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Report to the Chairman, Committee on Education and Labor, House of Representatives

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PRIVATE PENSIONS

Sponsors of 10 Underfunded Plans Paid Executives Approximately $350 Million in Compensation Shortly Before Termination

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GAO-10-77

Highlights

Highlights of GAO-10-77, a report to the Chairman, Committee on Education and Labor, House of Representatives

PRIVATE PENSIONS

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Why GAO Did This Study

When sponsors terminate underfunded plans during bankruptcy, it can deplete resources of the Pension Benefit Guaranty Corporation (PBGC), which protects the pensions of almost 44 million American workers and retirees who participate in over 29,000 defined benefit pension plans. In 2009, PBGC reported an estimated deficit of over $30 billion. GAO was asked to determine what pay and other compensation executives received in the years preceding their company's termination of an underfunded defined benefit pension plan.

To identify case study examples GAO analyzed a listing of the 1,246 underfunded plans that were terminated from 1999 to 2008 and selected public companies with large unfunded liabilities, large unfunded liabilities per participant, and a large number of plan participants. GAO reviewed documents provided by companies and executives, and interviewed PBGC and company officials. GAO also reviewed Securities and Exchange Commission (SEC) filings and PBGC documents disclosing plan underfunding at the time of termination and missed contributions. Executive compensation figures may be understated because some company executives could not be located, did not respond to document requests, declined interviews, and did not give GAO access to their tax records.

View GAO-10-77 or key components.
For more information, contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

What GAO Found

GAO found that 40 executives for 10 companies received approximately $350 million in pay and other compensation in the years leading up to the termination of their companies' underfunded pension plans. GAO identified salaries, bonuses, and benefits provided to small groups of high-ranking executives at these companies during the 5 years leading up to the termination of their pension plans. For example, beyond the tens of millions in base salaries received, GAO found that executives also received millions of dollars in stock awards, income tax reimbursements, retention bonuses, severance packages, and supplemental executive-only retirement plans.

Case Study Plan Details and Executive Compensation

Industry	Pension details[a]	Compensation details
Airline	122,556 participants $7.8 billion underfunded	Company missed nearly $1 billion in required pension contributions while awarding its top 3 executives over $50 million in salary, bonuses, stock, and supplemental retirement benefits.
Airline	61,296 participants $2.8 billion underfunded	Over a period of 8 years, company went through 2 bankruptcies and 4 CEOs, who collectively received over $120 million in salaries, bonuses, severance packages, and supplemental retirement benefits.
Electronics	10,593 participants $318 million underfunded	Company's top 3 executives received nearly $8 million in salary and bonuses, along with over $8 million in other benefits, such as tax reimbursements and car allowances for themselves and family members.
Insurance	7,718 participants $121 million underfunded	Company paid its 2 top executives nearly $20 million each in salary and bonuses, while providing millions in additional benefits, such as personal use of corporate aircraft for family vacations to Europe, millions of dollars in life insurance, and millions of stock options.

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

[a]Underfunded amounts and funding percentage were provided by PBGC and represent the unfunded guaranteed benefits payable, as calculated on a termination basis.

In some cases, plan participants had their benefits reduced due to the underfunding of the plan when it was terminated. For example, a retired pilot saw his monthly pension payment reduced by two-thirds. The reduction in benefits occurred because federal law caps the benefits PBGC can guarantee when it takes over an underfunded pension plan. In addition, PBGC has no oversight power with regard to executive compensation prior to a company's bankruptcy. During bankruptcy, executive compensation must be approved by the bankruptcy court, and after this approval PBGC has extremely limited ability to recover those payments to executives. GAO did not find any illegal activity with respect to executive compensation on the part of either the 10 companies or the 40 executives under review.

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Abbreviations

BAPCPA	Bankruptcy Abuse Prevention and Consumer Protection Act of 2005
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIGIE	Council of the Inspectors General on Integrity and Efficiency
COO	Chief Operating Officer
ERISA	Employee Retirement Income Security Act of 1974
FSA	funding standard account
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation
PPA	Pension Protection Act
SEC	Securities and Exchange Commission

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United States Government Accountability Office
Washington, DC 20548

October 21, 2009

The Honorable George Miller
Chairman
Committee on Education and Labor
House of Representatives

Dear Mr. Chairman:

The Pension Benefit Guaranty Corporation's (PBGC) mission is to protect the pensions of almost 44 million American workers and retirees who participate in more than 29,000 defined benefit pension plans.[1] These plans are sponsored by a wide range of employers, including large companies with over 100,000 covered participants, and small ones which may have as few as a dozen participants. PBGC is responsible for the current and future pensions of about 1.3 million people even though their sponsor companies may no longer be in business.

