

March 2006

# PRIVATE PENSIONS

## Opportunities Exist to Further Improve the Transparency of PBGC's Financial Disclosures

On May 1, 2006, page 6, in line 1 of the second paragraph, the “standards promulgated by” was revised to read “FASB standards, as permitted by.”





Highlights of [GAO-06-429](#), a report to congressional requesters

## Why GAO Did This Study

The Pension Benefit Guaranty Corporation's (PBGC) single-employer insurance program insures the pension benefits of over 34 million participants in almost 29,000 private sector defined benefit pension plans. The increase in PBGC's probable claims has raised questions about PBGC's monitoring and financial disclosure practices, including whether the information that PBGC discloses is sufficient for interested parties to understand the effect on PBGC's financial condition. GAO examined (1) the steps that PBGC takes to monitor and ensure the accuracy of its probable claims, (2) how PBGC's financial liability reporting compares with those of publicly traded companies, and (3) the steps PBGC has taken to improve the transparency of its financial reporting and whether additional improvement is needed.

## What GAO Recommends

To improve the transparency of the information PBGC discloses about its financial condition, GAO recommends that PBGC

(1) disclose in its press releases whether a newly terminated plan was already included in its published deficit, and (2) make its interest rate methodology more widely available to the public. PBGC agreed with our recommendations. Also, PBGC, FDIC, and SEC provided technical comments on the draft. We incorporated each agency's comments as appropriate.

[www.gao.gov/cgi-bin/getrpt?GAO-06-429](http://www.gao.gov/cgi-bin/getrpt?GAO-06-429).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov).

## PRIVATE PENSIONS

# Opportunities Exist to Further Improve the Transparency of PBGC's Financial Disclosures

## What GAO Found

PBGC takes steps to monitor and ensure the accuracy of its single-employer probable claims forecasts. PBGC reported it monitors its probable claims on an ongoing basis by contacting plan sponsors to obtain certain plan financial information, reviewing filings submitted by probable plans to conduct a risk analysis, and performing valuations to determine the present value of net probable claims and expected date of probable plan termination. To ensure the accuracy of its probable claims, PBGC reported that it uses an automated system and available plan financial data to calculate the assets and liabilities for probable plans.

PBGC and public companies have different practices for disclosing certain information about liability settlements, including probable losses, that arise from the differences between PBGC's responsibilities and disclosure policies, and the Security and Exchange Commission's (SEC) requirements for public companies. While PBGC and public companies follow the same accounting standards for recording probable losses in their annual financial statements, they each follow different policies and requirements when reporting information about probable losses throughout the fiscal year. When reporting information on liability settlements, public companies are required to follow the standards set forth by SEC requirements, while PBGC, which is not subject to SEC requirements, follows its own set of policies and procedures. GAO found that PBGC's disclosure practices regarding probable losses are more comparable to those of the Federal Deposit Insurance Corporation (FDIC).

PBGC has made efforts to improve the transparency of the information it discloses about its financial condition, but pension experts, financial analysts, and others believe that additional improvements are still needed. PBGC has recently taken steps to include more information about its methodology for determining probable claims in its annual reports and make more detailed information on its financial condition available on its Web site. However, pension experts, analysts, and industry association representatives still have concerns about transparency. Many stated that the press releases PBGC issues that announce newly terminated plans do not provide the public with enough information to determine the financial impact of such plans on PBGC's published deficit. In addition, these parties expressed concern about the lack of transparency regarding the methodology PBGC uses to determine its interest rate its uses to calculate its liabilities. Specifically, these parties told us the fact that PBCG does not widely disclose the interest rate methodology contributes to ambiguity about PBGC's assumptions and means that these parties are unable to fully assess PBGC's financial condition.

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## Abbreviations

ACLI	American Council of Life Insurers
CWG	Contingency Working Group
ERISA	Employee Retirement Income Security Act
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
GAAP	Generally Accepted Accounting Principles
IPVFB	Integrated Present Value of Future Benefits
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation
SEC	Securities and Exchange Commission

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United States Government Accountability Office  
Washington, DC 20548

March 27, 2006

The Honorable John Lewis  
Ranking Minority Member  
Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives

The Honorable Earl Pomeroy  
House of Representatives

The Pension Benefit Guaranty Corporation's (PBGC) single-employer insurance program is a federal program that insures certain benefits of the more than 34 million workers and retirees covered by almost 29,000 private sector defined benefit pension plans. In recent years, because of the collapse of several large underfunded pension plans, the program's financial condition has deteriorated from a \$9.7 billion cumulative surplus at the end of fiscal year 2000, to a \$22.8 billion cumulative deficit as of the end of fiscal year 2005. PBGC's liabilities include liabilities incurred from plans that have already terminated and, as required under Generally Accepted Accounting Principles (GAAP), estimated losses incurred from "probable" terminations, also referred to as "probable claims." A plan is classified as a probable claim if PBGC determines that it is likely to terminate in the future. Forty-six percent (\$10.4 billion) of PBGC's cumulative deficit as of the end of fiscal year 2005 represents PBGC's estimated liability for its probable claims. PBGC cites the deteriorating financial position of a number of PBGC-insured plans and the companies that sponsor them as a primary reason for the increase in the amount booked as probable claims. GAO has previously reported on this and other structural problems facing PBGC's single-employer program.<sup>1</sup> In 2003, we

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<sup>1</sup>See GAO, *Pension Benefit Guaranty Corporation: Single-Employer Pension Insurance Program Faces Significant Long-Term Risks*, [GAO-04-90](#) (Washington, D.C.: Oct. 29, 2003); *Private Pensions: Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules*, [GAO-05-294](#) (Washington, D.C.: May 31, 2005); *Private Pensions: Revision of Defined Benefit Pension Plan Funding Rules Is an Essential Component of Comprehensive Pension Reform*, [GAO-05-794T](#) (Washington, D.C.: June 7, 2005); *Private Pensions: The Pension Benefit Guaranty Corporation and Long-Term Budgetary Challenges*, [GAO-05-772T](#) (Washington, D.C.: June 9, 2005); and *Private Pensions: Questions Concerning the Pension Benefit Guaranty Corporation's Practices Regarding Single-Employer Probable Claims*, [GAO-05-991R](#) (Washington, D.C.: September 9, 2005).

