

**GAO**

Testimony

Before the Special Committee on Aging,  
U.S. Senate

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**PENSION BENEFIT  
GUARANTY  
CORPORATION**

**Financial Challenges  
Highlight Need for  
Improved Governance and  
Management**

Statement of Barbara D. Bovbjerg, Director  
Education, Workforce, and Income Security



**GAO**

Accountability \* Integrity \* Reliability

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Highlights of [GAO-09-702T](#), a testimony before the Senate Special Committee on Aging, U.S. Senate

## Why GAO Did This Study

The Pension Benefit Guaranty Corporation (PBGC) insures the retirement future of nearly 44 million people in over 29,000 private-sector defined benefit pension plans.

In July 2003, GAO designated PBGC's single-employer pension insurance program—its largest insurance program—as “high risk,” including it on GAO's list of major programs that need urgent Congressional attention and agency action. The program remains on the list today with a financial deficit of just over \$11 billion, as of September 2008.

The committee asked GAO to discuss our recent work on PBGC. Specifically, this testimony addresses two issues: (1) PBGC's financial vulnerabilities, and (2) the governance, oversight, and management challenges PBGC faces.

To address these objectives, we are relying on our prior work assessing PBGC's long-term financial challenges, and several reports that we have published over the last two years on PBGC governance and management. GAO has made a number of recommendations and identified matters for Congressional consideration in these reports, and PBGC is implementing some of these recommendations. No new recommendations are being made as part of this testimony.

[View GAO-09-702T or key components.](#)  
For more information, contact Barbara Bovbjerg at (202) 512-7215 or [bovjberg@gao.gov](mailto:bovjberg@gao.gov).

# PENSION BENEFIT GUARANTY CORPORATION

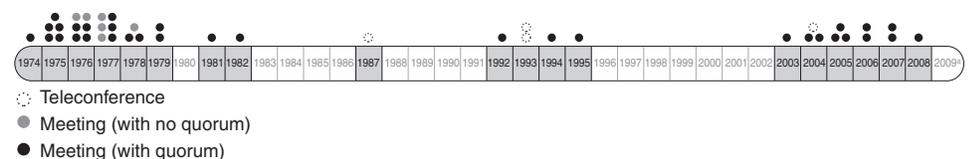
## Financial Challenges Highlight Need for Improved Governance and Management

### What GAO Found

Financial and economic conditions have deteriorated since we last reported on PBGC's finances. While PBGC's deficit improved for fiscal year 2008, the fiscal year ended just prior to the severe market downturn, and this lower deficit may be a product of conditions that no longer exist. As a result, it is likely that PBGC's net position looks different today. Other recent events have also added to PBGC's financial challenges. These events include: recent legislation that grants funding relief to certain sponsors, developments with PBGC's investment policy, and a concern that a wide array of industry sectors—including the automotive sector—are under financial distress and may expose PBGC to future claims. As a result, the potential for automaker pension plan terminations could dramatically increase not only PBGC's deficit, but also its administrative workload.

With mounting financial challenges and the potential for PBGC's workload to dramatically increase, our concerns about PBGC governance and strategic management have become acute, and improvements are needed, now more than ever. PBGC's board has limited time and resources to provide policy direction and oversight. The three-member board includes the Secretary of Labor, as the Chair of the Board, and the Secretaries of Commerce and Treasury. These board members have numerous other responsibilities and are unable to dedicate consistent and comprehensive attention to PBGC. With only 3 members, PBGC's board may not be large enough to include the knowledge needed to direct and oversee PBGC. In fact, the new board members have yet to meet, and there has not been a face-to-face board meeting in the last 15 months. In addition, without an appointed director, PBGC's governance structure is further exposed to challenges. Further, PBGC continues to lack a fully-adopted strategic approach to its acquisition and human capital management needs. Although contract employees comprise two-thirds of PBGC's workforce, PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities.

Number of PBGC Board Meetings 1974 to May 2009



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

Note: 2009 board meeting data is as of May 7, 2009.

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the financial and operational challenges facing the Pension Benefit Guaranty Corporation (PBGC). PBGC operates two pension insurance programs that protect the retirement income of nearly 44 million American workers in over 29,000 private-sector defined benefit (DB) pension plans. We last testified on the challenges facing PBGC in September. At that time we noted that many of the challenges, particularly the financial challenges, facing PBGC are long-term and structural in nature. In fact, we designated PBGC's single-employer pension insurance program, its largest insurance program, as "high risk" in 2003 because of these financial challenges.<sup>1</sup> The program remains on the list today with a projected deficit of just over \$11 billion, as of September 2008. However, recent events, particularly the steep downturn in the financial markets and worsening economic conditions, have likely further eroded PBGC's financial position and have also likely increased the risk that PBGC will have to assume responsibility for the underfunded plans of large, financially-weak employers.

My statement will discuss the (1) PBGC's financial vulnerabilities, and (2) the governance, oversight, and management challenges also facing PBGC. My statement is based on our prior work assessing PBGC's long-term financial challenges, and several reports we have published over the past two years on PBGC governance and management. We conducted our work 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.