In 2003, GAO placed PBGC on its high-risk list due, in part, to the significant underfunding of large plans in struggling industries.[2] In May 2009, PBGC's Acting Director testified before the Senate Special Committee on Aging that through the first two quarters of 2009, PBGC's estimated deficit had tripled to reach $33.5 billion, due largely to an increase in completed and probable plan terminations and a decrease in interest rates. Given the recent decline in global financial markets and increase in corporate bankruptcies, PBGC's deficit will likely continue to increase, with implications for PBGC's financial position. In this context, we were asked to determine what pay and other benefits selected executives received in the years preceding their company's termination of an underfunded defined benefit pension plan.

To determine pay and other benefits received by selected executives, we first obtained data from PBGC to identify companies whose underfunded

[1]A defined benefit pension plan is a type of plan where a sponsor provides a guaranteed benefit to an employee (generally expressed as a monthly benefit) based on a formula that generally combines salary and years of service to the company. This report is concerned only with single-employer defined benefit pension plans.

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

plans had been terminated in the past 10 years.[3] We focused on identifying companies that (1) were publicly traded prior to the termination of their pension plan(s), (2) had significant unfunded pension liabilities on a termination basis ($100 million or more), (3) had a high unfunded liability per plan participant ratio ($10,000 or more per participant), and (4) had more than 5,000 plan participants. Of the 1,246 underfunded plans terminated from 1999 to 2008, we selected 10 companies from approximately 30 companies that sponsored plans which met our criteria. We then requested and reviewed documents provided by selected companies related to the compensation of their executives. We reviewed Securities and Exchange Commission (SEC) filings and PBGC documents disclosing missed contributions and plan underfunding at the time of termination. We also interviewed PBGC and company officials, and plan participants. In addition, we requested documentation from all selected executives under review, including tax returns. We attempted to interview all selected executives, but some could not be reached or declined our interview requests.

Findings related to executive pay and benefits were limited by the availability of public documents and information voluntarily provided by companies, executives, and other entities (e.g., professional sports teams, golf clubs). Because some companies and executives did not provide information, declined to be interviewed, and/or did not consent to granting GAO access to copies of their tax returns from the Internal Revenue Service (IRS), we were not able to document all details concerning pay and benefits received beyond the details available in public documents or otherwise voluntarily provided. Thus, the executive compensation information in this report represents what we were able to determine and may be understated. All values listed for restricted stock awards were determined by reviewing SEC filings which list the value of stock awards as of the date of the award, and therefore may not represent their ultimate exercised value.[4] We did not attempt to determine the market value of stock options at the time of their award, nor their exercised value. We limited our review to the time period beginning 5 years prior to a

[3]For the purposes of this report, executive compensation is defined as any item of value given in consideration for services rendered in the form of employment that is taxable either immediately or on a future date.

[4]Restricted stocks are securities acquired in unregistered, private sales from the issuer or from an affiliate of the issuer. Before selling any restricted securities in the marketplace, they must be held for a certain period of time, generally 6 months.

company's first pension plan termination and ending with the company's final pension plan termination. Since some companies terminated multiple pension plans over a period of time, for those companies our review may cover more than 5 years. Due to the high turnover of executives at these companies, information regarding the total compensation of the executives discussed in this report may not have been available for the entire time period under review. The 10 case studies presented in this report were selected based on the criteria listed above and do not necessarily represent the magnitude or makeup of compensation provided to all executives. For a complete discussion of our scope and methodology, please see appendix I.

We conducted our audit and investigative work from January 2009 through September 2009. We conducted our audit work in accordance with U.S. 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings based on our objectives. We performed our investigative work in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

In written comments on a draft of this report, PBGC agreed with our assessment that the Employee Retirement Income Security Act of 1974 (ERISA) does not provide it with any oversight power regarding payments to company executives prior to a company's bankruptcy.[5] Further, PBGC agreed that it has limited power over executive compensation during bankruptcy, as such payments are under the purview of the bankruptcy court. See the Agency Comments and Our Evaluation section of this report for a more detailed discussion of PBGC's comments. We have reprinted PBGC's written comments in appendix II.

Background

PBGC was established by ERISA to pay participants in private defined benefit plans in the event that the sponsor could not.[6] PBGC is financed through insurance premiums paid by sponsors and by investment returns

[5]Pub. L. 93-406, 88 Stat. 829 (codified as amended in sections of 29 U.S.C.).

[6]Some defined benefit plans are not covered by PBGC insurance. Such plans include, for example, those sponsored by professional service employers, such as physicians and lawyers, with 25 or fewer active participants.

on held assets. Sponsors are responsible for making legally required contributions to pension trust funds that are intended to be sufficient to fund the promised benefits over time. Plan assets are then invested on behalf of participating employees.[7] The precise calculations for determining annual minimum funding requirements are set forth in ERISA, and compliance is monitored by the IRS. These requirements are designed to provide reasonable assurance that a plan's assets will be sufficient to fund the accrued benefits owed to participants when they retire.