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placed PBGC's single-employer insurance program on our high-risk list of agencies and programs that need broad-based transformations to address major challenges, because of our concerns about the program's long-term viability.

PBGC's financial condition is determined by comparing the values of its assets and its liabilities. PBGC's assets consist primarily of accumulated premiums paid by covered plans (invested in Treasury securities) and plan assets assumed by PBGC when it takes over a plan. PBGC's liabilities consist primarily of future benefit payment obligations for plans it takes over and for plans that it believes will probably terminate in the near future.<sup>2</sup>

The increase in PBGC's probable claims in recent years has raised questions about PBGC's monitoring and financial disclosure practices, including whether the information that PBGC discloses is sufficient for interested parties to understand the net effect of such claims and ultimately terminations. In September 2005, we provided detailed information about PBGC's process for determining single-employer probable claims and some information about PBGC's practices for disclosing information about these claims.<sup>3</sup> To address further questions about the transparency of PBGC's probable claims process and its disclosure practices, we are reporting on (1) the steps that PBGC takes to monitor and ensure the accuracy of its probable claims forecasts, (2) how PBGC's financial liability reporting compares with that of publicly traded companies, and (3) the steps PBGC has taken to improve the transparency of its financial reporting on its probable claims and financial condition and whether additional improvement is needed.

To determine the steps PBGC takes to monitor and ensure the accuracy of its probable claims forecasts, we reviewed PBGC documents and interviewed PBGC officials about the methods they use, including the information sources used to monitor claims. We also reviewed the agency's process and internal controls for ensuring the accuracy of claims and analyzed PBGC's historical data about its probable claims, but we did

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<sup>2</sup>Under Statement of Financial Accounting Standard Number 5, loss contingencies are classified as probable if the future event or events are likely to occur.

<sup>3</sup>GAO, *Private Pensions: Questions Concerning the Pension Benefit Guaranty Corporation's Practices Regarding Single-Employer Probable Claims*, GAO-05-991R (Washington, D.C. September 2005)

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not test its controls to ensure that they are effective. To determine and compare PBGC and public company practices for making financial disclosures, we reviewed applicable Generally Accepted Accounting Principles, Financial Accounting Standards Board (FASB) standards, Financial Accounting Standards Advisory Board (FASAB) standards, Securities and Exchange Commission (SEC) disclosure requirements, and the financial disclosures that PBGC and public companies issue. To determine the steps PBGC has taken to improve the transparency of its financial disclosures and whether additional improvement is needed, we identified PBGC initiatives aimed at improving disclosure and interviewed industry association representatives, financial analysts, and pension experts to determine what further improvements could be made. We conducted our work from September 2005 through February 2006 in accordance with generally accepted government auditing standards.

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## Results in Brief

PBGC reports that it takes steps to monitor and ensure the accuracy of its single-employer probable claims forecasts. PBGC monitors its probable claims on an ongoing basis by contacting plan sponsors to obtain certain plan financial information, reviewing filings submitted by probable plans to conduct a risk analysis, and performing valuations to determine, among other things, the present value of net probable claims and expected date of probable plan termination. PBGC also regularly reviews and updates its list of probable claims that it monitors. To help ensure the accuracy of its probable claim estimates, PBGC uses an automated system and available plan financial information to calculate the quarterly and fiscal year-end financial statement assets and liabilities for probable claims. PBGC officials believe their probable claims estimates are fairly accurate because the estimates are generally close to the final net liability amounts for those probable plans it ultimately took over.

PBGC and public companies have different practices for disclosing certain information about liability settlements, including probable losses, that arise from the differences between PBGC's responsibilities and disclosure policies, and SEC's requirements for public companies.<sup>4</sup> While PBGC and public companies follow the same accounting standards for recording probable losses in their annual financial statements, they each follow

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<sup>4</sup> For the purposes of this report, the term "liability settlements" is being used to discuss the information that PBGC, the Federal Deposit Insurance Corporations (FDIC), and public companies disclose about probable claims that occur between annual financial statements.

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different policies and requirements when reporting information about probable losses throughout the fiscal year. When reporting information on liability settlements, public companies are required to follow the standards set forth by SEC requirements, while PBGC, which is not subject to SEC requirements, follows its own set of policies and procedures. For example, SEC requires companies to disclose major events throughout the year, such as liability settlements, that shareholders should know about, which can include any probable losses that are considered to be material, in Form 8-K. In contrast, PBGC's policy prohibits the reporting of information on plans classified as probable claims in order to protect the economic health of the plan sponsor. We found that PBGC's disclosure practices regarding information about probable losses are more comparable to those of other government corporations, like the Federal Deposit Insurance Corporation (FDIC). According to officials from both agencies, PBGC and FDIC follow the same accounting standards and face similar risks when disclosing information on liability settlements, including probable losses. For example, both agencies state they do not disclose probable loss amounts in their financial liability disclosures because doing so might compromise their position in litigation and negatively affect the financial condition of entities under their jurisdiction.