In summary, financial and economic conditions have likely only worsened since we last reported on PBGC's finances. While PBGC's deficit improved for fiscal year 2008, the fiscal year ended just prior to the severe market downturn, and it is likely that their net position looks different today. Other events have occurred that also added to PBGC's financial challenges. These events include: recent legislation that grants funding

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

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relief to certain sponsors, developments with PBGC's investment policy, and a concern that a wide array of industry sectors—including the highly visible automotive sector—are under financial distress and may expose PBGC to future claims. As a result, the potential for automaker pension plan terminations could dramatically increase PBGC's deficit, as well as its administrative workload.

With mounting financial challenges and the potential for PBGC's workload to dramatically increase, our concerns about PBGC governance and strategic management have become acute, and improvements are needed, now more than ever. PBGC's board has limited time and resources to provide policy direction and oversight. The board includes the Secretary of Labor, as the Chair of the Board, and the Secretaries of Commerce and Treasury. These board members have numerous other responsibilities, and are unable to dedicate consistent and comprehensive attention to PBGC. With only 3 members, PBGC's board may not be large enough to include the knowledge needed to direct and oversee PBGC. In fact, the new board members have yet to meet, and there has not been a face-to-face board meeting in the last 15 months. PBGC's governance structure is further exposed to challenges as it does not yet have an appointed director. Further, although contract employees comprise two-thirds of PBGC's workforce, PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities. PBGC still lacks a fully-adopted strategic approach to its acquisition and human capital management needs.

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## Background

PBGC was created by the Employee Retirement Income Security Act of 1974 (ERISA)<sup>2</sup> to pay benefits to participants in private DB plans in the event that an employer could not. PBGC may pay benefits, up to specified limits, if a plan does not have sufficient assets itself to pay promised benefits and the sponsoring company is in financial distress. PBGC's single-employer insurance program guarantees benefits up to \$4,500 per month for age-65 retirees of plans terminating in 2009, with lower guarantees for those who retire before age 65. Currently, PBGC insurance covers 44 million participants, including retirees, in over 29,000 DB plans. PBGC pays monthly retirement benefits to more than 640,000 retirees in 3,860 pension plans that have ended, and is responsible for the current and future pensions of about 1.3 million people. ERISA also requires PBGC to

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<sup>2</sup>Pub. L. No. 93-406, 88 Stat. 829 (codified, as amended, at 29 U.S.C. §§ 1001-1461).

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encourage the continuation and maintenance of voluntary private pension plans.

PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of DB plans, recoveries from the companies formerly responsible for the plans, and investment income of assets from pension plans taken over, or “trusteed,” by PBGC. Under current law, other than statutory authority to borrow up to \$100 million from the Treasury Department,<sup>3</sup> no substantial source of funds is available to PBGC if it runs out of money. In the event that PBGC were to exhaust all of its holdings, benefit payments would have to be drastically cut unless Congress were to take action to provide support.<sup>4</sup>

The assets and liabilities that PBGC accumulates from trusteeing plans has increased rapidly over the last 6 years or so. This is largely due to the termination, typically through bankruptcies, of a number of very large, underfunded plan sponsors.<sup>5</sup> In fact, 8 of the top 10 firms presenting claims against PBGC did so from 2003 to 2007. These top 10 claims alone currently account for over 60 percent of all of PBGC’s claims and are concentrated among firms representing the steel and airline industries. Overall, these industries accounted for about three-quarters of PBGC’s total claims and single-employer benefit payments in 2007.

In 2003, GAO designated PBGC’s single-employer program as high-risk, meaning that the program needs urgent Congressional attention and agency action. We specifically noted PBGC’s prior-year net deficit, as well

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<sup>3</sup>29 U.S.C. § 1305(c).

<sup>4</sup>29 U.S.C. § 1302(g)(2).

<sup>5</sup>The termination of a fully funded DB plan is called a standard termination. 29 U.S.C. § 1341(b). Plan sponsors may terminate fully funded plans by purchasing a group annuity contract from an insurance company, under which the insurance company agrees to pay all accrued benefits, or by paying lump-sum benefits to participants if permissible. The termination of an underfunded plan, termed a distress termination, is allowed if the plan sponsor requests the termination and the sponsor satisfies other criteria. 29 U.S.C. § 1341(c). Alternatively, PBGC may initiate an “involuntary” termination. PBGC may institute proceedings to terminate a plan if the plan has not met the minimum funding standard, the plan will be unable to pay benefits when due, a reportable event has occurred, or the possible long-run loss to PBGC with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. 29 U.S.C. § 1342(a).

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as the risk of the termination among large, underfunded pension plans, as reasons for the program's high-risk designation.

As part of our monitoring of PBGC as a high-risk agency we have highlighted additional challenges faced by the single-employer program. Among these concerns were the serious weaknesses that existed with respect to plan funding rules<sup>6</sup> and that PBGC's premium structure and guarantees needed to be re-examined to better reflect the risk posed by various plans.<sup>7</sup> Additionally, the number of single-employer insured DB plans has been rapidly declining, and, among the plans still in operation, many have frozen benefits to some or all participants.<sup>8</sup> Further, the prevalence of plans that are closed to new participants seems to imply that PBGC is likely to see a decline in insured participants, especially as insured participants seem increasingly likely to be retired (as opposed to active or current) workers.

