Statement of Joshua Gotbaum
Director
PENSION BENEFIT GUARANTY CORPORATION
before the
Committee on Health, Education, Labor, & Pensions
United States Senate
December 1, 2010

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

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

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

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

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

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

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

PBGC Overview

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

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

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

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

What PBGC Does

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

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

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

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

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

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

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

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

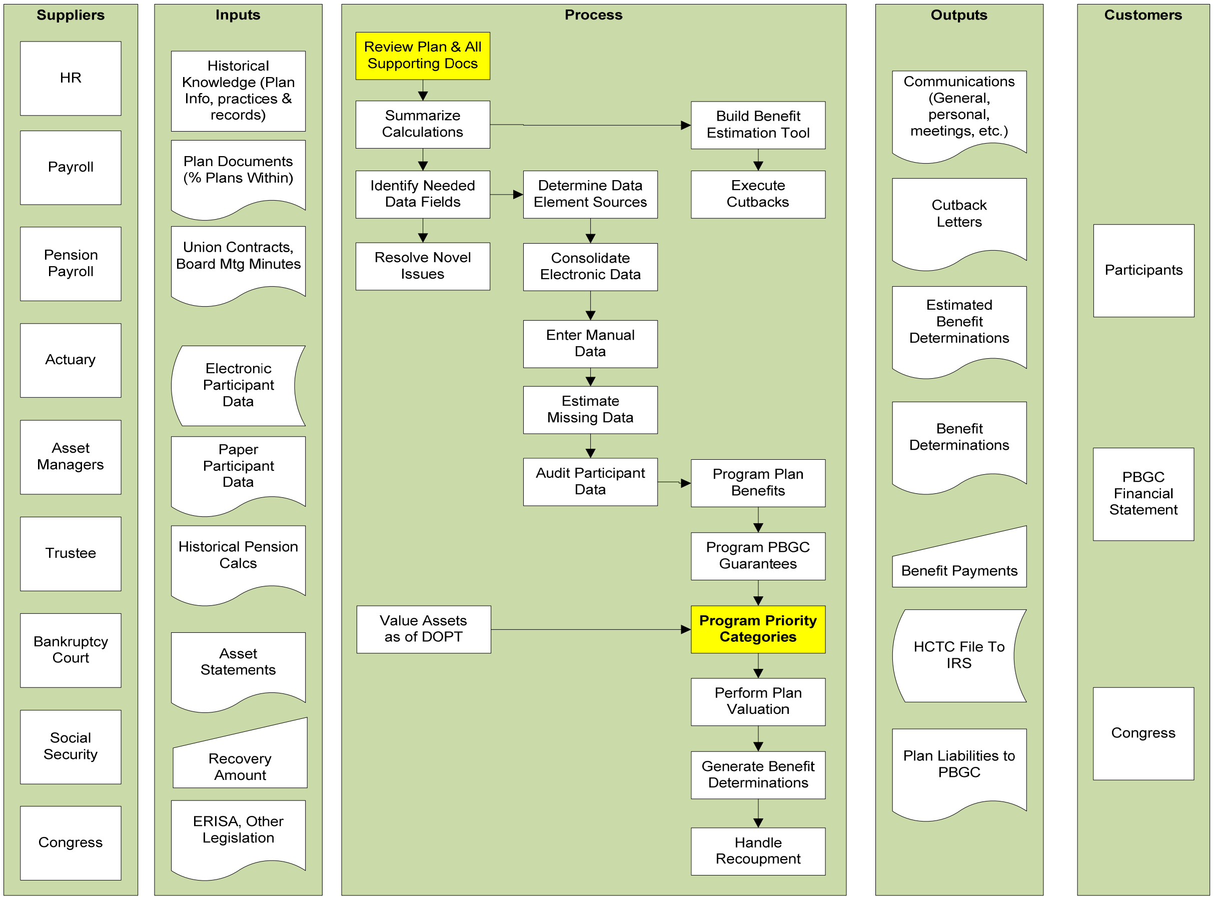
In addition to participants who were already retired when PBGC assumed responsibility for their plans, we also process about 3,000 benefit applications per month for new retirees. Nearly 85 percent of applicants receive their first payments within 45 days after PBGC has their completed applications.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

