EXAMINING THE CHALLENGES FACING THE PENSION BENEFIT GUARANTY CORPORATION AND DEFINED BENEFIT PENSION PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

COMMITTEE ON EDUCATION AND THE WORKFORCE

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C O N T E N T S

EXAMINING THE CHALLENGES FACING THE PENSION BENEFIT GUARANTY CORPORATION AND DEFINED BENEFIT PENSION PLANS

Thursday, February 2, 2012
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and the Workforce
Washington, DC

The subcommittee met, pursuant to call, at 10:35 a.m., in room 2175, Rayburn House Office Building, Hon. David P. Roe [chairman of the subcommittee] presiding.

Present: Representatives Roe, Wilson, Heck, Andrews, Kucinich, Loebsack, Kildee, Hinojosa, Holt, Scott, and Altmire.

Also present: Representatives Kline and Miller.

Staff present: Andrew Banducci, Professional Staff Member; Katherine Bathgate, Press Assistant/New Media Coordinator; Casey Buboltz, Coalitions and Member Services Coordinator; Ed Gilroy, Director of Workforce Policy; Benjamin Hoog, Legislative Assistant; Barrett Karr, Staff Director; Ryan Kearney, Legislative Assistant; Brian Newell, Deputy Communications Director; Krisann Pearce, General Counsel; Molly McLaughlin Salmi, Deputy Director of Workforce Policy; Todd Spangler, Senior Health Policy Advisor; Linda Stevens, Chief Clerk/Assistant to the General Counsel; Alissa Strawcutter, Deputy Clerk; Kate Ahlgren, Minority Investigative Counsel; Aaron Albright, Minority Communications Director for Labor; Tylease Alli, Minority Clerk; Daniel Brown, Minority Policy Associate; Jody Calemine, Minority Staff Director; Tiffany Edwards, Minority Press Secretary for Education; Brian Levin, Minority New Media Press Assistant; Megan O'Reilly, Minority General Counsel; Julie Peller, Minority Deputy Staff Director; and Michele Varnhagen, Minority Chief Policy Advisor/Labor Policy Director

Chairman ROE. Call the meeting to order. Thank you all for being here. I am sorry I am a little late, but you don't get up and leave when the President is praying, I can tell you that. We just attended the prayer breakfast.

A quorum being present, the Subcommittee on Health, Employment, Labor, and Pensions will come to order. Good morning, and welcome, to our witnesses.

Director Gotbaum, it is good to see you. This hearing is our first opportunity to have you before the subcommittee in the 112th Congress and we appreciate you taking time out of your very busy schedule to be with us today.

We are confronted today with two difficult realities. The first is the financial challenges facing the Pension Benefit Guaranty Corporation.

For more than 35 years the PBGC has provided an important safety net to millions of workers in the event a defined benefit pension plan becomes insolvent or is terminated. The sheer size of the corporation's responsibilities are quite remarkable and they continue to grow.

In 2011 the PBGC paid benefits to more than 819,000 retirees at a cost of $5.3 billion. At the same time, the PBGC assumed responsibility for 152 terminated plans, increasing its obligations to more than 4,300 plans. While the number may pale in comparison to other federal programs like Social Security and Medicare, PBGC still provides a federal backstop for the defined benefit plan for approximately 43 million Americans.

Unfortunately, the PBGC reports a deficit of $26 billion, and we learned just this week that the burden on the PBGC will continue to grow in the months ahead. The events surrounding American Airlines' bankruptcy and its resultant decision to terminate the pension plans of 130,000 workers are deeply troubling. Hostess Brands and Eastman Kodak are also in the process of bankruptcy and we await word on whether they too, will fail to meet their pension obligations.

The decision to declare bankruptcy and terminate a pension plan can involve more than a company's balance sheets and actuarial projects. It can also involve broken promises and the additional struggles workers will face to achieve financial security during their retirement years. Employers have a responsibility to do everything they can to meet their commitments and help ensure the loss of a job is not exacerbated by the loss of their retirement benefits.

This leads us to the second, more difficult reality we must confront: the state of the economy. Far too many employers are operating on thin margins where an unexpected burden can destroy their businesses.

We all want to see the finances of the PBGC strengthened. However, we must closely examine and fully understand the uninsured consequences of our policy decisions.

Excessive increases in premiums and unpredictable costs of defined benefit plans will have a direct impact on employers and job creation. At the same time, if we do not act appropriately we will undermine the financial standing of the PBGC and its ability to serve retirees.

Congress must remain engaged, and that is why I am concerned about surrendering some of our authority in this area. The oversight and guidance of this committee should continue to play an important role in this debate.

As we move forward, our task is a difficult one: Find a solution that can strengthen the PBGC without harming job creation or discouraging participation in our voluntary pension system. There will be no easy answers. However, I am confident that by working together we can find a responsible solution that protects the interests of employers, workers, retirees, and taxpayers.

Before I close, Director Gotbaum, let me add my voice to those who have raised concern with mismanagement of certain pension plans by the PBGC. The workers who receive benefits through the corporation are already coping with the devastating ordeal of an employer going out of business or choosing to sever ties with their workers' pension plan. It is deeply unfortunate when this difficulty is compounded by poor management at PBGC.

Recent reports by the PBGC's inspector general that retirees may not have received proper benefits are disturbing, and I hope you can provide assurances to this committee and the nation's workers that you are implementing a plan to fix these mistakes and prevent them from ever happening again. We stand ready to assist you in any way we can.

Again, welcome, Director, and thank you for joining us. We look forward to your testimony.

I will now recognize my distinguished colleague, Rob Andrews, the senior Democratic member of the subcommittee, for his opening remarks.

[The statement of Chairman Roe follows:]

Prepared Statement of Hon. David P. Roe, Chairman, Subcommittee on Health, Employment, Labor and Pensions

Good morning and welcome to our witnesses. Director Gotbaum, it is good to see you. This hearing is our first opportunity to have you before the subcommittee in the 112th Congress, and we appreciate you taking time out of your busy schedule to be with us this morning.

We are confronted today with two difficult realities. The first is the financial challenges facing the Pension Benefit Guaranty Corporation. For more than 35 years, PBGC has provided an important safety net to millions of workers in the event a defined benefit pension plan becomes insolvent or terminated. The sheer size of the corporation's responsibilities are quite remarkable, and they continue to grow.

In 2011, PBGC paid benefits to more than 819,000 retirees at a cost of $5.3 billion. At the same time, PBGC assumed responsibility for 152 terminated plans, increasing its obligations to more than 4,300 plans. While the number may pale in comparison to other federal programs like Social Security and Medicare, PBGC still provides a federal backstop for the defined benefit pension plans of roughly 43 million individuals.

Unfortunately, PBGC reports a deficit of $26 billion—and we learned just this week that the burden on PBGC will continue to grow in the months ahead. The events surrounding American Airlines' bankruptcy and its resultant decision to terminate the pension plans of 130,000 workers are deeply troubling. Hostess Brands and Eastman Kodak are also in the process of bankruptcy, and we await word on whether they too will fail to meet their pension obligations.

The decision to declare bankruptcy and terminate a pension plan can involve more than a company's balance sheets and actuarial projections. It can also involve broken promises and the additional struggle workers will face to achieve financial security during their retirement years. Employers have a responsibility to do everything they can to meet their commitments, and help ensure the loss of a job is not exacerbated by the loss of retirement benefits.

This leads us to the second, more difficult reality we must confront: the state of the economy. Far too many employers are operating on thin margins where an unexpected burden can destroy their businesses. We all want to see the finances at PBGC strengthened. However, we must closely examine and fully understand the unintended consequences of our policy decisions.

Excessive increases in premiums and unpredictable costs of defined benefits plans will have a direct impact on employers and job creation. At the same time, if we do not act appropriately we will undermine the financial standing of PBGC and its ability to serve retirees. Congress must remain engaged, and that is why I am concerned about surrendering some of our authority in this area. The oversight and guidance of this committee should continue to play an important role in this debate.

As we move forward, our task is a difficult one: Find a solution that can strengthen PBGC without harming job creation or discouraging participation in our voluntary pension system. There will be no easy answers. However, I am confident that by working together, we can find a responsible solution that protects the interests of employers, workers, retirees, and taxpayers.

Before I close, Director Gotbaum, let me add my voice to those who have raised concerns with mismanagement of certain pension plans by PBGC. The workers who receive benefits through the corporation are already coping with the devastating ordeal of an employer going out of business or choosing to sever ties with their workers' pension plan. It is deeply unfortunate when this difficulty is compounded by poor management at PBGC. Recent reports by PBGC's Inspector General that retirees may not have received proper benefits are disturbing, and I hope you can provide assurances to this committee—and the nation's workers—that you are implementing a plan to fix these mistakes and prevent them from happening again. We stand ready to assist you in any way we can.

Again, welcome Director Gotbaum and thank you for joining us. We look forward to your testimony. I will now recognize my distinguished colleague Rob Andrews, the senior Democratic member of the subcommittee, for his opening remarks.

Mr. ANDREWS. Mr. Chairman, and I appreciate you calling this hearing.

Mr. Gotbaum, welcome to the committee, as we welcome the other witnesses as well.

There are tens of millions of Americans who have gone to work every day and worked as hard as they can, and they have held up their end of the bargain. The end of the bargain that is coming to them is that they are guaranteed, in some cases, a pension check for the rest of their lives.

That promise is nonnegotiable. A person who has gone out every day and done what he or she is supposed to do and relies on that pension check should never have to worry that their personal version of the American dream will be imperiled because the pension won't be there.

Now, I think the chairman is very right that the keeping of that promise, in the case of Americans who are enrolled in defined benefit plans, is somewhat in jeopardy. And he has correctly stated that it is our responsibility to try to remove that jeopardy and reignite and restore that promise that has been made to workers and retirees throughout the country.

And I think to do that we have got to meet two principles that would at first seem to be in opposition to each other, but I think are, in fact, quite complementary to each other. The first is that we have to meet the principle that says that we don't want to in any way burden our pensioners; we want to be sure that the solvency of the Pension Benefit Guaranty Corporation is established and maintained. We want to be sure that any—in instances where companies are no longer able and plans are no longer able to meet their obligations the PBGC is able to meet those obligations.

The second principle is one I think just about everybody on this committee would agree with and most American taxpayers would agree, which is no more bailouts—no more bailouts of anybody. And in a sense, that is what this discussion is about.

How do we be sure that this promise that has been made to American workers and retirees is honored in a way that would never require taxpayers to step in and make sure that promise is honored? Which is another way of saying, how can we be sure that the PBGC is managed in such a way it is self-financing, that the revenues are there to meet the PBGC's obligations into the future?

This is a daunting problem because of the data the chairman cited, which that the PBGC presently projects a $26 billion when one compares its current assets versus its current obligations. Chairman is also right, though, that the solution to this problem is economic growth. And I think there is no better evidence of that if you look at the deficit of the PBGC in recent years.

In 2008, before the financial meltdown hit the American economy, the PBGC's deficit was $10.7 billion. By 2009 that had gone to $21 billion, so we essentially had a doubling of the PBGC's deficit in 1 year as the economy was collapsing around the people of the United States.

Now, there has still been growth in that deficit, but between 2009 and 2011 it grew by about 25 percent. That is unacceptable, but it doubled in 1 year when the economy was cratering.

So I do think the chairman is correct that the first order of business of the committee, of the Congress, of the country should be to reignite economic growth. And as we consider various remedies to cure the deficit of the PBGC we should look at each one of them through the prism of its impact on economic growth.

The second point that I would make is that it is essential, though, that we come to a reasonable conclusion to this, that it is reflexive and well understood for people to say, "Well, whatever you do, don't ever raise premiums on PBGC participants." That is a very attractive option. But if there is a way that more revenue can come into the PBGC that does not retard economic growth, that promotes the fiscal soundness of the PBGC, then it is our obligation and our responsibility to take a look at that.

Purpose of this morning's hearing, and I agree with it, is to begin to explore the particulars of honoring this promise to American workers and American retirees.

Mr. Chairman, I am glad to be a part of it and we look forward to the witnesses' testimony.

Chairman ROE. I thank you for your remarks.

And pursuant to Committee Rule 7(c), all members will be permitted to submit written statements to be included in the permanent hearing record. And without objection, the hearing record will remain open for 14 days to allow such statements and other extraneous material referenced during the hearing to be submitted for the official hearing record.

Now it is my pleasure to introduce our first distinguished panel. Joshua Gotbaum is the director of the Pension Benefit Guaranty Corporation, and—where he is responsible for the agency's management, personnel organization, budget, and investments.

And before we start—before we recognize you, let's see—you know, you understand the system. You have been here before. But the light in front of you will turn green; when 1 minute is left it will turn yellow; and when your time is expired the light will turn red, at which point I will ask you to wrap up your remarks at that point.

And with no further comments, Mr. Gotbaum?

STATEMENT OF HON. JOSHUA GOTBAUM, DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION (PBGC)

Mr. GOTBAUM. We are on now. Sorry.

Mr. Chairman, Mr. Andrews, thank you very, very much for holding this hearing and for inviting us to testify. I want to start—because these issues are issues that go beyond PBGC. These are issues, as you pointed out, of economic growth, of economic security, retirement security, and we are grateful that you have asked us to talk about that.

I want to start, to be blunt, by apologizing for the lateness of the submission of my testimony. There are a lot of cooks in the pension kitchen, and so it took us longer to get a testimony to you all than you would have liked on—especially on something that was as complicated as this, and so I hope the committee will accept that, and given the shortness of time—although I have asked to go a little beyond 5 minutes—I am just going to hit the high points, and I have every confidence that you will not let me get away with anything without some important questions.

The reason that we think this hearing is so important is because retirement security is not only a—already a serious concern, it is getting to be more so. Last April the Gallup organization took a poll. They polled lots of folks, but the thing that hit me hardest was that the people who were far away from retirement—people who were 30 to 49 years of age—more than three-quarters of them were worried about their retirements—more than were worried about their paychecks or their health care. And it is not as if those—there isn't a basis for those worries, because the trends are disturbing.

The good news is we are living longer. Fifty years ago the average person, we think, retired at about age 62, lived to be about 79—that is 17 years. Today the average person works a little longer already, maybe 63, lives to be 84—21 years. So in 50 years we have seen an increase in the average retirement, round numbers of about 25 percent. That is the good news.

If you could do the first slide?

The bad news is that pensions haven't kept up. This admittedly hard-to-read slide shows the number of people who have an employer-based pension, whether defined benefit or defined contribution, for the last 30 years.

And what you see in it is a couple of things. One is it is important to recognize that half of people who are working today don't have an employer pension plan at all, and a third of them don't even have access to one.

Second is that most of the people who do—and that is the yellow part of the slide—have only a 401(k)-type plan. These were originally intended, as you all know, as supplements. They have become the main pension for most folks. And, as we also know, unfortunately, with the collapse in stock markets, they lost a lot of their value.

People in DB plans—and those are the green folks—they feel more secure, they are more secure. But the fact is, the percentage of the workforce that has DB plans has been declining. Nonetheless, there are still some 70 million people in America who have them.

The fundamental point is that since people are living longer, healthier lives retirement is going to have to cost more, not less.

This means people will have to save more and retirement plans are going to have to cost more.

The other point is that there is no single solution to this, and it is the—some say the right things to do is to create new options; some people say the right thing to do is to preserve plans. We think the right thing to do is to do both.

Now, why is the PBGC even raising these issues? Because our mandate from the day we were founded is to encourage voluntary private plans, not just DB plans.

PBGC has been a safety net for 37 years. I want to be clear about what we do and what we don't do.

When companies can't afford their plans we pay benefits. But first, we always try to see if the companies can afford to keep their plans because by law there are limits on our benefits. There are dollar limits on our pensions, we don't pay for health care, and, to pick a case that is in the headlines immediately, that is what we are doing at American Airlines. We are trying to see if the company can be reorganized successfully without having to terminate the pension plans on 130,000 people.

I want to say that this is a complicated task and by and large the PBGC does a very good job of it. We survey customer satisfaction in the same way that private businesses do, and I will tell you that PBGC's customer satisfaction is among the very best in the federal government and better than a lot of businesses that I have been in, and I spent most of my career in business.

But there are plenty of challenges, and I will mention some of them, and then I am sure you will raise additionals. One is, PBGC is now $100 billion financial institution but its finances are unsound. We are not looking for tax dollars. We are funded by premiums. We have never taken a dime of taxpayer money.

However, unlike other government insurance programs in this nation, unlike pension insurance agencies in other nations, and unlike every private insurance company I have worked with in business, our premiums are not set by us, they are set by law. They are set too low and they are set in a way that punishes the majority of companies that sponsor plans.

I want to be clear: We have got enough assets to pay benefits for the near future—we have got $81 billion in assets. But our obligations are greater.

If I could have the slide? Okay.

When you compare our assets to our obligations, as you, Mr. Chairman and Mr. Andrews, both mentioned, we have a lot of assets but our obligations are greater and they are not shrinking. Our current deficit is $26 billion. If the plans at American are terminated we estimate that deficit would increase to about $35 billion.

This is not an immediate situation, but unless changes are made, ultimately the PBGC is either going to run out of money or have to come back for taxpayer bailout. That is not something we ever want to discuss.

Our view of this is, Congress has time and again recognized this and bit the bullet and raised premiums. We think the time has come to consider it again. We propose to do it in a way that, A, we think encourages plans, and B, takes into account the fact that we are in hard times right now, that defers it. So that is one challenge.

Second challenge, which you also mentioned, Mr. Chairman, is that as pension plans got more complex and complicated we didn't keep up. And as a result, on the pension plans—and I will name them; it is embarrassing, but I will name them—at United Airlines and at National Steel, when we were trying to track the assets to make sure that we did the benefits right the agency did a bad job. Even worse than that, we didn't find the mistake; our inspector general did.

When I got here a year and a half ago I said some things are going to have to change and they are. We are going back and we are going to do it right. If we have underpaid people we are going to pay them what we owe them with interest and an apology and we are making a bunch of changes to make sure it doesn't happen again.

PBGC has a really complicated job and I am not going to try to snow you. Nobody is perfect. But when we find a mistake we are going to fix it.

Third challenge, multiemployer plans. You have witnesses speaking on this so I am just going to raise a couple of basic points because this is something that we pay a lot of attention to and care about.

One is, multiemployer plans involve hundreds of thousands of small businesses all across the country and tens of millions of workers. Like most pensions, during the 1990s things went fine and in the last decade, unfortunately, things have not.

The Congress 5 years ago gave multiemployer plans some tools to deal with underfunding and plans are using those tools. For probably most plans those tools and an economic recovery will be sufficient to get them out of the woods but it is pretty clear that there are some who are going to need more capabilities.

And so when the Congress reconsiders PPA you are going to have to reconsider those issues. As in the past, it has got to involve both business and labor; it has got to be bipartisan. And we are working on some reports and some analysis to help in that regard.

The last thing I will mention before we do questions is what I started with, which is the hardest challenge is to, how do you enhance voluntary retirement plans? And I was just going to mention three approaches that we do.

One is to facilitate more options. There are folks who say, "I would like something that isn't just a traditional defined benefit final average pay plan," and there are folks who would say, "I would like something that is different from the traditional DC plan." We ought to make clear that there are options and we ought to make those options available so that employers can use them.

Second point—and I will wrap up—is we have to preserve the plans that we have by reducing administrative and regulatory burdens.

The fact is, companies get out of the traditional defined benefit system for a lot of reasons but we shouldn't encourage them out by regulating alone. And my last point is that we need to continue to help people understand their choices.

Everyone recognizes these issues are complicated, that there is no one solution, that the government can't impose one, that it has got to be bipartisan, and that it has got to be deliberate. And that, frankly, is why we are so grateful that you are holding this hearing, and as you do this PBGC would obviously like to help, so——

[The statement of Mr. Gotbaum follows:]

Prepared Statement of Joshua Gotbaum, Director, Pension Benefit Guaranty Corporation

Thank you for holding this hearing and inviting me to speak about the PBGC and defined benefit pensions. I'll be speaking to these concerns against the backdrop of retirement security more broadly. These retirement security issues are important to the nation, because it is clear that the retirement world is changing and that more needs to be done to strengthen our retirement system and help Americans achieve a secure retirement.

Challenges to Retirement Security

It's no secret that people are concerned about retirement. Each day some 10,000 baby boomers turn 65.[1] Baby boomers are the largest generation that's ever faced retirement. But the concern isn't limited to baby boomers. According to a 2011 Gallup Poll, the number one financial concern for Americans is not having enough money for retirement. Gallup found that 77% of Americans age 30-49 are worried about not having enough money for retirement.

Thanks to better health, better technology, and better lifestyles, today we're living longer, healthier lives.

That's great news, but it also means that retirement costs more. Fifty years ago, by our estimates, the average person retired at age 62 and lived to be 79: about 17 years. Today, after retirement at about 63, the average person can expect to live about 21 years—some 30% longer. And that's just average life-spans; about a quarter of us will live into our 90s.[2]

Once we do the math, it's clear that retirement is going to cost more, not less. Unfortunately, pensions haven't kept up.

- About one-third of American workers have no access to employer-provided retirement benefits; about one-half actually have such benefits.[3]
- Of those that do, the majority have only have a defined contribution (DC) plan, usually a 401(k). Many of these plans lost value during the recent economic downturn.
- The tens of millions of Americans that have DB pension plans are better off, but employers have been turning away from such plans.

An important trend has been the replacement of traditional DB plans with DC plans. DC plans provide portability benefits for those who change jobs frequently and allow people to set and invest their own savings. Unfortunately, DC plans also shift a number of investment and other risks onto the shoulders of American workers. Furthermore, we tend to forget about the chance that we'll live longer than average and don't buy annuities, so the chances of people running out of money are rising.

Today, most people don't think they have enough money to retire—and they're right. The Administration is committed to do what we can to strengthen retirement security, which is an important priority not only for workers and retirees but also for our economy and our nation.

PBGC: Safety Net and Preserver of Pensions

PBGC was founded in 1974 to patch a hole in America's retirement security system. We ensure that once a company makes a pension promise, it does not vanish: it's protected up to legal limits.

Today, PBGC guarantees payment of basic pension benefits earned by nearly 44 million participants in more than 27,000 private-sector DB pension plans.

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[1] Pew Research Center, "Baby Boomers Approach Age 65—Glumly," December 2010 *http://pewresearch.org/pubs/1834/baby-boomers-old-age-downbeat-pessimism.*

[2] These are PBGC calculations based on our own actuarial analysis of a 2011 Boston College study.

[3] Bureau of Labor Statistics, DOL, "Employee Benefits in the United States—March 2011" (July 26, 2011).

Working to Preserve Plans

But the best outcome, for workers, retirees, their families, and our pension insurance programs, is for companies to be able to keep their own pension plans.

When a company is in trouble, we try first to see whether it can reorganize successfully and still keep its pensions. We work with companies both before and during bankruptcy, so that they continue to keep their own pension promises after the sponsor reorganizes, or after a new owner assumes operations. Companies that continued their plans following bankruptcy in FY 2011 include Chemtura Corp. with 15,000 participants and Visteon Corp. with 23,000 participants.

Of course, we don't always succeed, but PBGC would rather prevent pension losses than pick up the pieces.

The Pension Safety Net

When a plan cannot keep its pension commitments, we make sure the plan's participants get their benefits, up to the limits of federal pension law, on time. When we take over a plan, we make sure that pension checks don't stop, even while we're figuring out people's benefits. In fact, our 2006 study estimated that 84 percent of people receive their full pension benefits.

And, we do it without taxpayer money. Our benefits are funded by premiums, by the assets of the plans we take over, investment earnings on our assets, and by recoveries in bankruptcy.

Over the years we've become responsible for about 1.5 million people in more than 4,300 failed plans. In FY 2011, 873,000 people received benefits from PBGC. Every month, on average, we pay benefits totaling $458 million. We are also responsible for future payments to about 628,000 people who have not yet retired. During FY 2011, we assumed responsibility for more than 57,000 additional workers and retirees in 134 failed pension plans.

Continuing Reforms to PBGC

In the 37 years since ERISA became law, both the retirement landscape and PBGC have changed dramatically. When it started, the agency had fewer than 50 personnel. Some 25 years later at the end of FY 1999, PBGC had just over 1,400 personnel (some 750 federal employees and 680 contractors) and about a $7 billion surplus, with assets of $19 billion and liabilities of $12 billion. Today, the agency is operated with about 2,300 personnel, including some 980 federal employees as of the end of FY 2011. However, PBGC also now has a $26 billion deficit, with assets of $81 billion and liabilities of $107 billion.

Congress has continually made changes, both in PBGC's organization and programs, and in other parts of the law. For example, under the original ERISA structure, PBGC was required to assume responsibility for a plan even if the plan sponsor could afford to keep it. In 1986, Congress added a financial distress test.

Furthermore, in the past Congress has recognized that PBGC premiums are too low, and has raised them repeatedly. As this Committee knows, we think it is again time to reconsider and reform premiums.

PBGC's Current Financial Position and Future Prospects

PBGC is funded entirely through insurance premiums paid by plan sponsors, assets from failed plans, investment earnings on our assets, and recoveries in bankruptcy. The agency does not take even a dime of taxpayer funds.

Each year, we report our financial position, as well as estimates of our future exposure. As one who has spent a lifetime in finance, I'm pleased to report that PBGC's accounts have been approved and given a clean opinion by independent accountants and its Inspector General for two decades.

Over the past twenty years, accounting for large financial institutions has become more realistic. Assets and liabilities are now marked to current market. We can no longer pretend that assets are worth their "average over the past three years." Nor can we estimate our liabilities based on the average of past decades or on a hope that interest rates will rise.

Long before this was required of other financial institutions, PBGC accounts were marked to market. The discount rates used to determine the agency's liabilities are derived from market quotes for annuities—the same type of annuities that PBGC's benefits provide.

On this basis, PBGC reports a very substantial deficit (i.e., our liabilities exceeded our assets). This past year it increased to $26 billion, as of September 30, 2011.

There are some who suggest that PBGC should use other methods to estimate its liabilities than the market test. We don't agree.

No matter how PBGC's deficit is calculated, the agency's liabilities exceed its assets. Some have suggested that we use corporate bond rates, like ongoing pension plans; if we had, our FY 2011 deficit would still have been some $21 billion. If we had used the discount rate of private insurance companies, the deficit would be approximately $28B.

It is important to emphasize that none of these deficit figures includes any exposure for future claims that we think could easily run into the tens of billions of dollars. But PBGC's liabilities are paid out over decades, and we have sufficient funds to pay benefits for the near future. Nonetheless, our obligations are clearly greater than our resources.

Premium Reform Proposal

If PBGC's finances aren't reformed, the agency will eventually run out of money to pay benefits. We cannot ignore our own future financial condition any more than we would of the pension plans we insure.

That is why, a year ago, the Administration proposed that Congress reform PBGC premiums. We think that doing so is necessary to the financial soundness of PBGC and important to encourage the preservation of responsible pension plans.

Since the agency was founded, its premiums have been set by Congress. ERISA's original annual premium was one dollar per participant for the single-employer program and 50 cents per participant for the multiemployer program. Congress has repeatedly raised premiums, and made other changes.

Unfortunately, neither the level nor the form of premiums has kept up with changes in retirement plans. For some companies and plans, our premiums are far lower than any private insurance company would charge. American Airlines provided only the latest and most graphic example. American sought and received funding relief from Congress. Instead of funding their pensions, they set aside a cash pool of over $4 billion.[4] Since their bankruptcy filing, they have made it clear that they would like to terminate their pension plans. Doing so would increase PBGC's deficit by some $9 billion. For this insurance, American has paid a total over 37 years of about $260 million in premiums.

But what's just as disturbing is that financially sound companies are asked to make up the difference. And if Congress were to increase those premiums just to cover the actions of other companies, it would make the situation worse. Think how hard it is to convince companies to keep their plans while you're asking them to pay for the losses of others.

We recognize that there are many issues involved in making PBGC responsible for establishing premiums that are both fair and financially sufficient. The Administration proposed a range of safeguards to allay the legitimate concerns of businesses and plans that rates might rise too quickly or unfairly. No increases at all would be permitted until after a year of consultation with the affected constituencies. No increases would be allowed without a vote of PBGC's board. The increase on any individual company or plan would be strictly limited and all increases would be phased in over a period of years as the Board may determine. Furthermore, unlike the current variable rate premium, the Board would be charged, to the extent feasible, with setting premiums to minimize increases during times when the economy or markets are weak.

It is not surprising that companies and plans would like to avoid increases in their premiums; all of us would. However, the arguments against doing so are weak. Some claim that allowing PBGC to set premiums this way would be "unprecedented"—even though most other government insurance programs in our nation, every pension insurance agency in other nations, and every private insurance company in the world already does so.

Some claim that PBGC doesn't need the money yet. In one sense, that's true: PBGC has sufficient current funds to meet its obligations for the near future. But deferring action now will necessitate more drastic actions in the future. Without the tools to set its financial house in order and to encourage responsible companies to keep their plans, PBGC's may face, for the first time, the need for taxpayer funds. That's a situation no one wants to face.

PBGC Challenges

PBGC is now a $100 billion financial institution, one that like other financial institutions operates in a changing and complicated environment. There are plenty of challenges; I'll mention some of the more important ones.

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[4] See AMR's news release on filing bankruptcy: *http://aa.mediaroom.com/index.php?s=43&item=3397.*

Companies that Take Advantage of the Current System

Termination of a pension is not something a company should do lightly. We work hard to make sure that terminations are necessary and that companies understand the consequences. However, there are some aspects of the current system that make it easier for companies to terminate plans.

One, already mentioned, is that PBGC's premiums are neither high enough nor individually calibrated to discourage terminations. There are other examples. Often when an investor buys a company in bankruptcy, it structures the transaction as a purchase of assets and refuses to assume the pension obligations. Unfortunately, there are also instances where investors that are already owners of bankrupt companies arrange to "sell the company to themselves" in order to avoid their pension commitments.

In some cases, investment firms design transactions to avoid being part of a controlled group, so that, should a plan be terminated, the investment firm's assets cannot be reached. The only real tool that PBGC has at that point is to go to court and threaten plan termination, which is far from optimal.

Improving Service Quality

When people first come in contact with PBGC, their lives have already been turned upside-down. They face the possibility of losing some pension benefits, and may have already lost the benefits PBGC does not guarantee, such as retiree health plans. All too often they have also lost their jobs.