In 2005, we found that, of the 100 largest defined benefit pension plans (including many underfunded plans), on average 62.5 percent had received no cash contributions each year from 1995 to 2002.[8] These plans were able to meet minimum funding requirements through the use of accounting credits. Compliance with the minimum funding requirements is recorded through the plan's funding standard account (FSA). The FSA tracks events that affect the financial health of a plan during that plan year: credits, which reflect improvements to the plan's assets, such as contributions, amortized experience gains, and interest; and charges, which reflect an increase in the plan's financial requirements, such as the plan's normal cost and amortized charges such as the initial actuarial liability, experience losses, and increases in a plan's benefit formula. If FSA credits exceed charges in a given plan year, the plan's FSA registers a net increase. Compliance with the minimum funding standard requires that the FSA balance at the end of the year is non-negative. An existing credit balance accrues interest and may be drawn upon to help satisfy minimum funding requirements for future plan years, and may offset the need for future cash contributions.[9] In 2006, Congress enacted the Pension Protection Act (PPA) to address some identified deficiencies in funding requirements.[10] Because these changes in funding requirements are applicable to plan years beginning after 2007, we are unable to comment on what impact, if any, the act would have had on our case studies.

[7]Contributions may be made in cash or through the use of accounting credits associated with events such as returns on assets in excess of those assumed for funding purposes.

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

[9]Plan sponsors may request and receive waivers from IRS of certain annual funding requirements. These waivers allow a sponsor demonstrating hardship to postpone a required minimum contribution over a set future period.

[10]Pub. L. 109-280, 120 Stat. 780 (codified as amended in scattered sections of 29 and 26 U.S.C.).

For defined benefit plans, the accrued benefit is the amount that the plan participants would receive as a life annuity beginning at the normal retirement age, as defined by the plan. It is determined by a plan's benefit formula and is recalculated annually as participants complete an additional year of service. ERISA requires sponsors to provide information to the federal government regarding plan benefits, summary financial information, and funding information. Sponsors must estimate their liabilities each year to determine whether their plans are fully funded or underfunded, with the assumption that the sponsor will continue to maintain the plan in its current form for the foreseeable future.[11]

If a sponsor needs to terminate a plan, it must conduct a valuation of plan assets and liabilities to determine whether it is fully funded.[12] The valuation assumes that no further benefits will accrue and no further contributions will be made. If this valuation finds the plan to be underfunded, the sponsor must meet certain criteria set by ERISA in order to file a claim with PBGC.[13] If the sponsor meets these criteria, PBGC becomes trustee of the plan and will assume responsibility for paying guaranteed benefits to plan participants. However, payments to an individual beneficiary are subject to a maximum annual dollar limit, as set in accordance with ERISA. For 2009, this limit is $54,000.[14]

[11]An underfunded plan does not necessarily indicate that the sponsor is unable to pay current benefits. Underfunding means that the plan does not currently have enough assets to pay all accrued benefits, the majority of which will be paid in the future, under the given actuarial assumptions about asset rate of return, retirement age, mortality, and other factors that affect the amount and timing of benefits.

[12]If a plan is fully funded at termination, the sponsor may pursue a standard termination, in which the plan assets are immediately distributed to plan participants as lump sums or annuities.

[13]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 (such as ongoing bankruptcy proceedings). Alternatively, PBGC may initiate an "involuntary" termination. Under such a termination, PBGC will institute proceedings to terminate a plan because 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 be expected to increase unreasonably if the plan is not terminated. See 29 U.S.C. 1342(a).

[14]Some participants in PBGC-trusteed plans receive benefits that exceed the PBGC guarantee level. This can occur if the plan has sufficient assets to fund benefits above the guarantee or if PBGC recovers, or is deemed to recover, additional funds from the plan sponsor through bankruptcy proceedings. In addition, PBGC's maximum limits assume a retirement age of 65. Individuals retiring prior to age 65 are subject to a reduced annual limit, and individuals retiring after age 65 have an increased limit.

Executives at 10 Companies Received Approximately $350 Million in Compensation

Executives at 10 companies received approximately $350 million in pay and other benefits in the years leading up to the termination of their companies' underfunded pension plans. We identified the salaries, bonuses, and benefits provided to small groups of high-ranking executives at these companies. Executives at some companies received salaries in excess of $10 million dollars in the years leading up to bankruptcy. We also found that some executives at these companies received millions of dollars combined in other financial benefits such as income tax reimbursements,[15] retention bonuses, severance packages, split-dollar life insurance,[16] and supplemental retirement plans.[17] Along with financial compensation received, some executives were provided other benefits such as apartments, personal trips on company airplanes and helicopters, club memberships, legal fee reimbursement, and automobiles. We did not attempt to determine whether these benefits were customary. Further, for each of the 10 selected companies, at least one executive we reviewed sat on the company's Board of Directors. We did not find any illegal activity related to executive compensation on the part of either the 10 companies or the 40 executives under review.