PBGC has remained high-risk with each subsequent report in 2005, 2007, and, most recently, 2009. In our 2007 high risk update we noted that major pension legislation had been enacted which addressed many of the concerns articulated in our previous reports and testimonies on PBGC's financial condition. The Deficit Reduction Act of 2005 (DRA) was signed into law on February 8, 2006 and included provisions to raise flat-rate premiums and create a new, temporary premium for certain terminated

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<sup>6</sup>GAO, *Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules*, [GAO-05-294](#) (Washington, D.C.: May 31, 2005).

<sup>7</sup>GAO, *Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks*, [GAO-04-90](#) (Washington, D.C.: Oct. 29, 2003).

<sup>8</sup>A plan freeze is an amendment to the plan to limit some or all future pension accruals for some or all plan participants. See GAO, *Defined Benefit Pensions: Plan Freezes Affect Millions of Participants and Pose Retirement Income Challenges*, [GAO-08-817](#) (Washington, D.C.: July 21, 2008) and GAO, *Private Pensions: Timely and Accurate Information Is Needed to Identify and Track Frozen Defined Benefit Plans*, [GAO-04-200R](#) (Washington, D.C.: Dec. 17, 2003).

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single-employer plans.<sup>9</sup> Later that year the Pension Protection Act of 2006 (PPA) was enacted; it included a number of provisions aimed at improving plan funding and PBGC finances.<sup>10</sup> The provisions aimed at improving plan funding included such measures as raising the funding targets DB 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. Reforms aimed at shoring up PBGC revenues included a termination premium for some bankrupt sponsors, and limiting PBGC’s guarantee to pay certain benefits. However, the overall impact of PPA remains unclear; PPA did not fully close potential plan funding gaps, and provided special relief to plan sponsors in troubled industries. PBGC’s net financial position improved from 2005 to 2006 because some very large plans that were previously classified as probable terminations were reclassified to a reasonably possible designation as a result of the relief granted to troubled industries such as the airlines.

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## PBGC’s Financial Condition Has Likely Worsened Since September 2008

While PBGC’s deficit improved for fiscal year 2008, the fiscal year ended just prior to the severe market downturn, and it is likely that their net position looks different today. Since we last reported to Congress on PBGC,<sup>11</sup> PBGC issued its fiscal year 2008 financials and reported that the net deficit for its insurance programs was \$11.2 billion.<sup>12</sup> In some ways, this was good news. PBGC’s net deficit reached a peak of \$23.5 billion in 2004 largely as a result of a number of realized and probable claims that

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<sup>9</sup>Pub. L. No. 109-171, § 8101, 120 Stat. 4, 180-83 (codified, as amended, at 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 is \$34 per participant in insured single-employer plans. For multiemployer plans the flat rate premium is \$9 per participant. These rates are adjusted annually by an average-national-wage index. The legislation created a new premium for sponsors of plans that are terminated on an involuntary or distressed termination basis. The required payment is \$1,250 per plan participant, per year, for three years after the termination. For sponsors whose plans were terminated while the program was being reorganized under chapter 11 of the bankruptcy code, the premium would be levied after the sponsor emerges from bankruptcy. Under DRA the premium would not apply to firms that are liquidated by a bankruptcy court or to terminations after December 2010.

<sup>10</sup>Pub. L. No. 109-280, 120 Stat. 780.

<sup>11</sup>GAO, *Pension Benefit Guaranty Corporation: Improvements Needed to Address Financial and Management Challenges*. [GAO-08-1162T](#) (Washington, D.C.: Sept. 24, 2008).

<sup>12</sup>Pension Benefit Guaranty Corporation, *Annual Management Report Fiscal Year 2008*, (Wash. D.C.: Nov. 17, 2008).

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occurred during that year.<sup>13</sup> However, the lower 2008 deficit may be a product of conditions that no longer exist. For example, PBGC's net deficit is a resulting difference between its assets and its liabilities.<sup>14</sup> (See figure 1 for the difference between PBGC assets and liabilities for both insurance programs from 1990 to 2008.) As of PBGC's September 30, 2008 financial statement—even before the severe market downturn in October—PBGC saw an investment return of -6.5 percent over the year, which contributed to diminishing its assets from the prior year by about \$5.5 billion. The net deficit improved, despite the performance of its assets, because of the decrease in its liabilities. According to PBGC, the improvement was due largely to successful negotiations in bankruptcy proceedings, a favorable change in interest factors used to value PBGC's liabilities, and the fact that PBGC saw significant reductions to its liabilities for probable terminations. PBGC has likely seen its net financial condition hurt by increased exposure due to declines in funding levels of many large plans, from the termination of underfunded plans, and by an increase in its liabilities due to a likely decrease in the interest rates used to value its liabilities.<sup>15</sup>