PBGC works hard to help them with compassion and professionalism. And I'm pleased to say that, by and large, the agency does so exceedingly well. For over a decade, PBGC has surveyed its customers using the same measures of service as private industry, the American Customer Satisfaction Index (ACSI). Our customer satisfaction scores are among the highest of any government agency and higher than many private companies.

In 2011, retirees receiving benefits from PBGC scored us at 90. Participants who called us with questions rated us at 86. Our online tools for participants and plan administrator were scored 83 and 79, respectively. An ACSI score of 80 is considered excellent, whether for government or private business.

But this doesn't mean there isn't plenty of room for improvement. Under ERISA, rather than offering a uniform benefit, like the Social Security Administration, we are required to calculate each person's benefit under their own former plan, and then apply the intricate limits and provisions of the pension law. Getting those personalized calculations right is a core part of what we do.

Correcting Our Mistakes. The benefit determination process is complex and, over time, as plans themselves got more complex, PBGC didn't always keep up. The agency made mistakes. Even worse, PBGC didn't catch them; our Inspector General did.

When I joined PBGC a year and a half ago, it was clear that changes needed to be made. Over the years, PBGC had done a bad job on some parts of some benefit determinations (making sure we knew the values of the assets of the plans we took over). These affected benefits paid to people who worked at United Airlines, at National Steel, and other plans. As a result, some people have been overpaid, and others underpaid.

We're now going back and correcting our mistakes. If we underpaid a person, we'll pay what we owe them with interest—and an apology.

Equally important, we've made and are making changes so that similar mistakes don't happen again. We changed the people who were tracking plan assets, we put reviewers on each plan processing team, and we're training people more and more carefully. I also began a top-to-bottom review of the entire benefits operations, including processes, organization, and personnel. We have begun making changes, and will implement more in the coming year.

Being More Responsive to Companies and Plans

PBGC is acutely aware that this is a voluntary system and is taking steps to be more responsive. After complaints from industry that premium election procedures had confused them, PBGC has allowed some companies to correct their submissions. PBGC also provided relief from some premium penalties.

PBGC is also being more responsive to companies and plans in enforcing ERISA section 4062(e)—a statutory provision that imposes liability in certain situations when plan sponsors downsize. In light of comments, the agency plans to issue a re-proposed regulation on 4062(e). We have also begun to consider changes in how resources are directed within the 4062(e) enforcement program, in order to focus on the real threats to the retirement security of people in traditional pension plans.

Multiemployer Plans

More than 10 million of America's workers and retirees participate in and rely on multiemployer plans. Small businesses depend especially on these plans to provide retirement security to their employees. Some plans are in relatively good health—and have been for decades, even in the face of industry decline. But many are substantially underfunded; and for some, the traditional remedies of increasing funding or reducing future benefit accruals won't be enough.

We have been studying the challenges facing multiemployer plans and listening to stakeholders about possible approaches to address them. It is clear that as Congress considers multiemployer plans in the coming months, PBGC's multiemployer program will also have to be reviewed and revised. We are working with Congress to begin to address these major challenges and will publish a Multiemployer Plan report soon to help advance the process.

Improving Retirement Security

Going forward, the challenge is not only to preserve the many valuable parts of our current retirement system, but also to rethink and enable new forms of retirement security.

In December, PBGC held a forum on the future of retirement security. We invited leading thinkers from the pension community to discuss the present and future of retirement security, including the place of defined benefit plans. We structured the forum as an opportunity to begin a conversation and to listen. What we heard was illuminating.

Some employers, who have seen overall benefit costs rise, are looking for ways to limit costs and risks, and share them with employees. Some who have shifted to DC plans are considering ways to get some of the benefits common in DB plans. For example, they are looking at auto-enrolling their workforce, so that workers participate by default. Some employers with DB plans have told us they would consider hybrid DB options with some features of DC plans as an alternative to freezing their plans.

Retirement experts across the spectrum agreed that delivering pooled risk was a key to providing retirement security, whether that meant finding a way to build it into a DC plan or making DB plans more attractive.

What Can Government Do?

There are many approaches that government can take to encourage more secure retirements. Some of these options include finding ways to strengthen existing plans, facilitating new options, helping individuals understand their retirement choices, and reducing administrative and regulatory burdens.

In the year and a half I've been at PBGC, I've learned a bit about the rhythm of pension policymaking. Pensions are so complicated that legislative consensus has taken years to develop. Legislative changes have been bipartisan and usually involved both the labor and tax committees of both houses.

We all recognize that the Congress has many priorities this year. Nonetheless, it is significant that you are holding this hearing. America's workers are already concerned about the adequacy of their retirement programs and hearings like this help advance the discussion we will need to respond to them.

Those deliberations must involve all constituencies in a spirit of cooperation. They must be both far-sighted and practical. PBGC has broad expertise both in retirement programs and in business's ability and willingness to provide them, and looks forward to assisting.

Thanks very much for the opportunity to report on our agency and to raise some of the concerns about retirement security that we share. I would be happy to answer any questions.

Chairman ROE. Thank you for your testimony.

And I am going to start by injecting something a little personal. My father lost his job when he was 50, and this is prior to ERISA, and basically after almost 30 years post World War II ended up with, at 50 years old with a high school education and no retirement plan.

Now, I think we have a solemn promise to people when you make those promises that we keep those promises, and I think when a person is out working—many of these very hard jobs, labor jobs—they plan on this retirement along with their Social Security and whatever money they can save for their years. And what most Americans fear now, and you see it all the time when you talk about your seniors, is outliving your retirement plan. So these are very important.

I think one of the things that—I was—served on our pension committee in my business in practice for almost 30 years and we, for the reason of expense, gave up a defined benefit plan in 1980. For a small business it was very hard to project—we figured 30 years ago it was going to be very difficult for us to fund this so we went to a defined contribution plan at that point.

Having said that, though, there are many Americans—over 40 million—who have a defined benefit plan, they expect to get paid what they are told. And also, I wanted to ask, in the company you use to do your audits, it is a little bit disconcerting when people are already fearful that they have lost their pension plan. I can assure you there are a hundred and something thousand American Airlines workers right now that are worried to death: Am I going to get what I was promised?

And then we find out that, through the I.G., that maybe we haven't, in eight of the ten that the largest termination plans, and this same company was used that didn't do it correctly, how do we know it is done correctly and how much is it going to cost to correct the mistakes?

Mr. GOTBAUM. Very important. Let me say that we—for all of the reasons that we just said we think it is important to preserve the plans that people have. At PBGC it is also important that they not worry that they are getting the benefit they are entitled to.

And the fact of the matter is you are absolutely right that the mistakes that the agency made some number of years ago undermines the security we want to offer to everybody. So let me tell you again what we did.

One is, the company that was doing those so-called audits wasn't an auditor. They weren't a CPA firm. They are not doing audits for PBGC anymore; we have hired CPA firms to do the job. That is one.

Two, for—we are starting on the ones where we know we made a mistake, which is United and National Steel, and we are then applying those lessons to the other plans, and—because we are going to find our mistakes and we are going to correct them——

Chairman ROE. Well, the reason this is very important is that trust is important because if I am a retiree out there and I have paid in I am now questioning, learning this, am I getting what I should be getting? And that is a very honest question on their part—am I getting paid what I should be getting paid?

Let me go to another line of questioning. I know we just saw the American Airlines just yesterday, I guess it was, or day before yesterday, about pension. Do you see any companies that would be out there that would be using the bankruptcy, I guess, ability to shed their pension liability? We are looking at $8 billion here of liability that they won't have, I think, is what I read, or more with—they have assets, obviously, but do you see that?

Mr. GOTBAUM. Mr. Chairman, this one is a difficult question because, as you have said, we are trying to do several things at once here. One is, we want to. When a company cannot afford to pay its pension we will step in, absolutely. But there are times—I ran an airline in bankruptcy so I have some experience in this—there are times when companies in bankruptcy ask for things they don't really need, and so part of what we have to do is we have to say, "What are the facts? What can you really do? What choices do you really have? Do you have to, in order to succeed as a business, kill your employees' pension plans?"

We think it is important to do both, to be ready to pick up benefits if the plans need to be terminated, but first to see whether they can't be saved. That is what we do every day, and I will tell you, having been—as a—I was across the table from PBGC when I ran Hawaiian Airlines. I will tell you, they are pretty good at it.

Chairman ROE. So you will be looking, along with the bankruptcy judge, will make those decisions. Is that correct?

Mr. GOTBAUM. Yes, sir.

Chairman ROE. So that we won't be—there won't be a situation where they can walk away from this liability unscathed.

Mr. GOTBAUM. No, sir. If either we believe that a company can't afford its pension or the bankruptcy court believes then we take on the pension.

Chairman ROE. Okay.

Mr. Andrews?

Mr. ANDREWS. Mr. Chairman, I am going to defer to Mr. Miller as our first questioner this morning.

Mr. MILLER. Thank you very much, Mr. Andrews.

And thank you, Mr. Chairman.

I would like to continue where the chairman was going, Mr. Gotbaum. And thank you very much for your service. Thank you very much for your candor on the issue of the United Airlines. You inherited this mess; it is almost a decade old. But I appreciate the tenacity with which you are going after it and I hope that we will have good results for those employees that have missed the benefits of the proper appraisal of those assets.

I wrote you a letter earlier and I am very concerned that we don't repeat some of the downside of the United Airline, and American Airline obviously timed its filing and its pension contribution here together, so instead of paying $100 billion they decided—I mean, they—$100 million they decided they would pay 6.5—they would pay 6 percent of what they owed under the plan.

The question is, do you have the ability or will you pursue the ability to go after that money in the bankruptcy court? I appreciate the rationale of bankruptcy why they did this. We all know why they did it; it was cleverly thought out. But are you going to pursue that additional—$90 million—in that payment?

Mr. GOTBAUM. Yes, Mr. Miller, we are, but we are going to do it in two different ways. One is, the powers of PBGC are not infinite, but one thing that we can do is when a company doesn't make a pension contribution that they are supposed to is we can go outside the bankruptcy process and file liens against those parts of the company that aren't in bankruptcy——

Mr. MILLER. You will pursue that?

Mr. GOTBAUM. Oh, we have already done so.

Mr. MILLER. Thank you.

The other question is, PBGC gave up its right in the United case to restore the pension should United become profitable with some obligation for the pension. I assume we are not going to give up that right. United is now profitable and the taxpayers are still stuck and the workers are still stuck. I assume that that will not be given up in this effort without some negotiation or some benefit to the workers and to the taxpayers?

Mr. GOTBAUM. As I said, Mr. Miller, as you know, first thing we are going to try to do is see if we can keep those plans in place. If there is termination the answer is yes, we are going to try to protect the interest of the retirees and of the PBGC, and that means being smart about getting the best recovery we can.

Mr. MILLER. Well, the other lesson was that then on the morning that the bankruptcy determination was made the workers took their cuts, the taxpayers took the liability, and the executives of United Airline all got bonuses for steering United Airlines through bankruptcy. I assume there will be some challenge if that money is available for bonuses it might be available to lower the burden on the taxpayers of this country and on the workers who will lose a significant portion of their pensions should this happen and should they be entitled only to those payments under PBGC.

Mr. GOTBAUM. Yes. Yes, Mr. Miller. One of the things—I can tell you from personal experience, because I have been on the other side of the table from PBGC, is the folks at PBGC are active creditors. They believe in getting the best that they—we possibly can for our recovery to protect ourselves, and, although nobody puts it quite that way, bankruptcy is about equity and we go for justice.

Mr. MILLER. I guess I am a little bit suspect about how active they were in the United case, okay, and I think that taxpayers got screwed and I think the workers got screwed, okay? So I would just like to know that this PBGC, under your leadership, is going to be more active about conserving the taxpayer resources and conserving the workers' resources in this plan.

Mr. GOTBAUM. I hope——

Mr. MILLER. I don't think United has been liable for workers or taxpayers.

Mr. GOTBAUM. Mr. Miller, I hope that the actions of the PBGC over the last month have convinced you that the PBGC is going to be——

Mr. MILLER. I say that, as you read here, that this is going to be the largest, largest pension default in the history of the country. This is an airline that is into us for, I believe, $1 billion for the change in interest rates that the Senate changed in the minimum wage bill. Minimum wage workers got 75 cents and American Airlines got $1 billion in the same bill.

So that $1 billion, I assume that must—is that beyond reach in the bankruptcy court? That is the—suggested that that has been the value of that change in interest rates.

Mr. GOTBAUM. Yes. What that is is that over time American got funding relief that enabled them to avoid putting $1 billion into their pension plans——

Mr. MILLER. Right.

Mr. GOTBAUM [continuing]. $1 billion that would have increased benefits if the plans are terminated——

Mr. MILLER. And the fact is they are about to offload $1 billion onto the taxpayers after getting $1 billion in relief. So they are into us for $2 billion.

And so they scheduled the payments and they got the Senate to change the amendment so that they could change their payments or their contributions to the pension plan and then they schedule their bankruptcy so they could minimize the payments. This is a hell of a deal. It is just not very good for taxpayers; it is not very good for workers.

And, you know, we are really relying on you in this one. This is a test for other reasons of others that are falling. But if you can work it out, if you can get an early bailout and you can reschedule your payments, and then you can reschedule your payments in bankruptcy, there are 14 million homeowners who would like to have the same shot at that deal.

So you have got a big load to carry. I have a lot of confidence in you, but this is—these are tough adversaries.

Thank you very much.

Chairman ROE. I thank the ranking member.

Now, Dr. Heck?

Mr. HECK. Thank you, Mr. Chairman.

And thank you, Mr. Gotbaum, for being here this morning. I appreciated your testimony.

The administration's premium proposal calls for the PBGC to have the discretion to set variable rate premiums, including the authority to adjust premiums to account for risk as a private insurance company would. Of course, defined benefit plan sponsors are captive customers of the PBGC as they are required by law to pay the premiums and there is not a private market alternative.

Can you explain why the power to essentially tax plan sponsors should be centralized with a government agency that may have an incentive to increase premiums to offset its own operational shortcomings but not to provide a competitive price to the consumers? This is just akin to the fox watching the hen house.

Mr. GOTBAUM. Yes, Mr. Heck. That is a very important question because I spend a lot of time talking to my customers because my view is that the businesses that pay premiums to PBGC are PBGC's customers too.

And it is funny, but having been in business two-thirds of my life, none of us likes to have premiums go up. Doesn't matter whether it is a government insurance agency or a private insurance agency, et cetera.

The reason why we think it is important to move to a more business-like scheme is two-fold. One is that right now, because we have to wait until there is legislation, the PBGC's deficit gets large enough so that some folks are getting nervous. But that is not the main reason, from my perspective.

The main reason is that when you have premiums set by law you have to use a kind of one-size-fits-all approach. And let me take a specific case.

You are going to hear from the panel—later on in the panel from U.S. Steel, a company with which I a long time ago did business. And U.S. Steel makes the point that they care about their pension plans, they fund their pension plans, and they are responsible citizens, and they are.

But right now the way premiums are determined, if we have to take on the pensions of American Airlines and our deficit goes up by $9 billion American isn't going to pay those increases, U.S. Steel is going to. And so for that reason we think it makes more sense not to punish U.S. Steel for being a good citizen, for caring about pension plans and—but to say, "You deserve lower rates than the guys who are higher risk." That is the reason we proposed it.

Now, I want to be real clear: There are lots of issues about how do you make sure that PBGC doesn't go off the reservation? How do you make sure that things don't go—what the administration has done is proposed a starter proposal to the Congress in the hopes that we can have a discussion about how best to do this.

We think it is important to do it. We don't think that anybody has a monopoly on wisdom on how, but I would like to get to a system that I could explain as fair to solid customers like U.S. Steel.

Mr. HECK. And I appreciate that, and as I would express, the concern would be not that PBGC would necessarily go off the reservation but that we start seeing changes in premiums because of internal difficulties that PBGC is having and not necessarily based upon the risk for a given policy, and that would be the concern.

And I thank you, Mr. Chairman, and I yield back.

Chairman ROE. Thank the gentleman for yielding.

Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman.

Mr. Gotbaum, thank you for your testimony. I wanted to explore your ideas about closing this $26 billion deficit. And, I mean, obviously what we all hope is that we would have economic growth that would make the assets that you hold more valuable.

I mean, a quick back-of-the-envelope guess is if the Dow Jones were at 15,000 your assets are probably worth about $120 billion today and you wouldn't have a deficit. But I don't think that we can legislate that or hope for that. I mean, I am trying to pass a bill that says that we will win the lottery in my family but it hasn't worked so far.

So we do have to look at two other issues, and one is premium increases, and the other is the way that you calculate your deficit—the assumptions you are making in calculating your deficit.

Let me say, with respect to premium increases, that—and I speak only for myself on this—that I share the concern of those who would create simply discretionary authority for you or anyone else to set these increases. I think Dr. Heck's question is well founded.

And again, without prejudice, how would you react to a thought that there would be two limitations on your premium authority—the first is that any premium increases would have to be completely dedicated to the assets of the PBGC, could not be sent to any other purpose in the federal government. In other words, we couldn't raise the premiums and then drain the revenue for general purposes.

And then the second would be that there would be some statutory ceiling with which you have to operate. You would have authority to increase your premiums up to X, and X could be tied to some general economic metric rather than simply what the agency thinks.

How would you react to that?

Mr. GOTBAUM. I would say, Mr. Andrews, that you are talking about just the sorts of issues that we think must be talked about in order for the Congress to have comfort doing this. This is exactly the kind of discussion we hope to have.

I will tell you two things in response to your specifics. One is, we agree that this has to be for PBGC. PBGC's funds are not taxpayer funds. We are trying to make sure that we never ask for them.

Mr. ANDREWS. Right.

Mr. GOTBAUM. And so premiums are dedicated for that purpose.

Secondly, last year we put a little flesh on the bones. We proposed that PBGC get the authority—that the PBGC's board get the authority to raise rates, but some important things: One is, we proposed a dollar limit on the total amount of the increase. That is one.

Secondly, we proposed that no matter how it was—got done, that nobody's—no company's premium could go up by a certain amount above where it was last year. And the reason we were doing that, sir, was to deal with exactly the issues that you talked about, which is we want to keep our customers. We want to keep companies in the DB system. We don't want to scare them away.

Mr. ANDREWS. Let me ask you about the valuation side of the equation. The assets are presently valued at around $90 billion. Is that right?

Mr. GOTBAUM. A little over $80 billion, sir.

Mr. ANDREWS. A little over $80 billion. Are most of them held in bonds? Where are the assets?

Mr. GOTBAUM. Yes, sir. The investment policy of the PBGC has changed from time to time over the 37 years, but for most of its existence it looks like this: It is roughly a third in equities, a third in fixed income instruments, and about a third in treasuries. And that has been—it has bounced around. The GAO did a report——

Mr. ANDREWS. What assumption are you making about bond rates——

Mr. GOTBAUM. Okay, if I may, the way we evaluate our obligations is—and this has been the case for a very long time—is we mark them to market but we mark them to the annuity market because our obligations look like annuities——

Mr. ANDREWS. But I am asking about the assets, not the obligations. What are you assuming——

Mr. GOTBAUM. The assets are marked to market at current value, so in other words, whatever bonds trade at today.

The liabilities, though—the liabilities are the hard part. That depends on what you think interest rates are. We—and our accountants have supported this for 20 years—we mark our liabilities to market by getting quotes for annuities, because our benefits are annuities. That works out to be—last time I looked it was a little under 5 percent as the implied discount rate in the——

Mr. ANDREWS. Are these all based upon a certain economic forecast? I mean, I think it is pretty broadly assumed that because of the artificially low short-term interest rates that we are now living with that at some point in the near future interest rates are going to rise. Have you taken that into your consideration in stating the size of your deficit?

Mr. GOTBAUM. Yes, Mr. Andrews, we have, but I have—there are a lot of folks, including some who are sitting behind me with whom I have had lots of discussions, who would say, "Why don't you evaluate your liabilities based on the corporate bond rate?" The reason we don't is because we think we should mark it to market and so we use a rate that is different. But if we use the corporate bond rate our deficit would be instead of $26 billion, $21 billion.

Other people say, "You are an insurance company. Maybe you should use the discount rate that insurance companies use." In that case our deficit would be $28 billion.

If I may make one more point, which is, I don't think the issue is by any means just the deficit, because what isn't in our deficit is the plans that are coming in the future. For example, the $26 billion which we announced in November, as at December—as at September 30th—doesn't include American Airlines. If American Airlines comes in it is going to be——

Chairman ROE. You have got to finish up, Mr. Gotbaum.

Mr. ANDREWS. Thank you, Mr. Gotbaum.

Thank you, Mr. Chairman.

Chairman ROE. Thank you, Mr. Andrews.

Mr. Wilson?

Mr. WILSON. Thank you, Chairman Roe, for holding this important hearing.

And, Mr. Gotbaum, thank you for being here today. As you stated in your testimony, the PBGC has reported a $26 billion deficit at the end of the fiscal year. And again, it is going to look like Congressman Andrews and I are in lockstep on issues relative to asking a question, and it relates to our mutual interests in how you calculate the deficit.

My understanding is that the deficit is calculated using interest rates that are even lower than today's artificially low rates. Is that accurate?

Mr. GOTBAUM. Our liabilities are calculated by going to insurance companies and getting quotes for annuities that mirror our obligations. This is what we have been doing.

When you compare those to the current bond rates that are used by corporate pension plans they are lower by, last time I looked, about 75—by about 75 basis points. But the point that I think is, again, worth making is that even if we used the corporate bond rate our deficit would be over $20 billion, and that excludes if we end up holding pensions like American Airlines. It excludes future claims.

Mr. WILSON. And people may be disagreeing on this because Ken Porter will be testifying in the second panel, and he believes that if normal pre-economic downturn interest rates were used that the PBGC would have no deficit. In other words, if we used interest rates in effect before the government began its concerted effort to keep interest rates low the PBGC would have no deficit.

In this context, why is PBGC asking for $16 billion in additional premiums and why isn't the PBGC publicly disclosing that the deficit is a product of the artificially low interest rates?

Mr. GOTBAUM. If I may, let me say a couple things. One is, I have a lot of respect for Ken Porter and for the folks he represents. PBGC is now a $100 billion financial institution, and one of the facts over the last decade is it has become clear that financial institutions need to be more accountable, not less.

There are folks, like Ken, who would argue that we should go back to some of the tools that pension plans used to use of smoothing or average interest rate. Our view is that is not consistent with honest accounting and we don't think we should change our accounts, and our auditors agree.

Mr. WILSON. And I do have to tell you, when you mention mark to market, I am a former real estate attorney, and I was just startled by using mark to market that mortgages that I felt like had value somehow came back with no value. But I just raise that to you, that it is—we wish you the best and I am just so happy that Chairman Roe is working on this issue.

So I would refer back to the chairman.

Chairman ROE. I thank the gentleman.

Mr. LOEBSACK. Thank you, Dr. Roe.

Mr. Gotbaum, I do appreciate you being here today. Last week I was privileged to be able to take part in a field hearing held by Chairman Harkin from the Senate Health Committee, and much of that focused around helping to ensure the survival of the middle class. And I guess I can't state strongly enough that for the sake of the middle class of America that we need to make the middle class a priority on this committee, and I think we really do need to focus on improving the retirement system for American workers. It is really critical for the American middle class, particularly the defined benefit programs, but as well, those defined contribution programs.

So I am really happy we are having thing hearing today. And I think it is good that we are learning more about these issues.

I do applaud you for standing up for the American Airlines workers. I appreciate that. I hope you continue to do so, as Mr. Miller mentioned.

And also for thinking about the long-term solvency of the PBGC. There is simply no way around it. We have to do that. We have to figure out how we are going to really continue this process and continue the great work that the PBGC does.

But I have concerns, like everyone here I think, about the long-term solvency issue of the fund, and I am concerned about ensuring adequate guarantees, of course, for hardworking Americans who were relying on their retirement funds.

I want to just piggyback a little bit on what Mr. Andrews brought up as far as, you know, how you are going to fund this system in the future. Can you explain in particular how a risk-based system might affect already cash-strapped companies that are out there and pension plans and how that can be countered? Because there is certainly a fear, I think, that increased cost could drive some of these companies to a breaking point given the economic crisis that we have now. So can you answer that particular question?

Mr. GOTBAUM. That, Mr. Loebsack, is a very important question and we have given it a lot of thought. It is, by the way, an issue that other government insurance programs and other agencies, like the FDIC, which has risk-based premiums, like the flood insurance, like the crop insurance program has as well.

What we think needs to happen is that we should take the facts of each company and plan into account but there ought to be limits and there ought to be a waiver process, there ought to be limits, and there ought to be enough consultation and care in putting this together so that—I may be loose when I say—going off the record—so that we don't accidentally create a situation that is a problem. We are pretty comfortable that within the range of premiums that we are talking about we are not going to put anybody out of business. Premiums work out on a per-hour basis to be about three and a half cents an hour, so if you—you know, if you even triple them you would be talking an increase of seven cents an hour, which is, for the average industrial worker, a fairly small piece.

But even though the numbers, we think, in practice would be small, we agree with you completely that there need to be safeguards to make sure that we don't by accident create a situation that would get somebody out of the DB system, because that is not what we are trying to do.

Mr. LOEBSACK. Right. I think that is a fear that a lot of companies have, and some labor unions, as well.

Mr. GOTBAUM. It absolutely is. And that is why, by the way, we think that if we can get you all to consider this there are going to have to be safeguards. There are going to have to be limits and procedural safeguards, et cetera, so that you have some comfort that we do this in a way that actually enhances the system.

Mr. LOEBSACK. What about some other ideas that might be out there, other ways to do this other than the system that you are thinking about? What else have you taken into account?

Mr. GOTBAUM. We have heard only a limited number of alternatives. For example, a lot of folks have said, "Just don't raise the premiums and wait until you really do run out of money." We don't think that is—we think that undermines security so we don't think that is a responsible thing to do.

Other folks have said, "Why don't you just keep raising premiums the way you have in the past?" And the reason we don't like that so much is because now half of our money comes in what is called the variable rate premium, and that premium base is based on how underfunded a plan is. And that means that when the economy goes down, when markets go down, when stock values go down pension plans become underfunded and their PBGC premiums go through the roof just at the time they can't pay it.

Mr. LOEBSACK. Right.

Mr. GOTBAUM. So our view is, let's not do it that way. Let's find a way so that premiums don't hit you hardest when you are least able to pay.

Mr. LOEBSACK. All right. Thank you. I really do appreciate it.

Thank you, Dr. Roe, for having this hearing.

Chairman ROE. I thank the gentleman for yielding.

Chairman Kline?

Chairman KLINE. Thank you, Mr. Chairman.

And thank you, Director Gotbaum, for being here and being so forthcoming in your answers. A lot of discussion today about exactly how much this deficit is it $26 billion—$22 billion sort of hike thing, but it is money. And now, just looking at this little chart and realizing that from the first day I arrived the PBGC—in Congress back in 2003—the PBGC has been operating at a deficit. I am feeling some personal responsibility here about that.

But on a more serious note, we are concerned, clearly, about the health. We are interested in the request for premium increases. We are going to examine that here in this committee. I think the questions that Mr. Andrews, and Mr. Wilson, and Dr. Heck, and other—Dr. Loebsack asked are right on point.

One of the things you mentioned as I was walking in late—and again, I apologize; I think it has probably been explained that there was a National Prayer Breakfast today, and incredibly, the traffic in Washington was tough, and so we were late getting back. But you mentioned very briefly as I was walking in some concerns about multiemployer plans, and that works a little bit differently in the PBGC than the single employer plans.

And I am looking at a note here about the 2010 Annual Exposure Report that said it is possible for the multiemployer program to be insolvent in the next 10 to 20 years. Have you got an update on that? Is it better or worse?

Mr. GOTBAUM. Oh, it is clearly getting more troubling, Mr. Chairman. The multiemployer universe is, as you know, very important, covers lots of small business, covers lots of people. It is also a part of the pension world about which we know less because we don't get—in other words—for example, the folks at U.S. Steel, they are a public company so we know something about their economics, okay?

We don't know very much about all of the small businesses and large businesses that participate in multiemployer plans, so we are working in something which the very distinguished actuaries sitting behind me from PBGC would be offended if I called really educated guesses. But based on those models and projections, it does look like there are clearly some multiemployer plans that are going to get into trouble, and the way we do our accounts, if you will, is we kind of look forward 10 years. So when you have got a plan that might go insolvent 11 years from now it probably isn't in our accounts; if it is going insolvent in 9 years it probably is. That is where we are about now.

So we think this is a problem which is growing. We also think it is a problem that is important.

Fortunately, as you can tell from the fact that I am talking 10 years, this is something which this committee can consider in a reasoned and bipartisan fashion over the next couple of years, and we hope that is what you will do. And obviously we would like to help assist and provide advice on that.

Chairman KLINE. Well, I thank you for that answer, and that is, of course, the answer that I expected. We do know that there are some pretty large multiemployer plans that are indeed in trouble, and we are watching those.

And I was thinking back to a few years ago when we did the Pension Protection Act and we tried to grapple with the multiemployer plans, and sure enough, it is more complicated. It is not straightforward; there is not a single company. You have companies coming and going, and they have to pay withdrawal liability, and it—grappling with it I thought that we made a decent effort at it—to get at it, but looking at it, there is going to be some more work that is going to be required not just because of the PBGC, but the structure needs to be looked at.

Anyway, I want to thank you very much for your time here today.

And, Mr. Chairman, I will yield back.

Chairman ROE. Thank the chairman.

Mr. Kildee?

Mr. KILDEE. Thank you, Mr. Chairman.

Mr. Gotbaum, what percentage of what the—they had expected from Delphi did the salaried Delphi employees receive from PBGC?

Mr. GOTBAUM. Mr. Kildee, this is a good question, but unfortunately, because of some work I did before I joined the federal government—I was working with some institutions that became involved in Delphi—I am recused from discussions of Delphi. So if I may, can I have my staff, who is not recused, get back and answer those for the record—answer any of your questions on that subject for the record? It is very important that we answer them, but I am not allowed to do it personally.

Mr. KILDEE. Can we do that at this time, or——

Mr. GOTBAUM. I think it would be better if we did it through the record process. I promise you we will answer those, because my view is, part of our job of providing retirement security has to be that we answer the questions of the folks whose pensions we take care of.

Mr. KILDEE. Let me just ask you this—maybe you can——

Mr. GOTBAUM. Sure.