Table 1 shows details of our 10 case study companies where we reviewed salaries, bonuses, and benefits paid to executives.[18] Some companies sponsored multiple plans which were terminated; for these companies the details of their pension plans are presented in aggregate. Further detail on 4 of these cases follows the table.

[15]Income tax reimbursements are provided to executives in order to ensure that other taxable benefits have a net-zero effect on the executive's annual income taxes.

[16]Split-dollar insurance is a method of paying for insurance by splitting the premiums and proceeds between the employer and the employee. Employees may benefit through tax-free withdrawals or tax-free policy loans.

[17]Supplemental retirement plans include defined contribution plans, individual trust payments, and certain types of deferred compensation. These benefits are commonly provided to executives in recognition of the fact that their benefits under a tax-qualified defined benefit plan are limited by tax considerations.

[18]The compensation described in each of these case studies was paid prior to the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Pub. L. 109-8 Stat. 23 (codified as amended in various sections of 11 U.S.C.). BAPCPA imposes restrictions on payments to executives of companies in bankruptcy.

Table 1: Case Studies Show Executive Compensation

Case no.	Industry/ Termination date(s)	Pension details[a, b]	Total compensation received by executives	Benefits received by executives[c]
1	Airline – Dec. 2004; Mar. 2005; June 2005	• 122,556 participants[d] • $7.8 billion underfunded[d] • 40% funded at termination[d] • $978.8 million in missed or waived pension contributions[d]	• $55.5 million to 3 executives (includes $14.8 million in salary and cash bonuses)	• Over $30 million in stock. • Personal retirement benefits of more than $7.5 million. • Unlimited free travel, with reimbursement of related income taxes.
2	Airline – Mar. 2003; Jan. 2005	• 61,296 participants[d] • $2.8 billion underfunded[d] • 37% funded at termination[d] • $206.8 million in missed or waived pension contributions[d]	• $120.4 million to 4 executives (includes $9.9 million in salary and cash bonuses)	• Stock worth over $40 million, along with nearly $30 million in reimbursement of related income taxes. • Nearly $150,000 in automobile expenses.
3	Electronics – July 2002	• 10,593 participants • $318 million underfunded • 67% funded at termination • No missed or waived pension contributions	• $16.1 million to 3 executives (includes $7.7 million in salary and cash bonuses)	• Nearly 1 million stock options. • Usage of company car. • Over $8 million in other benefits, such as rent and travel reimbursements.
4	Insurance – Feb. 2002; Jan. 2004	• 7,718 participants • $121 million underfunded • 54% funded at termination • $29.2 million in missed or waived pension contributions	• $69.7 million to 5 executives (includes $59.3 million in salary and cash bonuses)	• Over $10 million in other benefits, including over $3.5 million in split-dollar life insurance. • Use of company plane and helicopter for personal travel valued at over $200,000 to locations including Greece, China, Spain, Hawaii, and Puerto Rico.
5	Manufacturing – Sep. 2002	• 7,941 participants • $128 million underfunded • 47% funded at termination • No missed or waived pension contributions	• $23.7 million to 5 executives (includes $12.0 million in salary and cash bonuses)	• The company's new senior management team received nearly $4 million in bonuses upon the company's emergence from bankruptcy in 1998.
6	Steel – June 2002	• 9,322 participants • $193 million underfunded • 28% funded at termination • $28.8 million in missed or waived pension contributions	• $8.7 million to 2 executives (includes 7.6 million in salary and cash bonuses)	• Retiring Chief Executive Officer (CEO) received severance package of 2 years salary and benefits, valued at approximately $800,000. • Incoming Chief Operating Officer (COO) received signing and retention bonuses upon hiring totaling $350,000.

Case no.	Industry/ Termination date(s)	Pension details[a, b]	Total compensation received by executives	Benefits received by executives[c]
7	Steel – May 2003	• 35,152 participants • $1.2 billion underfunded • 46% funded at termination • $67.2 million in missed or waived pension contributions	• $8.4 million to 4 executives (includes $6.0 million in salary and cash bonuses)	• Outgoing CEO received a severance package worth over $500,000, while being retained as a consultant for an additional 3 months.
8	Steel – Mar. 2002; Dec. 2003	• 83,137 participants • $2.1 billion underfunded • 50% funded at termination • No missed or waived pension contributions	• $19.4 million to 4 executives (includes $8.2 million in salary and cash bonuses)	• CEO and COO received $6.5 million combined in retention payments during bankruptcy, including $4 million in supplemental retirement benefits.
9	Textiles – Aug. 2005	• 30,927 participants • $243 million underfunded • 37% funded at termination • No missed or waived pension contributions	• $7.4 million to 5 executives (includes $6.2 million in salary and bonuses)	• $500,000 in living expense reimbursements to maintain an apartment in New York City. • Personal use of company Learjet.
10	Textiles – Oct. 2003	• 27,717 participants • $189 million underfunded • 59% funded at termination • $10.6 million in missed or waived pension contributions	• $21.3 million to 5 executives (includes $9.1 million in salary and bonuses)	• According to SEC filings, CEO received $1.8 million in cash and stock combined as a signing bonus, then worked less than 9 months before ending his employment. • Relocation benefits, including corporate-funded home purchase.