Although PBGC has taken measures to improve the transparency of the information it reports related to its financial condition, pension experts, financial analysts, and others said that additional improvements are needed. PBGC recently began to include more information about its methodology for determining probable claims in its annual reports and has made more detailed information on its financial condition available on its Web site. However, pension experts, analysts, and industry association representatives said that they have specific concerns about the transparency of information PBGC reports about its financial condition. For example, they told us that the press releases PBGC issues to announce new plan terminations do not provide the public with enough information to determine the terminations' financial effect on PBGC's published deficit. Pension experts and others said that such omissions may give the false impression that the announced liability in the press release is a new financial liability to PBGC and that PBGC is adding the entire amount of the announced liability to its current financial deficit. However, if the terminated plan was among PBGC's probable claims included in its year-end financial statement, much of the plan's liability would already be included in PBGC's deficit figures. Pension experts and others also expressed concern about the lack of transparency regarding PBGC's interest rate assumptions, such as information about the methodology PBGC uses to calculate its interest rate. Specifically, the fact that PBGC



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does not widely disclose the methods it uses to determine its interest rate assumptions raises ambiguity about its assumptions and means that others are unable to fully assess PBGC's financial condition. Finally, most parties agreed that the information PBGC reports about its financial condition is likely to become increasingly important if changes are made to pension accounting rules, because such changes could have an effect on defined benefit plans insured by PBGC.

Because of the questions raised about PBGC's financial disclosure practices, we make recommendations to PBGC to disclose, in its press releases, whether a newly terminated plan was classified as a probable claim and already included in its reported deficit in its annual financial statement; and to make its interest rate methodology more widely available to the public on its Web site. PBGC agreed with our recommendations. PBGC stated that in its future media releases it would note whether or not reserves have previously been made relating to the termination of the subject company's defined benefit plans and post additional details regarding its interest methodology on its Web site.

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## Background

PBGC's single-employer insurance program is a federal program that protects the retirement incomes of more than 34 million workers and retirees covered by almost 29,000 private sector defined benefit pension plans. Defined benefit pension plans promise to pay a specified monthly benefit at retirement, commonly based on salary and years on the job. PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income, assets from pension plans taken over by PBGC, and recoveries from the companies formerly responsible for the plans it took over. In addition, PBGC uses Form 5500 information—the primary source of information for both the federal government and the private sector regarding the operation, funding, assets, and investments of private pension plans—to monitor single-employer defined benefit pension plan activities, focusing on assets, liabilities, number of participants, and funding levels. Form 5500 information is also used to forecast PBGC's potential liabilities.

The Employee Retirement Income Security Act of 1974 (ERISA) established PBGC to insure the pension benefits of participants, subject to

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certain limits, in the event that an employer cannot pay its promised benefits.<sup>5</sup> ERISA also required PBGC to encourage the continuation and maintenance of voluntary private pension plans and to maintain premiums set by the corporation at the lowest level consistent with carrying out its obligations.<sup>6</sup> PBGC may pay only a portion of a participant's accrued benefit because of limits on the PBGC benefit guarantee; PBGC generally does not guarantee benefits above a certain amount, currently \$47,659 annually per participant at age 65. Additionally, benefit increases arising from plan amendments in the 5 years immediately preceding plan termination are not fully guaranteed, although PBGC will pay a portion of these increases. Finally, sponsors of PBGC-insured defined benefit plans pay annual premiums to PBGC for their coverage.<sup>7</sup>

PBGC prepares its financial statements in accordance with FASB standards, as permitted by the Federal Accounting Standards Advisory Board.<sup>8</sup> For procedures on how to record and report contingencies, FASB's Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (FAS No. 5), specifically requires that a liability for loss contingency be recorded if two conditions are met: (1) information available prior to issuance indicates that it is probable that a liability has been incurred at the date of the financial statements, and (2) the amount of the loss can be reasonably estimated. For fiscal year 2005, PBGC received its 13th consecutive clean or unqualified audit opinion from its independent auditors.

As a wholly-owned government corporation, PBGC is subject to the financial and internal control reporting requirements of Chapter 91 of Title 31 of the U.S. Code (commonly known as the Government Corporation Control Act). The Office of Management and Budget (OMB) issues

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<sup>5</sup>Some defined benefit plans are not covered by PBGC insurance; for example, plans sponsored by professional service employers, such as physicians and lawyers, with 25 or fewer employees.

<sup>6</sup>29 U.S.C. §1302(a).

<sup>7</sup>Premiums have two components: a per participant charge paid by all sponsors and a "variable-rate" premium that some underfunded plans pay based on the level of unfunded benefits.

<sup>8</sup>The Federal Accounting Standards Advisory Board (FASAB) considers and promulgates accounting concepts and standards for the federal government. FASAB is sponsored by the Comptroller General of the United States, the Director of the Office of Management and Budget (OMB), and the Secretary of the Treasury of the United States.

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guidance to the heads of federal agencies and government corporations that sets out the annual process for them to make a statement as to the adequacy of their entity's internal controls. In light of new requirements for publicly-traded companies relating specifically to internal controls over financial reporting and management's related responsibilities, contained in the Sarbanes-Oxley Act of 2002,<sup>9</sup> OMB recently revised its guidance to adopt enhanced requirements for internal controls over financial reporting by major federal agencies. Specifically, OMB added an entirely new appendix to its existing guidance requiring that these agencies establish a formal process for assessing their internal controls over financial reporting. This new requirement, however, applies only to the 24 CFO Act agencies,<sup>10</sup> and thus these specific requirements do not apply to PBGC.