Mr. KILDEE. Is this amount—what percentage they are getting from what they had expected from the corporation, getting from PBGC—is that determined by hard law or by some type of formula that is——

Mr. GOTBAUM. It is actually more complicated than that, Mr. Kildee. The rules are, we start with the pension plan that was terminated. So we figure out what benefit each person would get under that pension plan when it was terminated.

We then have a separate—an additional set of rules—there are limits on how much we can pay—that we also. And unfortunately, this complicated process takes a long time. I wish it were different. I wish we were like Social Security, in which case we would just have a formula, but we don't.

So what I am sure we are doing now at Delphi is we are following the process that we have to follow, which is first figure out what their plan provides, then apply the limits that we have, and then tell folks about it. And if they disagree—and plenty of folks do—we have an appeals process and a review process to do that.

But if you want to get more specific details I would be more than happy to make sure that we talk with you and your staff with folks who don't have to be recused.

Mr. KILDEE. I would appreciate that and I will defer until that time.

Mr. GOTBAUM. Thank you very much.

Mr. KILDEE. Thank you very much.

Chairman ROE. Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Mr. Chairman.

Mr. Gotbaum, thank you for joining us today. Before I proceed with my questions I would like to underscore that retirement security is vitally important to millions of American workers, and as many of our colleagues here in our committee have stated, our nation must maintain its longstanding commitment to protect Social Security and Medicare guarantees and ensure that workers receive their promised pensions.

My question to you, Director, is I understand that American Airlines is proposing to terminate their four pension plans. How do American Airline pension obligations compare to those of other airlines?

Mr. GOTBAUM. That, Mr. Hinojosa, is one of the issues that we are trying to find out, because from our perspective, as I mentioned, we can't say nobody should be allowed to terminate their pension if they really can't afford it, and part of the issues in a competitive industry like the airline industry—and I worked in that industry—is you have to look at what you do versus other competitors. However, I will tell you that it is not just pension costs that go into this. It is the cost of all workers that go into this comparison so that, for example, I can tell you that last year American's per employee pension costs were less than those of Delta by about 60 percent, okay? They were higher than those of United by a smaller percentage.

That is the kind of information which we need to get in order to form a judgment about whether they need to terminate their pension plans. That is one piece of it.

The other piece of it, so that I give you a full answer, is what other options do they have? Can they think about other ways of raising revenue? Can they think about other ways to cut costs besides killing their employees' pension plans?

Mr. HINOJOSA. So when you get that information that compares the airlines what can we in Congress do to improve the retirement security of defined contribution plans such as our own 401(k)?

Mr. GOTBAUM. I am really glad you asked that question because from our perspective that is another important issue on retirement security. We understand that employers, for a lot of reasons, want to go into defined contribution. We also understand that people are unhappy with it.

So what we are trying to do—my colleagues in the Treasury are leading the charge—is trying to make—excuse me—to allow changes in defined contribution plans that give workers more security. So we are trying to find ways to give them options that offer lifetime income streams.

We are trying to find ways to give them options so that they don't have to remember to sign up for the plan in order to be in the plan. Those are efforts that my colleague, Mike McKeever, at Treasury has been leading for some time. We think it is a really important question, and I have got to say, I am really glad that you asked it, and——

Mr. HINOJOSA. In looking at the chart that was given to us that came from your office there are three types—the defined benefit, the both defined benefit and defined contribution, and the last one, the defined contribution only. Speak to us about the fundamental importance of the defined benefit plan for American workers.

Mr. GOTBAUM. Throw me into the briar patch. Thank you.

As you all know, pensions are really complicated. People don't have time to do the math, they don't have time and the skill to pick investments, et cetera, and that is all the reasons why the traditional defined benefit plan, in our view, provides better retirement security, because defined benefit plans don't require us to become actuaries. They don't require us to become investment experts.

And they provide workers with a secured income for their entire life. They don't require people to guess whether they are going to live to be 85, 90, or 95. So for all those reasons we think defined benefit pension plans are a better way to go.

However—and this is important, too—it is also clear that because this is a voluntary system that there are a lot of companies who have said, we will not or we cannot take the effect of having a pension plan on our reported financials, or the expense, or whatever, et cetera. That is more than we will do.

And so from our perspective, that is why it is important that we encourage, make available hybrid options that have some of the benefits of defined benefit but share some of the risk with employees.

Mr. HINOJOSA. Thank you.

Mr. GOTBAUM. From an employee's perspective——

Mr. HINOJOSA. My time has run out.

Thank you, Mr. Chairman.

Chairman ROE. Thank you, Mr. Hinojosa.

Mr. Scott?

Mr. SCOTT. Thank you. Thank you, Mr. Chairman.

Mr. Gotbaum, just a series of kind of quick questions. The state and local pension funds have been pointed out as a cause of concern. They are not under your jurisdiction at all. Is that right?

Mr. GOTBAUM. No, Mr. Scott, they are not.

Mr. SCOTT. The defined contribution plans that my colleague from Texas just talked about—this just shows the number of people covered by the defined contribution, it doesn't show the size of the fund?

Mr. GOTBAUM. That is right. This is the number of people in private industry.

Mr. SCOTT. But most of those are woefully inadequate for any kind of meaningful retirement plan. Is that right?

Mr. GOTBAUM. I would say it differently——

Mr. SCOTT. The median for the defined contribution is totally inadequate for any meaningful retirement plan.

Mr. GOTBAUM. I would like to agree with you completely, Mr. Scott, but I think it is worth saying that I think the situation has some additional complications, which is there—if you look at the average defined contribution plan amount for people who are close to retirement, that is a much bigger number that we are talking about.

Mr. SCOTT. The median, not——

Mr. GOTBAUM. Yes, yes. However, what happens is that if the markets go down just before somebody retires they are stuck. So if you had somebody who was counting on their 401(k) and was going to retire in 2009, they ain't going to be retiring. So that is why we think defined benefit is——

Mr. SCOTT. Well, that is an additional risk that the market may go down right when you need it. In addition to that, the median is somewhere in the $30,000 to $50,000 range. Is that——

Mr. GOTBAUM. Yes. That is with regard to all ages——

Mr. SCOTT. Which means that that is not going to be much of a retirement. Now, one of the things that I have noticed is the amount of money we are trying to collect with this deficit, you have about 40 million people covered at $25 each, that would be $1 billion, which is not enough to cover the gap. We need to be focusing on making sure that plans don't fail as—rather than trying to raise enough money to cover them.

Now, are these plans—the funds set aside for these plans, are they subject to bankruptcy? I mean, the company goes bankrupt, these plans are set aside and can't be gobbled up by creditors; they are separate for the pensioners. Is that——

Mr. GOTBAUM. Yes, sir. That is right.

Mr. SCOTT. Now, is the PBGC a priority creditor in bankruptcy or are you just in line with all the other unsecured creditors?

Mr. GOTBAUM. For the vast majority of our claims we are another unsecured creditor. We are, to be fair, usually the largest unsecured creditor, and I am proud to say my colleagues at the PBGC are some of the most knowledgeable and smartest creditors any place, but yes, we are general—for the vast majority of our claims we are just an unsecured creditor.

Mr. SCOTT. Is it a crime to fail to contribute to a plan as promised?

Mr. GOTBAUM. It is not a crime, sir, no.

Mr. SCOTT. So if you have promised plans, if you just sit around and don't contribute to your plan that is just a civil offense, not a criminal offense?

Mr. GOTBAUM. Yes. It means you get a discussion with us.

Mr. SCOTT. Now, you have a fund—assets about $80 billion?

Mr. GOTBAUM. Yes, sir.

Mr. SCOTT. And you said you had one third, one third, and one third. Who manages that? Do you manage it internally or do you outsource the management?

Mr. GOTBAUM. There is a team of people within PBGC who are responsible for oversight but the actual day-to-day provisions are done by private sector managers who we oversee. We interview them, we hold competitions to pick managers, and then we pick managers and then we hold them accountable.

So there is a team of folks within PBGC who provide the oversight and—but the people who actually day by day——

Mr. SCOTT. Could you give us, for the record, a list of those and how many are women-owned and minority firms?

Mr. GOTBAUM. Of course.

Mr. SCOTT. Okay. We have talked about the growth rate that you assume in your planning for ascertaining whether you are solvent or not. I understand that the assumed growth rate is lower than the financial accounting standards for the FASB board number. Is that right?

Mr. GOTBAUM. I actually wouldn't say it that way, sir. There is an accounting standard which we follow for how do you measure your obligations, technically liabilities. There are two ways you can do it.

Most pension funds use the estimated return either on all of their assets or on bonds. PBGC, because what we do is we offer annuities, we do it by a market test. We get quotes from insurance companies for annuities and we add up those quotes to create a market price for our obligations. And we have been doing that for a long time.

Mr. SCOTT. And that number is lower than the Financial Accounting Standards Board's projected growth rate?

Mr. GOTBAUM. It is lower than—slightly lower than the corporate bond rate, but as I mentioned before, if we took the corporate bond rate our deficit would be north of $20 billion, and that is before American Airlines.

Chairman ROE. Okay. Thank you.

Dr. Holt?

Mr. HOLT. Thank you, Mr. Chairman.

And thank you for your testimony. I would like to continue along the lines of questioning of my colleague from Virginia to get a sense of how serious the problem is for the defined contribution compared to defined benefits.

I realize this is a defined benefit program and I realize that your financial liabilities deal with defined benefit programs. But you do have a responsibility for retirement programs in general, and I am not quite sure how you would quantify it.

But if your deficit of some ten—depending on how you count it, some tens of billions—represents how insecure the retirement is for those people in defined benefit that you might have to pick up for their retirement, what would be a comparable way of calculating—what would be a comparable figure for how insecure—how unlikely it is that defined contribution people would have a similar standard of living in their retirement? Do you see what I am trying to get at——

Mr. GOTBAUM. Yes, Mr. Holt. I do——

Mr. HOLT [continuing]. To quantify the scale. Because we are spending a lot of time here talking about, you know, this serious problem defined benefit plan funding for 10 percent of retirees, and I really want to make sure that we have clear on the record how large the problem is for the defined contribution.

Mr. GOTBAUM. And, Mr. Holt, with—I am going to answer your question as best I can, and with your permission I am going to send you all some further information afterwards for the record.

You are right that we don't ensure defined contribution plans but we do care about retirement security, and actually, the Congress has asked us to set up a missing participate list on defined contribution plans so we are paying attention to that part of the world, too. There is not the same quality of information that we have on the defined contribution side and the defined benefits side, so what I am going to mention now—and I will send you some more later—is some studies that were done by the Employee Benefits Research Institution, which is a nonpartisan, very well respected group.

They have estimated the effects on retirement income for both defined benefit plans and defined contribution plans, and what they say, which is, from my perspective, important, is that if you have a defined benefit plan the odds that you will end up being poor when you retire are cut dramatically, whereas if you have a defined contribution plan the odds that when you retire you will not have adequate income—and they have multiple tests for that—are actually disturbingly substantial. I would like, with your permission, to amplify that by sending you the——

Mr. HOLT. I will look forward to that. I hope we can cover that again, as we have somewhat in the past, in more detail at future hearings.

With regard to the premium adjustments, or proposed premium adjustments, I don't understand how the premium of the single employer relative to the multiemployer plans is determined. Forty years ago it was two-to-one roughly, I think. Now it is four-to-one. Can you explain that simply?

And after the premium adjustment that you are looking for it would still be four-to-one, or three-to-one, or something like that, I think. If you can do that simply I would appreciate it.

Mr. GOTBAUM. It is a good question. Let me start by pointing out the fact that the level of guarantee on the single employer program is a more generous level than the level of guarantee on the multiemployer program.

In the multiemployer program the most I can pay for someone who works for 30 years is just under $13,000 a year—a little over $1,000 a month, okay? For the single employer universe, yes, it is about four times that.

Now, I would like to tell you that the premiums were carefully calibrated based on both of those, but it wasn't that scientific because, as I mentioned, the premiums have been done as part of recurrent pension or budget legislation and that is part of the reason why we would like to be responsible for doing it within some limits, because we would like for there to be a fair relationship between exposure.

Mr. HOLT. Well, my time is about to expire. In your proposed adjustment in the premiums are you trying to readjust that or will the same imbalance remain? That should be a short answer because my time——

Mr. GOTBAUM. It is a fair question. We haven't said yet—what we have asked for is the ability to makes some judgments, propose them publicly, discuss them with the community, and then put them out for comment. That would clearly be an issue when we do that.

Chairman ROE. Thank you.

And thank you, Mr. Gotbaum. It has been, obviously, very informative. We appreciate your time and being here and I will now ask the other—you are excused and I will ask the other panel to please step forward and we will introduce you. Thank you.

Mr. GOTBAUM. Thank you very much, Mr. Chairman.

Chairman ROE. I thank the second panel for being here. It is now my pleasure to introduce our second distinguished panel this morning.

First is Mr. Ken Porter. He is president of Benefits Leadership International, LLC. His firm provides actuarial and international benefits consulting services.

Thank you for being here.

And Gretchen Haggerty is the executive vice president and chief financial officer of the U.S. Steel. She is testifying on behalf of the ERISA Industry Committee.

Randy DeFrehn is the executive director of the National Coordinating Committee on Multiemployer Plans.

And John McGowan is a professor of accounting at Saint Louis University. And Dr. McGowan has been an active teacher in the areas of taxation and international accounting for over 15 years.

I welcome the panel, and first I will explain—you have heard the lighting and we won't go through that again.

We will open with Mr. Porter?

STATEMENT OF KENNETH W. PORTER, PRESIDENT, BENEFITS LEADERSHIP INTERNATIONAL, LLC

Mr. PORTER. Mr. Chairman Roe, Ranking Member Andrews, and members of the subcommittee, thank you very much for this great opportunity to be here today. I must emphasize that I am here on my own behalf; I am not representing a company or any trade association.

I will note that my prior experience included extensive experience for a multinational corporation where I was the global—I had global responsibility for insurance risks as well as was the global chief actuary. I am an actuary by background.

I applaud the subcommittee for its extremely timely hearing that it is holding today. The historically low interest rate environment we are in is creating an artificial funding crisis for employers across the country. The crisis is diverting billions of dollars away from job retention and creation and away from economic recovery. Low rates are likely to cause pension plans to be vastly overfunded in a few years when the rates increase.

In addition, today's artificially low rates are costing the government billions of dollars by—because it must reimburse government contractors who are compelled to fund their plans in excess because of the lower interest rate environment. Measurement of pension liability is an inexact science. It requires a myriad of assumptions about economic future and long-term economic behavior.

Current rules inadvertently mandate that the assumption that today's difficult economy will remain unchanged for the next century. None of us wants that to happen.

Certainly the Federal Reserve doesn't believe it will. They clearly acknowledge their role in holding interest rates down as a means to stimulate the economy. I have no objection to that.

They fully expect, however, that rates will start going up after they cease their control in 2014, or sometime shortly thereafter. Nevertheless, it is required by law that pensions be funded as if the economy will never improve.

Frankly, the Pension Protection Act was predicated on a free market economy where interest rates would remain relatively in a normal range. There was no serious consideration about the prolonged effect that a prolonged Federal Reserve activity would have on the implications for pension funding or on the PBGC liability.

The problem is clear: It is inappropriate to require pension funding to assume economic distress will continue indefinitely. Similarly, the required presumption of perpetual economic distress creates the illusion of a PBGC deficit. The PBGC, however, is not as underfunded as it would appear.

For example, the PBGC's own reports say the bulk of their reported deficit is directly attributable to interest rate declines beginning in 2008 when the Federal Reserve began its economic stimulus activity. The return to more normal rates will therefore eradicate most of this deficit.

In addition, it is reasonable to expect the PBGC investments will outperform the current historically low interest rate environment. In fact, the PBGC's own investment returns have averaged about 10 percent over the last 3 years. While we can't guarantee that in perpetuity, these returns could certainly resolve the remainder of the reported deficit.

In short, the PBGC's deficit is based on assumptions even the Federal Reserve doesn't think will happen. It is what is there.

Accordingly, Congress should not use reported deficit as a basis for increasing the premiums. PBGC has asked for authority to set its premiums like an insurance company. Unfortunately, the insurance company analogy falls apart quickly.

If it were a true insurance company it never would have insured many of the plans that it now has assumed. When a company goes to buy insurance the company decides what and how much insurance to buy, it enters into negotiations with the insurers of its choice, company can eliminate its coverage all together if it doesn't like the deal. Meanwhile, commercial insurance companies are under strict supervision of insurance commissioners and must be competitive in cost and responsiveness to the needs of its customers.

These factors help assure a fair and competitive insurance purchasing environment. None of this is present today with the PBGC.

Plan sponsors are captive clients. There are no negotiations, no discussions of business need, no choice of coverage, and no choice of providers. Except for the oversight of the U.S. Congress there is no form of protection that we are aware of at this point that would be afforded to premium payers.

Finally, I would like to discuss briefly an issue that is of great concern to the pension community. It is related to the ERISA Section 4062(e).

In the summer of 2010 the PBGC issued proposed regulations dealing with liabilities attributable to the shutdown of a facility. The proposed regulations are inconsistent with our understanding of the statute, inconsistent with previously published PBGC guidance, and with the PBGC's historical enforcement. The statute was not intended to do that.

Finally, the PBGC has now correctly identified that the proposed regulation as needed—is needing review under the applicable executive order. Nonetheless, it is my understanding that the enforcement arm of the PBGC continues to enforce this rule as if it were formal and final guidance. This is having a detrimental effect on ordinary business transactions that are posing no risk to the PBGC and are essential as companies work toward economic recovery.

I thank you for the opportunity to testify and I look forward to your questions.

[The statement of Mr. Porter follows:]

Prepared Statement of Kenneth W. Porter, Founder and Owner, Benefits Leadership International; Retiree, the DuPont Co.

Chairman Roe, Ranking Member Andrews, and Members of the Subcommittee, I am grateful for the opportunity to appear before you on the challenges facing PBGC and defined benefit pension plans. My name is Ken Porter, and I worked for 35 years for The DuPont Company, from which I retired as the Finance Director for Corporate Insurance and Global Benefits Financial Planning. I also served as Global Risk Manager and Corporate Chief Actuary with responsibilities that included DuPont's defined benefit pension plans covering more than 160,000 participants in the United States and with about $18 billion in U.S. defined benefit plan assets. I also had actuarial oversight responsibility for defined benefit pension plans in every other country where the company sponsored defined benefit plans.

I am currently founder and owner of Benefits Leadership International, which provides consulting services. I formerly headed up the American Benefits Council's international and actuarial groups, and served as director of the Council's research and education affiliate, the American Benefits Institute.

Today, I am testifying on my own behalf and am not representing any specific employer or association.

I applaud this Subcommittee for holding this extremely timely hearing. The hearing is timely because there is one clear issue that is strangling the defined benefit system and causing job loss across the country. That issue is the application of today's artificially low interest rates to defined benefit pension plans.

Today's historically low interest rates are creating an artificial funding crisis for employers across the country. This crisis will divert billions of dollars away from job retention and creation and away from economic recovery. Instead, those billions will cause pension plans to be vastly overfunded in a few years when interest rates return to normal. That is a sad waste of America's resources.

In addition, as I discuss below, today's artificially low interest rates are costing the government billions of dollars because the same pension funding rules also apply to government contractors and the government must, in turn, reimburse the contractors for making these required contributions. Briefly, this is a shocking waste of government money. Moreover, correcting the problem will actually help both the government and the government contractors by preventing both from being required to waste resources.

Measurement of pension liability is not an exact science. Rather, it requires a myriad of assumptions about future economic behavior. Current rules effectively, but inadvertently, mandate the illogical assumption that today's economy will never improve. None of us wants that assumption to be true. Certainly, the Federal Reserve doesn't believe it will since they clearly expect interest rates to go back up. Nevertheless, it is the law for pensions to be funded as if the economy will not improve.

Similarly, the assumption that today's artificially low interest rates will continue forever creates the illusion that the PBGC is underfunded. It is clearly not underfunded by any responsible measurement of what might happen in the future, as I discussed in detail in a recent article and as I will summarize that article here today. In this context, any increase in PBGC premiums is not a premium increase, but simply a further tax on those American businesses that tried to do the right thing by providing retirement security for their employees.

Frankly, pension funding rules were promulgated without serious consideration that prolonged Federal Reserve activity aimed at stimulating the overall economy would have deleterious implications for pension funding and for the PBGC liability.

The problems described above are clear. The solution is correspondingly clear: apply historically stable interest rates for funding purposes and for determining PBGC's true longer-term economic status.

Funding Crisis

Background. As mentioned above, in order to address the critical challenges facing our economy, the government has made great efforts to keep interest rates at historically low levels. Within the last couple of weeks, the Federal Reserve signaled its intent to keep short-term interest rates at or near zero percent at least through the end of 2014. These valid government efforts to stimulate the economy are significantly negated by the extraordinary pension funding impacts on those companies that sponsor large defined benefit pension plans.

For pension funding purposes, plan liabilities are calculated by discounting projected future payments to a present value by using legally required interest rates based on corporate bonds: the lower the rate, the greater the liability. Thus, today's artificially low rates, which are expected to last until at least the end of 2014, are triggering artificially high pension liabilities. The obvious implication of the statement from the Federal Reserve is that low interest rates will ultimately go away and be replaced by higher rates. When rates do go back up to more normal levels, the measured pension liabilities will go back down.

For example, in the case of a typical pension plan, the effective interest rate required by law has dropped by approximately 70 basis points from 2011 to 2012, which increases liabilities by approximately 10%. Thus, a plan with $7 billion of liabilities a year ago would have $7.7 billion of liabilities today. That translates into an additional funding shortfall of $700 million. That in turn triggers a company obligation to make an additional contribution of approximately $119 million per year for seven years. That $119 million is not needed to pay benefits; that obligation is simply the result of artificially low interest rates that have no relationship to the plan's ability to pay long-term benefits. However, this reflects only one year of the Federal Reserve action to artificially lower interest rates which began in 2008. Thus for this example, the true annual amount of unnecessary contributions might be multiples of this amount since this year's amortization schedule is layered on top of similar amortization schedules from prior years.

On a national basis, a study by the Society of Actuaries indicates that required pension funding contributions for 2012 and later years will be far greater than the amount required for prior years, unnecessarily diverting billions of dollars away from job retention and creation and from business investments. As discussed further below, reducing those pension contributions not only saves jobs, but increases tax revenue and decreases government spending by many billions of dollars.

Recommendation. With respect to interest rates, we need to learn from the lessons of the last few years. Economic conditions can change quickly, and interest rates are often maintained at very low levels during difficult economic periods. Under the current funding rules, that will mean that when we encounter a downturn in the economy, interest rates may well fall, exacerbating the problems for pension plan sponsors and undermining any economic recovery by unnecessarily diverting assets away from business investments. Conversely, if interest rates were to temporarily return to the double-digit levels of the early 1980's, pension liabilities could be slashed by, perhaps, two thirds. This does not make sense, especially since pension plan obligations are long-term obligations.

We need to move to a sounder system for setting interest rates. Why should obligations due over 50 years be calculated based on interest rate movements that may be aberrational and/or attributable to governmental economic policy? It would make far more sense to base interest rates on a long-term average, such as 25 years, that is consistent with the long-term nature of pension liabilities. This one change would solve the short-term funding crisis and provide American businesses with the predictability and stability they need to make business plans and manage risk.

Budget effects. As noted, this change in the law would have very positive budget effects in the billions of dollars. First, during this period of low interest rates, basing funding interest rates on historical averages will reduce funding. (Correspondingly, during periods of high interest rates, this will increase funding.) Decreasing funding has, over the years, had two positive budget effects. First, it increases tax revenues by decreasing deductible contributions to a tax-exempt trust. Second, decreasing funding creates negative outlays on the spending side by increasing the variable rate premiums paid to the PBGC.

The proposal would also decrease government spending in a very significant manner. Generally, government contractors in the energy area are reimbursed for their pension contributions. In the defense area, new rules have just been adopted under which defense contractors will, subject to a phase-in period, generally be reimbursed for their full pension contributions. Thus, since the proposal reduces required funding contributions during this period of low interest rates, federal government spending would appear to be correspondingly reduced, likely by billions of dollars.

Moreover, the government spending being reduced appears to be spending that is completely unnecessary in economic terms. There is widespread agreement that interest rates are being held artificially low to stimulate the economy at least through the end of 2014. In this context, if contributions are made to pension plans based on the artificially low interest rates, and the plans become fully funded or close to fully funded based on such rates, those same plans will be vastly overfunded when interest rates return to normal levels. In fact, it is distinctly possible that many of the plans will be overfunded indefinitely, which means that the required contributions were wasteful.

The solution to the government spending issue is not to reduce government reimbursements. That would simply mean the government does not believe those contributions will be necessary over the long term even though the law requires the contractors to make them. If the government believed otherwise, the contributions would need to be reimbursable. The solution, therefore, is to correct the interest rates being used so that no one has to make completely unnecessary payments.

Conclusion. To maintain the current funding rules would be to ignore the painful lessons of the last few years. Interest rates are susceptible to artificial fluctuations that can hide the true value of pension liabilities. This can result in unnecessary expenditures by businesses and the government, slowing economic growth and leading to government waste. My recommendation would address this conflict by preventing artificially low interest rates from slowing any economic recovery or creating unnecessary spending. In addition, my recommendation would give American businesses the predictability they desperately need to make business plans.

PBGC premiums

The Pension Benefit Guaranty Corporation is charged with protecting the pension benefits of workers and retirees in the event a company sponsoring a defined benefit pension plan goes bankrupt. The PBGC is partially financed through premiums paid by the sponsors of defined benefit pension plans. Premiums paid to the PBGC would be increased under two recent proposals. Under the first proposal, the Administration's proposal calls for PBGC to have the power to raise its own premiums, with the increase focused primarily or exclusively on plans maintained by "high-risk" companies". This proposal was estimated to raise $16 billion over the 10-year budget window. Under the second proposal, the House Budget Committee proposed raising premiums by $2.7 billion.

These calls for increased premiums are premised on the belief that doing so is necessary to address concerns about the PBGC's financial stability. But the PBGC is actually extremely stable financially.

No deficit. Defenders of a premium increase point to the PBGC's $26 billion deficit. Using historically normal interest rates, the PBGC has no deficit, according to a study I recently completed.

• Almost 80% of the PBGC's self-reported deficit is directly attributable to the Federal Reserve action beginning in 2008 to reduce interest rates to historically low levels. While this national policy is expected to help stimulate the economy, such action translates into a calculation of temporarily higher pension liabilities. Therefore, when interest rates rise in the future, that PBGC's artificially created deficit will shrink, if not evaporate.

• Much, if not all, of the remaining 20% of the deficit results from PBGC using an interest rate that is materially lower than the rates employer-sponsored plans are required to use by the Financial Accounting Standards Board (FASB) and pursuant to the Pension Protection Act of 2006. There is no logic for the government to use one rate, and to require private employers to use another.

• Finally, current rules implicitly presume that yields on the investment of PBGC assets will perpetually match the current, artificially low interest rates. Thus, there is no recognition that these billions of dollars held by the PBGC are expected to outperform current, near zero interest rates over the long term. While this cannot be guaranteed, it is instructive to recognize that the PBGC annual reports show actual investment returns of 13.2%, 12.1% and 5.1% for fiscal years 2009, 2010 and 2011, respectively. Thus, it is fair to expect investment performance to also mitigate some of PBGC's reported deficit.

I have not been able to review the American Airlines plans and the effect on the PBGC if those plans were terminated. But based on the methodology used by PBGC to calculate its deficit, their estimates of the shortfalls in those plans could well be overstated.

Tax, not a premium. If Congress were to raise PBGC premiums following a careful analysis of the true market value of the protection being provided by the PBGC, that could be rightly labeled a premium increase. If, however, Congress were to raise premiums without such a careful analysis, that would not constitute a premium increase; it would be a tax on defined benefit plan sponsors. At this point, there is no economic basis established for the Administration's proposed increase. In that context, such a premium increase would simply be an additional tax increase on those employers that tried to do a good thing by maintaining a defined benefit plan.

According to PBGC itself, no bailout is foreseeable. Some argue that a premium increase is necessary now to avoid a taxpayer bailout. This is simply wrong. It is clear that the PBGC does not pose a risk to taxpayers for the foreseeable future. PBGC's own annual report states: "Since our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future." This gives policymakers and the defined benefit plans most affected by a premium increase the opportunity to thoughtfully consider ways to strengthen the defined benefit pension system in a way that protects plan benefits and taxpayers but does not impose unwarranted increases in costs on plans and the participants they benefit.

Moreover, on November 10, 2011, PBGC announced projections of its deficit in 2020. The agency concluded, based on 5,000 simulations, that the chances of the single-employer insurance guaranty program running out of money in 2020 were zero. Moreover, in a majority of the 5,000 simulations, PBGC's position improved over the next ten years. So even using its extremely unfavorable assumptions, PBGC concedes that the financial condition of its single-employer program will likely improve over the next decade.

Administration's proposal would undermine economic recovery. Congress should continue to reject calls to weaken its own authority to set PBGC premiums. The Administration's budget proposal would give the PBGC Board the authority to set and adjust the level of premiums that a retirement plans sponsor would pay, taking into account an employer's financial condition. This would require the government to evaluate the financial condition of private companies, including tax-exempt organizations, a very disturbing intrusion of the government into private business.

Moreover, under the Administration's proposal, per-participant premiums could quadruple for the companies in the worst financial condition, which could cost these struggling companies tens of millions of dollars annually. Accordingly, basing PBGC premiums on the plan sponsor's financial condition could create a downward corporate spiral for companies that are facing financial difficulties, increasing their cash flow burden and potentially forcing unnecessary bankruptcies with devastating consequences for workers and our economy.

The Administration's proposal would also cause many companies to offer lump sums to former employees so as to potentially reduce their PBGC premiums by tens of millions of dollars annually. This would have serious policy implications and would dramatically shrink the PBGC's premium base.

In short, we should not use defined benefit plan sponsors as a revenue source in the attempt to tackle the budget, without a policy basis. The PBGC's issues should be carefully studied before any new taxes or premium increases are imposed.

Proponents of the proposal to allow the PBGC set its own premiums have pointed to the ability of commercial insurance companies to set their own premiums. This insurance company analogy collapses quickly on analysis. Sponsors of defined benefit pension plans already purchase commercial insurance for a variety of business purposes. In these commercial insurance situations, it is the purchaser who decides: (a) Whether to buy any insurance; (b) How much insurance to buy; (c) Which insurance company or companies to do business with, usually based on cost and quality considerations; and, (d) Whether to modify its insurance "wants" based on extant market conditions. Pension plan sponsors have no such rights with respect to benefits protected by the PBGC.