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

[a]Underfunded amounts and funding percentages were provided by PBGC and represent the unfunded guaranteed benefits payable as calculated on a termination basis.

[b]Missed or waived pension contribution amounts were provided by PBGC and include the total missed or waived minimum funding requirements, as defined by ERISA, during the 5 years prior to plan termination.

[c]Stock awards are valued using the market value at the time of issuance to the executive, as stated in SEC filings, and therefore may not accurately represent the actual realized value to the executive(s).

[d]Data on these plans are based on estimates provided by PBGC as of February 2009, as the financial valuations of the plans were not yet complete.

Case 1: In September 2002, this airline hired a new CEO, who also served as President and Chairman of the Board, to help lead the company through potentially difficult times ahead. Three months later, the company declared bankruptcy and did not emerge until February 2006. During bankruptcy, the company terminated four pension plans from December 2004 to June 2005 that according to PBGC were underfunded by a total of $7.8 billion. This airline missed or waived nearly $1 billion in required minimum contributions. During this CEO's tenure, through the termination of the company's four pension plans, the CEO and two other executives received a total of $55.5 million in salary, benefits, and other compensation. See table 2 below for the components of compensation received by these three executives.

Table 2: Case Study 1 – Components of Executive Compensation Provided to Three Executives Over 5 Years

Salary	Cash bonuses	Other benefits
$7.9 million	$6.9 million	$40.7 million • $31.8 million, stock awards • $7.6 million, retirement and deferred compensation • $0.3 million, tax reimbursements • $1.0 million, other compensation including company car and driver, country club membership, and financial planning 3.0 million stock options and stock appreciation rights

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

The new CEO received a $3 million signing bonus, and the company established a supplemental retirement trust fund worth $4.5 million in his name "in consideration of retirement benefits foregone as a result of resignation from his former employer." Upon the airline's reorganization, the COO also received $2.6 million to set up an irrevocable trust in his name, along with a separate $100,000 in 401(k)-related payments.

All officers were given unlimited free travel on the airline or its subsidiaries, along with a complimentary membership in the company's VIP travel club.[19] The company also reimbursed its executives for any income taxes which they might have owed on this free travel. In addition to these travel benefits, according to the company's Officer Benefits Statement, executives would be reimbursed for the cost of "social and business club memberships…where there is a benefit to be realized to the company" and offered payments for financial advisory services.

PBGC's takeover of these plans in such an underfunded state had significant consequences for some of the company's pilots, who lost large portions of their pensions due to PBGC's statutorily mandated benefit caps. We spoke to several retirees, including one pilot who lost two-thirds

[19]This VIP travel club is a membership service offered by the airline which provides, among other benefits, complimentary food and drinks, personalized travel assistance, and member lounges in some airports.

of his monthly pension payments when his pension plan was turned over to PBGC. Prior to the pension termination, he had made the decision to retire 2 years early at age 58 to spend more time at home after 35 years of routine flights to and from Southeast Asia.[20] He told us that he made this decision after careful consideration of numerous retirement benefit estimates he had received over the years from the airline. Within 2 years of his retirement, PBGC had taken control of his plan and his benefits payments had been reduced to a third of what he had been promised at retirement.

Case 2: This airline went through four CEOs and two bankruptcies during its struggle to survive in the face of considerable financial losses beginning in 2000. During the course of its two bankruptcies (the first in August 2002 and the second in September 2004), the airline turned over four pension plans to PBGC. It had missed or waived $206.8 million in required minimum contributions, with a total of $2.8 billion in underfunding reported by PBGC. The plan covering the company's pilots was terminated during the first bankruptcy. The remaining three plans, which covered mechanics, flight attendants, and others, were terminated during the company's second bankruptcy. From 1998 to 2005, four CEOs received over $120 million in total compensation. See table 3 below for the components of compensation provided to these four executives.

[20]At the time of his retirement, the Federal Aviation Administration required pilots to retire at age 60.