To estimate the present value of its future liabilities, PBGC develops interest rate factors, similar to interest rates, to use for these calculations, based on surveys of insurance companies conducted by the American Council of Life Insurers (ACLI) for PBGC and the Internal Revenue Service (IRS).<sup>11</sup> The survey asks insurers to provide the net annuity price for annuity contracts for plan terminations. PBGC develops interest rate factors, similar to interest rates, from the survey results that together with PBGC's other actuarial assumptions produce prices in line with those of the private sector insurers surveyed, which are adjusted to the end of the year using an average of the Moody's Corporate Bond Indices for Aa and A-rated corporate bonds for the last 5 trading days of the month. The adjusted interest rate factors are published in mid-December for use in January. The interest rate factors are then further adjusted each subsequent month of the year on the basis of the average of the Moody's bond indices. All other things being equal, when interest rates are lower, more money is needed today to finance future benefits because this money will earn less income when invested. Therefore, lower interest rate assumptions result in higher liability amounts, while higher interest rate assumptions result in lower liability amounts.

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<sup>9</sup>Pub. L. No. 107-204, §§ 302, 404, 116 Stat. 745, 777, 789 (July 30, 2002).

<sup>10</sup>31 U.S.C. § 901.

<sup>11</sup>ACLI conducts four surveys annually. PBGC interest rate factors used for its financial statements are based on an average of the surveys conducted in June and September.

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In 1997, we reported that the cash-based federal budget, which focuses on annual cash flows, does not adequately reflect the cost or the economic impact of PBGC's single-employer pension insurance program and other federal insurance programs.<sup>12</sup> Generally, cost is only recognized in the budget when claims are paid rather than when the commitment is made. Benefit payments of terminated plans assumed by PBGC may not be made for years, even decades, because plan participants generally are not eligible to receive pension benefits until they reach age 65. Once eligible, these benefits are paid over a period of years or even decades. As a result, there can be years in which PBGC's current cash collections are estimated to exceed current cash payments, regardless of the expected long-term cost to the government. We concluded that the use of accrual concepts in the budget for PBGC and other insurance programs has the potential to better inform budget choices.

SEC, the principal federal regulator of the U.S. securities markets, requires public companies to disclose meaningful financial and other information to the public. SEC's mission is to protect investors, maintain fair orderly and efficient markets, and facilitate capital formation. Public companies are required to submit reports to SEC on Form 8-K, the "current report" companies must file with SEC to announce certain major events that shareholders should know about, including any expected losses that are considered to be material. In addition, public companies must submit annual reports on Form 10-K and quarterly reports on Form 10-Q.<sup>13</sup> These disclosures are designed to keep the public informed about any information that could be considered important for investors. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security.

FDIC is a government corporation. In addition to its roles as primary federal regulator of state-chartered banks that are not members of the Federal Reserve System and back-up regulator for all insured depository institutions, FDIC said it promotes public confidence and stability in the U.S. financial system by insuring deposits in banks and thrift institutions;

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<sup>12</sup> GAO, *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/AIMD-97-16 (Washington D.C.: Sept. 30, 1997).

<sup>13</sup>The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition and includes audited financial statements. The Form 10-Q includes unaudited financial statements and provides a continuing view of the company's financial position during the year. The report must be filed for each of the first three fiscal quarters of the company's fiscal year.

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by examining and supervising financial institutions; by identifying, monitoring, and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails. Similar to PBGC, FDIC receives no congressional appropriations; it is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities.

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## **PBGC Has a Process in Place to Monitor and Ensure the Accuracy of Its Single-Employer Probable Claims Forecasts**

PBGC reports that it monitors its probable claims on an ongoing basis by contacting plan sponsors to obtain certain plan financial information, reviewing filings submitted by probable plans to conduct a risk analysis, and performing valuations to determine, among other things, the present value of net probable claims and expected date of probable plan termination. PBGC also regularly updates and reviews its list of probable claims that it monitors. PBGC also takes certain steps to ensure the accuracy of its probable claims, such as using an automated system for estimating probable claims and the most currently available data when calculating its estimates. We found that PBGC's probable claims estimates are reasonable because they are generally close to the final claim amounts that are determined for these plans that PBGC ultimately takes over.

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## **PBGC Has Procedures in Place to Monitor Single-Employer Probable Claims on a Year-round Basis**

PBGC assesses underfunded plans to determine which plans should be classified as probable claims and monitored on an ongoing basis. To be classified as a probable claim, a plan must meet at least one of the seven criteria PBGC uses, five of which it characterizes as objective, and two as subjective. According to PBGC officials, objective criteria are used when substantial evidence exists to indicate that the plan sponsor is in liquidation or insolvency proceedings or will meet the requirements for a distress or involuntary termination. Subjective criteria involve management judgment.<sup>14</sup> Table 1 shows the different applications of the objective and subjective criteria used to classify plans as probable claims.

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<sup>14</sup>According to PBGC, subjective criteria must typically be used when most plans meet the criteria for recognition under FAS No. 5 of GAAP while in or close to reorganization under Chapter 11 bankruptcy.

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**Table 1: List of Probable Classification Criteria**

<b>Criterion type</b>	<b>Description</b>
Objective	The plan's contributing sponsor(s) is in liquidation under Title 11 of the United States Code or comparable state insolvency proceeding.
Objective	PBGC has received a distress termination filing, and substantial evidence exists that the requirements for a distress termination are likely to be met.
Objective	PBGC has been informed that a distress termination will be filed, and substantial evidence exists that the requirements for a distress termination are likely to be met.
Objective	PBGC has advised the plan administrator that a distress termination should be filed, and substantial evidence exists that the requirements for a distress termination are likely to be met.
Objective	PBGC is considering or is expected to consider the plan for an involuntary termination, and substantial evidence exist that the requirements for an involuntary termination are likely to be met.
Subjective	The plan was classified as reasonably possible and it was determined that the plan is a very high risk plan that should be classified as probable.
Subjective	Plans can be classified as probable if any other set of circumstances exist that in PBGC's judgment constitute a probable termination.