Moreover, commercial insurance companies must: (a) Remain cost competitive or face loss of business to competitor insurers; (b) Work collaboratively with their customers to tailor insurance products to meet those customers' needs; and, (c) meet rigid requirements imposed by various state insurance laws, as regulated by the respective state-level insurance commissioners. None of these consumer protections exists in the governance of the PBGC.

In short, the ability of commercial insurance companies to set their own premiums does not provide sufficient precedent to justify granting similar authority to the PBGC. Since none of the above characteristics of commercial insurance exist relative to the PBGC, Congress must continue its significant oversight role. Only Congress is in a position to consider all aspects and assure that premiums charged by the PBGC remain at appropriate levels that are fair to all parties.

Sales and Movements of Business Units

I also want to mention briefly one PBGC regulatory issue that is causing great concern within the pension community.

In the summer of 2010, the PBGC issued proposed regulations dealing with liabilities to the PBGC that arise under ERISA in connection with a shutdown of a facility. The proposed regulations were not consistent with the statute, previously published PBGC guidance, or PBGC's historical enforcement practices. Under the statute, liability is triggered if "an employer ceases operations at a facility in any location". The statute was clearly intended to apply to situations where operations at a facility are shut down. Instead, under the proposed regulations, liability can be triggered where no operations are shut down, but rather operations are, for example, (1) transferred to another stable employer, (2) moved to another location, or (3) temporarily suspended for a few weeks to repair or improve a facility.

Moreover, the liability created by the proposed regulations can be vastly out of proportion with the transactions that give rise to the liability. For example, in many cases, a de minimis routine business transaction affecting far less than 1% of an employer's employees can trigger hundreds of millions of dollars of liability, even in situations where a plan poses no meaningful risk to the PBGC.

The PBGC correctly identified the proposed section 4062(e) regulations as needing review pursuant to Executive Order 13563 on Improving Regulation and Regulatory Review. The PBGC stated:

In light of industry comments, PBGC will also reconsider its 2010 proposed rule that would provide guidance on the applicability and enforcement of ERISA section 4062(e).

However, it is my understanding that PBGC personnel, in communications with plan sponsors, continue to refer to the proposed regulations as current law, and are enforcing them as such. It is inconsistent with the President's Executive Order to announce a reconsideration of troublesome proposed regulations, while at the same time actively enforcing them as current law.

This situation needs to be addressed. The PBGC's enforcement practices are having a severely detrimental effect on business' efforts to enter into business transactions that pose no meaningful risk to the PBGC and that are essential to a functioning business world where transactions can facilitate our economic recovery.

Conclusion

In conclusion, the use of today's artificially low interest rates is:

- Creating pension funding obligations that undermine job retention and economic recovery,
- Resulting in billions of dollars of wasteful government spending, and
- Creating an illusion that the PBGC has a deficit, triggering consideration of unneeded new taxes on defined benefit plan sponsors.

These issues need to be fixed through the use of historically stable interest rates.

Thank you for the opportunity to testify. I would be happy to answer any questions you may have.

Chairman ROE. Thank you, Mr. Porter.

Ms. Haggerty?

STATEMENT OF GRETCHEN HAGGERTY, CHIEF FINANCIAL OFFICER, U.S. STEEL

Ms. HAGGERTY. Thank you for the opportunity to testify on behalf of—I am sorry—thank you for the opportunity to testify on behalf of the ERISA Industry Committee and United States Steel Corporation. We believe pensions play a critical role in providing retirement income for millions of Americans and are valuable tools that allow employers to attract and retain highly qualified workers.

I am the chief financial officer of U.S. Steel and my responsibilities include financing new investments, managing our cash flow, and ensuring we honor all of our obligations. I also serve as chairman of the U.S. Steel and Carnegie Pension Fund. U.S. Steel has managed a large domestic plan for over 100 years.

We take a responsible, prudent approach to managing our long-term pension obligations. For many years we have been voluntarily contributing to our plan $140 million annually—over $1.3 billion since 2003—in order to smooth out our future annual funding requirements.

The financial crisis hit our company particularly hard in 2009 and we lost $1.4 billion that year. We idled five of our eight steelmaking locations; we cut our capital budget by $300 million, or 40 percent. But we still made a $140 million voluntary pension contribution to our plan.

Our last publicly released funding results from 2010 showed that our plan was over 100 percent funded; however, that would drop to 85 percent if we used today's exceptionally low rates and—resulting from the Federal Reserve policy.

The combination of such low rates and increased funding requirements arising under the PPA, the Pension Protection Act, are severely burdening companies, undermining the future of defined benefit plans, and threatening economic recovery. The PPA dictates the interest rate used to calculate pension liabilities and minimum funding requirements. The lower interest rates are, the higher liabilities and potential funding requirements.

These interest rate rules were conceived and developed over a period of years long before the financial crisis. Since then the Fed has adopted a monetary policy to lower and maintain interest rates that are extraordinarily low by any historical standard. Last week they indicated that they intend to maintain these low levels of rates for years to come.

This current interest rate environment is so much different than the environment and the historical perspective at the time the PPA was enacted that I believe if the interest rate rules had been developed in today's environment they would be much different and more flexible than they are today. These actions by the Fed impose a significant near-term burden on sponsors of defined benefit pension plans, something that the Fed has acknowledged.

Minimum funding amounts will be higher in the near term than necessary for a long-term obligation. This creates great economic inefficiency and impacts other important capital allocation decisions that can help the economy.

U.S. Steel is pursuing a large capital investment program with spending in 2011 and 2012 approaching $1 billion a year. We are currently building new facilities in Pennsylvania, Indiana, and Ohio, and we are strongly considering new capital projects in Minnesota, Michigan, Alabama, and elsewhere.

These planned investments will create thousands of construction jobs and hundreds of permanent jobs but they could take backstage to our pension funding demands under the current rules and in this low interest rate environment. Within the next few years the cash needed to fund our main plan could be significantly higher—perhaps multiples of our $140 million voluntary contribution that we have been making.

With increased levels of cash outflow required to fund our main plan our capital expenditures will likely be impacted as one of our most significant, controllable cash outlays. If other companies also reduce such important and economically beneficial investments the economy will continue to disappoint and underperform.

Therefore, on behalf of United States Steel Corporation and the ERISA Industry Committee I urge you to give serious consideration to the industry proposal on funding stabilization. This proposal would better align PPA funding rules with economic reality without deteriorating long-term solvency of pension funds or the PBGC.

Simply stated, the proposal would stabilize discount rates and modestly lengthen amortization periods for the unfunded shortfall within a framework that still requires all plans to be 80 percent funded within 7 years but allows plans whose funded status is within the 80 to 100 percent range to amortize over a 15-year period. If enacted soon, this important reform could be the most constructive legislation Congress could pass to help ensure continued economic recovery, especially among capital-intensive industries where we want to continue to encourage productive investment in new plants and equipment.

Before concluding I would also say that the business community remains strongly opposed to any proposals that would dramatically increase PBGC insurance premiums or give broad powers to the PBGC to vary the amount of premiums based on their subjective view of a company's credit worthiness. The best way to ensure a plan's future is to increase its funded status by stable and predictable funding infusions, not by charging higher insurance premiums.

The funding stabilization proposal offers the best path forward for the PBGC's long-term viability, for plan sponsors who want to maintain their plans as long as the costs remain affordable, and for beneficiaries who are counting on those benefits in their retirement years.

Thank you. That concludes my prepared remarks.

[The statement of Ms. Haggerty follows:]

February 2, 2012

"Balancing Pension Security and Economic Growth"

Gretchen R. Haggerty
Executive Vice President and Chief Financial Officer
United States Steel Corporation

On behalf of the ERISA Industry Committee
Before the Health, Education, Labor & Pensions Subcommittee
Committee on Education and the Workforce

Good morning and thank you for the opportunity to testify on behalf of the ERISA Industry Committee on an issue that is more closely linked to the economic health and welfare of the country than most people realize.

Pensions -- whether in the form of defined contribution or defined benefit plans -- play a critical role in providing retirement income for millions of Americans. Pension plans are also valuable tools that allow employers to attract and retain highly qualified and valuable workers.

This Committee has the responsibility of balancing many competing objectives through your efforts to encourage employers to offer pension benefits, to safeguard those benefits for all beneficiaries, and to ensure that American workers have sufficient financial resources from their private pensions and savings to carry them through retirement. The employer community has long respected the role you play in this arena.

As the Chief Financial Officer of United States Steel Corporation, my primary responsibility to the company and our shareholders is to ensure we are earning an acceptable rate of return on the capital entrusted to us, by guiding the financial affairs of a very complex global enterprise. The company relies upon my recommendations and judgment to finance new investments, manage our cash flow, and ensure we honor all of our obligations, among other matters.

U. S. Steel is an integrated steel producer of flat-rolled and tubular products with major production operations in North America and Europe. An integrated producer uses iron ore and coke as primary raw materials for steel production. According to World Steel Association's latest published statistics, we were the eighth largest steel producer in the world in 2010. U. S. Steel is also engaged in other business activities consisting primarily of transportation services (railroad and barge operations) and real estate operations.

The ERISA Industry Committee (ERIC) is a non-profit association committed to representing the advancement of the employee retirement, health, and compensation plans of America's largest employers. ERIC's members provide benchmark retirement, health care coverage, compensation, and other economic security benefits directly to tens of millions of active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver those benefits, their cost and their effectiveness, as well as the role of those benefits in the American economy.

I also serve as the Chairman of the U. S. Steel and Carnegie Pension Fund. U. S. Steel has managed a large domestic pension plan for almost as long as we have been in the steel business. We have weathered many economic storms during our 110 year history while providing pension benefits to hundreds of thousands of retirees and their beneficiaries during this time.

Today, we continue to honor pension commitments made generations ago by executives long since retired. Our largest U.S. defined benefit pension plan (Plan) has approximately 78,000 participants, most of whom are retired. This Plan was closed to new entrants in June 2003 in order to lessen the interest rate, market, legislative and other risks of the Plan to our capital structure. Nonetheless, we expect to be paying benefits to retirees from our Plan for at least 50 years from now. Over half a century ago, my predecessors laid the groundwork for the billions of dollars of benefits that we have paid to our retirees by investing wisely and funding even when they were not required to do so, and that is the legacy I plan to leave for my successors, too.

We take a responsible, prudent approach to managing our long-term pension obligations. For many years, we have been voluntarily contributing to our Plan $140 million annually -- $1.3 billion since 2003 -- in order to smooth out our future annual requirements. The financial crisis hit our company particularly hard in 2009 and we lost $1.4 billion. We idled 5 of our 8 steel-making facilities, we reduced compensation for our leadership and we cut our capital budget by $300 million or over 40%, but we still made a $140 million voluntary pension contribution to our Plan. Our last publicly released funding results from 2010 showed that our Plan was over 101% funded. It seemed at the time that our prudent and conservative approach to funding had paid off and that we had weathered the financial storm very well. However, if we had used today's exceptionally and artificially low interest rates resulting from Federal Reserve policy, this percentage would have been about 85%.

I understand that the topic of pension funding rules is one that sometimes causes eyes to glaze over, so I will do my best to avoid a legal or actuarial discussion of the Pension Protection Act. I would however, like to explain how 1) interest rates that are at unprecedented low levels, and 2) the pension funding rules enacted under the Pension Protection Act of 2006 (Pension Protection Act) are severely burdening companies, undermining the future of defined benefit plans and potentially threatening our larger national economic recovery.

The Pension Protection Act requires the use of an interest rate yield curve (either a full yield curve or one segmented by short, medium and longer term periods) to develop the interest rate used to calculate pension liabilities and minimum funding requirements. The lower the interest rates, the higher the liabilities and potential funding requirements. These interest rate rules were conceived and developed over a period of years and long before the financial crisis. Since the financial crisis, the Federal Reserve has adopted a monetary policy to lower and maintain interest rates at levels that are extraordinarily low by any historical standard. It is clear from their actions at the Federal Open Market Committee meeting on January 25 that they intend to maintain these low levels of interest rates for years to come to support a stronger economic recovery, although the federal funds rate target is about 4% lower than the

Fed's targeted rate over the longer run. This current rate environment is so much different than the interest rate environment and historical rate perspectives that existed at the time the Pension Protection Act was enacted that I believe the interest rate rules developed would have been much different and more flexible than they are today. They should be revised now.

The actions by the Fed to control interest rates potentially put a significant near-term burden on sponsors of defined benefit pension plans, something that the Fed has acknowledged. Minimum funding amounts will be higher in the near-term than necessary for a long term obligation, which creates great economic inefficiency and impacts other important capital allocation decisions that can help the economy. The Pension Protection Act further penalizes companies like U. S. Steel who have prudently and voluntarily funded significant amounts by requiring the reduction of actual plan assets by our credit balances in determining our minimum funding contributions.

What the combination of the Pension Protection Act funding rules and extraordinarily low interest rates means to our business and the economy at-large could also be very significant. U.S. Steel is pursuing a large capital investment program with spending in 2011 and 2012 approaching a billion a year. We are building new coking facilities in Pennsylvania and Indiana, and a new pipe mill and a continuous annealing facility in Ohio. We have also received all the permits required to expand and modernize an iron ore mine in Minnesota and have several dozen other projects under consideration for facilities in Michigan, Alabama and elsewhere. These planned investments will create thousands of construction jobs and hundreds of permanent jobs. Billions in goods and services will be bought from local and national suppliers. We will be investing in products and processes intended to make us a viable and competitive company long into the future.

Some of these investments, however, could take backstage to our pension funding demands under the current rules and this artificially low interest rate environment. Within the next few years, at these rate levels, the cash needed to fund our main pension plan could be significantly higher than--perhaps multiples of--the $140 million per year that we have been voluntarily funding for years now. With increased levels of cash outflow required to fund our main plan, our capital expenditures will likely be impacted since that is one of our most significant controllable cash outlays. If other companies like U. S. Steel have to reduce important and economically beneficial investments like these to fund significant increases in pension contributions as a result of the Pension Protection Act and extraordinarily low interest rates, the economy will continue to disappoint and under perform. Timing is everything. That's true for the economy, our business, and our pension plans.

Therefore, on behalf of U. S. Steel and the ERISA Industry Committee (ERIC), I urge you to give serious consideration to the "Industry Proposal on Funding Stabilization." This proposal would better align Pension Protection Act funding rules with economic reality, without deteriorating long-term solvency of pension funds or the PBGC.

There are two components to the proposal. The first component, and from our perspective most important, would stabilize segment discount rates and raise the effective rate for many plans by roughly 120 basis points currently. The industry proposal utilizes floors for interest rates based on long term trends, smoothing market aberrations caused by short term monetary policy. This would only apply to plans electing segment rates. The second component would lengthen amortization periods of the unfunded shortfall, but within a framework that still requires all plans to be 80% funded within 7 years, but at the same time, allows plans whose funded status is within the 80% to 100% range to amortize over a 15 year period.

The Industry Proposal on Funding Stabilization is intended to be a permanent approach that would produce more stable and predictable minimum contribution requirements. It is a responsible approach that protects beneficiaries and the PBGC. It is also a responsive approach to the economic choices facing plan sponsors over the next several years. Congress should fix a problem that is the direct, although perhaps unintended, result of government policy.

This proposal is built on the same concepts Congress has approved in the past and the relief could not come at a more critical time. If enacted soon, this important reform could be the most constructive legislation Congress could pass to help ensure continued economic recovery, especially among the capital intensive industries where we want to continue to encourage productive investment in new plants and equipment.

Before I conclude, I would also like to say that U. S. Steel and other ERIC members remain strongly opposed to any proposals that would dramatically increase PBGC insurance premiums or that give broad powers to the PBGC to vary the amount of premiums based on the PBGC's subjective view of a company's credit worthiness. U. S. Steel and other companies who have well-funded pension plans and a history of meeting their pension obligations should not have to pay a higher premium than other plan sponsors solely due to their credit worthiness. There is no doubt PBGC insurance premiums are an important revenue source for the PBGC and also help to mask the size of the federal deficit, but as each of us in the pension community is well aware, the best way to ensure any pension plan's future is to increase its funded status by stable and predictable funding infusions.

The current draconian funding requirements of the Pension Protection Act also burden the PBGC's pension plans, which are affected by the same artificially low interest rates as affect plan sponsors. The Industry Proposal on Funding Stabilization offers the best path forward for the PBGC's long term viability, for plan sponsors who want to maintain their plans as long as the costs remain affordable, and for beneficiaries who are counting on those benefits in their retirement years.

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Chairman ROE. Thank you.
Mr. DeFrehn?

STATEMENT OF RANDY DeFREHN, EXECUTIVE DIRECTOR, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

Mr. DEFREHN. Chairman Roe, Ranking Member Andrews, and members of the committee, I am pleased to appear here on behalf of the National Coordinating Committee of Multiemployer Plans, and advocacy organization for jointly managed health, pension, and other welfare benefits. We commend the committee on conducting this hearing to examine the PBGC and defined benefit plans. For the tens of millions of Americans whose retirement security is provided through the defined benefit system your attention to preserving this system is critically important.

Our detailed remarks are part of the record. This morning I would like to make a few brief points specific to the multiemployer community and look forward to your questions.

For over 60 years multiemployer plans have provided a mechanism for tens of thousands of predominantly small employers in industries with very fluid employment patterns to provide modest but regular and dependable retirement income to their employees. According to the PBGC's 2011 Annual Report, approximately 10.3 million people are covered by the approximately 1,460 insured multiemployer defined benefit plans.

While most often associated with the building and construction and trucking industries, multiemployer plans actually cut across the economy, and while sharing the common objective of providing a social safety net for the American workers whose defined benefit plans have failed, PBGC's two insurance fundamental differences. Unlike the single employer system, which acts as an insurer of first resort, the multiemployer system presents much lower risk of claims, acting instead as insurer of last resort, stepping in only when all of these employers that contribute to a multiemployer plan are unable to meet their collective funding obligations.

The differential risk characteristics of the two guaranty funds have been reflected since their inception in a much lower guarantee level and corresponding premium structures. That discussion was held earlier in your exchange with Mr. Gotbaum. My only comment to supplement that is that it should be noted that from 1982 until 2002 that that fund maintained a surplus, even with those low premium rates.

In relative terms, the number of plans that have received assistance from the guaranty fund has remained very low when compared with a single employer system. While the number of multiemployer plans has declined by nearly 700 since 1980, only about 50 plans have ever received assistance from that fund. The remainder were merged into plans that were significantly larger or stronger.

In its latest report the PBGC reported assistance was paid to a total of 49 plans totaling $115 million in 2011. In other words, when compared with the single-employer system the multiemployer system represents one of every four insured participants but only 1 percent of the total number of plan failures, 2 percent of the total dollars paid out, and just 5 percent of the numbers of participants receiving benefits.

It should also be noted that the benefit numbers for multiemployer plans includes all administrative costs since the agency doesn't take over responsibility for administering any of the multiemployer plans. All in all, by having the pool of contributing employers reinsure each other for the risk of a failing contributor the agency gets the best of all worlds from multiemployer plans.

In my remaining time I would just like to make three concluding points. First, as a rule, multiemployer plans have been very well funded. They would have been better funded but competing tax policies prevented sponsors from funding them above 100 percent. Nevertheless, the new funding rules of the PPA and additional tools for plans to deal with their liabilities have imposed a level of discipline on plan sponsors that has caused them to take responsible actions that have allowed the majority of plans to begin to rebound from the recession, but for the continuing drag on plan contributions resulting from the depressed employment.

After initial zone certifications that showed green zone plans represented nearly 80 percent of all plans before the recession, dipping to a low of 20 percent in 2009, trends remain positive, with a single company survey completed in January of 2011 showed approximately 66 percent have returned to the green zone.

Second, we recognize that there are a limited number—two, actually—of major plans with severe funding difficulties resulting from unintended consequences of other public policy decisions made by Congress, specifically the deregulation of the trucking industry and the Clean Air Act, which these two plans will soon, as you have heard from Mr. Gotbaum, approach the PBGC for assistance.

Proposals to limit the exposure of the PBGC and, to a lesser degree, contributing employers and plan participants have been proposed for consideration by Congress. We believe that some variation of those earlier proposals are worthy of consideration as you deliberate further on this issue.

Finally, we appreciate the interest shown by the committee in better understanding the challenges created by the Pension Protection Act in anticipation of the sunset of the multiemployer funding rules at the end of 2014. As we have evaluated those challenges we have concluded that it may be time to address some additional structural issues of the underlying laws which can help ensure that multiemployer plan participants can continue to receive regular, reliable pension benefits, but which also can reduce the risk to employers that currently present an obstacle to new employers joining the system.

To that end, we have convened more than 40 groups representing employers and employee representatives from the full range of industries that rely on the multiemployer model for providing retirement benefits to carefully evaluate the current system and all viable alternatives designed to address those objectives. We look forward to bringing the ideas of this Retirement Security Review Commission to you as a community in the near future and to working with you so that these plans can continue to provide the tens of thousands of small businesses and their employees with a sound retirement vehicle for another 60 years.

Thank you very much for your attention.

[The statement of Mr. DeFrehn follows:]

Prepared Statement of Randy G. DeFrehn, Executive Director, National Coordinating Committee for Multiemployer Plans (NCCMP)

Chairman Roe, Ranking Member Andrews and Members of the Committee, it is an honor to speak with you today on this important topic. My name is Randy DeFrehn. I am the Executive Director of the National Coordinating Committee for Multiemployer Plans (the "NCCMP").[1] The NCCMP is a non-partisan, non-profit ad-

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[1] The NCCMP is the premier advocacy organization for multiemployer plans, representing their interests and explaining their issues to policy makers in Washington since enactment of ERISA in1974.

vocacy corporation created in 1974 under Section 501(c)(4) of the Internal Revenue Code, and is the only such organization created for the exclusive purpose of representing the interests of multiemployer plans, their participants and sponsoring organizations.

For over 60 years, multiemployer plans have provided a mechanism for employees of tens of thousands of predominantly small employers in industries with very fluid employment patterns to receive modest but regular and dependable retirement income.[2] They are the product of collective bargaining between one or more unions and at least two unrelated employers that are obligated to contribute to a trust fund that is independent of either bargaining party whose benefits are distributed to participants and beneficiaries pursuant to a written plan of benefits. While most often associated with the building and construction and trucking industries, multiemployer plans are pervasive throughout the economy including the agricultural; airline; automobile sales, service and distribution; building, office and professional services; chemical, paper and nuclear energy; entertainment; food production, distribution and retail sales; health care; hospitality; longshore; manufacturing; maritime; mining; retail, wholesale and department store; steel; and textile and apparel production industries. These plans provide coverage on a local, regional, multiple state, or national basis and can cover groups of several hundred to several hundred thousand participants. By law, these plans must be jointly and equally managed by both employers and employee representatives.

According to the PBGC's 2011 Annual Report, approximately 10.3 million people are covered by the approximately 1459 insured multiemployer defined benefit pension plans. This represents a slight decline from the prior year's report which showed 10.4 million participants in approximately 1500 plans. This decline is primarily a function of the impact of the recession on employment patterns, the magnitude of the market contractions and the sluggish nature of the recovery for many covered industries. It also reflects the fact that a few plans have had to avail themselves of the multiemployer guaranty fund of the PBGC.

I would like to direct my comments today to an examination of that fund, the infrequent number of multiemployer plans that have had to take advantage of its protections since its inception, its importance to specific troubled industries, and the multiemployer community's ongoing commitment to jointly address the evolutionary challenges that threaten the continuation of this system as evidenced by the recent creation of a "Retirement Security Review Commission."

The Multiemployer Guaranty Fund

Unlike the single employer guaranty fund which became effective with the passage of the Employee Retirement Income Security Act (ERISA) in 1974, the implementation of the multiemployer guaranty fund was originally discretionary,[3] becoming mandatory only with the enactment of the Multiemployer Pension Plans Amendments Act (MPPAA) in 1980. While sharing the common objective of providing retirement security for American workers whose employer based defined benefit plans have failed, these two funds have fundamental differences. First and foremost, the single employer system acts as the insurer of first resort, assuming responsibility to pay benefits when the corporate sponsor is no longer able to meet its obligations; whereas the multiemployer system presents a much lower risk of claims as the insurer of last resort, stepping in only when the all of the employers that contribute to a multiemployer plan are unable to meet their collective funding obligations. This risk is directly mitigated by the pooling of liabilities and by the existence of withdrawal liability (also a creation of MPPAA) which imposes an "exit fee" on employers that cease to participate or no longer have an obligation to participate in a multiemployer plan with unfunded vested benefits. This exit fee represents either the departing employer's proportionate share of the overall plan underfunding, or, under certain methods, liabilities that are directly attributed to that employer. It was enacted to stem the departure of employers from plans who realized they could transfer their liabilities to their competitors without penalty in the period immediately following the passage of ERISA.

The risk characteristics of the two guaranty funds was reflected from inception in much lower guarantee levels and corresponding premium structures for multiemployer plans. The adequacy of this structure for the multiemployer fund was evidenced by the fact that it operated at a surplus from 1982 until 2002, (cor-

[2] The median benefit paid to participants of plans surveyed was $908—See DeFrehn, Randy G. and Shapiro, Joshua, "The Road to Recovery: The 2010 Update to the NCCMP Survey of the Funded Position of Multiemployer Plans", The National Coordinating Committee for Multiemployer Plans, 2011.

[3] Until 1980 the PBGC only provided assistance to 10 plans.

responding with the end of the first of the two "once-in-alifetime" market contractions in the past decade and the doubling of guaranteed benefits to their current levels) and the fact that only 23 plans had ever received funding assistance from the PBGC through that time. The increase in 2001 marked the only time benefits had been raised since the guaranty fund's inception, bringing the maximum guaranty level to its current modest level. The current PBGC multiemployer plan benefit is a function of a formula based on the participant's accrual rate and years of service, providing 100% of the first $11 of the accrual and 75% of the next $33. For a participant with 30 years of service, the maximum guarantee is $1,072.50 per month ($12,870 per year), or approximately one-fourth of the current single employer guaranteed amount.

It is also important to note that unlike in a single employer plan failure, the PBGC does not assume the operation of a multiemployer fund; rather, the fund continues to operate as it had in the past, paying benefits and performing normal administrative functions until the plan becomes insolvent. At that time the plan is required to reduce benefits to the statutory guarantee levels and receives a "loan" from the agency to continue to make required benefit payments to remaining plan participants.

In relative terms, the number of plans that have received assistance from the guaranty fund has remained low when compared with the single employer system. While the number of multiemployer plans has decreased from 2,244 in 1980 to the current level, the vast majority of plans that are no longer free-standing were merged into plans that were significantly larger or stronger (especially plans with 5,000 or more participants), generally producing plans that are stronger, with an expanded contribution base of employers and reduced administrative overhead created through the greater economies of scale. Nevertheless, with the onset of the "Great Recession" of 2008, many plans that had entered the year well funded (see below) were faced with significant funding challenges, with some passing beyond the point where they could be expected to recover. In the latest (2011) annual report, the PBGC deficit has increased from $1.4 to $2.8 billion with assistance being paid to 49 plans totaling $115 million in FY 2011. Furthermore, they forecast future liabilities for plans that are "reasonably probable" to need the assistance of the Guaranty Fund to reach $23 billion. While one might assume this large increase would imply widespread plan failures, the fact of the matter is that these liabilities are essentially attributable to two large plans that exist in industries that have been adversely affected by public policy decisions with unintended consequences that were severely impacted by the market failures. These plans and efforts to address their situation will be discussed in greater depth below.

The Funded Position of Multiemployer Plans

As a rule, multiemployer funds have been very well funded, in part in response to the parties' desire to eliminate unfunded vested benefits that would result in assessment of withdrawal liability. Comparisons with the funded status of single employer plans often misinterpret that fact when observing that multiemployer plans had typically been funded at levels that were significantly lower than single employer plans. What is missed in drawing that conclusion is the fact that contributions to single employer plans are set by the employer and when they became overfunded (or even funded above the minimum funding requirements) as was common during the late 1980s and 90s, the employer simply made no further contributions. Conversely, multiemployer plans are funded as a result of contributions negotiated in binding collective bargaining agreements. In most cases, the plan fiduciaries that are responsible for determining benefit levels do not have the authority to waive or adjust the required contributions. Therefore, plans that reached their maximum deductible contribution levels had no alternative than to raise the plans' benefit levels (and corresponding liabilities) in order to protect the current deductibility of the employers' contributions. It has been estimated that upwards of 70% of all multiemployer plans were required to take that action in the years leading up to the millennium.

This conflicting public policy objectives (ensuring adequate funding of pension plans, but preventing the tax sheltering of income above full funding) failed to recognize the underlying premise of long-term funding assumptions: that in order for a long-term assumption to work it is necessary to be able to set aside gains in years that exceed that assumption in order to make up for years in which the markets underperform. This shortcoming was addressed in the Pension Protection Act of 2006 (PPA), but unfortunately, the action came too late for most plans.

By the time the situation was corrected, many plans had taken on liabilities that, due to the anti-cutback provisions of ERISA, could not be rescinded and are now a part of the plans' costs. While the market downturn that led to the passage of the Pension Protection Act of 2006 (PPA) resulted in significantly increased contributions and reduced future benefit accrual reductions in anticipation of its implementation, most plans entered 2008 well funded with an average market and actuarial value of assets of approximately 90%.[4] When the first required "Zone Certifications" were completed at the beginning of 2008, 80% of all plans reported they were in the "Green" zone. One year later, their fortunes had reversed, with only 20% reporting Green Zone status, direct casualties of market declines.[5]

In response to the uncertainty of the depth and duration of the recession, Congress passed limited relief in the form of the Worker, Retiree and Employer and Relief Act of 2008, followed by additional reforms in the Preservation of Access to Medicare and Pension Relief Act of 2010. These measures, coupled with direct action by plan sponsors (70% of which had increased contributions, approximately 35% had reduced future accruals, or adjustable benefits and over 40% that did both) enabled many plans to begin the climb back to the Green Zone. In 2010, approximately 48%[6] had done so and by 2011, according to a survey by the Segal Company, that number had increased to approximately 66%. While certainly encouraging, and a sign of improving strength across the majority of plans, the sluggish recovery continues to depress contribution income, offsetting much of the strength of the investment returns of 2009 and 2010.