Table 3: Case Study 2 – Components of Executive Compensation Provided to Four Executives Over 8 Years

Salary	Cash bonuses	Other benefits
$6.6 million	$3.3 million	$110.5 million • $42.1 million, stock awards • $27.9 million, tax reimbursements • $32.6 million, retirement and deferred compensation • $0.4 million, split-dollar life insurance • $0.2 million, relocation • $0.2 million, automobile • $0.2 million, personal travel • $6.4 million, severance • $0.5 million, other compensation (including financial planning) 4.1 million stock options

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

For example, one executive received $16 million in stock and an additional $16 million in related income tax reimbursements during his tenure as CEO and Chairman of the Board. He also received a lump-sum payment in excess of $14 million for his pension plan holdings at the time of his resignation. His successor, who previously served as COO, received $1.2 million in incentive awards, as well as nearly $17 million in stock when he was promoted to CEO, a position which he held for 3 years. At the time of his resignation, he received over $15 million in supplemental executive retirement benefits. Another executive, whose tenure as CEO lasted 25 months, was provided a severance package that included triple his annual salary and bonuses plus over $1 million in payments related to a supplemental defined contribution retirement plan.[21]

These executives also received millions of dollars in other benefits. For example, the airline paid the four CEOs a combined total of nearly $500,000 for living and relocation expenses during their tenures. And, as in case 1, the executives were provided unlimited free transportation on the airline and were reimbursed for any income taxes incurred on such travel.

[21]A defined contribution plan is a type of tax-qualified pension plan that establishes individual accounts for employees to which the employer, participants, or both make periodic contributions. Defined-contribution plan benefits are based on employer and participant contributions to and investment returns (gains and losses) on the individual accounts.

In addition, they received a lifetime benefit of membership in the airline's frequent flyer program, which grants unlimited free first-class travel upgrades. They further received hundreds of thousands of dollars worth of benefits for split-dollar life insurance, and reimbursements for financial planning services and automobile expenses.

Case 3: In December 1995, this electronics company's newly hired CEO and Chairman of the Board stated it was "clear to [him] that the company could achieve meaningful growth." He announced a broad restructuring plan to improve the company's profitability which eventually resulted in the termination of nearly 3,000 employees. However, the company experienced a net loss for the next 6 years before declaring bankruptcy in October 2001. When PBGC took over the company's pension plan in July 2002, it was underfunded by $318 million, though the company had not missed or waived any required contributions. See table 4 below for components of compensation provided to three executives.

Table 4: Case Study 3 – Components of Executive Compensation Provided to Three Executives Over 5 Years

Salary	Cash bonuses	Other benefits
$4.6 million	$3.1 million	$8.4 million • $6.0 million, stock awards • $1.5 million, retirement and deferred compensation • $0.5 million, relocation • $0.3 million, tax reimbursement • $0.1 million, other compensation including legal fee reimbursement 0.8 million stock options

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

In the 5 years leading up to its bankruptcy, the company paid three of its executives salaries totaling over $4 million and granted them bonuses equal to more than half that amount. Further, these executives received $6 million in stock awards, along with nearly 1 million stock options. When the Chief Financial Officer (CFO) resigned 10 months before the company declared bankruptcy, her severance package included 2 years' salary and bonuses, continuation of medical benefits, and $600 thousand for her holdings in the company's supplemental pension plan. Soon after, the CEO received a $1.4 million retention bonus because, according to the company's bankruptcy filings, "[the board of directors] did not want him to have his attention distracted from the core problem of keeping the company moving along the track and wanted him not to be worrying about time spent or uncertainty for him and his family personally."

These executives also were reimbursed for expenses such as foreign taxes, rent, utilities, shipping, health club memberships, and legal advice to help protect their interests during bankruptcy. One executive received a $380,000 loan to help with the purchase of a new home near the company's headquarters. This loan and related interest were to be forgiven completely over the course of 4 years if the executive remained employed by the company. In addition, some executives were provided with company car usage, along with coverage for all car-related business expenses. The company not only provided these benefits for its executives, but also provided additional benefits for families of executives. One executive received thousands of dollars for his wife's continuing education, as well as assistance to help her purchase a new car, and reimbursements for some of his wife and daughter's travel.

Case 4: This insurance company and its parent company were owned and run largely by a single family whose members served on the boards of directors of both companies, as well as in senior officer positions such as CEO and COO. The insurance company was taken over by its state regulators during May 2001, resulting in the termination of its pension plan that was underfunded by $108 million, to PBGC in February 2002. The parent company declared bankruptcy in June 2001, soon after the takeover of the insurance company, leaving behind a second, smaller pension plan, underfunded by $13 million in January 2004. These two plans missed or waived a combined $29.2 million in required minimum contributions. In the 5 years leading up to the company's failure, five executives received a total of nearly $70 million in salary, bonuses, and benefits. See table 5 below for components of compensation provided to these five executives.

Table 5: Case Study 4 – Components of Executive Compensation Provided to Five Executives Over 5 Years

Salary	Cash bonuses	Other benefits
$25.3 million	$34.0 million	$10.4 million • $3.5 million, split-dollar life insurance • $1.4 million, retirement and deferred comp. • $0.2 million, personal use of corporate aircraft • $5.3 million, other compensation 11.9 million stock options

Source: GAO analysis of information provided by PBGC, SEC, executives, and corporations.