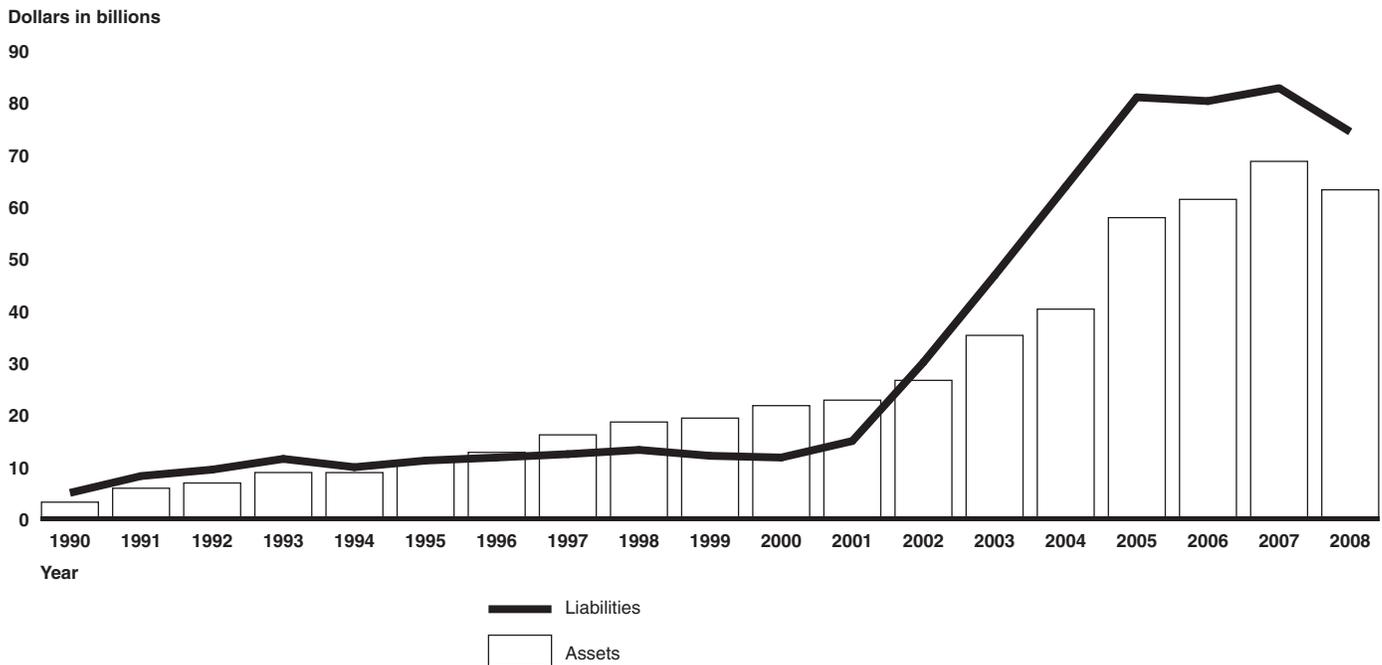
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<sup>13</sup> Claims are the net cost of terminating a pension plan—the gap between its assets and its liabilities.

<sup>14</sup> PBGCs assets are composed of insurance income from sponsors (largely from premiums), income from its investments, and the assets it assumes from failed plans. PBGCs liabilities include the benefit obligations in the form of monthly payments to participants and beneficiaries in terminated defined benefit plans, financial assistance to multiemployer plans, as well as PBGCs operating expenses.

<sup>15</sup> Liability valuations reflect the time value of money—that a dollar in the future is worth less than a dollar today, because the dollar today can be invested and earn interest. Using a lower interest rate will increase the present value of a stream of payments because it implies that, as a smaller amount of investment income will be received, a higher level of assets today will be needed to fund those future payments.

**Figure 1: PBGC Assets and Liabilities, Fiscal Year 1990 to 2008**



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

Note: Figure includes assets and liabilities of single-employer program and multi-employer program. The single-employer program accounts for over 94 percent of all assets and liabilities within each year over this period.

The current economic environment has likely increased the exposure PBGC faces from financially distressed sponsors with large, underfunded plans. The funding of many large plans has likely eroded as a result of the lowered financial health of many sponsors, thereby potentially increasing PBGC's exposure to probable terminations,<sup>16</sup> developments that the most recent estimates may not reflect. Estimating PBGC's future claims has always been difficult to predict over the long-term due to the significant volatility in plan underfunding and sponsor credit quality over time. However, the current economic environment seems to have put sponsors under particular stress.

<sup>16</sup>Probable terminations represent PBGC's best estimate of claims for plans that are likely to terminate in a future year.

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There is likely a wide range of industry sectors that have been affected by the current economic environment, and particularly the automotive sector. For example, the pension plans of Chrysler and General Motors (GM) today pose considerable financial uncertainty to PBGC. In the event that Chrysler or GM cannot continue to maintain their pension plans—such as in the case of liquidation or an asset sale—PBGC may be required to take responsibility for paying the benefits for the plans, which, as of the most current publicly available information, are underfunded by a total of about \$29 billion.<sup>17,18</sup>

Although it is impossible to know what the exact claims to PBGC would be if it took over Chrysler's and GM's pension plans, doing so would likely strain PBGC's resources, because the automakers' plans represent a significant portion of the benefits it insures. Further, from an administrative standpoint, PBGC would be presented with an unprecedented number of assets to manage as well as benefit liabilities to administer. For example, GM's and Chrysler's plans include roughly 900,000 participants, both those receiving benefits now and those who have earned benefits payable in the future, which would increase the total number of PBGC's current or future beneficiaries by nearly 80 percent.<sup>19</sup> Even with Chrysler's bankruptcy and concern about GM's viability, it is not certain that PBGC would take over responsibility for either plan. For example, a number of auto parts suppliers in Chapter 11 with collectively

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<sup>17</sup>Chrysler LLC is currently undergoing reorganization under Chapter 11 of the Bankruptcy Code and will receive financial assistance from the federal government to fund its operations during bankruptcy. According to the Administration, Chrysler's pension plans will be preserved. The Department of Treasury is also providing financial assistance to GM to assist its restructuring efforts, and has given the company until June 1 to develop a credible strategy for achieving viability.