Severely Troubled Plans

While many plans were able to benefit from the relief, a few had suffered a fatal blow due to fraud (Madoff and other similar situations), or simply because the industry could no longer survive. As noted above, two specific plans requiring relief have suffered from unintended consequences of other public policy decisions: in one, the deregulation of the trucking industry in 1980 resulted in the decline and demise of virtually all of the major contributing commercial carriers; in the other, the Clean Air Act caused the cessation of a large portion of the bituminous coal mining industry that previously contributed to the plan, resulting in an active employee population that is a small fraction of the previous number and a retiree to active ratio of 12:1. In both instances, the plans had managed to remain well funded until the unprecedented market collapse imposed irrevocable harm on the plans' investments.

In response to demonstrations of the need for additional, targeted relief by the multiemployer community, companion proposals were introduced in both the House (the "Preserve Benefits and Jobs Act") and the Senate that would have provided much needed assistance to these severely troubled plans while preserving a portion of the plan that could remain viable for future participants, primarily by reducing the exposure of contributing employers and to the PBGC by modifying the existing rules governing partition; however, these particular provisions were not included in the final relief measures.

Similarly, we had strongly advocated for extending the authority previously exercised by and acknowledged by the PBGC, to facilitate mergers of weaker plans into stronger ones in the same industry to achieve the same objectives of the hundreds of mergers which took place since 1980, but which have become more problematic under the current fiduciary constraints imposed by the Pension Protection Act.

In looking to the future, we would encourage Congress to reconsider each of these measures as a way to reduce the potential financial exposure to all stakeholders and ensure that the safety net available through the multiemployer guaranty fund is preserved.

Meeting Future Challenges

The Pension Protection Act of 2006 contains funding provisions for multiemployer plans that are scheduled to sunset at the end of 2014. In our collective experience with the existing rules it has become apparent that they are not sufficiently adaptable to the level of volatility plans have experienced in recent years and that they will need to be modified going forward. We have welcomed the interest shown by your Committee staff and that of the other Committees of jurisdiction, as well as the regulatory agencies in learning how the Act could be modified to better meet the needs of plan participants, sponsors and the plans themselves.

In the course of reviewing proposals for modifications, we have come to the conclusion that now is an appropriate time to consider taking a more fundamental assessment of the rules governing the multiemployer defined benefit system. We recognize

[4] Entering 2008, the average multiemployer plan was approximately 90% funded on both a market and actuarial value of assets basis. (See DeFrehn, Randy G. and Shapiro, Joshua; "Multiemployer Pension Plans: Main Street's Invisible Victims of the Great Recession of 2008"; National Coordinating Committee for Multiemployer Plans; April 2010; Page 18.)

[5] Ibid, page 20.

[6] See "Road to Recovery . . .", page 8.

that the body of law and regulations that has evolved over the past 60 years has become unwieldy and in many ways runs counter to the original intent of providing affordable worker retirement security with predictable costs and minimal administrative burdens for the contributing employers.

Retirement Security Review Commission

In order to ensure that the interests of all stakeholders are reflected in this evaluation, the NCCMP has convened a "Retirement Security Review Commission" comprised of representatives from over 40 labor and management groups from the industries which rely on multiemployer plans to provide retirement security to their workers. The group began its deliberations in August and meets monthly to evaluate their collective experience with current laws and regulations. The group has adopted a methodology that reaches out to a variety of disciplines to systematically review current and potential plan design, funding, economic, investing and regulatory environments to identify what currently works and any statutory and regulatory impediments to achieving its objectives.

The group has limited its objectives to two:

1. Ensuring that any recommendations to modify the existing laws or regulations provide regular and reliable retirement income; and

2. Reducing the risks to employers that provide an incentive to existing employers to withdraw from the system and present impediments to new contributing employers from joining.

The Commission has established an ambitious time table for its deliberations with a target of developing legislative recommendations by this summer. We look forward to providing periodic briefings as the project evolves and to extensive collaboration to achieve needed modifications that will enable multiemployer plans to survive and provide affordable, reliable and secure retirement income to future generations of American workers and employers.

Conclusion

We appreciate this opportunity to share our comments with you on the future of multiemployer defined benefit pension plans and on the importance of preserving the existing safety net for participants of plans that can no longer provide such security on their own and look forward to your questions.

Chairman ROE. Thank you.

Dr. McGowan?

STATEMENT OF JOHN McGOWAN, PROFESSOR, SAINT LOUIS UNIVERSITY

Mr. MCGOWAN. Yes. Thank you.

Honorable Chairman Roe, Member Andrews, member of the subcommittee, I am honored and appreciate the opportunity to be here. My interest is also in multiemployer plans. I have done some research, and I bring this into the classroom for the students and it is an amazing opportunity for me to hear from respected members of Congress about how you are dealing with these important problems.

I looked at, in my study, Form 5500 data, and I see a slightly different pattern in Missouri. There is a steady, serious decline in the financial solvency of these multiemployer pensions. Admittedly, it is an anecdotal sample, but these are real pension plans that are going downhill.

A little more detail about the state of PBGC with respect to multiemployer plans—Mr. DeFrehn talked about it, but a little more specificity, if you will. At the time of my 2008 report with respect to multiemployer plans there was $1.2 billion of assets and $2.1 billion of accrued liabilities—$700 million deficit.

Okay, there seems like there has been a downward spiral for MDBP plans since then. September 2010 the deficit was $1.4 billion with respect to these plans. It doubled to $2.8 billion end of

2011, and it is projected in the recent PBGC report as going to $4.8 billion. So it is going in the wrong direction.

They talked about low interest rates and the PPA 2006 funding requirements. Maybe the committee could think about relaxing those.

And one other idea I would toss out there is the withdrawal liability. Now, the idea was good at first, you know, when all of these employers exiting the plan to try to, you know, throw off the liability, but what is happening is new employers do not want to join—they want to have nothing to do with these plans because of the proposed withdrawal liability. They stay away from it like the plague.

So maybe the thought is relaxing some of the withdrawal liability requirements for new entrants into the plan and make it less draconian and less obnoxious for new entrants to come in may be a way to change that dynamic with respect to withdrawal liabilities.

Maybe modifying the partitioning rules. Central States was on ICU in May of 2010. Senator Harkin's proposal, maybe changing some of the partition rules to deal with some of the weaker plans.

And last, you know, there is a dynamic in the private sector, in either the assurance or banking industry, when you have major financial problems. In that case a guarantor is appointed by the state; they come in; they take charge of the assets, and then they do with—they consider the effects of all the claimants and do the best job they can to distribute those assets out to those claimants who have claims on those.

At some point you might want to do that, because right now the unions themselves control all the pension assets and not the employers, which is a difference from the single-employer plan.

Beyond that, I wish the committee all the luck in solving this very important dilemma. I appreciate you guys convening, and the remarks—I have been very impressed with them and I look forward to your results. Thank you.

[The statement of Mr. McGowan follows:]

Prepared Statement of Dr. John R. McGowan, Ph.D., CPA, CFE, College Professor and Author

Honorable Chairman Roe, Ranking Member Andrews, and Members of the Subcommittee, I am honored and appreciate the opportunity to appear before you on the challenges facing PBGC and defined benefit pension plans. My name is John McGowan. I have been a professor at Saint Louis University for 25 years. My Ph.D. is in economics and I have a strong interest in retirement planning from both a writing and consulting perspective. My testimony today is offered on my own behalf, and not on behalf of any other organization.

I honor the Subcommittee for holding this important timely hearing. The hearing is timely. The financial footing of MDBP plans continues to slip. My primary concern is the welfare of so many retirees depending on MDBP plans. In the same way I think it is important that taxpayers not pick up the bill because of poor planning by Congress.

Presented next is an update to a study I originally performed in 2008. That study was based on 2006 data. My current study includes data through 2010. An overview of many MDBP pensions in Missouri paints a declining picture.

Current retirement prospects for workers in US

The primary focus of this report is the current and future prospects for defined benefit multiemployer pension (MDBP) plans in the US. The motivation for this report is to educate, inform and empower retirees involved generally in any type of retirement plan and specifically in MDBPs. More than at any other time in US history, people should be actively involved in the planning and preparation of their retirement plans.

It should be noted that challenges for retirees in the US are not limited to participants in multiemployer pensions. The US Census reports that the average retirement account for persons in the US is $50,000. Moreover, the median retirement fund is $2,000 and more than 43 percent of Americans have less than $10,000 saved for retirement.[2] Nearly 1 in 4 Americans will rely on Social Security as their primary source of retirement. One major cause of retirement woes is the 20 percent decline of the S&P from 2000 to 2010. This decade long slide in the stock market has done little to brighten the retirement prospects for working Americans.

On May 27, 2010, the GAO released a study entitled, "Long Standing Challenges Remain for Multiemployer Pension Plans.[3] The report discusses in detail how multiemployer defined benefit pension (MDBP) plans face significant ongoing funding and demographic challenges. These challenges will lead to more plan failures and will increase the financial burden on the Pension Benefit Guarantee Corporation (PBGC).

Multiemployer pension plans have a number of structural problems when compared with single employer pension plans. Such challenges include a continuing decline in the number of multiemployer pension plans and an aging participant base. A decline in collective bargaining in the United States has also left fewer opportunities for plans to attract new employers and workers. Consequently, the proportion of active participants paying into the fund has also been falling.

The problems with MDBP plans are indicative of the overall structural economic breakdown of defined benefit plans in the US. Many companies have concluded that defined benefit pension plans are too rich and to costly to maintain after the economic crisis of 2008.[4] Watson Wyatt documents the overall movement away from DB plans as part of their 2009 survey. They reported for the first time that Fortune 100 companies began offering new employees only one type of retirement plan: a 401(k) or similar "defined contribution" plan. Moreover, due to the financial strain on the PBGC uncertainty is growing with respect to the viability of failed single and multiemployer pension plans.

In 1974 Congress attempted address the growing troubles brewing with employer provided pensions. They passed The Employee Retirement Income Security Act of 1974 (ERISA). Congress thought they could regulate employee pensions and ensure their availability for retirees. Ironically, a good case can be made that these same rules are playing a major role in the decline and possibly ultimate collapse of these same pension plans.

The first part of this report briefly discusses the unintended effects of ERISA. The second section looks at the current financial condition of the PBGC. Thirdly, a number of MDBP industry surveys are presented for the years 2008 thru 2011 to help assess recent performance of MDBP plans. In 2006 I examined Form 5500 data for a sample plans based largely in Missouri to gather anecdotal empirical evidence on the performance of MDB pensions. This study is updated and expanded in the fourth section of this report with data for 2007, 2008 and 2009. The following section reviews recent Congressional proposals to rescue certain MDP plans. This report concludes with a look at a couple of investment strategies for retirees and companies to consider in light of these challenging conditions.

Current financial state of PBGC

More than 10 million current workers and retirees rely on multiemployer plans. For decades, multiemployer plans were in reasonably good health, even in the face of industry decline. Unfortunately, for many multiemployer plans, that is no longer the case. Many are substantially underfunded; for some, the traditional remedies of increased funding or reduced future benefit accruals will not keep the plans afloat.

At the time of my earlier report (McGowan 2008), PBGC assets supporting the multiemployer program had a value of $1.2 billion and accrued liabilities of $2.1 billion in the multiemployer insurance as of September 30, 2007. At that time the net deficit was $900 million. These liabilities represent the present value of future financial assistance for plans that PBGC has identified as "probables" for purposes of PBGC's financial statements. A probable" plan is one that is currently receiving, or is projected to require, financial assistance. Thus, a "probable" plan is usually a terminated or insolvent multiemployer plan. Unfortunately, the downward spiral for MDBPs has accelerated since that time. By September 2010, the PBGC deficit related to MDBPs rose to $1.4 billion. By the end of September 2011, the MDBP related deficit at PBGC doubled to $2.8 billion. Similarly, the total PBCG deficit rose from $23 billion at the end of fiscal 2010 to $26 billion by the end of the 2011 fiscal year.

MDBP Surveys for 2008 thru 2011: Are They on the Road to Financial Recovery?

A number of studies have been performed to assess the recent performance of MDBP plans. These results for these studies are shown chronologically in the next section.

Financial Crisis of 2008

The National Coordinating Committee for Multiemployer Plans (NCCMP) is an advocacy organization of multiemployer pension funds. Each year they perform a survey on the financial health of MDBP plans. This annual survey includes a major percentage of multiemployer pension plans. For the beginning of 2008 plan years the NCCPMP reported that over 75% of plans included in the survey were in the 'green zone', indicating a strong financial position. During 2008 the financial crisis caused the average reported funded status to decline to 77% from 90% at the beginning of the year. Moreover, by the end of the year only 20% of MDBP respondents indicated their plans were still in the green zone. Similarly, 42% of plans in the survey identified themselves as critical status or 'red zone' plans.

The plummeting financial status of defined benefit pension plans in 2008 was articulated in my earlier study (McGowan, 2008). That study analyzed certain 2006 MDBP data and projected 2008 based on the plunging indexes of the stock market. At the time, a number of local trade unions were vigorously assaulting the study as flawed and inaccurate. However, a number of other studies described the same financial difficulties for 2008 multiemployer pension plans. For example, Watson Wyatt Worldwide observed that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.that the top 100 multiemployer pensions were just 79 percent funded.

One major cause of this shift in MDBP plans can be traced to the investment results for 2008 where the median asset return was −22.1%. Moreover, the NCCMP report stated that the true impact of the crisis was even more dramatic than these figures indicated.[8] The PPA funded percentage measure relies on the actuarial value of pension plan assets and typically recognizes investment gains and losses gradually over time. On a market value of assets basis, the average funded percentage was much worse. The average funded market value percentage declined from 89% to 65%.

In addition to investment results, the financial impact on a plan is also a function of employment levels. When a plan becomes underfunded, it is important that there be a large population of active members with strong employment levels to create a contribution base capable of offsetting the shortfall. Unfortunately, an equally historic level of unemployment followed the historic market collapse of 2008. This unemployment level has also severely limited the ability of many plans to recover.

Returns improve in 2009: high unemployment continues

There was a high response rate for the 2009 NCCMP survey. Total plan participants numbered 6.3 million and represented 60 percent of the multiemployer plan population. Plans included in the NCCMP survey reported a median 2009 asset return of 16.6%. This figure however was not nearly enough to offset the devastating returns of the prior year. The International Foundation of Employee Benefit Plans (IFEBP) reported similar results in 2009 their survey of MDBP plans. As of August, nearly three-quarters of MDBP plans were less than 80 percent funded. The 2009 IFEBP survey had a much smaller sample size (213 plans).[9] Nevertheless, the results were proportionate and consistent with other surveys for that time period. The number of plans in the endangered or critical status had tripled from 2008.

During 2009, participants and sponsors of multiemployer pensions responded by increasing contributions and reducing benefit accrual levels. Similarly, many plans in the IFEBP survey indicated that they were taking advantage of the temporary freeze option available to MDBP plans in 2009.

Returns stable in 2010: unemployment shows little improvement

Participants in the 2010 NCCMP survey declined to 3.6 million or approximately 35 percent of multiemployer plans. For a second straight year, respondents reported strong investment returns in 2010. Consequently, these plans reported an increase in average fund status to over 82% from 77%.

The 2010 strengthening for pensions was not confined to multiemployer plans. Milliman is among the world's largest independent actuarial and consulting firms in the world. Their annual study covers 100 U.S. public companies with the largest defined benefit pension plan assets for which an annual report (Form 10-K) is released by March 3 of the following year. Their study also reflected an overall improvement in funding status due to increased fund contributions. However, the improvement was somewhat curtailed by ongoing low interest rates.

More specifically, the record cash contributions for these plans and investment gains (12.8% actual returns for 2010 fiscal year vs. 8.0% expected returns) were offset by the 7.7% increase in liabilities generated by the decrease in discount rates (5.43% for 2010, down from 5.82% in 2009 and 6.36% in 2008) used to measure pension plan liabilities. The lower discount rate coupled with record cash contributions culminated in a small improvement in the funding ratio for these plans in 2010. The average increased to 83.9% from 81.7%.

Reasons for improved plan status in 2010 and 2009

As noted in the NCCMP report, the number of plans in the green zone (more than 80 percent funded under PPA 2006 rules) more than doubled from 20 to 48% by the end of 2010. Similarly, the number of plans in the red zone (critical status) declined from 42 to 32%. The report traced this improvement to three factors. First, there were strong investment returns. Second, the plans and sponsoring employers implemented a combination of contribution increases and benefit cuts to shore up their financial status. Thirdly, the funding relief provisions of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 helped improve multiemployer funding status.

Pension expense continues to rise for 2010

Record levels of pension expense were recorded in 2010. A $30.0 billion charge was recorded for firms in the 2010 Milliman Pension Funding Study. There were 11 companies with pension income (e.g., negative expense) in 2010, down from 16 in 2008. Pension expense is projected to increase for 2011 as companies using asset smoothing are still reflecting the impact of losses in 2008.

Accounting changes adopted by some companies

A number of companies elected to recognize substantially all of their accumulated losses for 2010. This accounting change resulted in a significant charge to the year-end balance sheets for Honeywell, Verizon and AT&T. The elimination of this charge in 2010 will lead to a reduction of future years' pension expense through the elimination of the annual charge to earnings for those losses. Milliman estimates that similar charge to earnings for the remaining 100 companies would have resulted in a $342 billion charge to their cumulative balance sheets and a reduction in their 2011 pension expense of about $19.9 billion.

Proposed change to International Accounting Standards

There is also a serious debate raging regarding whether International Accounting Standards should be converged with or adopted in place of U.S. GAAP. A proposed change to International Accounting Standards would eliminate the pension expense credit for Expected Return on Assets (8.0% for the Milliman 100 companies in 2010). Under this change, companies would have a pension expense equal to the discount rate on the excess of liabilities over assets (or a similar credit if the plan were more than 100% funded). If that change had been adopted for U.S. GAAP accounting in 2010, the pension expense for the Milliman 100 companies (and the charge to corporate earnings) would have increased by about $30.0 billion. Such changes would have a commensurate effect on multiemployer pension plans. Therefore pension expenses would be pushed higher.

Defined Benefit Plans in 2011

A review of defined benefit plan performance in 2011 in Canada shows that things also took a turn for the worse. Towers Watson has kept a tracking index to represent defined benefit pension plans across the country for more than a decade. In 2011, the index declined from 86 at the start of the year to 72 by the end. The index was at 100 in December 2000 and after a brief rise in 2001, has been on a steady decline ever since.[10]

Expected plan contributions expected for 2012

CFO Magazine reports that big pension contributions are expected in 2012. According to a new report from Credit Suisse and accounting analyst David Zion, Companies in the S&P 500 will likely have to contribute $90 billion to fund pension plan gaps in 2012, up from $52 billion in 2011.

A sample of Missouri based MDBP plans: an expansion and update

My original 2008 study was also presented at a Senate Hearing on May 27, 2010.[11] The Senate Hearing was entitled: "Building a Secure Future for Multiemployer Pensions." The purpose of this hearing was to address the structural problems of multiemployer pensions.[12]

The key findings of my 2008 report are:

- The assumption of failing pensions by PBGC had led to an overall deficit of $955 million
- By September 2007, the PBGC insured about 1,500 multiemployer (sometimes called union plans) plans and promised benefits to about to roughly 10 million participants
- Multiemployer pensions problems were forcing fund managers to cut benefits
- The other avenue to improve multiemployer fund status was to increase contributions
- Central States required a withdrawal liability payment of $6 billion from UPS
- Both employers and employees were encouraged to carefully consider the financial condition of multiemployer pension plans whether they were current or prospective participants

Measuring the funding status of multiemployer plans

The Pension Protection Act of 2006 places the task of computing the funded status of MDBP plans in the hands of the actuary. Various actuarial assumptions and methods are used to determine cost, liabilities, interest rates, and other funding factors. While these assumptions must be reasonable, they tend to make the actuarial value of the assets significantly higher than market value. For example, the actuarial value of the assets recognizes investment gains and losses gradually over time.

The PPA 2006 directs actuaries to place MDBP plans in one of three separate zones: green for healthy (80% funded), yellow for endangered (65% funded) and red for critical (under 65% funded). Plans are in the green or healthy zone if they are more than 80 percent funded. Yellow zone or endangered plans are funded at least 65 but less than 80 percent. Plans are also in the yellow zone if they have had a funding deficiency in the past 7 years. When a plan hits both conditions they are considered "seriously endangered." According to Eli Greenblum, an actuary and senior VP of the Segal Co., "Yellow zone plans cannot cut protected or adjustable benefits, there is no official shelter from funding-deficiency penalties, and there are no employer surcharges."[13] If a plan people covered by a traditional defined-benefit pension plan should receive a funding notice every year, which gives workers an idea of how well the plan is doing. However, people frequently do not have access to the funding notice. In these cases,FreeERISA.com.[14] people can get a rough idea of how well their plan is doing by looking at Form 5500. Moreover, participants in private pension plans have the legal right to request the most recent Form 5500 from their plan administrator. Participants can also find a less recent copy of the Form 5500 on a web site called

Certain multiemployer pension administrators take such strong exception to the notion that people are able to get a rough idea of the financial solvency of their multiemployer pensions by looking at data on IRS form 5500. Then Pension Rights Center stands behind this notion and presents it clearly on their website.[15] The Pension Rights Center encourages people to determine the funded status of their pension by dividing the current value of plan assets by the "RPA 94" current liability. The RPA 94 (Retirement Protection Act of 1994) current liability is based on the present value of benefits accrued to date. This liability is discounted using a statutory interest rate assumption range that is tied to average long-term bond yields.[16] Numerous studies have used this funding ratio as provided on Form 5500 as a proxy for the financial solvency of multiemployer or union pension plans.used this funding ratio as provided on Form 5500 as a proxy for the financial solvency of multiemployer or union pension plans.used this funding ratio as provided on Form 5500 as a proxy for the financial solvency of multiemployer or union pension plans.

Sample of MDBPs in Missouri

This study expands on the sample of Missouri based multiemployer pensions next. As can be seen from a casual review of the actuarial data presented here from Form 5500s is that these plans are not doing well.

- Serves Laborers' International Union of North America Locals #42, #53, and #110.

Congressional Efforts to "Rescue" Certain Underfunded MDBP Pension Plans

In May 2010, Senator Casey introduced S. 3157 under the title of Create Jobs and Save Benefits Act of 2010. The bill mirrors legislative proposals introduced in 2009 by Reps. Earl Pomeroy and Patrick Tiberi. Among other things, the bill proposes to transfer all pension liabilities of "orphan" retirees—those who had worked at the now-defunct trucking firms whose pensions are being funded by the surviving truckers to the PBGC. Senator Casey characterized the current dilemma as follows, "The current costs of multi-employer pension compliance represent a huge, hidden tax on large and small business." This characterization understates the problem. Michael H. Belzer, a professor at Wayne State University is one of the nation's foremost experts on tru8cking labor law. He was correct when he recently said, "the multi-employer concept was "dumb" and an inconceivably great failure" of public policy.

6. What is a realistic option for workers going forward?

Congress should have the courage to address the real problems with MDBPs. The solution is not to write a blank check to fund these pensions. The private sector is reflecting modern economic reality when it comes to pension plans. There will be a continued migration away from DB plans and toward 401K plans, or perhaps some combination of DB and 401(K) plans, and possibly forced contributions from both employers and employees to retirement plans.

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Defrehn, R.G. and J. Shapiro, "The Road to Recovery, The 2010 Update to the NCCMP Survey of the Funded Status of Multiemployer Defined Benefit Plans," See *http://www.nccmp.org/*.

McGowan 2008, The Financial Health of Defined Benefit Pension Plans: An Analysis of Certain Trade Unions Pension Plans, U.S. Senate Committee on Health, Education Labor and Pensions.

ENDNOTES

[1] I would like to acknowledge the support of Associate Builders and Contractors. The views reflected in this study are my own and do not necessarily reflect those of Saint Louis University.

[2] C. Sutton, CNN Money, March 2010.

[3] Statement of Charles A. Jeszeck, Acting Director Education, Workforce, and Income Security Issues as part of Testimony Before the Committee on Health, Education, Labor and Pensions, U. S. Senate.

[4] S. Block, "Traditional Company Pensions are going away fast," USA Today, May 22, 2009.

[5] Leveson, I, Economic Security a Guide for an Age of Insecurity, iUniverse p. 18, April 29, 2011.

[6] See, Moody's: Growing Multiemployer Pension Funding Shortfall is an Increasing Credit Concern," Sept. 10, 2009.

[7] See, Furtchgott-Roth D., and A. Brown, "Comparing Union-Sponsored and Private Pension Plans: How Safe are Workers Retirements?" Hudson Institute, September 2009.

[8] Defrehn, R.G. and J. Shapiro, 2010 Update to MCCMP Survey of Funded Status of Multiemployer Defined Benefit Plans, p. 1.

[9] See Wojcik, J., "73 percent of multiemployer pension plans underfunded: Study," Business Insurance, Sept. 29, 2009. CBC News.CA, "Defined benefit pension plans had bleak 2011," Jan. 4, 2012.

[11] See summary at *http://www.help.senate.gov/imo/media/doc/McGowan.pdf*

[12] See *http://www.help.senate.gov/imo/media/doc/McGowan.pdf.*

[13] See comments by Eli Greenblum at March 21, 2007 at BNA sponsored pension conference. goes into the red zone or funding level below 65 percent, the trustees must adopt a rehabilitation plan. Pension trustees may reduce certain benefits under the rehabilitation plan.

[14] See:*http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.*

[15] *http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.*

[16] See: *http://www.actuary.org/pdf/pension/moodys—march06.pdf Letter from D.J. Segal, VP of Pension Practice Counsel to American Academy of Actuaries March 1, 2006.*

[17] See: Allen, S.G., R.L. Clark, and A.A. McDermed, "Post-Retirement Increases in Pensions in the 1980s: Did Plan Finances Matter?" National Bureau of Economic Research Working Paper #4413; D., Furchtgott-Roth, "Union vs. Private Pension Plans: How Secure Are Union Members' Retirements?" Hudson Institute, Summer 2008, September 2009; Addoum, J.M., J.H. van Binsbergen, and M.W. Brandt, "Asset Allocation and Managerial Assumptions in Corporate Pension Plans," Duke Working Paper 2010; McGowan, J.R., "The Financial Health of Multiemployer Pension Plans, PBGC and the Recent Government Bailout Proposal: Create Jobs and Save Benefits Act of 2010," Report prepared for Senate Committee on Health, Education, Labor and Pensions: Building a Secure Future for Multiemployer Pension Plans, May 27, 2010, See: *http://help.senate.gov/hearings/hearing/?id=6a51d13d-5056-9502-5d61-e47c92a6a05f.*

Chairman ROE. Thank you, Dr. McGowan.

I am going to just start by—with Ms. Haggerty, if you don't mind, and want to thank you for making the investment in U.S. companies, for funding your pension plan. And I have got to ask you, how do we get out of this catch-22?

Let me go back 30 years. This would have been no problem—I remember the first home I bought was 15 percent interest—is still living in the same house. I Mastercharged the house. That is what the interest rates were in 1982.

And when you plug these formulas in—and I, you know, refinanced it 50 times until they got down to a reasonable interest rate, but that is easy when you plug 10 percent return, or 15 percent. If you were to plug the same rules in your pension plan would have been overfunded forever if you looked at that and carried on, as Mr. Porter was saying.

So how do we get out of when the Fed has something to do with monetary policy, holding it way down, which forces this liability? How do we get out of that?

Ms. HAGGERTY. That really is the purpose of the industry stabilization proposal, or the funding stabilization proposal, because if you look at interest rates over a much longer period of time than the act now allows you to do, like 25 years, and if you take out the peak—so you would cut off the 15 percent, which would probably unfairly reduce the level of your liability—but you would also cut off the low interest rates and look at something that over time is much more realistic, if you do that and you do that for an extended period of time it has the effect of smoothing out the contributions for long periods of time, which makes it much easier for companies to plan what their funding is going to be and to keep up with it on a regular basis.

Chairman ROE. What length of time are you speaking of?

Ms. HAGGERTY. Well, our proposal is to—there are really two aspects to the proposal. One is to stabilize the discount rate by using these longer-term maybe 25-year rates and cutting off the extremes, okay?

The other part of it that goes hand-in-hand with the proposal is to take any shortfall amortizations that you might have because of the volatility in the market or how you measure your obligation and amortize that over 7 years if your plan is less than 80 percent funded, which is, you know, what we are doing today. But if you are in the 80 to 100 percent funded, so you are a reasonably well funded plan and there are a lot of reasons why companies want to be in that zone instead of below 80 percent, you know, with the benefit restrictions and what have you, then you can amortize that shortfall over 15 years. So by stretching it out you are smoothing out how you fund your plan, and the—I can't tell you how much effect this low interest rate is having on how people calculate what is going to happen just over the next couple of years, so it is important that we do something now.

Chairman ROE. Here is the other thing that I want to ask you is that—before I came here, as I said, I was on my medical practice's pension plan and worked on that, but secondly, I was mayor of the city—Johnson City, Tennessee. And in looking at that we looked at—from the time I went on there, the 6 years I was on the city commission, we went from paying 12 percent of an employee's salary to 19 percent in making up that difference, and it became—it looked almost inconceivable that we kept going up. And as the market went down the taxpayer liability went up and up and up.

So what our city did was a promise made is a promise kept. If you are working for the city right now that is the plan you have; we are going to honor that plan. But going forward, you are going to have a defined contribution plan if you are a new hire to the city so you will have some idea—future taxpayers down the road won't be on the hook for just what you are talking about.

I agree. I think you have got to have a better way—a longer way to look at this, because your—I mean, I think I read in one of the testimonies this is a 50-year—many of these pensions—I think it was yours—is going to be—pay out over 50 years, not over 2 years, and——

Ms. HAGGERTY. Absolutely.

Chairman ROE [continuing]. And what do you think? And I haven't got much time left, but what do you think the future of the defined benefit plan is?

Ms. HAGGERTY. Well, Mr. Chairman, I think that we have seen the future playing out before us and the defined benefit plans are being reduced, you know, in multiples every year. We, in fact, closed our defined benefit plan to new entrants in 2003 as a result of some of the risks that we saw on the horizon, and most of the participants in our current plan are current retirees but we expect to be continuing to pay for that for well over 50 years.

But I think you are seeing people being driven out of defined benefit plans. I think that people were able to, as you did in the city, to create defined contribution plans that are quite valuable to their employees.

You can make them competitive for employees. In this day and age they tend to move from company to company so it is much easier for them to take their retirement with them. They don't have that option with a defined benefit plan; they may never get vested.