In the 5 years leading to the companies' downfall, five executives received nearly $60 million in salaries and bonuses. This figure includes nearly $20 million for the CEO and a comparable amount for his brother, who served as the COO. According to the companies' compensation committees, executive compensation is meant to "establish a relationship between compensation and the attainment of corporate objectives." However, in 1 year, an executive failed to meet his target objectives, yet received a $1.5 million bonus "given [the Executive Compensation Committee's] continued confidence that he will achieve superior results in the future." In addition to salaries and bonuses, the executives also received over $10 million in other benefits. The CEO received split-dollar life insurance benefits in some years in excess of $1 million. Combined, these five executives received nearly 12 million stock options.

The CEO and COO together received free personal travel on corporate aircraft valued at over $200,000, as reported by the companies. We reviewed documents provided by the companies and found extensive personal use of corporate aircraft: a Boeing 727-100 airplane and a Sikorsky helicopter. One executive described the plane as "nicely appointed" with multiple rooms. From 1997-1999, we found personal trips by the CEO, COO, and their families to China, Spain, Greece, Miami, Hawaii, Puerto Rico, and Mexico. In addition, the CEO took over 80 trips to his home in Quogue, N.Y. using the company's helicopter, of which more than 20 trips were solely for the transport of his wife and children. Further, the CEO and COO used both the company aircraft during the course of a family trip to Europe. Figure 1 below shows the same make and model of the helicopter used by company executives.

Figure 1: Sikorsky S-76B Helicopter

Source: Sikorsky Aircraft Corporation.

In June 2002, the insurance company's Board of Directors was sued for breach of fiduciary duties. In the complaint against them, "excessive compensation and preferential transfers" were cited as factors in the company's failure. A separate lawsuit was filed in 2003 against the company's COO, alleging that he had improperly received millions of dollars in compensation. These suits were both settled for a total of $85 million in May 2005. All but one of the executives described in this case study are currently receiving monthly pension payments from PBGC in amounts ranging between $4,400 and $8,200.[22]

[22]As discussed on page 7, some participants in PBGC-trusteed plans receive benefits that exceed the PBGC guarantee level, in part due to retirement after PBGC's normal retirement age of 65. Several of the executives described here retired after the PBGC normal retirement age.

PBGC Has Limited Recovery Ability Regarding Executive Compensation

During our review of case studies, we noted that PBGC has little to no oversight authority regarding executive compensation. Companies are not required to report specific executive compensation details in financial disclosures to PBGC prior to plan termination. Further, while many plan terminations occur during bankruptcy, PBGC's ability to recover payments made to executives is limited by bankruptcy law.

Companies are required to disclose certain financial information to PBGC, such as financial statements and projections, prior to terminating a defined benefit pension plan. The PBGC officials we spoke with indicated that these disclosures do not normally separate executive compensation from general companywide salary and benefits information.[23] They further indicated that PBGC has no authority to demand that adjustments be made to salaries, although general adjustments to large categories of discretionary spending (which may include overall salaries) may be considered during evaluations of the company's ability to maintain a pension plan.

During bankruptcy, PBGC has little power to recover amounts paid as compensation to executives. Any executive compensation paid during the course of a bankruptcy must be approved by the court, and once approved, cannot be recovered.[24] Like any other creditor, PBGC can object to specific executive compensation plans, but the final decision regarding such plans is made by the bankruptcy judge, who is responsible for determining whether the plan is justified by the facts and circumstances of the situation.[25] For executive compensation paid within the 2 years prior to a company's bankruptcy petition, creditors have extremely limited ability

[23]Publicly-traded companies must disclose the details of compensation paid to their executives to SEC on an annual basis. However, SEC only has jurisdiction over the disclosure of compensation, and not over any decision by a company regarding the amount and type of compensation to give an executive.

[24]The U.S. Trustee Program, a component of the Department of Justice that oversees the federal bankruptcy system, is considered an interested party to all bankruptcy proceedings, and may file objections to executive compensation plans, though the final approval authority remains with the bankruptcy judge.

[25]All of the case studies that we reviewed for this report precede the enactment of BAPCPA. As a result, we did not assess the extent to which BAPCPA currently affects the approval of executive compensation. Prior to BAPCPA, the court applied a "business judgment" standard for approving executive compensation. Currently the court must find that the obligation incurred by the company is essential to the retention of the executive because the executive has a bona fide job offer from another company at the same or higher rate of compensation. [11 U.S.C. 503(c)(1)(A)]

to recover some amounts, but generally only in situations where extreme mismanagement of funds has occurred. In addition, since PBGC is normally considered a general unsecured creditor during bankruptcy procedures, the agency has low priority for the payment of any such recoveries.

Agency Comments and Our Evaluation

In written comments on a draft of this report, PBGC agreed with our assessment that ERISA does not provide it with any oversight power regarding payments to company executives prior to a company's bankruptcy. Further, PBGC agreed that it has limited power over executive compensation during bankruptcy, as such payments are under the purview of the bankruptcy court. We have reprinted PBGC's written comments in appendix II.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. We will then send copies of this report to interested congressional committees and the Acting Director of the Pension Benefit Guaranty Corporation. The report also will be available at no charge on the GAO Web site at http://www.gao.gov.