<sup>18</sup>Estimates of pension funding levels vary based on the methods and assumptions used. According to PBGC, GM's plans were underfunded by \$20 billion and Chrysler's by \$9.3 billion on a termination basis as of November 30, 2008, for GM and January 1, 2009, for Chrysler. Termination liability reflects the cost to a company of paying an insurer to meet its pension obligations should the plan terminate. This is calculated by using actuarial assumptions PBGC makes including interest and mortality. Termination liability is often higher than liability calculated for other purposes. According to GM's financial statements, its U.S. pension plans were underfunded by \$13.6 billion as of December 31, 2008; according to information provided by Chrysler, its U.S. pension plans were underfunded by \$3.6 billion as of December 31, 2008.

<sup>19</sup>Additionally, PBGC would pay all the plans' benefit promises, up to certain limits set by statute. These limits mean that some individuals, typically younger retirees, would see reduced benefits.

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bargained pension plans have emerged from reorganization without terminating their pension plans.

While the events surrounding the automakers and their pension plans are clearly an area of concern for the PBGC, the recession has likely affected many industry sectors. Although, PBGC's past claims have been concentrated to industries like steel and airlines, there is cause for concern that future claims will come from a much broader array of industries.

PBGC's insurance programs held \$63 billion in assets as of September 30, 2008, and the Corporation has stated it has sufficient liquidity to meet its obligations for a number of years. However, to the extent additional claims from vulnerable industries markedly increase PBGC's accumulated deficit and decrease its long-run liquidity, there could be pressure for the federal government to provide PBGC financial assistance to avoid reductions in guaranteed payments to retirees or unsustainable increases in the premium burden on sponsors of ongoing plans.

PBGC's overall exposure has increased for additional reasons. The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA),<sup>20</sup> passed in December, grants funding relief to certain sponsors and delays the implementation of certain aspects of the PPA. WRERA makes several technical corrections to PPA and contains provisions designed to help pension plans and plan participants weather the current economic downturn. For a number of sponsors, this legislation may mean lower plan contributions than they would otherwise have had to pay under the phase-in of PPA and, at least temporarily, potentially increase levels of plan underfunding. As we noted in our 2009 high-risk update on PBGC, this legislation is likely to increase PBGC's risk exposure, perhaps significantly.

Finally, PBGC's newly-adopted investment policy may expose the Corporation to additional risk. The new policy reduces the proportion of PBGC assets allocated to fixed-income investments, such as Treasury and corporate bonds; increases its proportional holdings in international equities; and introduces new asset classes, such as private equity, emerging market debt and equities, high-yield fixed income, and private real estate. While the investment policy adopted in 2008 aimed to reduce

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<sup>20</sup>Pub. L. No 110-455, 122. Stat. 5036.

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PBGC's deficit by investing in assets with a greater expected return, in a report last summer, we found that the new allocation will likely carry more risk than acknowledged by PBGC's analysis.<sup>21</sup>

Our assessment found that, although returns are indeed likely to grow with the new allocation, the risks are likely higher as well. Although it is important that the PBGC consider ways to optimize its portfolio, including higher return and diversification strategies, the agency faces unique challenges, such as PBGC's need for access to cash in the short-term to pay benefits, which could further increase the risks it faces with any investment strategy that allocates significant portions of the portfolio to volatile or illiquid assets. According to PBGC the new allocation will be sufficiently diversified to mitigate the expected risks associated with the higher expected return. PBGC also asserted that it should involve less risk than the previous policy. The Congressional Budget Office has also pointed out such risks, saying that "the new strategy...increases the risk that PBGC will not have sufficient assets to cover retirees' benefit payments when the economy and financial markets are weak."<sup>22</sup>

PBGC has only implemented portions of the policy. PBGC told us that it has begun the process of reducing the percentage of its assets in fixed-income investments, but it has not yet begun to increase its portfolio of certain asset classes, specifically private equity and real estate. PBGC also told us that the process it follows for its current implementation of the investment policy follows industry best practices for large transactions.<sup>23</sup> However, PBGC officials also told us that the intended asset allocation targets set by the current implementation of this policy could easily be derailed if PBGC is required to assume the assets of very large and severely underfunded sponsors.

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<sup>21</sup>GAO, *PBGC Assets: Implementation of New Investment Policy Will Need Stronger Board Oversight*, GAO-08-667 (Washington, D.C.: July 17, 2008).

<sup>22</sup>Congressional Budget Office, "A Review of the Pension Benefit Guaranty Corporation's New Investment Strategy," Letter to the Honorable George Miller (Wash. D.C.: April 24, 2008).