So I think we have to be flexible with some of these structures but I think that we also need to encourage people that still have defined benefit plans to fund them in a reasonable way.

Chairman ROE. Thank you.

I yield now to Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. I would like to begin by asking unanimous consent to enter into the record a letter from the ranking member, Mr. Miller, to Mr. Gotbaum; and a letter from Dana Thompson, of the Sheet Metal and Air Conditioning Contractors, to yourself and myself; and also to ask unanimous consent that some questions for the record be submitted to the witnesses, as well.

[The information follows:]

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January 31, 2012

The Honorable Joshua Gotbaum
Director
Pension Benefit Guarantee Corporation
1200 K Street, NW, 12th Floor
Washington, D.C. 20005-4026

Dear Mr. Gotbaum:

Last week, American Airlines sent a letter to its employees regarding their concerns about the status of the company's pension plans in light of American's bankruptcy. I appreciate the Pension Benefit Guaranty Corporation's quick reaction to that letter, pointing out how it misleads and downplays the implications of freezing or terminating workers' pension plans. Tens of thousands of American Airlines' employees and retirees count on these pension plans, not just for their accrued benefits but for their expected benefits as well. These individuals committed to a career with the airline and worked hard in exchange for the promise of a secure retirement.

Having fought to save pension plans at United Airlines several years ago and having heard from thousands of those plan participants and their families, I know full well that there is no silver lining for workers and retirees in a pension plan termination. These terminations can wreak havoc on families. Termination should only be a last resort and not part of any business strategy to exploit the bankruptcy process and dump pension liabilities onto the taxpayer. In the case of United Airlines, we saw the company and the PBGC ultimately agree to terminate that airline's pension plans. Even worse, not only were all of the pension plans terminated, but the PBGC ceded its right to ever restore the plans to United Airlines, as well as its right to seek additional assets from United, should the company ever become profitable again. Not only did United reap profits in subsequent years, a GAO investigation found[1] that leading up to and through the termination of United Airlines' four pension plans, the airlines' CEO at that time and two other executives received a total of about $55 million in salary, benefits and other compensation.

To protect the taxpayer and plan participants, I urge you to avoid allowing a repeat of United Airlines. American Airlines employees and retirees, like those at United, have mortgages,

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[1] Government Accountability Office, *Private Pensions: Sponsors of 10 Underfunded Plans Paid Executives Approximately $350 Million in Compensation Shortly Before Termination*, GAO-10-77 (October 2009) *Available at* http://www.gao.gov/new.items/d1077.pdf

The Honorable Joshua Gotbaum
January 31, 2012
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tuition payments, and other financial obligations to meet. Participants in the American Airlines retirement plans made countless life choices in relying on the promise that a career with American would provide benefits adequate for them to comfortably live out their retirement years. I urge the PBGC to do everything it can to prevent a termination from happening.

Sincerely,

GEORGE MILLER
Senior Democratic Member

February 1, 2012.

Hon. PHIL ROE, *Chair;* Hon. ROB ANDREWS, *Ranking Member,*
Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, U.S. House of Representatives, Washington, DC 20515.

Re: *Examining the Challenges Facing PBGC and Defined Benefit Plans*

DEAR CHAIRMAN ROE AND RANKING MEMBER ANDREWS: I am writing on behalf of the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA). SMACNA is supported by more than 4,500 construction firms supplying expertise in industrial, commercial, residential, architectural and specialty sheet metal and air conditioning construction throughout the United States. The majority of these contractors run small, family-owned businesses. Pension funding issues figure prominently in the day-to-day business decisions of SMACNA contractors. In 2010, SMACNA contractors contributed more than $315 million to the Sheet Metal Workers' National Pension Fund (NPF) and many of the contractors also contribute to a local defined benefit pension fund. Overall, construction industry plans comprise approximately 54 percent of multiemployer defined benefit pension plans.

SMACNA is pleased you are holding this hearing and believe it is a good beginning to a long process. Few in Congress fully understand how multiemployer pension plans work and the serious consequences of not addressing the issues facing the plans when the Pension Protection Act (PPA) sunsets in 2014. Labor and management have both recognized a need to improve the health of plans and are working jointly with each other and government to jointly develop solutions to ensure the plans and the system are sustainable. The current rules, the economic environment and the instability of the equity markets have all converged to put plans at risk which threatens the viability of contributing employers. The construction industry has been especially hard hit by the lingering economic recession.

Taking a balanced view of the PPA, it is fair to say it helped employers and plans but has proved inflexible in the face of changing equity markets and depressed construction economic markets. The PPA has made positive changes. It:

- Requires timely and extensive reporting so that all contractors are well-informed on the status of the fund and their fund obligations—problematic before PPA enactment;
- Allows funds needing corrective action to take 10 or 15 years to bring the fund to a better funded position. Before PPA, contractors contributing to some funds were facing funding deficiencies, which had to be made up in full by employers in under one year. In addition, excise taxes of five and ten percent and higher could be levied by the IRS on the employer, benefitting the U.S. general treasury and not the fund;
- Forces funding issues to be addressed;
- Allows for reduction of some accrued benefits for plans in the worst shape; and
- Maintains the integrity of the bargaining process.

However, more reforms are needed. PPA proved inflexible for construction employers who operate on a very thin profit margin and must maintain positive cash-flow until the completion of a construction project.

- A second historic equity market plunge occurred and investment returns for plans plummeted below the expected rate of return and into massive losses.
- The construction market hit a long-term market cycle depression.
- Congressional relief was hard to get and slow to come.
- PPA did not take market cycle or another massive equity loss into account. Fund conditions worsened. PPA funding targets could not be met;
- Employers continue to look at increased contributions, and workers face reduced wages and benefit accrual reductions at a time when it is a significant hardship fostering intergenerational conflict among workers in the industry.

SMACNA employers know there are painful steps that must be taken and that structural reforms are needed. Life expectancy has increased and most Americans are unable to accumulate sufficient retirement income to live securely. SMACNA member firms take pride in the living wages and good benefits they provide their employees and they are committed to providing long-term retirement security to their workers as they simultaneously work to ensure the viability of their companies. We are willing to work with our union partners and Congress to enact reforms to create an environment where responsible construction employers working to do the right thing can continue to provide a long-term retirement that may look different than the current defined benefit system but will still provide retirement security for their workers.

Respectfully,

DANA THOMPSON, *Assistant Director, Legislative Affairs, SMACNA, Inc., Capitol Hill Office.*

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November 30, 2011

The Honorable Hilda L. Solis
Secretary of Labor
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

The Honorable Tim Geithner
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable John E. Bryson
Secretary of Commerce
U.S. Department of Commerce
1401 Constitution Avenue, N.W.
Washington, DC 20230

Dear Secretary Solis, Secretary Geithner, and Secretary Bryson:

Given your positions on the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC), I am writing to express my grave concern over the failure of PBGC to ensure a fair and accurate accounting of the pension promises made to this country's workers, retirees, and their families. As you are aware, the PBGC Office of the Inspector General (OIG) has released an evaluation report focusing on the PBGC's mishandling of the United Airlines pension plan terminations. The report finds "serious flaws in each of the original plan asset audits intended to establish the fair market value of United Airlines plans assets." The report notes that, while PBGC is revaluing those plan assets, it has thus far been "unsuccessful in determining" their fair market value. The proper valuation of terminated pension plan assets and liabilities is critical to assuring that workers and retirees will receive the accurate amount of pension benefits to which they are entitled.

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Additionally, OIG identified that "each of the [United Airlines plan asset] audits failed to meet applicable professional standards, contained myriad obvious errors and omissions as well as unsupported conclusions." This confirms what OIG had previously reported to me as Chairman, and which prompted the more comprehensive investigation, that PBGC had accepted a number of poor quality and mistake-ridden audits associated with the United Airlines terminations. The OIG's evaluation concludes that over a six-year period PBGC spent $26 million on these botched audits and services from a particular contractor, Integrated Management Resources Group, Inc. (IMRG). Moreover, it is my understanding in communications with OIG that IMRG and its contracts with PBGC have been the subject of prior OIG, Government Accountability Office, and Department of Justice interest. For this reason, I am copying the United States Attorney General to bring the present evaluation report involving IMRG to his attention.

During the course of the OIG's investigation, PBGC began efforts to correct its valuations of the United Airlines plans. Yet the OIG reports that, during those efforts, PBGC contracted with a Certified Public Accounting (CPA) firm and "once again accepted and paid for UAL plan asset valuation work that did not accurately value plan assets." Among other things, "PBGC agreed to the CPA firm's use of a flawed methodology that was inconsistent with federal regulations." This finding does not instill confidence that current efforts underway at PBGC to remedy these problems will be finished in a timely and accurate fashion.

Today's report comes on the heels of similar findings related to PBGC's handling of the National Steel pension plan termination. The OIG has found systemic problems in PBGC's plan asset valuation work that goes beyond these particular plans, involving both contractor work and PBGC's review and oversight of that work. In fact, OIG believes IMRG had worked on at least eight of the ten largest pension plan terminations in the PBGC's history.

The United Airlines workers and retirees have complained repeatedly about the handling of their pension plan terminations. The IG's investigation confirms that these individuals had every right to be concerned.

I cannot adequately put into words how troubled I am by the findings of the OIG's report. Proper auditing of a pension plan's assets and liabilities is an essential function of PBGC. Workers and retirees depend on PBGC to do its job correctly. Over the years, countless workers gave their working lives to their companies and through no fault of their own, were stripped of their retirement plans. PBGC and its Board owe these workers and retirees prompt and professional treatment.

I understand that these problems did not develop overnight. They have been brewing for many years. Now that they have been uncovered, it is time to clean up these processes post haste.

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I believe this matter requires your immediate intervention. I ask that you work with OIG and PBGC to identify all flaws in the valuation and benefit calculation work performed on the United Airlines pension plans – as well as all other plans handled since the inception of IMRG's work on these matters – and make all corrections necessary to protect plan participants. I ask that you ensure that PBGC has sufficient resources and expertise available and in use to perform this work accurately. I expect that you will hold all parties responsible for these botched audits and miscalculations fully accountable. And I ask for your commitment that any plan participant underpaid as a result of these failures will be made whole with interest and without delay.

Additionally, I respectfully request a response within 14 days providing a timeline for when United Airlines plan participants will know whether and by how much their benefits were affected by PBGC's failures.

I look forward to your immediate response and your assistance in overseeing the activities of the PBGC and ensuring that the millions of workers who depend on the PBGC for their monthly benefits receive every penny to which they are entitled. If you have any questions please feel free to contact me or have your staff contact Kate Ahlgren my investigative counsel at 202-226-2068.

Sincerely,

George Miller

GEORGE MILLER
Senior Democratic Member

cc: The Honorable Eric Holder
Attorney General
U.S. Department of Justice

The Honorable John Kline
Chairman
Committee on Education and the Workforce

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CAROLYN McCARTHY, NEW YORK
JOHN F. TIERNEY, MASSACHUSETTS
DENNIS J. KUCINICH, OHIO
RUSH D. HOLT, NEW JERSEY
SUSAN A. DAVIS, CALIFORNIA
RAÚL M. GRIJALVA, ARIZONA
TIMOTHY H. BISHOP, NEW YORK
DAVE LOEBSACK, IOWA
MAZIE K. HIRONO, HAWAII
JASON ALTMIRE, PENNSYLVANIA

January 18, 2012

The Honorable Hilda L. Solis
Secretary of Labor
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, D.C. 20210

The Honorable Tim Geithner
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Ave. N.W.
Washington, D.C. 20220

The Honorable John E. Bryson
Secretary of Commerce
U.S. Department of Commerce
1401 Constitution Ave., N.W.
Washington, D.C. 20230

Dear Secretary Solis, Secretary Geithner, and Secretary Bryson:

I write seeking additional information about the Administration's efforts to remedy widespread and long-standing systemic failures at the Pension Benefit Guaranty Corporation (PBGC), which were recently highlighted by the PBGC's Office of Inspector General (OIG). [1] As you know, the OIG found, among other weaknesses, that PBGC failed to effectively oversee the accounting of the terminated United Airlines pension plans' assets and liabilities. Much to my concern, this is neither the first nor likely the last OIG report on the topic of erroneous retirement plan asset valuations.

I wrote you on November 30, 2011, seeking a timeline by which the PBGC will correct the valuation and determination errors, and notify United Airlines plan participants accordingly. I also asked for information about all the other pension plans overseen by the PBGC that were impacted by the botched audits performed by the Integrated Management Resources Group, Inc. (IMRG). I appreciate the information provided in your January 11, 2012 letter. I am troubled to learn that the PBGC will take until August 15, 2012, a projected 8 months, before reaching out to

[1] Evaluation Report: PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient, Pension Benefit Guaranty Corporation Office of Inspector General (November 30, 2011).

January 18, 2012
Page 2

United Airlines plan participants with information about their pensions. I also continue to have questions about the other retirement plan participants, beyond United Airlines, who are potentially impacted by the IMRG audits.

Accordingly, I am reiterating and supplementing my November 30 request with the following questions:

1) What specific steps is the PBGC taking to value the plan assets and benefit determinations leading up to the projected August 15, 2012 timeline for informing United Airlines participants about whether their benefits are affected, and, if so, by how much and when their benefits checks will be adjusted accordingly?

2) What action is the PBGC taking to identify and correct IMRG's erroneous retirement plan valuation and benefit calculations with respect to all other plans?

3) What action is the Board taking to ensure the PBGC identifies and corrects IMRG's erroneous retirement plan valuation and benefit calculations for all affected plans?

4) What action is the Board taking to ensure that the PBGC has sufficient resources and expertise to accurately value retirement plan assets and determine benefits?

5) What action is the Board taking to ensure all parties responsible for the IMRG botched audits and miscalculations are held accountable?

In light of the seriousness of these issues, I respectfully request a written response to my questions within 14 days. I look forward to your assistance in ensuring that the PBGC can fulfill its mission to insure the pension benefits promised to millions of workers and their families. If you have any questions regarding this request, please contact me or have your staff contact my investigative counsel, Kate Ahlgren, at (202) 226-2068.

Sincerely,

George Miller

GEORGE MILLER
Senior Democratic Member

cc: The Honorable John Kline
Chairman
Committee on Education and the Workforce

SECRETARY OF LABOR
WASHINGTON

JAN 1 1 2012

The Honorable George Miller
Committee on Education and the Workforce
U.S. House of Representatives
Washington, DC 20515

Re: Pension Benefit Guaranty Corporation (PBGC)
United Airlines Pension Plans Asset Audits

Dear Congressman Miller:

Thank you for your letter of November 30, 2011, regarding the recent evaluation report published by the PBGC Office of the Inspector General (OIG) on the processing of the terminated United Airlines pension plans. The asset valuation problems you brought to the OIG's attention when you requested this evaluation are serious. As Chair of the PBGC Board of Directors (Board), I am responding on behalf of the Board to let you know that we share your concerns about the issues described in the report. We are taking steps to address these problems.

The Board is closely consulting with the OIG and PBGC management to ensure that the asset valuation problems get fixed quickly so that United Airlines participants can have confidence in their benefit determinations. The PBGC projects informing United Airlines participants by August 15, 2012, whether their benefits are affected, by how much, and when their benefit checks will be adjusted. Any participants who were underpaid will be paid in full with interest. We will keep you apprised of any changes to this timeline.

The ability of the PBGC to effectively select and monitor outside auditors goes to the core management function of being a good steward for the plans it trustees. The benefit determinations of participants in plans taken over by the PBGC should never be undermined by deficient audits. In consultation with the OIG, the Board will work to ensure that the PBGC has in place an adequate set of internal controls and safeguards to reduce the risk that these errors happen again.

On behalf of the Board, we appreciate your continued leadership in making sure that the United Airlines participants receive the benefits to which they are entitled. The Board shares your commitment to making the necessary changes to avoid these problems in the future.

Sincerely,

Hilda L. Solis

HILDA L. SOLIS
Secretary of Labor

Chairman ROE. Without objection, so ordered.

Mr. ANDREWS. Thank you.

This has been a very edifying two panels. Thank you for your contributions to it.

And, Dr. McGowan, we could use all the luck you can give us, so thanks for contributing in many ways.

Mr. PORTER [continuing]. And Ms. Haggerty, you have complementary but not identical ideas about how to reduce the gap in PBGC's projections and not kill the goose that laid the golden egg by not requiring employers to put more in than they are.

What argument would you make to a skeptical taxpayer who would say, "Well, if you make more generous interest rate assumptions from the point of view of the plan's sponsor and things go wrong, as they have so often in the last couple years in American financial sector service—things go wrong, and therefore the plans aren't as healthy as we thought they were going to be, and therefore the PBGC's obligation is more likely to be invoked, and therefore some moral hazard to the taxpayer is likely to be invoked"? What would you say to that skeptical taxpayer about each of your proposals?

Mr. PORTER. First, I think I would step back for a moment. Mark to market——

Mr. ANDREWS. Skeptical taxpayers don't let you do that, but——

Mr. PORTER. I understand. I hear you—apologize.

Fundamental underpinning of mark to market accounting is a belief, in many sectors, that free market interest rates form the basis of proper accounting and proper measurement. Today's interest rates are not free market.

If it is true that free market interest rates are the proper way to measure liabilities what can we say about interest rates that are artificially constrained? They are not proper——

Mr. ANDREWS. Okay.

Mr. PORTER [continuing]. Okay?

We don't know what the right number is; we don't know what rates would have been had the market been allowed to operate freely. But what we do know is what we have is constrained. And it ripples through the corporate bond rates, and it ripples through the interest rates the PBGC is using, through the annuity purchase rates that it is quoted.

Everything is operating in a constrained mode, not in free market mode for now, and will continue at least through 2014. What we are proposing, however it is done, is to find some way to back out the artificiality that is in the marketplace today and have something that more reasonably reflects the long-term market and where it would have been in a free market.

Mr. ANDREWS. Would you agree that it should reasonably reflect the most responsible but pessimistic view of the free market in the long run to be conservative? In other words, I understand you are talking about substituting for the market some metrics that would drive the interest rate because we are looking over the long term. Don't you think it would be prudent to take the most pessimistic credible forecast and use that?

Mr. PORTER. I don't know that I would agree with the most pessimistic because there are some people in this country who can be extremely pessimistic beyond reason. I would think that it needs to be——

Mr. ANDREWS. All of the United States Senate, on many occasions. [Laughter.]

Mr. PORTER. I am not pointing fingers.

I think a reasonable conservative view is appropriate. The most conservative, I think—you are always going to find somebody who would write—rather be more conservative than the next person.

Mr. ANDREWS. Kind of ironic we are having this discussion this morning because on the House floor in a matter of minutes is going to be a piece of legislation that would compel the CBO to do something called dynamic scoring on tax cuts, and it would write into law the supply side religion. And there is some evidence that supports that tax revenues do grow over time when rates are lower, but it really isn't a compelling case, and the House is about to do—to write into law or try to write into law the most optimistic forecast about revenues, which I don't think would serve us well.

Ms. Haggerty, what do you think about this question?

Ms. HAGGERTY. I guess I would just say that—I am sorry; I did turn it on—but I would just say that the risk of going too conservative is that you will have companies that are not investing in important things that need to be—that we need for this country. And I could just give you an example: In 2009, when things were so difficult for our company, we pushed off some significant capital investments in coke facilities that we needed—about $750 million of capital we delayed.

Mr. ANDREWS. You don't mean the Coke Brothers. You mean——

Ms. HAGGERTY. I mean coke for steel-making. So, but, you know, it is an important thing for us and it was actually a—it is something that was very significantly—a very significant cost reduction project for us.

And so we—you know, we made less money in the years since then because we failed to make those investments. And the more profitable we are the better able we are to make the long-term contributions that we need to make.

So there is a balance that has to be struck here. We have to hold up to our obligations but we still have to have a company that is profitable enough to do it over the long term.

Mr. ANDREWS. I thank you.

I would say to the chairman that this is a matter, I think, that calls for his surgical skills, because I think there is a way—empirically speaking, there is a way to write into the law or write into our policy at least forecasting practices that do not constrain business investment but are sufficiently conservative to protect taxpayers. I really do think that there is a way to do that. I am not sure that the two proposals before us do that, but I think that they are a good start.

And there is also a way, I think, then, to give, perhaps as a trigger, that if things don't turn out to be so rosy that there is some mechanism that lets the PBGC get more revenue in order to meet its obligations. Perhaps that is a way we should look at this.

I thank you and I yield back.

Chairman ROE. Mr. Scott?

Mr. SCOTT. Thank you. Thank you, Mr. Chairman.

Mr. Chairman, we have heard from many of the members the preference for the defined benefit plan over the defined contribution plan, but the corporate interests are much more aligned with the defined contribution because you make the contribution then you can forget about it. There is no more risk and there is no more concern.

What can we do to encourage corporations to stay with the defined benefit plans that take the risk of the market fluctuation off of the employee? Are there any things—are there any market, for example, for insurance products that you could buy as you go along to create the—to pay the defined benefit? Is there any market for those products?

Ms. HAGGERTY. I think that Director Gotbaum maybe was trying to imply that there was, but I guess I would just say it this way, sir: The defined benefit plan, it is a great benefit for somebody that is going to stay at a company for a longer period of time. A defined contribution plan benefit may actually be better for someone who would prefer to change jobs periodically because they can take it with them.

So I would say that a defined contribution can be an excellent benefit but for someone that stays at one—in one place, like myself—I have been at U.S. Steel for 35 years—a defined benefit plan is an excellent thing to have.

As far as having a product, there is no magic bullet that will take your obligation and turn it into, you know, what your payment is going to be, you know, and everything is going to come out right. I think people try to argue for de-risking plans, and I think that works for some. But by de-risking plans you are, in all likelihood, investing the funds in your plan at a rate that is much more comparable to your discount rate. So therefore, you are not really earning anything above that discount rate over a long period of time.

And I would just argue, if you look at our history, over 60 years in our plan we have paid out probably close to $30 billion in benefits, yet we have—that is maybe five times the amount of contributions that we have had to put in. So we have had great success investing for the long term, and I think that is better for defined benefit plans to have the flexibility.

Mr. SCOTT. Well, the problem is what goes up might come down.

Mr. DeFrehn, you indicated a tax policy that discourages overfunding in the good years. Could you describe what that problem is?

Mr. DEFREHN. Yes. For many years we had a problem with the full funding limitations of the code, which said that if you continue to make contributions to a plan that was fully funded the employer couldn't take a current deduction for those contributions.

If you think about these plans as being a collection of collective bargaining agreements—sometimes thousands of collective bargaining agreements related to one plan—the idea of trying to open those agreements at the point where the plan became fully funded and cease contributions was impractical. And also, the boards of trustees who are the fiduciaries for those plans are often not the same people who negotiate the plans—the arrangements.

So they had little choice but to increase the liabilities through benefit improvements in order to raise the cost of the plan high enough to keep the contributions deductible. It seems like a bizarre way to go about doing it but it was the only route that was available until we were able to successfully get that resolved in the Pension Protection Act.

Mr. SCOTT. Can any of the panelists comment on whether or not programs that are insolvent—whether or not they should pay a higher premium—risk-based premium—and how that should work? If you are woefully underfunded should your premium not be higher than somebody that is 100 percent funded——

Mr. PORTER. If you are talking about insolvent there is nothing for them to——

Mr. SCOTT. Under 80 percent funded. Should there be a premium addition?

Mr. PORTER. I guess there is a question—right now the rules say the—yes, you pay more if you are underfunded. Other rules—proposals that the PBGC has put out—is that you don't base it on underfunding as much as you base it on the ability of the company to survive.

We have a situation right now because of the artifice of the interest rates where they are where a lot of companies find themselves below 80 percent but never have before and most likely won't be once interest rates return to a normal range. Do we charge people more simply because of the aberration of the marketplace? That doesn't seem—feel right at all. So I am not sure that an absolute on 80 percent is the right answer, either.

Mr. PORTER. Mr. McGowan?

Mr. MCGOWAN. The other potential problem with that is it hits the pension plans at their weakest moment. Their risks go up when they are least able to pay and so it sort of accelerates, possibly, that downward spiral. So you might want to, you know, factor that into consideration when you are considering the level of higher premiums associated with risk because that could accelerate that downward decline.

Chairman ROE. Mr. Altmire?

Mr. ALTMIRE. Thank you, Mr. Chairman.

And welcome especially to Ms. Haggerty. I, as you know, am from the Pittsburgh area myself and am grateful that you took the time to come have this discussion before the committee.

Same for all of the panelists.

And I did want to ask, you mentioned, Ms. Haggerty, in the previous question, about $30 billion in benefits over the past 60 years. You are speaking specifically and only about pension benefits, right? Retirement——

Ms. HAGGERTY. Correct. That is correct.

Mr. ALTMIRE [continuing]. Not the other benefits?

Ms. HAGGERTY. Right.

Mr. ALTMIRE. And you address this a little bit in your testimony, but that made me think about that 60-year period, which we all understand what that has meant for our region in western Pennsylvania and for the steel industry in the country. And I wonder if you could talk a little bit more about maybe especially 30 and 40 years ago and the very difficult times that the industry went through, and the decisions that were made, and the impact that they are having today on current employees and on retirees, what the lessons that were learned, and maybe in retrospect, were there decisions that you wish, in your current position, had been made differently at that time? And what can we learn across all sectors from that experience?

Ms. HAGGERTY. Thank you, Congressman Altmire. Appreciate the question.

If you look back in—the situation that the congressman is referring to is in the late 1970s and 1980s in our region we had to undergo a significant amount of restructuring in our industry and we cut—we closed many facilities, and as a result we have many retirees today. I have 78,000 retiree—I have 78,000 participants in my main pension plan and maybe 90 percent of those are retirees, many from the 1970s and 1980s and the early 1990s when we had such difficulty.

I would say that the lessons that we learned are good lessons for people and it really—I really have my predecessors to thank for it. In the early 1950s we began managing our own pension plan and we have managed it in house—we are kind of unusual in that regard—we have managed it in house since that time. And we have taken a very long-term view to investing the funds that have been entrusted in that plan.

But one of the things that my predecessors did was that they funded the plan in the 1950s and they invested it in ways that were very wise and long-term oriented, and we were therefore able to restructure our industry and our company in the 1970s and 1980s and still honor all of the benefits to the employees that we had made—all the promises that we had made. So I think it really is a great success story for taking a long-term view to funding and investing in a defined benefit pension plan.

Mr. ALTMIRE. Dr. McGowan, I wonder from an academic perspective if you could comment on international competitiveness and the decisions that we have to make regarding the PBGC and the future of these types of retirement plans and pensions and what impact that is going to have on American manufacturing, which is of great discussion in this Congress, and our industry—what other countries are doing and what is the competitive nature of this policy we are talking about.

Mr. MCGOWAN. Right. I really appreciate that question. I was wanting to make that very point 3 or 4 minutes ago and it is like a student asking the perfect question so I really appreciate that.

You know, and the point is that we do live in a global economy where we have an international economic marketplace and companies in the U.S., in a sense, have to compete with those global companies. And around the world this dynamic of defined benefit pension plans kind of being replaced, as Ms. Haggerty said at U.S. Steel 2003, is going on and on relentlessly.

And so for our companies in this country to compete in the global marketplace we have to come up with some other options. Realistically, like Mr.—you know, the chairman of the PBGC said, there are other options, like a combination of defined benefit-defined contribution, or just defined contribution. You know, I have a defined contribution plan with the university and they have matched it over—throughout the years, and I am going to be okay, with, you know, other investing and planning.

So, yes, that is a great question. That brings up a really important point about how U.S. companies have to compete in a global marketplace.

Mr. ALTMIRE. Thank you to the entire panel.

And thank you, Mr. Chairman.

Chairman ROE. Thank you to the gentleman for yielding.

Again, I want to thank the witnesses. This has been a great two panels. I would like to thank you all for taking your time to come and testify on this very important issue.

My medical license is still current if we need any antidepressants after this panel. We can take care of that.

I will yield now to the ranking member for closing comments.

Mr. ANDREWS. Well, again, I want to thank both panels and you, Mr. Chairman, and our colleagues. We frankly should have more hearings like this in the Congress.

This was a serious and, I think, substantive discussion of a real problem, and it is one I believe we can solve. I really do think we can thread that needle of making sure there are never any bailouts—taxpayer-funded bailouts of the PBGC—but doing so in a way that strikes the proper balance between a more rational accounting of what the situation really is and then more rational flexibility to raise revenue if we need to. I really do think this is a problem with a solution.

And I look forward to working with you on that solution in a way, as we have, frankly—Speaker Boehner sat in that chair in 2006, and I think that we produced a piece of legislation together that has improved the situation, along with minor assistance from the Senate, and I think we certainly could do that as well here. So I thank you for this opportunity.

Chairman ROE. I thank the gentleman for yielding. And I will finish by saying that this is almost a catch-22. I see companies, I see employees wanting to work together because one of the great uncertainties, as you see people go forward, is outliving their money, is how do you figure out how to have enough retirement savings—Social Security, your own retirement, your pension plan, whatever it may be—to not outlive your money? And I think I see both employees and employers sitting here today trying to figure out how you do that and how you make a promise and you keep the promise.

So I thank you for being here and this subcommittee will continue to work on this. Obviously there needs to be some work done and I think a combination or a blend is something that we will come up with. And I thank you all for being here.

With no further comments, the meeting is adjourned.

[Additional submissions by Chairman Roe follow:]

February 1, 2012.

Hon. PHIL ROE,
U.S. House of Representatives, Washington, DC 20515.

Re: *Examining the Challenges Facing PBGC and Defined Benefit Pension Plans*

DEAR REPRESENTATIVE ROE: On behalf of the Associated General Contractors of America (AGC), I want to thank you for holding a hearing "Examining the Challenges Facing PBGC and Defined Benefit Pension Plans." Multiemployer pension plans are common in the unionized sector of the construction industry and provide employers the opportunity to provide their employees with a defined benefit plan that gives them "portability" to earn continuous benefits as they go from job to job within the same industry. Of the 10 million participants in multiemployer defined benefit plans, nearly 45 percent are construction industry workers and retirees.

The majority of multiemployer plans suffered significant losses as a result of the financial crisis. Recently enacted relief legislation and some improvements in investment returns have helped some plans, but the current rules, long-term demographics, and market conditions continue to put at risk the viability of the plans and their contributing employers. This is particularly true for the construction industry, which has been affected by the economic recession to a far greater degree than most industries. In short, further legislative reform is needed and, with the Pension Protection Act nearing sunset, the process must begin now.