For further information about this report, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

Sincerely yours,

Gregory D. Kutz
Managing Director,
Forensic Audits and Special Investigations

Appendix I: Scope and Methodology

To determine pay and other compensation received by executives in the years preceding their company's termination of an underfunded defined benefit pension plan, we first obtained a database from the Pension Benefit Guaranty Corporation (PBGC) identifying companies that had terminated underfunded pension plans from 1999 to 2008. This database contained information on 1,246 terminated pension plans. We focused on identifying companies that (1) were publicly traded prior to the termination of their pension plan(s), (2) had significant unfunded pension liabilities on a termination basis ($100 million or more), (3) had a high unfunded liability per plan participant ratio ($10,000 or more per participant), and (4) had more than 5,000 plan participants. Of the 1,246 underfunded plans terminated from 1999 to 2008, we selected 10 companies from approximately 30 companies that sponsored plans which met our criteria. The 10 case study companies we selected were not meant to be representative of all companies whose plans have been taken over by PBGC in the past decade.

We requested and reviewed documents provided by selected companies related to the compensation of their executives. We reviewed Securities and Exchange Commission (SEC) filings and PBGC documents disclosing plan underfunding at the time of termination and missed contributions. We also interviewed PBGC and company officials, as well as plan participants. In addition, we requested documentation from all selected executives under review, including tax returns. We attempted to interview all selected executives, but some could not be reached or declined our interview request.

Findings related to executive pay and benefits were limited by the availability of public documents and information voluntarily provided by companies, executives, and other entities (e.g., professional sports teams, golf clubs). Because some companies and executives did not provide information, declined to be interviewed, and/or did not consent to granting GAO access to copies of their tax returns from the Internal Revenue Service, we were not able to document all details concerning pay and benefits received beyond the details available in public documents or otherwise voluntarily provided. Thus, the executive compensation information in this report represents what we were able to determine and may be understated. All values listed for restricted stock awards were determined by reviewing SEC filings which list the value of stock awards as of the date of the award, and therefore may not represent their ultimate exercised value. We did not attempt to determine the market value of stock options at the time of their award, nor their exercised value. We limited our review to the time period beginning 5 years prior to a company's first pension plan termination and ending with the company's final pension plan termination. Since some companies terminated multiple pension plans over a period of time, for those companies our review may cover more than 5 years. Due to the high turnover of executives at these companies, information regarding the total compensation of the executives discussed in this report may not have been available for the entire time period under review. We did not conduct an exhaustive review of each company's executive pay and benefit practices; we reviewed information related to executive pay and compensation in the years preceding the termination of a defined benefit pension plan.

To assess the reliability of PBGC data related to the termination of defined benefit pension plans from 1999 through 2008, we (1) interviewed PBGC officials familiar with the data related to terminated pension plans and (2) matched the data provided by PBGC for the pension plans in each case study against records available on the agency's Web site to verify that the data we were provided were exported correctly. We found the data to be sufficiently reliable to identify case studies for further investigation.

We conducted our audit and investigative work from January 2009 through September 2009. We conducted our audit work in accordance with U.S. 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 finding and conclusions based on our audit objective. We performed our investigative work in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

Appendix II: Comments from the Pension Benefit Guaranty Corporation

PBGC
Protecting America's Pensions

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

Office of the Director

October 9, 2009

Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations
U.S. Government Accountability Office
Washington, D.C. 20548

Dear Mr. Kutz:

Thank you for the opportunity to comment on the draft version of your report entitled, "Private Pensions: Sponsors of 10 Underfunded Plans Paid Executives Approximately $350 Million in Compensation Shortly Before Termination."

PBGC makes every effort to secure plan assets for the benefit of participants under the Employee Retirement Income Security Act as part of the plan trusteeship and termination process. However, as the report correctly notes, ERISA does not provide PBGC with any oversight power regarding payments to company executives prior to a company's bankruptcy, and once a company is in bankruptcy, such payments are under the purview of the bankruptcy court.

We appreciate the efforts of you and your staff in preparing this report. PBGC remains committed to fulfilling its mission and taking the steps necessary to safeguard America's pension insurance programs. Again, thank you for the opportunity to comment.

Sincerely,

Vincent K. Snowbarger

Vincent K. Snowbarger
Acting Director

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Gregory D. Kutz, (202) 512-6722, or kutzg@gao.gov

Staff Acknowledgments

In addition to the contact named above, the individuals who made major contributions to this report were Christopher Backley, Gary Bianchi, Robert Graves, Rebecca Guerrero, Matthew Harris, Ken Hill, Leslie Kirsch, Flavio Martinez, Vicki McClure, Jonathan Meyer, Sandra Moore, George Ogilvie, and Barry Shillito.

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