Source: GAO analysis of PBGC data.

Once probable plans are identified, PBGC uses certain information to more closely monitor such plans and the future claims they represent. To accomplish this, PBGC primarily relies on information it receives from plan sponsors, information from Section 4010 filings, reportable event and distress termination filings, and other sources.<sup>15</sup>

- **Information from plan sponsors:** PBGC officials said they contact plan sponsors in order to monitor the case and obtain any required information not submitted by the plan sponsor, such as the plan's most recent Form 5500 filing and actuarial valuation report. PBGC officials said they also make an assessment of the potential for termination. This is part of a process that encompasses (1) querying the plan sponsor about the intentions with regard to its pension plans, (2) obtaining estimates of due

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<sup>15</sup>At least one of the following criteria must be met in order for PBGC to approve a distress termination filing: (1) liquidation in bankruptcy (Chapter 7) or insolvency proceedings; (2) reorganization in bankruptcy (Chapter 11); (3) a company will be unable to continue to stay in business unless its plan is terminated; and (4) unreasonable, burdensome pension costs caused solely by a decline in workforce.

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and unpaid employer contributions and unfunded benefits, and (3) performing a risk analysis.

- **Section 4010 filings:** These filings provide PBGC with actuarial and other information on some underfunded plans and financial information for companies that meet certain criteria. PBGC said that these filings are an important component of PBGC's monitoring activities. Section 4010 of ERISA requires the reporting of plan actuarial and company financial information by employers with plans that have aggregate unfunded vested benefits in excess of \$50 million, missed required contributions in excess of \$1 million, or outstanding minimum funding waivers in excess of \$1 million. The information required to be filed includes (1) plan identifying information, (2) information regarding the fair market value of plan assets and the value of benefit liabilities on a PBGC termination liability basis, and (3) financial information, such as financial statements.
- **Reportable event and distress termination filings:** The major types of reportable event filings that PBGC uses to monitor underfunded plans include the inability of a plan to pay participants the benefits due them in the form prescribed by the plan, bankruptcy or insolvency proceedings, liquidation proceedings or the dissolving of the plan sponsor, and failing to meet the minimum funding standards. According to PBGC officials, PBGC is notified of reportable events affecting approximately 300 plans per year. On average, 200 of these plans either undergo standard terminations or continue without termination, resulting in PBGC not taking over the plan.<sup>16</sup> The remaining 100 plans eventually become distress terminations or involuntary terminations.<sup>17</sup>
- **Other sources:** PBGC uses Form 5500 information to monitor plan funding. PBGC also monitors news sources (e.g., Bloomberg, Livedgar, and NewsEdge) to identify transactions that could adversely affect plan funding status and ultimately PBGC. In addition, PBGC contracts with Dun and Bradstreet's First Alert Service, which reports on bankruptcy filings within several days of the filing.

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<sup>16</sup>The termination of a fully funded defined benefit plan is called a standard termination. According to PBGC officials, in a standard termination the plan sponsor either purchases annuities for the plan's participants or the plan pays them lump sum distributions to satisfy its financial obligations.

<sup>17</sup>PBGC may initiate involuntary terminations for several reasons, including if PBGC's loss from that plan may be expected to increase unreasonably if the plan is not terminated. 29 U.S.C. §1342(a).

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As part of its monitoring process, all probable claims are reviewed by PBGC's Contingency Working Group (CWG), which is composed of representatives from various departments and divisions within PBGC. The CWG is responsible for approving probable plan classifications and probable loss amounts. PBGC updates its probable claims three times per year, and performs valuations for financial reporting purposes on all plans on the probable claims list. For each financial reporting date (March 31, June 30, and September 30), PBGC actuaries prepare a preliminary list of probable claims that also contains the estimated date of plan termination and the present value of the each plan's net claim. For each period, the Contingency Working Group reviews and approves the finalized list of probable claims.

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### **PBGC Takes Steps to Ensure the Accuracy of Its Probable Claims**

PBGC reports that it takes certain steps to help ensure the accuracy of its probable claims. One of PBGC's key controls to help ensure accuracy is an automated system for estimating probable claims. The Integrated Present Value of Future Benefits (IPVFB) system estimates the probable losses and does so according to GAAP and FAS No. 5 standards. To calculate the fiscal year end financial statement assets and liabilities for probable plans, plan information such as Form 5500 filings, asset statements, annuity purchases, contributions, and estimated dates of plan termination are entered into the IPVFB system as of the estimated date of plan termination and fiscal year end. This system adjusts the liabilities from the plan's assumptions, such as mortality, interest, and expected retirement age, to standard assumptions used by PBGC, and then produces a report that provides PBGC staff with information on how the assets and liabilities are brought forward from the Actuarial Valuation Report date to the date of the financial statements. PBGC officials reported that the agency's process for estimating its probable claims is reviewed by its financial auditors as part of its annual audit of its financial statements. As noted earlier, the auditors have issued unqualified audit opinions for the last 13 years.

PBGC officials also told us they help ensure high levels of accuracy by using the most current data available as the starting point in their valuation process, but there's room for improving the timeliness of the data. For example, PBGC has 4010 data for the largest plans that it designates as probable claims, but even those data are 3 ½ months old when received, and they are received only once per year. On occasion, PBGC is able to obtain more current actuarial valuation reports, but it is not able to do this regularly for all plans on the probables list.