AGC believes that Congress should enact reforms that will:

• Provide a reasonable and secure retirement benefit for employees through shared risk;
• Preserve the flexibility and protection of the "construction industry exemption" while mitigating the long-term effects of the "last man standing rule";
• Share the burden equitably through benefit reductions and continued employer contributions;
• Transfer appropriate amount of risk from employers to employees by facilitating and incentivizing the option to transition from a defined benefit plan to a defined contribution or hybrid plan;
• Provide predictable contribution rates for employers and more tools to allow employers to prepare for and weather economic downturns;
• Create formal mechanisms for rolling back participants' accrued benefits when a defined benefit plan comes under severe financial stress, as a way to moderate employers' financial exposure and thus revive their interest in sponsoring defined benefit plans; and,
• Allow for the "de-risking" of multiemployer pension plans by lowering the expected rate of return gradually over a number of years to a level that is conservative and sustainable. The increased actuarial liability associated with lowering the expected rate of return should be amortized over a long period of time. Only after a plan over achieves its expected rate of return, could it grant benefit increases.

AGC appreciates your leadership in examining multiemployer plans and looks forward to working with you on these important issues. The reforms recommend by AGC should never be viewed as a "union bailout;" rather, they are needed to help the tens of thousands of small employers that contribute to the plans and to protect the retirement security of their hardworking employees.

Sincerely,

JEFFREY D. SHOAF,
Senior Executive Director, Government Affairs.

Prepared Statement of Hon. John Engler, President, Business Roundtable

Chairman Roe, we commend you, Ranking Member Andrews, and the other members of this Subcommittee for holding this hearing. Pension plans and the companies that sponsor them are facing unprecedented challenges in the current economic climate. A thorough examination of the operations of the Pension Benefit Guaranty Corporation (PBGC) and the current issues faced by defined benefit plans and their sponsors is warranted and timely.

Business Roundtable (BRT) is an association of chief executive officers of leading U.S. companies with over $6 trillion in annual revenues and more than 14 million employees. BRT member companies comprise nearly a third of the total value of the U.S. stock market and invest more than $150 billion annually in research and development—nearly half of all private U.S. R&D spending. Our companies pay $163 billion in dividends to shareholders and generate an estimated $420 billion in sales for small and medium-sized businesses annually. BRT member companies provide retirement and health benefits to their employees and their families, including pension plans benefiting millions of workers and retirees.

We believe that the best way to protect retirement security is for Congress to sustain a retirement system for private-sector employers that is fair and stable. All pension plans should be systematically funded to ensure that benefits are paid when due, but funding rules should not impose volatile, unpredictable, and untimely contribution requirements on employers. Nor should employers that voluntarily maintain pension plans for the benefit of their employees be threatened with the massive and unjustified premium increases that are then used to fund unrelated federal spending.

As outlined below, consideration of carefully tailored action to stabilize pension funding rules is warranted today based on the lessons learned since the economic downturn of late 2008 and the unprecedented interest rate situation we are facing today. On the other hand, the historically anomalous interest rates should not be used as a pretext to justify excessive and unwarranted PBGC premium increases or, conversely, to undermine the important long-term reforms enacted in the Pension Protection Act of 2006 (PPA). Fundamental changes in retirement policy should be undertaken only after careful study of the implications on retirement security and on the economy as a whole.

Interest rates and plan funding

Under the PPA, a single employer pension plan's[1] funded level and the annual funding requirements are determined based on corporate bond interest rates. This conservative measure of liability remains the best measure to ensure the adequacy of pension funds for future retirees. However, short-term fluctuations in interest rates can temporarily distort the measurement of pension liabilities—liabilities that span decades. The PPA funding rules

Without further action by Congress, resources that must be devoted to meet the unexpected new funding mandates will have to be diverted from increasing payrolls and will delay the business investments necessary to create jobs and spur the recovery. This is much more than a cash flow issue for employers that sponsor pension plans. It is about jobs and about the economic recovery, and will directly affect every American. Volatile and unpredictable pension funding requirements, like those employers face today, make it impossible for employers to plan, slowing the economy. Moreover, forcing larger pension contributions as the nation battles to emerge from the current economic downturn will divert resources from capital spending and exaggerate the economic cycle. As Business Roundtable has stated in the past, "procyclical" pension funding requirements, like those we are facing today, result in an economy that overheats more during upturns and has deeper recessions during downturns.[2]

We urge you to consider appropriate adjustments in the plan funding rules that take into account the extraordinary interest rate environment we are experiencing, but that do not undermine the long-term objective of ensuring retirement plans are funded systematically over the long-term. Stabilizing the pension funding rules in a way that minimizes volatility would not only create jobs, but could also help reduce the PBGC's deficit and strengthen our pension system.

PBGC Deficits and Premiums. The PBGC's own 2010 Annual Report states that: "[s]ince our obligations are paid out over decades, we have more than sufficient funds to pay for benefits for the foreseeable future." Nonetheless, the PBGC asserts that its reported long-term deficit justifies $16 billion or more in new taxes on defined benefit plans in the form of PBGC premium increases. We strongly disagree.

A large portion of the PBGC's reported deficit is the direct result of the Federal government's actions to hold down interest rates. Moreover, serious questions exist regarding the methodology that the PBGC uses to calculate its deficits. As a start, no significant increases in premiums should even be considered until the PBGC fully discloses and justifies its methodology for calculating its deficit and the Congress and the public have the opportunity to review that methodology. Moreover, PBGC premium increases should not be adopted without a thorough investigation of the deficiencies in the benefits administration and payments identified in the last three fiscal reports issued by the agency's inspector general.

It is important to keep in mind that PBGC premiums for the single employer program were already increased substantially four times since 1986, mostly recently in 2006. Since 2006, the PBGC per participant premium has been automatically increased for wage inflation, resulting in additional premium increases in 2007, 2008, 2009, and 2010. Moreover, because the PGBC's variable rate premium is based on a plan's funded level, which as discussed above goes down when interest rates decline, PBGC variable rate premium (VRPs) collections have increased dramatically since 2008. As reflected in PBGC Annual Reports, overall, PBGC's single employer program premium collections have been well in excess of $2 billion per year over the last three fiscal years (FY2009-FY2011), an increase of over 66% over the total premiums that were collected in FY2008 and earlier. Almost all of this new pre-

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[1] Our testimony today focuses exclusively on the single employer pension plans and the PBGC's single employer benefit guaranty program. contain limited provisions that reduce (or smooth) the impact of common interest rate variations on the plan sponsor's immediate pension contribution requirements. But the PPA rules did not contemplate the sustained and extraordinary steps the Federal government has undertaken in recent years to drive and hold down interest rates in order to get the economy moving again. Unfortunately, the collateral damage from actions to hold down interest rates artificially is that those low interest rates are triggering artificially high pension liabilities and dramatically larger immediate funding obligations.

[2] Research done at the request of the Business Roundtable in 2005 by Robert F. Wescott, PhD. confirms that the failure to appropriately smooth interest rates fluctuations would exaggerate economic downturns. Dr. Wescott is an economist who works on and pension savings issues who served as Chief Economist at the Council of Economic Advisers and as Special Assistant to the President for Economic Policy. The study was reviewed by Professor Deborah J. Lucas, Household International Professor of Finance, Department of Finance, J.L. Kellogg Graduate School of Management, Northwestern University, and Professor Stephen Zeldes, Benjamin Rosen Professor of Economics and Finance at Columbia University's Graduate School of Business, and chair of the school's Economics Subdivision.

mium revenue has been raised through the VRP, with the VRPs paid to the PBGC by single employer pension plan sponsors having increased by over 400% between FY2008 and FY2010. In light of those trends, it is difficult to see how even greater premium increases are warranted, especially in the current economic climate.

In any event, further increases in PBGC premiums should only be considered after all the potential implications on the economic recovery and the defined benefit system are thoroughly considered. In particular, massive increases in premiums like those proposed by the PBGC could accelerate the exodus from the pension system, undermining retirement security and leaving the PBGC without plans to support it. We continue to believe that the best way to deal with any long-term financial problems at the PBGC is to keep more employers in the system, not to tax them out of the system.

Mr. Chairman and members of the Subcommittee, we thank you for the opportunity to share our views. We look forward to working with the Committee on the challenges facing our pension system as well as proposals dealing with the PBGC.

Prepared Statement of the U.S. Chamber of Commerce

The U.S. Chamber of Commerce would like to thank Chairman Roe, Ranking Member Andrews, and members of the Subcommittee for the opportunity to provide a statement for the record. The topic of today's hearing—challenges facing the Pension Benefit Guaranty Corporation (PBGC) and defined benefit plans—is of significant concern to our membership.

As sponsors of defined benefit plans and professionals in the retirement plan arena, Chamber members have a vested interest in the ongoing viability of the PBGC. The PBGC is the final backstop for participants in the defined benefit plan system. The existence of the PBGC is important to plan sponsors because it maintains the credibility of the defined benefit system. Therefore, it is necessary to ensure that the PBGC remains a credible institution.

Introduction

In the last several years, the defined benefit plan system has faced several significant challenges—industry bankruptcies, an overhaul of the funding rules, demographic changes, and a financial crisis affecting every type of industry and investment. The Chamber believes that this is an appropriate time to review the governance, policies and practices of the PBGC to ensure that the PBGC and the defined benefit plan system are able to withstand additional challenges in the future.

The Chamber recommends that Congress specifically consider the following four issues: the calculation of the PBGC's deficit; increases to PBGC premiums; the governance of the PBGC; and regulatory burdens imposed by the PBGC. Each of these issues is discussed in further detail below.

Discussion

Overly-Conservative Assumptions Create a Misleading View of the PBGC's Deficit. The business community has long questioned the accuracy of the PBGC's deficit numbers. To start, a substantial portion of the deficit is due to historically low interest rates that are also plaguing defined benefit plans.[1] The low interest rates are exacerbated by conservative discount rate assumptions used by the PBGC to calculate future liabilities and conservative assumptions on investment gains to calculate future assets.[2] While there is some room for differences in these assumptions, the Chamber believes that the PBGC assumptions are unnecessarily conservative and should be reviewed by Congress, as well as other interested parties to determine if they accurately reflect expected investment and interest rate experiences.

Since the establishment of the PBGC in 1974, it has most often operated at a deficit.[3] This on going deficit has led to many concerns about whether the PBGC can continue as a viable entity on its own or if a federal bailout will be necessary in the future. However, the deficit is not an indicator of an immediate crisis. Even the PBGC acknowledges that there is not a crisis. In its 2011 annual report, the PBGC states "[s]ince our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future."[4] Moreover, in its 2010 Exposure Report, the PBGC states that "[i]n the 5,000 scenarios simulated in SE-PIMS, there are none in which PBGC assets are completely exhausted within the 10-year projection horizon."[5]

If the PBGC is able to meet its financial obligations for the foreseeable future, then there is not a crisis. Congress should review the deficit calculations used by the PBGC to determine whether the assumptions accurately reflect the future financial expectations of the agency.

PBGC Premium Payments Must Be Predictable. Discussions about the deficit then often lead to talk of the premiums. The debate over premiums generally hinges on whether the PBGC is viewed as purely an insurance agency, where premiums should be directly associated with risk, or if it is viewed as a quasi-insurance agency, where premiums are based on various considerations. In either case, both of these issues directly impact plan sponsors and can impact the way employers decide to structure their retirement plans.

The business community has consistently opposed measures that increase PBGC premiums for the sole purpose of decreasing its deficit. For example, during the debate over the Pension Protection Act of 2006, the business community opposed proposals that would allow the PBGC to raise premiums without Congressional authorization. The Chamber continues to believe that it is important that Congress—as a neutral third party—determine whether premium increases are appropriate in the context of the defined benefit system as a whole and not just the PBGC deficit. As such, the Chamber believes that is important to have the conversation on premium increases in the context of the policy discussions mentioned in this statement and not as an independent issue.

In the last couple of years, the Administration has put forth recommendations to restore the solvency of the PBGC. These recommendations include giving the PBGC Board the authority to adjust premiums over time and would allow the Board to take into account the credit worthiness of a company.[6] Changes of this type and magnitude would undermine the private sector defined benefit pension system, hinder the economic recovery and could create an ill-advised precedent of government intrusion into normal business activities.

Raising the PBGC premiums, without making contextual reforms to the agency or the defined benefit system, amounts to a tax on employers that have voluntarily decided to maintain defined benefit plans. Proposals, like those included in the President's budget, that purport to raise $16 billion in additional PBGC premiums are flawed and, even if they were feasible, would result in an increase in PBGC premiums of almost 100 percent. Even less draconian PBGC premium increases, when added to the multi-billion dollar increases enacted in 2006, would divert critical resources from job creation and business investment.

Furthermore, a creditworthiness test, like the one proposed by the Administration, would inevitably result in the PBGC becoming an entity that makes formal pronouncements about the financial status of American businesses. This role is inappropriate for a government agency. Leaving aside the question of whether the PBGC can establish accurate mechanisms for measuring and adjusting an employer's credit risk across industries and across the country, even modest year-to-year changes in those government credit ratings could have implications well beyond PBGC premiums, potentially affecting stock prices or the company's access to other credit sources. We understand the pressures to address the budget deficits, but massive increases in PBGC premiums are not the solution.

Formal Procedures are Needed for the Governance of the PBGC. The PBGC's Board does not currently have any formal, written procedures in place describing a governance strategy. The Board is not required to meet any certain number of times annually, and has met infrequently over the past three decades. According to a recent GAO report, the Board has met 18 times since 1980.[7] In 2003, the board agreed to meet twice, although a review of meeting minutes indicates that there is generally not significant time spent on operational and strategic issues and the meetings usually only last about an hour.[8] According to the report, the Board relies on the Inspector General and PBGC's internal management committees to ensure the corporation is operating effectively.[9]

The PBGC's corporate governance structure has recently come under scrutiny by the Inspector General for the PBGC and the GAO citing several perceived flaws in its current system of governance. A recent report issued by the GAO identifies these issues in detail and proposes significant changes to the PBGC's current structure. The report details several recommendations for improvement to the PBGC's governance structure, including the following:

- more frequent board meetings;
- the establishment of formal guidelines clarifying administrative authority, responsibility and oversight;
- expanding the board of directors to include members with expertise in key areas relevant to the PBGC's mission;
- and establishing standing committees to deal effectively with issues facing the corporation.[10]

We are very concerned about the lack of formal guidance pertaining to the governance of the PBGC. In general, we support the recommendations laid out in the 2007 GAO report.

Regulatory Requirements are Overly Burdensome. In general, greater regulation often leads to greater administrative complexities and burdens. Such regulatory burdens can often discourage plan sponsors from establishing and maintaining retirement plans. The following are examples of regulatory burdens imposed by the PBGC that are overwhelming.

PBGC Rule on Cessation of Operations: In August of 2010, the PBGC published a proposed rule under ERISA section 4062(e) which provides for reporting the liabilities for certain substantial cessations of operations from employers that maintain single-employer plans. If an employer ceases operations at a facility in any location that causes job losses affecting more than 20% of participants in the employer's qualified retirement plan, the PBGC can require an employer to put a certain amount in escrow or secure a bond to ensure against financial failure of the plan. These amounts can be quite substantial.

The Chamber believes that the PBGC proposed rule goes beyond the intent of the statute and would create greater financial instability for plan sponsors. Furthermore, we are concerned that the proposed rule does not take into account the entirety of all circumstances but, rather, focuses on particular incidents in isolation. As such, the proposed rule would have the effect of creating greater financial instability for plan sponsors.

The PBGC recently announced that it is reconsidering the proposed rule. However, we continue to hear from members that the proposed rule continues to be enforced. This type of uncertainty is an unnecessary burden on plan sponsors and discourages continued participation in the defined benefit plan system.

Alternative Premium Funding Target Election: The PBGC's regulations allow a plan to calculate its variable-rate premium (VRP) for plan years beginning after 2007, using a method that is simpler and less burdensome than the "standard" method currently prescribed by statute. Use of this alternative premium funding target (APFT) was particularly advantageous in 2009 because related pension funding relief provided by the Internal Revenue Service served for many plans to eliminate or significantly reduce VRP liability under the APFT method. However, in both 2008 and 2009, the PBGC determined that hundreds of plan administrators failed to correctly and timely elect the AFPT in their comprehensive premium filing to the PBGC, with the failures due primarily to clerical errors in filling out the form or administrative delays in meeting the deadline.

In June of 2010, the PBGC responded to the concerns of plan sponsors by issuing Technical Update 10-2 which provides relief to certain plan sponsors who incorrectly filed. We appreciate the PBGC's attention to this matter and its flexibility in responding to this situation. However, we are concerned that the relief provided does not capture all clerical errors or administrative errors that may have occurred and, therefore, some plan sponsors remain unfairly subject to what are substantial and entirely inappropriate penalties. As such, we believe that the rules established under the current regulation and the Technical Update should be considered a safe harbor. The regulation should be revised to state that if the safe harbor is not met, the PBGC will still allow use of the APFT if the filer can demonstrate, through appropriate documentation to the satisfaction of the PBGC, that a decision to use the APFT had been made on or before the VRP filing deadline. Proof of such a decision could be established, for example, by correspondence between the filer and the plan's enrolled actuary making it clear that, on or before the VRP filing deadline, the filer had opted for the APFT. It is important that this regulatory change be made on a retroactive basis, so as to provide needed relief to filers for all post-PPA plan years.

Conclusion

Given the PBGC's role and the greater emphasis being placed on retirement security generally, this is the perfect time to re-examine the role of the PBGC and to re-define its policy objectives. As mentioned above, a recalculation of the PBGC's deficit, consistency in PBGC premiums, reformation of the PBGC's governing structure, and a lessening of regulatory burdens would go a long way in securing the future viability of the PBGC and the defined benefit system. We look forward to working with this Committee and Congress to enact legislation that will further these goals. Thank you for your consideration of this statement.

ENDNOTES

[1] In the single-employer program, approximately $1 billion of the net loss was due to a reduction in interest rate factors. PBGC 2011 Annual Report, p. 21.

[2] See, Proposed PBGC Premium Changes—A Reality Check by Kenneth Porter, Bloomberg BNA, Pension and Benefits Daily, September 14, 2011.

[3] The exception is from 1996-2001 when the PBGC's surplus ranged from $8 million to $9 billion. PBGC Insurance Data Book 2004, p. 26.

[4] Id, p. iv.

[5] 2010 PBGC Annual Exposure Report, p. 9, *http://www.pbgc.gov/documents/2010-Exposure.pdf.*

[6] See, The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform which recommends that the PBGC's board be given authority to raise the premium rate to restore solvency (p. 41), *http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12—1—2010.pdf.*

[7] Gov't Accountability Office, Pension Benefit Guaranty Corporation: Governance Structure Needs Improvements to Ensure policy Direction and Oversight, 3. GAO-07-808 (2007).

[8] Id. at 15.

[9] Id. at 3.

[10] Id. at 21-23.

Prepared Statement of the Financial Services Roundtable

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record to the U.S. House Education & Workforce Committee, Subcommittee on Health, Employment, Labor, and Pensions on "Examining the Challenges Facing PBGC and Defined Benefit Pension Plans."

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

The Roundtable Supports Retirement Security

The Financial Services Roundtable supports increased incentives and opportunities for Americans to save and invest. It is our belief that providing these opportunities for Americans is important because savings increase domestic investment, encourage economic growth, and result in higher wages, financial freedom, and a better standard of living. We believe that most Americans should approach retirement with a comprehensive strategy that incorporates a number of retirement vehicles.

Strengthening the retirement security of all Americans is a priority for the Roundtable. Employer-sponsored retirement plans are an important element for many Americans. However, the Roundtable opposes increasing the level of premiums paid by companies to the Pension Benefit Guaranty Corporation (PBGC) as request by President Obama. We believe that the Administration's proposal, if enacted, would undermine the safety and soundness of the pension system.

First, an increase in PBGC premiums similar to the one proposed in the President's 2012 budget (and is expected to included on the 2013 budget) amounts to a tax on employers who maintain defined benefit plans. Furthermore, such a tax is unnecessary because the PBGC's own annual report (2010) states that "[s]ince our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future." The PBGC is not in danger of being unable to perform its duties, nor are they in a position where they would need public funds for a bailout. The Roundtable urges the Subcommittee to examine the PBGC's financial situation more carefully, including examining the actual nature of PBGC's deficit.

Next, giving the PBGC the authority to arbitrarily increase its premiums diminishes Congress's oversight of the PBGC. Such a grant of authority would give the PBGC the ability to determine what its customers pay because by law all pension plans must pay the PBGC's premiums. In essence, the PBGC would be able to raise rates anytime it wanted to for almost any reason, and defined benefit plan sponsors would have no choice but to pay it.

Finally, there are almost 19 million people participating in about 48,000 private-sector defined benefit plans. The number of employers sponsoring pension plans goes down every year. Raising the PBGC's premiums without also instituting broader industry reforms will only serve to undercut the industry and the PBGC's goal of maintaining a robust fund to help cover the shortfalls in pension plans. If this proposal is implemented it will only quicken the trend of employers moving to defined contribution plans and away from sponsoring defined benefit plans.

The Roundtable believes our nation's current workplace retirement system has enhanced the retirement security of millions of American workers by increasing their retirement savings and the quality of life during their retirement years. The pension industry is aware of the challenges the Committee must confront. However, we firmly believe that increasing PBGC premiums will only serve to divert valuable pension resources that could be better spent on extending the longevity of pension plans.

In closing, the Roundtable thanks the Subcommittee for the opportunity to comment.

MICHAEL R. TURNER
3RD DISTRICT, OHIO

COMMITTEE ON ARMED SERVICES
CHAIRMAN
SUBCOMMITTEE ON
STRATEGIC FORCES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

ASSISTANT MAJORITY WHIP

Congress of the United States
House of Representatives
Washington, DC 20515

2454 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-6465

DISTRICT OFFICES:

120 WEST 3RD STREET
SUITE 305
DAYTON, OH 45402
(937) 225-2843

61 EAST MAIN STREET
WILMINGTON, OH 45177
(937) 383-8631

February 2, 2012

Mr. Joshua Gotbaum
Director
Pension Benefit Guaranty Corporation
1200 K St., NW
Washington, D.C. 20005

Dear Mr. Gotbaum:

I am writing to express my disappointment in the failure of your agency and Deputy Director for Operations Vincent Snowbarger to produce responses to questions I submitted at the November 14, 2011 Oversight and Government Reform Committee hearing on "Delphi Pension Fallout: Federal Government Picked Winners and Losers, So Who Won and Who Lost?" in Dayton, Ohio.

Despite providing Mr. Snowbarger with ample time to respond, no answers were forthcoming. As a result of this delay, I wrote Mr. Snowbarger on January 25, 2012 to provide him with a suggested deadline of January 31, 2012 for receipt of his answers. Your agency neglected that suggested deadline and continues to deprive Congress, Delphi salaried retirees, and the American taxpayer of the answers they deserve.

I expect you to use the full authority of your office to ensure that I receive timely and thorough answers to these questions. For your reference, I have enclosed the questions for the record as well as my letter to Mr. Snowbarger of January 25, 2012.

Sincerely,

Michael R. Turner

Michael R. Turner
Member of Congress

Written Testimony
Congressman Michael R. Turner (OH-3)
The House Committee on Education and Workforce
Health, Employment, Labor, and Pensions Subcommittee
"Examining the Challenges Facing PBGC and Defined Benefit Pension Plans"
10:00 AM, February 2, 2012 2175 Rayburn House Office Building

Thank you, Chairman Roe and Ranking Member Andrews for holding this hearing today and allowing me to submit testimony. Perhaps one of the greatest challenges facing the Pensions Benefit Guaranty Corporation (PBGC) is transparency. Specifically, PBGC struggles to overcome issues of transparency giving rise to conflicts of interest with respect to the termination of Delphi salaried retiree pensions in the wake of the General Motors bailout. Despite the efforts of Members of both the House and Senate calling for answers on this matter, the Administration continues to maintain its unacceptable silence. In this chamber alone, this Subcommittee, the Committee on Oversight and Government Reform, and the Committee on Financial Services have all held hearings to receive testimony on the plight of Delphi salaried retirees.

The bankruptcy of Delphi Corporation continues to have a major impact on my community of Dayton, Ohio. The Dayton region is the birthplace of Delphi Corporation. The company was founded as the Dayton Engineering Laboratories Company which evolved, through the hard work of Ohioans, into Delco, a division of General Motors. General Motors subsequently spun off Delphi Corporation, which at one point, was the largest parts supplier to General Motors.

Mr. Chairman, my father worked for General Motors for over 40 years. When Delphi declared bankruptcy in 2005, the company decided to close or sell several facilities in my congressional district including two facilities in Dayton, as well as facilities in Kettering, Moraine, and Vandalia. The job loss at these facilities has been estimated at over 5,000 jobs. The effect of these plant closures has been felt throughout the Dayton region as many of our family members, neighbors, and friends were Delphi employees. The closure of these facilities also has an impact beyond individual job loss. Whole neighborhoods have been affected by Delphi's bankruptcy through increased foreclosures, and community services have been affected because of an eroded tax base.

In the summer of 2009, Delphi petitioned for, and the United States Bankruptcy Court granted authority to turn over pensions for salaried retirees to the PBGC. These actions have resulted in approximately 20,000 current and future salaried Delphi retirees from across the country taking a severe cut in their promised pension benefits. By some estimates, this means a 70 percent reduction in pensions, and for some retirees, this news compounds the prior loss of health care benefits. However, not all groups have had these results. Delphi Salaried Retirees, as well as some so-called "splinter unions" such as the IUOE, IBEW, and IAM still face benefit reductions. This treatment of salaried retirees is particularly troubling in comparison to the benefits received by some in organized labor organizations.

I have worked along with members of this panel to advocate on behalf of *both* union and non-union labor to ensure that *all* retired workers receive whatever benefits they were promised. Mr. Chairman, all of these retirees, regardless of labor affiliation or not, worked alongside each other during their careers. They should not be treated differently in their retirement.

Congress and the hardworking Americans whose tax dollars were used to unjustly reduce the pension benefits of Delphi salaried retirees in the wake of the General Motors bailout deserve answers. Nevertheless, PBGC continues to obstruct oversight and deny calls for transparency. It is my sincere hope that the PBGC will overcome this challenge and engage openly on the decision-making process that resulted in these inequitable benefit reductions.

Mr. Chairman, salaried retirees made their careers by supporting Delphi Corporation, and while Delphi has been permitted to survive, their retirees continue to struggle. This problem should not even have been allowed to occur. I appreciate your holding this hearing today as we continue to look for additional answers.

NECA
NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION

February 3, 2012

The Honorable Phil Roe, Chairman
The Honorable Rob Andrews, Ranking Member
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and the Workforce
2175 Rayburn House Office Building

Dear, Chairman Roe and Ranking Member Andrews:

The National Electrical Contractors Association (NECA) appreciates the opportunity to submit testimony in response to the Subcommittee on Health, Employment, Labor and Pensions of the House Education and the Workforce Committee's hearing entitled "Examining the Challenges Facing PBGC and Defined Benefit Plans." NECA commends the Committee for having scheduled a hearing on this important subject and for the inclusion of two key witnesses that specifically addressed multiemployer pension plans.

Over 10 million businesses, mostly small in size, participate in multiemployer defined benefit plans and 54% of those business are in the construction industry. NECA is made up of over 4,000 companies that contribute to both a national and local pension plans. The current economic conditions in the construction industry, along with the volatile equity markets continue to put the multiemployer pension plans at risk. As a result, these pension funding issues have a tremendous impact on the day-to-day decisions of NECA members. In 2010, NECA companies contributed approximately $370 million into the National Electrical Benefit Funds (NEBF) with total assets over $11 billion. This total does not include contributions to local pension plans whose aggregate value is in excess of $15 billion.

Recently Congress enacted legislation that provided some relief to multiemployer pension plans and helped companies recover losses incurred as a result of the financial crisis. However, more changes are necessary to improve the health and viability of these plans. NECA believes this hearing proved to be a successful start to addressing some of the issues before the Pension Protection Act sunsets in 2014.

NECA appreciates the opportunity to submit this statement for the record in conjunction with this hearing and looks forward to working with Congress on this important issue.

NECA is the nationally recognized voice of the electrical construction industry, comprised of over 80,000 electrical contracting firms, employing over 750,000 electrical workers and producing an annual volume of over $125 billion in electrical construction. NECA includes 120 U.S. chapters in addition to several affiliated international chapters around the world.

Sincerely,

John M. Grau
Chief Executive Officer

NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION
3 Bethesda Metro Center • Suite 1100 • Bethesda, MD 20814 • 301 657 3110 • 301 215 4500 FAX
WWW.NECANET.ORG

[Additional submissions by Dr. McGowan follow:]

SAINT LOUIS UNIVERSITY,
3674 LINDELL BLVD.,
St. Louis, MO 63108, May 25, 2012.

Hon. PHIL ROE, *Congressman,*
Tennessee 1st District, 419 Cannon Office Building, Washington DC 20515.

DEAR CHAIRMAN ROE: Please be advised I have completed the study on multiemployer pensions and it is attached. The study was in process at the time of my testimony in February. Thanks for processing this study.

Let me know if you have any questions.

Cordially yours,

JOHN R. MCGOWAN, PH.D., CPA, CFE,
Professor of Accounting.

The Financial Health of Defined Benefit Pension Plans

An Analysis of Certain Trade Unions Pension Plans: 2012 Update[1]

By JOHN R. MCGOWAN, *Professor of Accounting*
Saint Louis University, 3674 Lindell Blvd., St. Louis, MO 63108

CURRENT RETIREMENT PROSPECTS FOR WORKERS IN US

The primary focus of this report is the current and future prospects for defined benefit multiemployer pension (MEPP) plans in the US. The objective of this report is to educate, inform and empower retirees involved in any type of retirement plan and specifically in MEPPs. More than at any other time in US history, people should be actively involved in planning and preparation for retirement.

Challenges for retirees in the US are not limited to participants in multiemployer pensions. The US Census reports that the average retirement account for persons in the US is $50,000. Moreover, the median retirement fund is $2,000 and more than 43 percent of Americans have less than $10,000 saved for retirement.[2] Nearly 1 in 4 Americans will rely on Social Security as their primary source of retirement. One major cause of retirement woes is the 20 percent decline of the S&P from 2000 to 2010. This decade long slide in the stock market has done little to brighten the retirement prospects for working Americans.

