not being turned over to the PBGC.

Certainly the PBGC has to take into their account what the risk—that they believe the probability that they might be turned over, but it's incumbent on us to continue, and to have policies that encourage these companies to continue to fund them—as they are doing today.

Even though new employees may not be participating, there are hundreds of thousands of employees who are continuing to participate as grandfathered employees in plans that have been frozen. We want those to continue; and those—just because they don't—

aren't available for current employees doesn't mean that they aren't necessarily healthy and are going to be a problem of the PBGC.

Not all of these plans are going to come to the PBGC for their efforts.

Senator FRANKEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and thanks again to all the witnesses for your testimony.

You know, it seems apparent that we need new board and new governance rules and obligations for the board; and also, contract procurement issues have been raised and need to have a lot more attention.

I've got lots of issues and questions.

Ms. Bovbjerg, I was interested in your testimony, talking about overpayments; and you stated that the management of PBGC's benefit determination process did not provide for separate reporting of performance measures for large complex plans; yet these plans are responsible for most long delays and processing in most cases with overpayments.

Can you discuss that?

Ms. BOVBJERG. It can be a long and difficult process to figure out what benefits are owed participants in a plan that PBGC trustees. When we looked at this issue, because a number of people in a former steel company were getting notices from PBGC that they had been overpaid by as much as $50,000.

Now, the odds that they're ever going to actually repay that are very, very slim because they would only lose a small amount of their benefit monthly for that. They probably wouldn't ever get to the point of having repaid it; however, they were counting on a certain benefit level, and then suddenly the sky falls; they're not getting the benefit level, they're getting a lower benefit, and it's reduced a little bit for the overpayment.

After waiting as long as 9 years for your benefit determination, that can be a terrible——

Senator HAGAN. Nine years?

Ms. BOVBJERG. The average is about 3 years, but it can go as long as 9 years for a very large and complex plan, which some of the steel plans were.

When we looked at what causes these overpayments, why these things take so long, it was always these large, complicated plans.

We thought that one way to think about—they made a number of changes that we suggested, but that one way to really hold their own feet to the fire on this was to just keep track of how quickly and how accurately they're calculating benefits for large plans separately from the overall average; and that's something that they haven't been willing to do yet.

Senator HAGAN. Well, I see that as a huge problem.

Mr. Porter, do you have any comments on the overpayment aspect?

Mr. PORTER. Overpayment is a challenge. In any defined benefit—complex point—benefit plan, calculation of a benefit is sometimes exacerbated by a lot of factors that might have occurred 10, 15 years in the past.

I can see the problems; I don't think a defined benefit plan in the private sector would be allowed to go 9 years to fix something. Three years seems like it's outside the normal range; but it is a very difficult challenge, and so something needs to be done, certainly, to make these calculations more quickly so that the people aren't held up like that. That's an incredible amount of time.

Senator HAGAN. I asked Mr. Gotbaum about the premiums. Do you see in your report—Ms. Bovbjerg, did you all talk about the premiums?

Ms. BOVBJERG. Some years ago we looked pretty hard at PBGC's finances; and you know, you do the math; it's premiums——

Senator HAGAN. Right.

Ms. BOVBJERG. Its investment incomes, or its better funding of plans so that if a company goes out of business and the plans come to PBGC, they're better funded; they're more assets associated with them.

The Deficit Reduction Act of 2005, I think, raised premiums; and so it's about—I want to say it's around $40 a participant, the flat rate; and it moves with inflation; and there's another part, it's about $10 for every thousand of underfunding. The underfunded plans have to put in some more as well.

Right after that, the Pension Protection Act in 2006 strengthened the funding rules so that employers who sponsored defined benefit plans would have less time to get to full funding, and had certain range of assumptions that they had to use.

The design was that when plans came to PBGC they would be in better shape; so you wouldn't have the Bethlehem Steels, frankly, who were fully funded 2 years before—close to it—before their bankruptcy. By the time of bankruptcy they were down to 30 or 40 percent.

Those things are designed to balance what flexibility employers need with protecting the PBGC's fiscal integrity.

The problem was, this was all designed to take place at the time of the market meltdown, and companies were under serious stress; so those particular provisions have been delayed in taking effect.