<sup>23</sup>These best practices include Chartered Financial Analyst Institute's Global Investment Performance Standards.

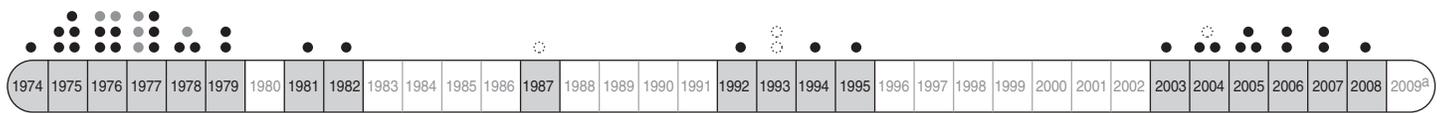
# Improvements Needed to PBGC's Governance and Management

## PBGC's Governance Structure Needs Improvement

PBGC's board has limited time and resources to provide policy direction and oversight.<sup>24</sup> PBGC's three-member board, established by ERISA, includes only the Secretary of Labor, as the Chair of the Board, and the Secretaries of Commerce and Treasury. We noted that the board members have designated officials and staff within their respective agencies to conduct much of the work on their behalf and relied mostly on PBGC's management to inform these board members' representatives of pending issues. PBGC's board members have numerous other responsibilities in their roles as cabinet secretaries and have been unable to dedicate consistent and comprehensive attention to PBGC.

Since PBGC's inception, the board has met infrequently. In 2003, after several high-profile pension plan terminations, PBGC's board began meeting twice a year (see figure 2). PBGC officials told us that it is a challenge to find a time when all three cabinet secretaries are able to meet, and in several instances the board members' representatives officially met in their place. Currently, the PBGC board has not met face-to-face in over one year—since February 2008.

**Figure 2: Number of PBGC Board Meetings 1974 to May 2009**



- Teleconference
- Meeting (with no quorum)
- Meeting (with quorum)

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

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

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Note: 2009 board meeting data is as of May 7, 2009.

While the PBGC board has met more frequently since 2003, very little time is spent on addressing strategic and operational issues. According to corporate governance guidelines, boards should meet regularly and focus principally on broader issues, such as corporate philosophy and mission, broad policy, strategic management, oversight and monitoring of management, and company performance against business plans.<sup>25</sup> However, our review of the board's recorded minutes found that although some meetings devoted a portion of time to certain strategic and operational issues, such as investment policy, the financial status of PBGC's insurance programs, and outside audit reviews, the board meetings generally only lasted about an hour.

The size and composition of PBGC's board does not meet corporate governance guidelines. According to corporate governance guidelines published by The Conference Board,<sup>26</sup> 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 did not identify any other government corporations with boards as small as at PBGC. Government corporations' boards averaged about 7 members, with one having as many as 15. In addition, PBGC is also exposed to challenges as the board, board members' representatives, and the director have changed with the recent presidential transition, limiting the board's institutional knowledge of the Corporation.

The revision of PBGC's investment policy provides an example of the need for an active board to help oversee the Corporation's challenges and strategic vision.<sup>27</sup> We found that PBGC board's 2004 and 2006 investment policy was not fully implemented. While the board assigned responsibility to PBGC for reducing equity holdings to a range of 15 to 25 percent of total investment, by 2008 the policy goal had not been met. Although the PBGC

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

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

<sup>27</sup>See [GAO-08-667](#).

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director and staff kept the board apprised of investment performance and asset allocation, we found no indication that the board had approved the deviation from its established policy or expected PBGC to continue to meet policy objectives. While PBGC's Board revised the investment policy in February 2008, the board has not held a meeting to discuss the new policy's implementation even though there has been a serious downturn in investment markets. In May 2009, PBGC officials told us that they have kept the new Board members—the Secretary of Labor, along with officials from the Departments of Commerce and Treasury—apprised of the progress in implementing the new investment policy.

In our July 2007 report on PBGC's governance structure, we asked Congress to consider expanding PBGC's board of directors, to appoint additional members who possess knowledge and expertise useful to PBGC's responsibilities and can provide needed attention.<sup>28</sup> Further, dedicating staff that are independent of PBGC's executive management and have relevant pension and financial expertise to solely support the board's policy and oversight activities may be warranted. In response to our finding, PBGC contracted with a consulting firm to identify and review governance models and provide a background report to assist the board in its review of alternative corporate governance structures. The consulting firm's final report describes the advantages and disadvantages of the corporate board structures and governance practices of other government corporations and select private sector companies, and concludes that there are several viable alternatives for PBGC's governance structure and practices.