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

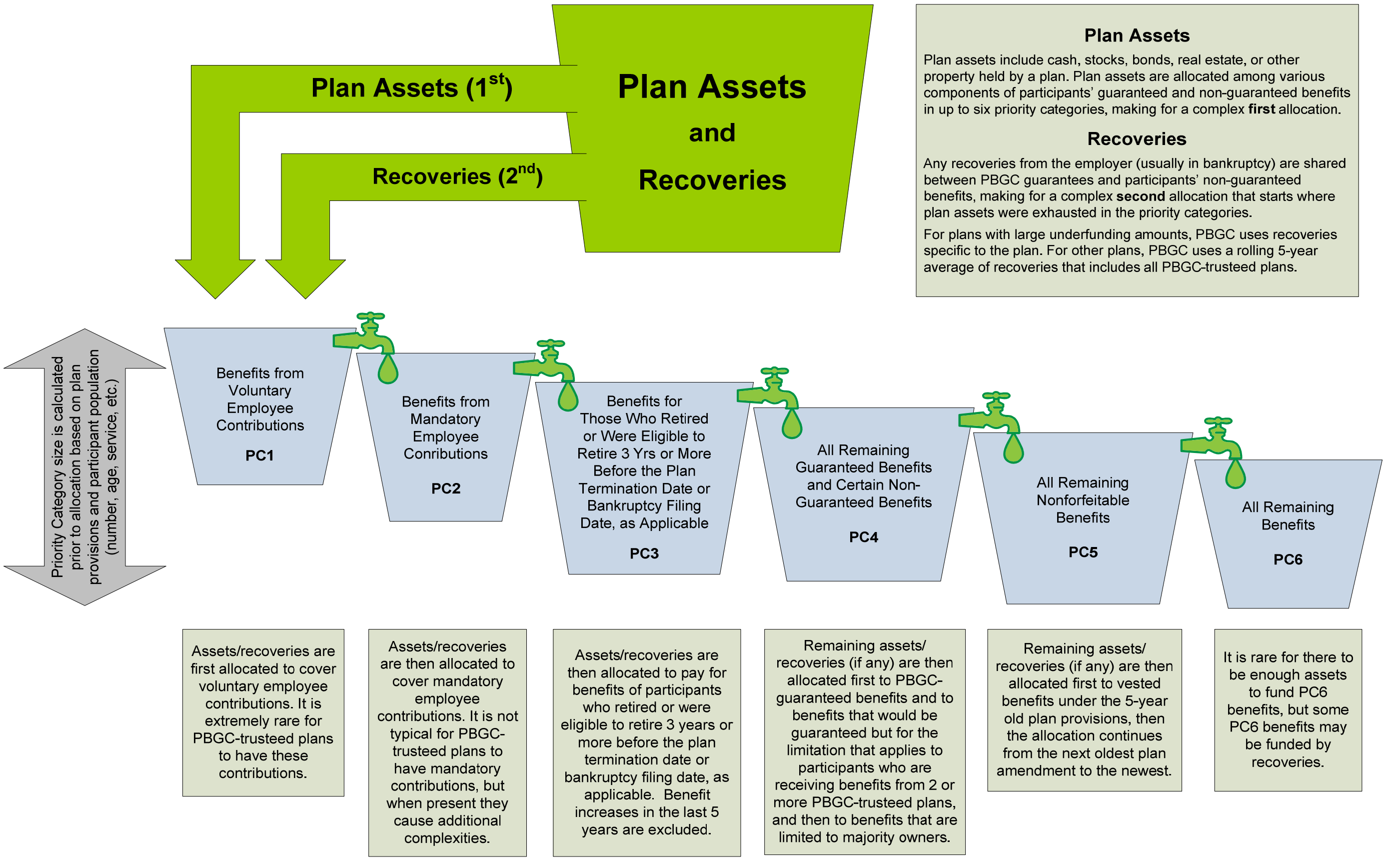
PBGC calculates benefits using a process spelled out in federal law. Actuaries calculate each participant's benefit according to the plan's provisions; then they must apply statutory and regulatory rules to determine how much the agency can pay. Finally, when the benefit determination is complete, PBGC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

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

Benefit Determination Process



Priority Category Allocation



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

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

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

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

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

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

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

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

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

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

Operations & Financial Position of the PBGC

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

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

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

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

Assessing the Risk of Future Plan Failures

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

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

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

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

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

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

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

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

Strengthening Pension Insurance

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

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

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

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

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

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

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