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PBGC officials also said since single-employer probable claims are estimates, factors that are not fully determinable can cause the actual claims PBGC receives to differ from its probable estimates. According to these officials, when they calculate their probable estimates, they usually do not have complete data on the provisions of the plan, the characteristics of plan participants, the exact date of plan termination, the precise value of plan assets and liabilities at that termination date, or the level of recoveries from the plan's sponsor, all of which may change over time. Additionally, potential changes in PBGC's valuations, knowledge of specific plan provisions, and participant characteristics combine in ways that can cause the actual claims from these plans to deviate from the estimates, regardless of the timeliness of the data used in preparing the estimates. When a probable claim becomes an actual claim, PBGC officials said they adjust the probable claim estimate to that of the actual claim amount as of the date of plan termination. If a plan is removed from the probables list for a reason other than termination, the previously estimated claim is removed from the probable claims total and reclassified, often as a reasonably possible claim.<sup>18</sup>

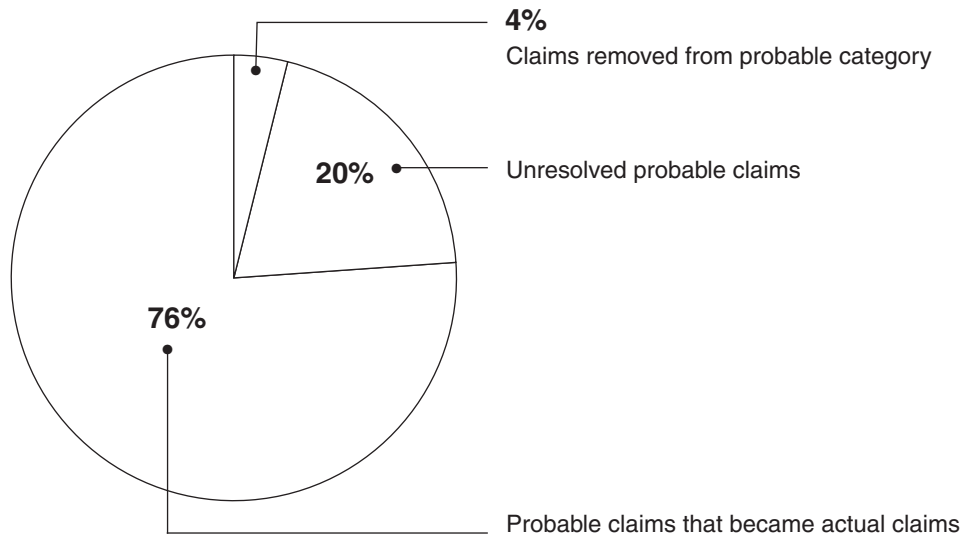
PBGC data showed its total probable claims estimates (\$21.8 billion) for all plans that eventually terminated were within one percentage point of the actual claim amount (\$21.9 billion). Ninety-five percent of the \$22.9 billion in resolved probable claims was in plans that terminated with PBGC.<sup>19</sup> In addition, historically the vast majority of probable claims (76%) subsequently become actual claims, as shown in figure 1.

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<sup>18</sup>Plans are classified as reasonably possible if they have over \$50 million in aggregate underfunding, the plan sponsor's bonds are below investment grade, the sponsor has applied for a minimum funding waiver with the Internal Revenue Service or has missed a minimum funding contribution, or the sponsor is in reorganization under Chapter 11.

<sup>19</sup>The \$22.9 billion amount represents both \$21.8 billion for probable claims that became actual claims and \$1.1 billion for claims that were removed from the probable category.

**Figure 1: Summary of Probable Net Claims Activity, Fiscal Years 1987-2004**



Source: PBGC data.

Moreover, of the \$16.9 billion of probable net claims that were reported in the financial statements as of the end of fiscal year 2004, more than \$10 billion was in plans that terminated during fiscal year 2005.

## PBGC and Public Companies Follow Different Reporting Requirements when Reporting Liability Settlements, Including Probable Losses

PBGC and public companies have different practices for disclosing information about liability settlements, including probable losses. Although PBGC and public companies follow the same accounting standards for recording probable losses in their annual financial statements, they each follow different policies and requirements when reporting information about probable losses throughout the fiscal year. When reporting information on liability settlements, PBGC follows its own set of policies and procedures, while public companies are required to follow the standards set forth by SEC requirements. PBGC's disclosure practices regarding financial liabilities are similar to those of other government corporations, namely FDIC, which operates similar programs and faces similar risks.

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## Differences in PBGC and Public Company Liability Settlement Reporting Result from Differences between PBGC Disclosure Policies and SEC Requirements

PBGC and publicly traded companies have different practices for disclosing information on liability settlements, including probable losses. Both PBGC and public companies follow the same accounting standards for recording probable losses in their annual financial statements. For example, PBGC announces an estimated liability from probable claims in its annual report, and public companies report similar information about probable losses in their annual reports. However, when reporting information about probable losses throughout the fiscal year, PBGC and public companies have different practices, which result from the different policies and requirements of each entity.

PBGC's reporting in its annual report, or elsewhere, is meant to avoid the disclosure of any information on specific plans classified as probable in order to prevent harm to the economic health of the plan sponsor. When a plan is classified as a probable claim and has not yet terminated, PBGC's policy precludes the disclosure of any information indicating that a specific plan has been classified as a probable claim. In its annual report, PBGC reports its probable claim estimates as an aggregated total value of net claims in order to conceal exactly which plans are included in the figure. PBGC also identifies its probable claim estimates by industry in its financial statements. PBGC officials said their policy of not disclosing any information on plans so classified is meant to avoid causing more economic distress to the plan sponsor, because such plans usually have plan sponsors that are already economically weak. According to these officials, this policy exists so that disclosure does not unnecessarily (1) compromise a company's ability to continue as a going concern and (2) influence a sponsor's decision whether to maintain or terminate its pension plans. For example, if investors knew that PBGC had classified a particular plan as a probable claim, this could encourage additional negative speculation about the financial health of the plan sponsor and trigger activity that might further the financial instability of the company.