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## As PBGC Relies Heavily on Its' Contractor and Federal Workforce, A More Strategic Approach Is Needed

Although two-thirds of PBGC's workforce includes contractor employees, PBGC's strategic planning generally does not recognize contracting as a major aspect of PBGC activities (see figure 3).<sup>29</sup> 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

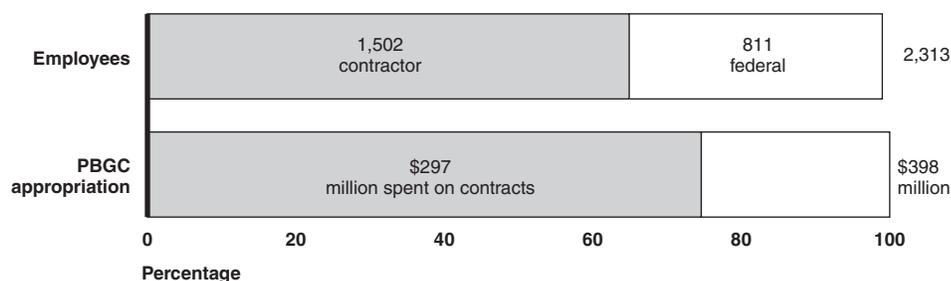
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<sup>28</sup>See [GAO-07-808](#).

<sup>29</sup> GAO, *Pension Benefit Guaranty Corporation: Some Steps Have Been Taken to Improve Contracting, but a More Strategic Approach Is Needed*, [GAO-08-871](#) (Washington, D.C.: Aug. 18, 2008) and GAO, *Pension Benefit Guaranty Corporation: A More Strategic Approach Could Improve Human Capital Management*, [GAO-08-624](#) (Washington, D.C.: June 12, 2008).

technology. As PBGC's workload grew due to the significant number of large pension plan terminations, PBGC relied on contractors to supplement its workforce, acknowledging that it has difficulty anticipating workloads due to unpredictable economic conditions.

**Figure 3: PBGC Overall Versus Contractor Spending and Personnel, Fiscal Year 2007**



Source: PBGC.

Last summer we reported that PBGC had begun to improve some of its contracting practices by updating contracting policies and processes, upgrading the skills of Procurement Department staff, and better tracking contracting data. While we reported that PBGC had begun to implement performance-based contracting that offers the potential for better contract outcomes, PBGC officials recently told us that the new field benefit administration contracts will not be performance-based.

PBGC lacks a strategic approach to its acquisition and human capital management needs. PBGC's strategic plan does not document how the acquisition function supports the agency's missions and goals. Further, although contracting is essential to PBGC's mission, we found that the Procurement Department is not included in corporate-level strategic planning. Based on these findings, we recommended that PBGC revise its strategic plan to reflect the importance of contracting and to project its vision of future contract use, and ensure that PBGC's procurement department is included in agency-wide strategic planning. (Appendix I includes selected GAO recommendations on PBGC Governance and Management). PBGC disagreed with our recommendation to reflect the importance of contracting and incorporate its vision for future contractor use in its strategic planning documents, as it believes its recently issued strategic plan is sufficiently comprehensive. However, PBGC's strategic plan only briefly mentions performance-based contracting, flexible staffing, and metrics for specific contracts, and therefore we believe that it

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does not reflect the important role contracting is playing in achieving PBGC's mission.

PBGC also needs a more strategic approach for improving human capital management. We found that PBGC's draft strategic human capital plan does not provide detailed plans for obtaining contract support or managing the workload fluctuations. While PBGC has made progress in its human capital management approach by taking steps to improve its human capital planning and practices—such as drafting a succession management plan—the Corporation lacked a formal, comprehensive human capital strategy, articulated in a formal human capital plan that includes human capital policies, programs, and practices. PBGC is generally able to hire staff in its key occupations—such as accountants, actuaries, and attorneys—and retain them at rates similar to those of the rest of the federal government. However, PBGC has had some difficulty hiring and retaining staff for specific occupations and positions, including executives and senior financial analysts. Since our report, PBGC officials told us that they have provided a human capital plan to the Office of Personnel Management (OPM) and are awaiting OPM feedback.

The need for a strategic approach to acquisition and human capital management is essential to ensure that PBGC is able to manage the administrative fluctuations of a pension insurance corporation. As noted earlier, General Motor's and Chrysler's plans include roughly 900,000 participants, both those receiving benefits now and those who have earned benefits payable in the future. These participants, if brought under PBGC administration, would raise the number of PBGC's current or future beneficiary population by roughly 80 percent. While it is uncertain whether an automaker plan would ever be assumed by PBGC, the concentration of large numbers of plan beneficiaries among just two sponsors illustrates the potential for a sudden and unprecedented administrative workload at PBGC.

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## Conclusions

While PBGC has been on our High Risk list since 2003—and many of its challenges are long-term in nature—the recession and market down-turn has magnified the challenges it faces. When we last reported on PBGC's financial challenges in September, we specifically mentioned the change in investment policy as a key challenge going forward. This is still the case, but even more recent events, such as legislative changes and the plight of the automakers and other financially weak sponsors in other industries, have the potential to expose PBGC to claims of a potentially unprecedented magnitude.

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While many of the financial challenges are a result of long-term weaknesses that are in many ways structural, PBGC does have some degree of control over challenges it faces with respect to governance, oversight, and management. GAO has made many recommendations in these areas, but given the potentially immense financial challenges the Corporation faces, the need to act is only growing. It is unfortunate that, during a time of financial crisis, the PBGC board has not met in 15 months. However, PBGC not only needs a board that meets regularly, but also a board that can be active and commit the time to understanding the weight and urgency of the issues facing the Corporation. Ideally, a more robust board structure would be in place as soon as possible so that the board can address current challenges and anticipate new ones. The current situation has important implications for all PBGC stakeholders: plan sponsors, insured participants, insured beneficiaries, as well as the government and, ultimately, the taxpayers. PBGC should not have to take on significant, additional claims from severely underfunded pension plans before situation is recognized.