As outlined in the May 27, 2010 GAO study, "Long Standing Challenges Remain for Multiemployer Pension Plans,[3] multiemployer (union) pension plans have a tough road to hoe. The report discusses in detail how MEPPs face significant ongoing funding and demographic challenges. The study documents how these challenges will lead to more plan failures and will increase the financial burden on the Pension Benefit Guarantee Corporation (PBGC). When compared with single employer plans, MEPPs have a number of more serious structural problems. Such problems include a continuing decline in the number of multiemployer pension plans and an aging participant base. A decline in collective bargaining in the United States has also left fewer opportunities for plans to attract new employers and workers. Consequently, the proportion of active participants paying into the fund has also been falling.

The problems with MEPP plans are indicative of the overall structural economic breakdown of defined benefit plans in the US. Many companies have concluded that defined benefit pension plans are too rich and too costly to maintain after the economic crisis of 2008.[4] Watson Wyatt documents the overall movement away from DB plans in their 2009 survey. In fact, they reported that for the first time Fortune 100 companies started offering new employees only one type of retirement plan: a 401(k) or similar "defined contribution" plan. Due to the financial strain on the PBGC uncertainty is growing with respect to both single and multiemployer pension plans.

The first part of this report briefly discusses the current financial condition of the PBGC. Second, a number of MEPP industry surveys are presented for the years 2008 thru 2011 to help assess recent performance of MEPP plans. These surveys send mixed signals. Some surveys suggest that MEPPs are on the way back after the 2008 financial crisis. Other surveys report that MEPPs are still having a tough time.

In 2008 (McGowan) I examined Form 5500 data for a sample plans based largely in Missouri to gather anecdotal empirical evidence on the performance of MEPP pensions. That study is updated here and expanded in the third section of this report with data for 2007, 2008 and 2009. A review of the data for these MEPPs in Missouri points to the conclusion that these plans are continuing their decline. This report also reviews recent Congressional proposals to rescue certain MEPP plans. Evidence suggests that Congress has not lost its energy to rescue certain troubled MEPP plans. The final section of this report discusses investment options for both employers and retirees in light of these challenging conditions.

CURRENT FINANCIAL STATE OF THE PBGC

At the time of my earlier report in 2008, PBGC assets supporting the multiemployer program had a value of $1.2 billion and accrued liabilities were $2.1 billion. These liabilities represent the present value of future financial assistance for plans that PBGC has identified as "probables" for purposes of PBGC's financial statements. A probable" plan is one that is currently receiving, or is projected to require, financial assistance. Thus, a "probable" plan is usually a terminated or insolvent multiemployer plan. At that time the net deficit was $900 million. Unfortunately, the downward spiral for MEPPs has accelerated since that time. By September 2010, the PBGC deficit related to MEPPs rose to $1.4 billion. Similarly, by the end of September 2011, the MEPP related deficit at PBGC doubled to $2.8 billion.

According to their most recent annual report, PBGC's obligations for future financial assistance to multiemployer plans have increased to $4.48 billion. This represents a 48 percent increase in obligations from the previous year. These sharply increasing PBGC liabilities do not inspire confidence for the sustainability of the multiemployer system over the next decade. Similarly, the total PBCG deficit rose from $23 billion at the end of fiscal 2010 to $26 billion by the end of the 2011 fiscal year.

MDBP SURVEYS FOR 2008 THRU 2011:
ARE THEY ON THE ROAD TO FINANCIAL RECOVERY?

A number of studies have been performed to assess the recent performance of MDBP plans. These results for these studies are shown the next.

FINANCIAL CRISIS OF 2008

The National Coordinating Committee for Multiemployer Plans (NCCMP) is an advocacy organization of multiemployer pension funds. Each year they perform a survey on the financial health of MEPP plans. The annual survey often includes a major percentage of multiemployer pension plans. For the plan years beginning in 2008, the NCCPMP survey reported that over 75% plans were in the 'green zone', indicating a strong financial position. Next, during 2008, the financial crisis caused the average reported funded status to decline to 77% from 90% at the beginning of the year. Moreover, by the end of the year only 20% of MEPP respondents indicated their plans were still in the green zone. Similarly, 42% of plans in the survey reported their plans were in critical status or the 'red zone.'

The plummeting financial status of defined benefit pension plans in 2008 was articulated in my earlier study (McGowan, 2008). That study analyzed certain 2006 MDBP data and projected 2008 fund status for a number of plans based on plunging indexes in the stock market. At the time, a number of local trade unions vigorously assaulted the study as flawed and inaccurate. Coincidentally, a number of other studies described the same financial difficulties for 2008 multiemployer pension plans. For example, Watson Wyatt Worldwide observed that the top 100 multiemployer pensions were just 79 percent funded.[5] Moody's Investors service also published a study in 2009 citing growing concern about multiemployer pension funding shortfalls.[6] The Hudson Institute also examined multiemployer pension data contained in Form 5500s. In their study,[7] Furchtgott-Roth and Brown concluded that the risks of multiemployer pension plans exceeded those of private pension plans.

One major cause of this shift in MEPP plans is the investment results for 2008 where the median asset return was −22.1%. According to the NCCMP report, the true impact of the crisis was even more dramatic than these figures indicated.[8] The PPA funded percentage measure relies on the actuarial value of pension plan assets and typically recognizes investment gains and losses gradually over time. On a market value of assets basis, the average funded percentage was much worse. The average funded market value percentage declined from 89% to 65%.

In addition to investment results, the financial impact on a plan is also a function of employment levels. When a plan becomes underfunded, it is important that there be a large population of active members with strong employment levels to create a contribution base capable of offsetting the shortfall. Unfortunately, an equally historic level of unemployment followed the historic market collapse of 2008. This unemployment level has also severely limited the ability of many plans to recover.

RETURNS IMPROVE IN 2009: HIGH UNEMPLOYMENT CONTINUES

There was a high response rate for the 2009 NCCMP survey. Total plan participants numbered 6.3 million and represented 60 percent of the multiemployer plan population. Plans included in the NCCMP survey reported a median 2009 asset return of 16.6%. This figure was not nearly enough to offset the devastating returns from the prior year. The International Foundation of Employee Benefit Plans (IFEBP) reported similar results in their 2009 survey of MEPP plans. As of August, nearly three-quarters of plans were less than 80 percent funded. The 2009 IFEBP survey had a much smaller sample size (213 plans).[9] Nevertheless, the results were proportionate and consistent with other surveys for that time period. The number of plans in the endangered or critical status had tripled from 2008.

During 2009, participants and sponsors of multiemployer pensions responded by increasing contributions and reducing benefit accrual levels. Similarly, many plans in the IFEBP survey indicated that they were taking advantage of the temporary freeze option available to MEPP plans in 2009.

RETURNS STABLE IN 2010: UNEMPLOYMENT SHOWS LITTLE IMPROVEMENT

Participants in the 2010 NCCMP survey declined to 3.6 million or approximately 35 percent of multiemployer plans. For a second straight year, respondents reported strong investment returns in 2010. Consequently, these plans reported an increase in average fund status to over 82% from 77%. While these results seem promising, the small sample size raises questions about the validity of this sample.

The 2010 strengthening for pension funds was not confined to multiemployer plans. Milliman is among the world's largest independent actuarial and consulting firms in the world. Their annual study covers 100 U.S. public companies with the largest defined benefit pension plan assets for which an annual report (Form 10-K) is released. Their study also reflected an overall improvement in funding status due to increased fund contributions. However, the improvement was somewhat curtailed by ongoing low interest rates.

More specifically, the record cash contributions for these plans and investment gains (12.8% actual returns for 2010 fiscal year vs. 8.0% expected returns) were offset by the 7.7% increase in liabilities generated by the decrease in discount rates (5.43% for 2010, down from 5.82% in 2009 and 6.36% in 2008) used to measure pension plan liabilities. The lower discount rate coupled with record cash contributions culminated in a small improvement in the funding ratio for these plans in 2010. The average increased to 83.9% from 81.7%.

REASONS FOR IMPROVED PLAN STATUS IN 2010 AND 2009

As noted in the NCCMP report, the number of plans in the green zone (more than 80 percent funded under PPA 2006 rules) more than doubled from 20 to 48% by the end of 2010. Similarly, the number of plans in the red zone (critical status) declined from 42 to 32%. The report traced this improvement to three factors. First, there were strong investment returns. Second, the plans and sponsoring employers implemented a combination of contribution increases and benefit cuts to shore up their financial status. Thirdly, the funding relief provisions of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 helped improve multiemployer funding status.

PENSION EXPENSE CONTINUES TO RISE FOR 2010

Record levels of pension expense were recorded in 2010. A $30.0 billion charge was recorded for firms in the 2010 Milliman Pension Funding Study. There were 11 companies with pension income (e.g., negative expense) in 2010, down from 16 in 2008. Pension expense is projected to increase for 2011 as companies using asset smoothing are still reflecting the impact of losses in 2008.

ACCOUNTING CHANGES ADOPTED BY SOME COMPANIES

A number of companies elected to recognize substantially all of their accumulated losses for 2010. This accounting change resulted in a significant charge to the year-end balance sheets for Honeywell, Verizon and AT&T. The elimination of this charge in 2010 will lead to a reduction of future years' pension expense through the elimination of the annual charge to earnings for those losses. Milliman estimates that similar charge to earnings for the remaining 100 companies would have resulted in a $342 billion charge to their cumulative balance sheets and a reduction in their 2011 pension expense of about $19.9 billion.

PROPOSED CHANGE TO INTERNATIONAL ACCOUNTING STANDARDS

There is also a serious debate raging regarding whether International Accounting Standards should be converged with or adopted in place of U.S. GAAP. A proposed change to International Accounting Standards would eliminate the pension expense credit for Expected Return on Assets (8.0% for the Milliman 100 companies in 2010). Under this change, companies would have a pension expense equal to the discount rate on the excess of liabilities over assets (or a similar credit if the plan were more than 100% funded). If that change had been adopted for U.S. GAAP accounting in 2010, the pension expense for the Milliman 100 companies (and the charge to corporate earnings) would have increased by about $30.0 billion. Such changes would have a commensurate effect on multiemployer pension plans. Therefore pension expenses would be pushed higher.

DEFINED BENEFIT PLANS IN CANADA FOR 2011

A review of defined benefit plan performance in 2011 in Canada shows that things clearly took a turn for the worse. Towers Watson has kept a tracking index to represent defined benefit pension plans across the country for more than a decade. In 2011, the index declined from 86 at the start of the year to 72 by the end. The index was at 100 in December 2000 and after a brief rise in 2001, has been on a steady decline ever since.[10] It is reasonable to conclude that pension plans in the US had similar experience for 2011.

EXPECTED PLAN CONTRIBUTIONS EXPECTED FOR 2012

CFO Magazine reports that big pension contributions are expected in 2012. According to a new report from Credit Suisse and accounting analyst David Zion, Companies in the S&P 500 will likely have to contribute $90 billion to fund pension plan gaps in 2012, up from $52 billion in 2011.

A SAMPLE OF MISSOURI BASED MDBP PLANS: AN EXPANSION AND UPDATE

My original 2008 study was presented at a Senate Hearing on May 27, 2010.[11] The Senate Hearing was entitled: "Building a Secure Future for Multiemployer Pensions." The purpose of this hearing was to address the structural problems of multiemployer pensions.[12]

The key findings of my 2008 report were:

- The assumption of failing pensions by PBGC had led to an overall deficit of $955 million
- By September 2007, the PBGC insured about 1,500 multiemployer (sometimes called union plans) plans and promised benefits to about to roughly 10 million participants
- Multiemployer pensions problems were forcing fund managers to cut benefits
- The other avenue to improve multiemployer fund status was to increase contributions
- Central States required a withdrawal liability payment of $6 billion from UPS
- Both employers and employees were encouraged to carefully consider the financial condition of multiemployer pension plans whether they were current or prospective participants

MEASURING THE FUNDING STATUS OF MULTIEMPLOYER PLANS

The Pension Protection Act of 2006 places the task of computing the funded status of MDBP plans in the hands of the actuary. Various actuarial assumptions and methods are used to determine cost, liabilities, interest rates, and other funding factors. While these assumptions must be reasonable, they tend to make the actuarial value of the assets significantly higher than market value. For example, the actuarial value of the assets recognizes investment gains and losses gradually over time.

The PPA 2006 directs actuaries to place MDBP plans in one of three separate zones: green for healthy (80% funded), yellow for endangered (65% funded) and red for critical (under 65% funded). Plans are in the green or healthy zone if they are more than 80 percent funded. Yellow zone or endangered plans are funded at least 65 but less than 80 percent. Plans are also in the yellow zone if they have had a funding deficiency in the past 7 years. When a plan hits both conditions they are considered "seriously endangered." According to Eli Greenblum, an actuary and senior VP of the Segal Co., "Yellow zone plans cannot cut protected or adjustable benefits, there is no official shelter from funding-deficiency penalties, and there are no employer surcharges."[13] If a plan goes into the red zone or funding level below 65 percent, the trustees must adopt a rehabilitation plan. Pension trustees may reduce certain benefits under the rehabilitation plan.

People covered by a traditional defined-benefit pension plan should receive a funding notice every year, which gives workers an idea of how well the plan is doing. However, people frequently do not have access to the funding notice. In these cases,[14] people can get a rough idea of how well their plan is doing by looking at Form 5500. Moreover, participants in private pension plans have the legal right to request the most recent Form 5500 from their plan administrator. Participants can also download copies of the Form 5500 on a web site called FreeERISA.com.

Certain multiemployer pension administrators take such strong exception to the notion that people are able to get a rough idea of the financial solvency of their multiemployer pensions by looking at data on IRS form 5500. Then Pension Rights Center stands behind this notion and presents it clearly on their website.[15] The Pension Rights Center encourages people to determine the funded status of their pension by dividing the current value of plan assets by the "RPA 94" current liability. The RPA 94 (Retirement Protection Act of 1994) current liability is based on the present value of benefits accrued to date. This liability is discounted using a statutory interest rate assumption range that is tied to average long-term bond yields.[16] Numerous studies have used this funding ratio as provided on Form 5500 as a proxy for the financial solvency of multiemployer or union pension plans.[17]

SAMPLE OF MEPPS IN MISSOURI

This study expands on the sample of Missouri based multiemployer pensions next. As can be seen from a review of the actuarial data presented here from Form 5500s is that these plans continue their decline. It should also be noted that the Carpenters Trust Pension Fund of SL showed a modest improvement for 2010. This performance is reflective of the improved market conditions for 2010. Other pension funds would be likely to show similar results. That being said, the financial status of MEPPs are still far below the funding levels of 2006.

Pension fund	Year	Current assets	Total liabilities	Percentage
Carpenters Pension Trust of SL	2010	$1,462,055,006	$3,264,817,009	44.7%
Carpenters Pension Trust of SL	2009	$1,176,145,761	$3,143,709,605	37.4%
Carpenters Pension Trust of SL	2008	$1,611,931,135	$2,794,336,754	57.6%
Carpenters Pension Trust of SL	2007	$1,589,538,148	$2,305,084,039	68.9%
Carpenters Pension Trust of SL	2006	$1,435,159,165	$2,031,453,937	70.6%
Construction Laborers of SL	2009	$361,501,014	$815,694,842	44.3%
Construction Laborers of SL	2008	$458,876,011	$719,746,151	63.7%
Construction Laborers of SL	2007	$437,851,451	$594,131,725	73.7%
Construction Laborers of SL	2006	$391,340,770	$519,434,403	75.3%
IBEW Local No 124	2009	$121,051,761	$254,496,469	47.6%
Plumbers and Pipefitters: Misc. Local Chapters		$79,631,277	$118,332,486	67.3%
Sheet Metal Workers Local 36	2008	$153,004,997	$262,235,832	58.3%
Sheet Metal Workers Local 36	2007	$140,785,417	$212,424,703	66.2%
Sheet Metal Workers Local 36	2006	$129,274,465	$201,574,482	64.1%
Roofers Local No 20	2009	$53,148,454	$93,805,474	53.8%
MO-KAN Teamsters	2010	$46,084,294	$120,499,797	38.2%
Kansas City Cement Masons	2009	$35,269,314	$93,852,982	37.5%
Painters District Council No 3	2009	$68,471,488	$249,667,631	27.4%
Operating Engineers Local 101	2010	$497,389,413	$1,113,743,496	44.6%
Insulators Local 27	2010	$22,761,378	$66,298,542	34.0%
Iron Workers of St. Louis	2009	$347,808,001	$847,967,614	41.0%
Bricklayers Union Local No. 1	2008	$66,319,296	$95,449,574	69.4%
Carpenters District Council of Kansas City	2009	$527,566,339	$1,312,230,524	40.2%

*Serves Laborers' International Union of North America Locals #42, #53, and #110.

CONGRESSIONAL EFFORTS TO "RESCUE" CERTAIN UNDERFUNDED MDBP PENSION PLANS

In May 2010, Senator Casey introduced S. 3157 under the title of Create Jobs and Save Benefits Act of 2010. The bill mirrors legislative proposals introduced in 2009 by Reps. Earl Pomeroy and Patrick Tiberi. Among other things, the bill proposed that the pension liabilities of all "orphan" retirees from the now-defunct trucking firms be transferred to the PBGC. Employers of the surviving trucking firms still in the multiemployer plan are now funding these pension liabilities. This proposal for the PBGC to take on new funding obligations generated a mixed reaction.

Those parties who stood to benefit from a PBGC takeover or rescue of certain unfunded pension liabilities were supportive. For example, YRC, trucking companies, teamsters, all loved the idea. On the other side of the coin, Diana Furtchgott-Roth wrote in TCS daily in opposition to this bill. She referred to this action as a "bailout" of union pensions that would dramatically increase the burden on U.S. debt and American taxpayers. Supporters of funding for "troubled" multiemployer pensions argue that the term "bailout" is unfair and dishonest. They maintain that as long as PBGC does not use any taxpayer funds to fund failed pensions it is not a bailout. Furthermore, certain supporters argue that the only way to salvage certain failing pensions is to "partition" them off and transfer them to the PBGC. The problem with this plan is that the PBGC is on its way to running out of money. As discussed in the next section, Chairman Gotbaum of the PBGC testified that the PBGC may run out of money as soon as 9 years from now. Moreover, certain major pension defaults occurring in 2012 as American and Kodak may accelerate that timetable.

PBGC FINANCES AND CHALLENGES TO MULTIEMPLOYER PENSIONS

On Feb. 2, 2012, the House Education and Workforce Subcommittee on Health, Employment, Labor and Pensions held a hearing entitled, "Examining the Challenges Facing PBGC and Defined Benefit Pension Plans." The hearing explored the financial and management challenges at the Pension Benefit Guaranty Corporation (PBGC), as well as policy proposals intended to strengthen the financial standing of the PBGC.

PBGC Director Joshua Gotbaum spoke at the hearing and addressed the $26 billion deficit the PBGC currently faces. He stated that the PBGC is a $100 billion dollar financial institution but that it is also unsound financially. The value of the assets is around $80 billion. Gotbaum discussed several options that Congress could take to encourage more secure retirements. Once new policy proposed by Gotbaum was an increase in employer pension insurance premiums. Gotbaum also addressed multiemployer pension plans and stated that some of the plans are substantially underfunded and the traditional remedies won't be enough.

In other words, Gotbaum recognized that some pensions were too far gone to recover. Once pensions deteriorate past a certain point, one of two things must occur. Either benefits must be reduced or there must be an infusion of capital from another source. Time will tell if Congress will revive the proposed "rescue" solution for certain pension funds.

The first two witnesses at the hearing emphasized the same two issues. Both Ken Porter, former chief actuary with DuPont and Gretchen Haggarty, CFO of U.S. Steel testified that low interest rates were a significant cause of current pension underfunding problems. Similarly, they both testified that the proposed increase in pension premiums would also be detrimental to economic growth. Thirdly, Randy DeFrehn of the NCCMP stated that while most multiemployer pensions are on the road to recovery, there are a sizeable group of pensions that still need to be rescued. He referred back to the 2010 proposal to "Preserve Jobs and Save Benefits Act" that rescues certain multiemployer pensions. He also suggested that weaker funds be allowed to merge into stronger ones. As the final witness, I highlighted the deteriorating nature of numerous multiemployer pensions in Missouri and suggested Congress reform certain provisions from the PPA of 2006. Specifically, the use of the withdrawal liability penalty is a harsh and unfair way to impose underfunded pension costs on new and existing employers.

STRUCTURAL PROBLEMS WITH MULTIEMPLOYER PENSION PLANS

As noted in the GAO report[18] from May 2010, the PBGC has paid $500 million in financial assistance to 62 insolvent plans. Major challenges exist for multiemployer plans. Such challenges include continuing decreases in the number of these plans and an aging participant base. Further, a decline in collective bargaining in the United States has left few opportunities for plans to attract new employers and workers. As a result, the proportion of active participants paying into the fund to others who are no longer paying into the fund has decreased, thereby increasing plan liabilities and the likelihood that PBGC will have to provide financial assistance in the future.

While there has been some improvement in MEPPs since 2010, many of the market and regulatory conditions discussed in this report will make it very difficult for substantial turnarounds in performance for union pensions. The review of a sample of Missouri based union pension plans illustrates this point.

What is a realistic option for workers going forward?

The private sector is reflecting modern economic reality when it comes to pension plans. There will be a continued migration away from DB plans and toward 401K plans, or perhaps some combination of DB and 401(K) plans. Certain commentators have discussed the possibility of required retirement plan contributions from both employers and workers. That seems unlikely given past emphasis on individual liberty in the United States.

The first thing workers should do is to increase their knowledge and understanding about their retirement. If they are part of a defined benefit pension plan they should investigate the financial solvency of that plan. Given the uncertain long-term stability of many defined benefit pension plans, individuals should also explore other retirement options that allow them more independence and control. Many employers match employee contributions to defined contribution plans. Over time these plans can grow into substantial sources of retirement income. There are also opportunities for individuals over the age of 50 to make "catch up" contributions with their existing retirement plans. Due to competitive pressures and demographic and economic changes, peoples' retirement prospects are becoming more challenging all the time. The best think people can do is to clearly study their retirement options and plan ahead.

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ENDNOTES

[1] I would like to acknowledge the support of Associate Builders and Contractors. The views reflected in this study are my own and do not necessarily reflect those of Saint Louis University.

[2] C. Sutton, CNN Money, March 2010.

[3] Statement of Charles A. Jeszeck, Acting Director Education, Workforce, and Income Security Issues as part of Testimony Before the Committee on Health, Education, Labor and Pensions, U. S. Senate.

[4] S. Block, "Traditional Company Pensions are going away fast," USA Today, May 22, 2009.

[5] Leveson, I, Economic Security a Guide for an Age of Insecurity, iUniverse p. 18, April 29, 2011.

[6] See, Moody's: Growing Multiemployer Pension Funding Shortfall is an Increasing Credit Concern," Sept. 10, 2009.

[7] See, Furtchgott-Roth D., and A. Brown, "Comparing Union-Sponsored and Private Pension Plans: How Safe are Workers Retirements?" Hudson Institute, September 2009.

[8] Defrehn, R.G. and J. Shapiro, 2010 Update to MCCMP Survey of Funded Status of Multiemployer Defined Benefit Plans, p. 1.

[9] See Wojcik, J., "73 percent of multiemployer pension plans underfunded: Study," Business Insurance, Sept. 29, 2009.

[10] CBC News.CA, "Defined benefit pension plans had bleak 2011," Jan. 4, 2012.

[11] See summary at *http://www.help.senate.gov/imo/media/doc/McGowan.pdf*

[12] See *http://www.help.senate.gov/imo/media/doc/McGowan.pdf.*

[13] See comments by Eli Greenblum at March 21, 2007 at BNA sponsored pension conference.

[14] See:*http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.*

[15] *http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.*

[16] See: *http://www.actuary.org/pdf/pension/moodys—march06.pdf Letter from D.J. Segal, VP of Pension Practice Counsel to American Academy of Actuaries March 1, 2006.*

[17] See: Allen, S.G., R.L. Clark, and A.A. McDermed, "Post-Retirement Increases in Pensions in the 1980s: Did Plan Finances Matter?" National Bureau of Economic Research Working Paper #4413; D., Furchtgott-Roth, "Union vs. Private Pension Plans: How Secure Are Union Members' Retirements?" Hudson Institute, Summer 2008, September 2009; Addoum, J.M., J.H. van Binsbergen, and M.W. Brandt, "Asset Allocation and Managerial Assumptions in Corporate Pension Plans," Duke Working Paper 2010; McGowan, J.R., "The Financial Health of Multiemployer Pension Plans, PBGC and the Recent Government Bailout Proposal: Create Jobs and Save Benefits Act of 2010," Report prepared for Senate Committee on Health, Education, Labor and Pensions: Building a Secure Future for Multiemployer Pension Plans, May 27, 2010, See: *http://help.senate.gov/hearings/hearing/?id=6a51d13d-5056-9502-5d61-e47c92a6a05f.*

[18] "Long-standing Challenges Remain for Multiemployer Pension Plans," GAO-10-708T, May 27, 2010.

[Questions submitted for the record and their responses follow:]

U.S. CONGRESS,
Washington, DC, March 29, 2012.

Hon. JOSHUA GOTBAUM, *Director,*
Pension Benefit Guaranty Corporation (PBGC), 1200 K Street, NW, Washington, DC 20005.

DEAR DIRECTOR GOTBAUM: Thank you for testifying at the February 2, 2012, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled, "Examining the Challenges Facing PBGC and Defined Benefit Pension Plans." I appreciate your participation.

Enclosed are additional questions submitted by Committee members following the hearing. Please provide written responses no later than April 16, 2012, for inclusion in the official hearing record. Responses should be sent to Benjamin Hoog of the Committee staff, who may be contacted at (202) 225-4527.

Thank you again for your contribution to the work of the Committee.

Sincerely,

PHIL ROE, *Chairman,*
Subcommittee on Health, Employment, Labor and Pensions.

QUESTIONS SUBMITTED BY CHAIRMAN PHIL ROE

1. As part of its "Plan for Regulatory Review," the Pension Benefit Guaranty Corporation (PBGC) is reconsidering its proposed regulations regarding facility shutdown liability under Section 4062(e) of the Employee Retirement Income Security Act (ERISA). If finalized, the proposed regulation would impose significant burdens on plan sponsors. However, reports suggest PBGC officials are still referencing these proposed regulations as "the law" in their interactions with plan sponsors. Is PBGC enforcing these proposed regulations? Does PBGC intend to finalize new 4062(e) regulations; and if so, how will they address the concerns of plan sponsors who noted their potential for disproportionately huge liability?

2. As part of last year's appropriations process, PBGC was granted discretion to use funds for "extraordinary" administrative expenses relating to its multiemployer program, provided it notifies the appropriations committees. How does PBGC define "extraordinary" in this context? Do we have your assurance that this power will not be used without notifying the congressional committees of jurisdiction, and used only as a last resort? How and under what circumstances do you intend to notify Congress regarding your use of this authority?

3. Section 4010 of ERISA requires certain pension plan sponsors to submit information to PBGC relating to plan funding. PBGC is required annually to submit a report on this information to the congressional committees of jurisdiction. Why has this report not yet been issued, and when will PBGC submit this report to Congress?

4. The PBGC's 2010 Annual Exposure Report stated that the possible deterioration of two large plans could cause PBGC's multiemployer program to run out of money. Has the status of those two plans improved? Have any new plans been added to the list of plans at substantial risk of insolvency that would materially affect PBGC?

5. As you know, so-called "orphan" liabilities of employers who went out of business but whose employees are still plan participants are a huge burden for companies that participate in multiemployer plans. When PBGC models the potential risk of plans, does it take into account that these rising liabilities—and consequently higher required plan contributions—may drive companies from the plan or even out of business? If so, please explain how the models reflect the consequences of rising liabilities.

6. Under ERISA Section 4005(c), PBGC is permitted to borrow up to $100 million from the U.S. Treasury. Under what circumstances would PBGC consider using this authority? Will you seek congressional approval prior to borrowing?

7. Section 221 of the Pension Protection Act of 2006 (PPA) required a report to be issued studying the effect of PPA on multiemployer pension plans. Congress was to receive this report by December 31, 2011. When will this report be submitted to Congress? What key findings and recommendations do you expect it to include?

QUESTIONS SUBMITTED BY REPRESENTATIVE MARTHA ROBY

1. As you know, the PBGC Inspector General has been extremely critical of the ways that plan asset valuation audits were conducted, particularly in the cases of United Airlines and National Steel. The IG noted that the contractor used in both of those audits has been used in eight of the 10 largest plan terminations in PBGC history. Are those other audits under review, and if so, will more irregularities come to light?

2. How much will it cost to contract with outside firms to redo the work in the United Airlines and National Steel audits? Will that money come from premium contributions and the assets of terminate plans?

3. Your Inspector General's "Report on Internal Controls," indicated that the Inspector General found that PBGC "did not exercise due professional care in the conduct and oversight of contracted audits of asset values;" and questioned whether PBGC personnel reviewed contractors' work. How can we know that PBGC is properly overseeing its contractors, and how does PBGC hold those contractors accountable for errors?

4. In a recent report on PBGC's internal controls, the Inspector General noted that it had uncovered instances of incorrect benefits calculations. This is troubling because benefits calculation is a core function of PBGC, and retirees were not provided with the benefits they were entitled to under ERISA and the terms of the plan. What specific, concrete steps is the agency taking to enhance training for its professionals who calculate benefits?

QUESTIONS SUBMITTED BY REPRESENTATIVE ROBERT ANDREWS ON BEHALF OF SENATOR HERB KOHL

1. In the GAO and PBGC Inspector General have written several reports emphasizing the need to reform the agency's governance structure. Do you think that any change in premium structure should include provisions to bolster PBGC's governance and oversight?

2. The Pension Benefit Guaranty Corporation Governance Improvement Act of 2009 (S. 1544 in the 111th Congress) would expand the board, require multiple board meetings, and create more efficient communication between the board, IG, advisory committee and professional staff. Do you support this legislation?

3. The bill in the last Congress created a variety of requirements for the four new board members, but a draft version currently circulating just requires that two come from each party, one be a financial expert, and one have specific understanding of retirement plans.

4. Do you have a problem with this proposed board makeup, or do you have suggestions on improving it?

[EDITOR'S NOTE: As of August 22, 2012, Director Gotbaum's response to questions submitted remains pending.]

[Whereupon, at 12:37 p.m., the subcommittee was adjourned.]

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