When PBGC takes over a plan, it typically issues a press release announcing the liability PBGC expects to incur, without indicating if the terminated plan had already been booked as a probable claim and consequently included in its previously announced deficit in its year-end financial report. According to PBGC officials, PBGC does not release the amount of its previously booked probable claims in its press releases for fear of compromising PBGC's position in litigation and of negatively affecting a company's financial condition. These officials said that releasing its previously booked probable claim amounts would enable someone to make a comparison between PBGC's booked liability for a particular plan and the amount of underfunding for that plan. Publicizing

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this information could affect PBGC's ability to recover the full amount of a plan's claims in litigation because companies are likely to resist a settlement with PBGC for more than the amount of PBGC's previously booked losses. In addition, announcing the previously booked liability also has a negative impact on a company's ability to obtain additional financing and may worsen its financial condition.

In contrast, public companies must follow SEC requirements for disclosing information on financial liability settlements, including probable claims. Federal securities laws enforced by SEC require that public companies disclose information on liabilities booked as a probable loss. Public companies must submit current reports to SEC on Form 8-K for a number of specified events, including any material event that might affect the investment decisions of shareholders. For example, when a public company books a material liability as "probable," the company is required to file a Form 8-K with SEC. Often companies issue such information in a press release, which they may attach to the 8-K.

Although SEC requires public companies, under certain conditions, to disclose information about a probable loss, there is much variability in how these companies choose to disclose this information. According to SEC officials, some companies choose to provide as much information as possible concerning their probable losses, while other companies choose to release less information. For example, some companies release the specific amount of a probable loss in an 8-K, and after the liability has changed from a probable claim to a certainty, these companies choose to redisclose the previously booked quantity to fully demonstrate the total financial impact of the liability on the company. Other companies choose to be more general in their disclosure of probable liabilities by disclosing information about these quantities in general terms, such as announcing a range instead of a specific number.

Pension experts, financial analysts, SEC officials, and others said that the different reporting practices and policies of PBGC and public companies are a consequence of the different risks and responsibilities faced by each entity. They agreed that there would likely be further economic distress for plan sponsors if PBGC divulged which plans are classified as probable before those plans terminate. These experts also noted that while PBGC has an obligation to not disclose information on its probable claims, public companies have a responsibility to report as much information as possible, including probable claims, in order to keep investors informed and able to make knowledgeable decisions. Finally, they said that the unique risks of

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PBGC as a government corporation make its disclosure responsibilities distinctively different from those of public companies.

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### **PBGC's Liability Settlement Reporting Practices Are More Comparable to Those of FDIC**

We found that PBGC's reporting practices are more comparable to those of government corporations like FDIC than they are to those of public companies. Both corporations operate similar types of programs, and both agencies have a responsibility to ensure the stability of the programs they operate. Unlike public companies, PBGC and FDIC are not subject to SEC requirements. In our discussions with PBGC and FDIC officials, we found that both agencies have adopted similar disclosure policies when reporting probable losses.

According to officials from PBGC and FDIC, both agencies follow the same accounting standards and face similar risks when disclosing information about probable losses. For example, officials from both agencies said they do not disclose case-specific, detailed information on probable claims in order to protect the entities under their jurisdictions from further economic distress. Just as PBGC avoids exacerbating the economic situation faced by plan sponsors whose plans are booked as probable, FDIC avoids any financial statement disclosure action that might cause further economic distress for the institutions it insures. In addition, PBGC follows a policy of not disclosing probable claim amounts in its press releases announcing the termination of a plan. FDIC officials said that the agency issues a press release on the day of institution failure that may or may not, depending on the nature and timing of the failure, include an estimated cost to the Insurance Fund. The unique responsibilities of each entity heavily influence the nature and content of the disclosures.

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### **PBGC'S Financial Disclosures Have Improved, but Transparency in Some Areas Remains an Issue**

Over the years, PBGC has made efforts to improve the transparency of its disclosures, including revising its annual report to include more detailed information about its methodology for determining probable claims, and it has published more detailed information about its financial condition on its Web site. Despite PBGC's efforts to improve the transparency of its disclosures, pension experts and others told us that they would like to see more information disclosed when PBGC announces the termination of a new plan in its press releases and that they have some uncertainty about PBGC's methodology for calculating its interest rate. In addition, pension experts, financial analysts, and industry association representatives told us that PBGC's disclosures are likely to become increasingly important in light of upcoming changes in the pension accounting rules for plan sponsors.

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## PBGC Has Taken Steps to Improve the Transparency of Its Financial Disclosures

PBGC officials told us they regularly review the agency's policies for disclosing information related to its financial condition and revise their disclosure documents as needed. According to PBGC officials, when making decisions to revise its disclosures, PBGC takes into consideration, among other things, current changes in the private pension environment that affect the agency's financial condition and information that would help the public better understand PBGC's current financial condition.