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Chairman Kohl, Senator Martinez, and Members of the Committee, this concludes my prepared statement. I would be happy to respond to any questions you may have.

# Appendix I: Selected GAO Recommendations on PBGC Governance and Strategic Management

**Table 1: GAO Governance Recommendations and PBGC’s Actions Taken**

GAO Observation	GAO Recommendation to PBGC	PBGC Actions
<p>PBGC has heavy use of contractors— with three-quarters of its operational budget currently being spent on contracting. While PBGC has made efforts to improve its acquisition infrastructure, it has not developed a strategic approach to its contracting process.</p>	<p>The Director of PBGC revise its strategic plan to reflect PBGC’s use of contractors, project its vision of future contractor use, and better link staffing and contracting decisions at the corporate level.</p>	<ul style="list-style-type: none"> <li>• PBGC believes its current strategic plan is sufficiently comprehensive to address the recommendation. In response, GAO stated that the strategic plan only briefly mentions performance-based contracting, flexible staffing and metrics for specific contracts, and therefore it does not reflect the important role contracting is playing in achieving PBGC’s mission.</li> </ul>
<p>The degree of the risk associated with PBGC’s new investment policy is unclear. Implementing PBGC’s new investment policy requires that the board have useful accountability measures to conduct careful oversight and to ensure that PBGC achieves its policy goals, such as protecting the pension benefits of retirees.</p>	<ul style="list-style-type: none"> <li>• The PBGC board should require PBGC director to formally submit an implementation plan that outlines accountability measure for carrying out the new investment policy.</li> <li>• Document the board’s agreement or disagreement with any deviations from the policy implementation plan.</li> <li>• The PBGC board should require the PBGC director to report periodically on the progress towards meeting the objectives, milestones, and time frames in the plan.</li> <li>• PBGC should conduct sensitivity analyses before implementing the new policy. These analyses should use a variety of assumptions of the risks and returns of the new allocation that incorporates assets, liabilities, and funded position.</li> </ul>	<ul style="list-style-type: none"> <li>• The PBGC director has submitted the implementation plan to the PBGC board.</li> <li>• The Board has not met since the new policy was approved.</li> <li>• PGBC officials told us they are keeping the Secretary of Labor, as well as officials at the Departments of Treasury and Commerce, apprised of their progress.</li> <li>• PBGC officials report they are implementing a risk management system and plan to stress-test once it is in place.</li> </ul>
<p>PBGC may face workforce challenges regarding key staff experience, retirement eligibility, and compensation limitations. It has has taken some steps to strategically manage its workforce, but has not prepared for possible workforce and compensation challenges.</p>	<ul style="list-style-type: none"> <li>• Integrate formal workforce and succession planning components as part of the Corporation’s efforts in developing a formal strategic planning approach to managing its workforce.</li> <li>• Systematically collect and analyze workforce data and integrate the results of such analyses into its workforce planning efforts.</li> <li>• Fully explore with the Office of Personnel Management and Office of Management and Budget all compensation options currently available to determine and document what options are appropriate and applicable within its statutory authority.</li> </ul>	<ul style="list-style-type: none"> <li>• PBGC officials report that a human capital plan and student-loan certification are with the Office of Personnel Management and the agency is waiting for feedback.</li> </ul>

GAO Observation	GAO Recommendation to PBGC	PBGC Actions
<p>PBGC is directed and overseen by one of the smallest and least diverse boards of directors, even though it is financially one of the largest Corporations within the federal government.</p>	<ul style="list-style-type: none"> <li data-bbox="521 464 1003 569">• Establish policies, procedures, and mechanisms for providing oversight of PBGC that are consistent with corporate governance guidelines.</li> <li data-bbox="521 600 1003 737">• Establish formal guidelines that articulate the authorities of the Board Chair and the Department of Labor, the other board members and their respective departments, and PBGC's Director.</li> </ul>	<ul style="list-style-type: none"> <li data-bbox="1032 464 1516 600">• PBGC contracted with a firm to identify and review governance models and provide a background report to assist the board in its review of alternative government structures.</li> <li data-bbox="1032 600 1516 737">• PBGC revised the Corporation's bylaws, specifically delineating the roles and responsibilities of board members, representatives, director, and senior management.</li> </ul>

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# Appendix II: Selected GAO Reports and Testimonies Related to the Pension Benefit Guaranty Corporation

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*High Risk Series: An Update.* [GAO-09-271](#). Washington, D.C.: January 2009.

*Pension Benefit Guaranty Corporation: Improvements Needed to Address Financial and Management Challenges.* [GAO-08-1162T](#). Washington, D.C.: September 24, 2008.

*Pension Benefit Guaranty Corporation: Need for Improved Oversight Persists.* [GAO-08-1062](#). Washington, D.C.: September 10, 2008.

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

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

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

*High Risk Series: An Update.* [GAO-07-310](#). Washington, D.C.: January 2007.

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

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

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

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

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

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

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

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

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

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# Appendix III: Contacts and Staff Acknowledgments

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

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