Our belief is that when they do take effect, it will improve funding, and it will mitigate the risk for PBGC. Every paper on the issue of premiums says that they need to be more risk-phased because no insurance company on earth would operate the way that we operate the PBGC.

Senator HAGAN. Mr. Porter, also in your testimony, you talked about the investment policy, and then the assumptions in an older report on the reported deficit.

Mr. PORTER. OK.

Senator HAGAN. About the investment policy, you believe it should be based on a diversified portfolio.

Can you tell me what changes—or we don't really know the investment policy.

Mr. PORTER. No. I certainly don't.

Senator HAGAN. Right.

Mr. PORTER. So I couldn't, therefore, prognosticate on what the changes ought to be. Clearly, there needs to be a balance of all the risks associated; it needs to have some longevity; it needs to be executed in a way that isn't detrimental.

Long-term investments' policies have served the pension community generally very well; and we would like to see some stability in it. There needs to be a balance of plan sponsor's needs because its premiums is going to be the protection of the participants; it has to be the public perception, because unfortunately, PBGC is very public, and the press has a view of what it thinks is right or wrong, as well.

That shouldn't be the driver; the driver should be the overall balance, so that we can maximize the return at an acceptable level of risk.

Senator HAGAN. I guess I'm surprised that we don't see what the investment policy is.

Mr. Chairman, I know my time is out, but I think you've had a good hearing, and we obviously have a lot to do in order to improve the PBGC with going forward; and I know our new director is certainly working on that.

Thank you.

Ms. BOVBJERG. May I jump in for a tiny second?

The CHAIRMAN. Yes.

Ms. BOVBJERG. We have a report underway that looks at PBGC's investment policies and practices over time, and most recently, that's coming out the end of February; and I think that that would answer some of your questions.

Senator HAGAN. Thank you.

The CHAIRMAN. Well, thank you all very much. I thank the panel for being here, and for your testimony, and for your work; and I thank the Senators who have participated here.

As I said, this is another in a series of hearings that we'll be having on this committee regarding the broad overview of retirement programs in America, and what's happening to retirement programs.

This is obviously one big slice of it, right here, the defined benefit pension programs, and the financial security and ability of the PBGC to meet its obligations.

There are other elements of retirement security that this committee's going to be looking at, but certainly things that have come up today regarding PBGC are things that I'm going to be discussing with Senator Enzi and other Senators on this committee to see what action, if any, we want to take.

I think there are some elements that have come out in the testimony today that I think compel us to do something about the continuity and board's expertise, and it is that type of thing that I think we need to take a very close look at.

I'll be discussing that with Senator Enzi and others to see what action we might want to take; not this year, of course, but sometime down the road.

Thank you all very much.

With that, the committee will stand adjourned.

[Additional material follows.]

ADDITIONAL MATERIAL

Prepared Statement of Senator Bingaman

Mr. Chairman, thank you for convening this morning's hearing on an issue essential to the economic security of the nearly 44 million Americans who participate in pension plans overseen and insured by the Pension Benefit Guaranty Corporation.

Although the prevalence of defined benefit plans has been on the wane, those who remain covered by a DB plan deserve protections of a well-managed overseer. Unfortunately, in recent years, the PBGC has not lived up to this mandate. As the Center for Public Integrity has found, over the past 2 years, PBGC has lost Social Security numbers stored on an unsecured storage drive, given erroneous information to lawmakers, and failed its own financial audit. This has led PBGC's own Inspector General, who is with us today, to conclude that "PBGC did not have effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operations."

I am grateful for the deep analysis conducted by many policymakers and independent agencies to identify structural flaws in PBGC's organization that have contributed to mismanagement.

I am particularly appreciative of Senator Kohl's commitment to this issue. His proposal embodies critical reforms: expanding the PBGC Board from three to seven members; requiring the PBGC to meet at least four times yearly; granting the PBGC's advisory committee, its inspector general, and general counsel direct access to the board; and preventing PBGC's director from any involvement in hiring money managers or from "participating in any matter that may have or appear to have a conflict of interest." I look forward to joining with Senator Kohl as a cosponsor of his bill when he reintroduces it in the 112th Congress.

I also look forward to working with you, Mr. Chairman, and with Senator Enzi and all of our colleagues on this committee to move reform legislation forward.

[Whereupon, at 12:03 p.m., the hearing was adjourned.]

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