Over the last several years PBGC took the following actions to improve the transparency of its disclosures:

- it published a fact sheet on its Web site that provides answers to questions that have been raised about PBGC financial condition, including its deficit, the true cost of its insurance program, and pension underfunding;
- it revised its annual report to include more detailed information about its methodology for determining probable claims;
- it revised its *Pension Insurance Data Book 2003*, which has detailed statistics for the agency's insurance programs, to include information related to PBGC's claims experiences in order to provide more historical data on the number and size of claims by the year the plans terminated, the funding levels of the plans at termination, and the size of the plans at termination;
- it released extensive data about PBGC's financial condition, as well as explanatory and white papers about how to understand PBGC's financial condition, reports, and methods available on its Web site ([www.pbgc.gov](http://www.pbgc.gov)); and
- it revised the agency's Web site to make it more user-friendly.

PBGC officials also said they conduct a range of educational outreach activities with their various stakeholders, including plan participants, experts, policy makers, and the press. For example, PBGC discusses its financial condition at various meetings with plan participants held each year. PBGC officials also regularly give speeches at gatherings of actuaries, lawyers, financial officers, benefit specialists, and other members of the plan sponsor community. PBGC also issues press releases regarding its current financial condition, in connection with the annual financial statements.

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## Pension Experts, Financial Analysts, and Others Have Concerns about the Transparency of PBGC's Disclosures

Some pension experts and others have expressed concern that some aspects of PBGC's disclosures are still unclear. For example, PBGC does not include sufficient information to determine the financial impact of new terminations on PBGC's financial position when it issues a press release. When announcing the termination of a new plan in its press releases, PBGC does not announce whether or not the terminated plan was previously booked as a probable and already included in its reported deficit and reported in its annual financial statement. For example, when a large plan is terminated, PBGC puts out a press release announcing the following information about the terminated plan:

- the type of termination and reason for termination;
- plan information, including the amount of assets, amount of liability, level of funding, and the number of employees covered by the plan;
- the current estimate of PBGC's liability; and
- a review of pension rules and guarantee limits.

When announcing a plan's termination, PBGC does not disclose whether the plan was previously booked as a probable claim, and experts and others said this practice leads some to believe that PBGC is assuming a wholly new liability, in addition to the large deficit already reported by PBGC in its annual report. According to PBGC officials, in the case of most large terminations, PBGC has already recorded a major part of the announced liability in its reported deficit as a probable claim. Thus, when PBGC issues a press release, it may appear that PBGC is assuming a considerable liability with the termination of a large underfunded pension plan when in fact most of the announced liability has been previously recorded in PBGC's annual financial statement and is already reflected in its previously reported deficit. Pension experts and financial analysts said that PBGC's press releases include PBGC's best estimate of the financial liability facing PBGC without any mention of how much of this liability has already been recorded as a probable claim in its annual financial statement. Experts and others told us that when PBGC puts out a press release announcing the termination of a new plan, they regularly receive telephone calls from the media and others asking if this announced liability is a new liability added to PBGC's deficit. By revealing whether the newly terminated plan was previously recorded as a probable claim, PBGC would give policy makers and others better information to understand the impact on PBGC's financial condition.

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Pension experts and financial analysts were also concerned that they remain uncertain about PBGC's methodology for calculating the interest rate it uses to discount its long-term liabilities and would like to see more information disclosed about this process. The interest rate used by PBGC to calculate its liabilities has a significant effect on the reported financial condition of PBGC. For instance, if PBGC reduced its interest rate, the value of its liabilities would increase, and conversely, if PBGC increased its interest rate, the value of PBGC's liabilities would decrease. Pension experts said that because PBGC's interest rate choice has a large impact on its reported financial position, they are troubled that the assumptions surrounding the interest rate decision are not transparent. Pension experts and financial analysts said that they are uncertain of the exact calculations used by PBGC to calculate its rate, and they believe that PBGC could do more to clarify its interest rate assumptions and the effect of this rate on its reported financial position.

According to PBGC officials, information about their interest rate calculations is available upon request but is not provided in its annual financial disclosure documents. Although PBGC discloses its interest rate factors and some of its actuarial assumptions in its annual financial statement, it does not disclose its entire interest rate methodology. PBGC officials also told us that in 2003, during bankruptcy proceedings for US Airways, the court reviewed PBGC's interest rate. During these proceedings, PBGC submitted a detailed presentation on how the rate is calculated, which is now part of the public record. The court upheld PBGC's use of its interest rate. PBGC officials told us they distribute documentation of their methodology when it is requested. However, while the assumptions and calculations PBGC uses to calculate its interest rate are public information, such information is not readily accessible to experts, plan sponsors, plan participants, or lawmakers because they may not know that this information is available upon request.

Pension experts and others also had additional concerns about PBGC's methodology and practices that PBGC has addressed. Specifically, they were concerned that PBGC's practices and disclosures overstate PBGC's economic distress by (1) including estimated probable claim liabilities in its deficit, (2) not publishing a projected date of PBGC's insolvency,<sup>20</sup> and

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<sup>20</sup>This is the date when PBGC's available resources will not be sufficient to pay the monthly benefits currently coming due.



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(3) using a low interest rate. For more information on these concerns and PBGC's responses to these concerns, see appendix III.

Concerns about the transparency of information on the financial condition of the PBGC are not new. As we previously reported, the cash-basis of the federal budget contributes to a lack of transparency about PBGC and other federal insurance programs that may delay recognition of emerging financial problems.<sup>21</sup> Furthermore, current budget reporting may not provide policy makers with information or incentives to address potential funding shortfalls before claim payments come due. Generally costs are recorded in the budget too late for policy makers to control them or even ensure that adequate resources will be available to cover them. The delayed budget recognition of these costs can reduce the number of viable options available to policy makers and may ultimately increase the cost to the government.

Finally, many of the pension experts, financial analysts, and industry association representatives we consulted observed that PBGC's disclosures are likely to become increasingly important if changes to the pension accounting rules currently under discussion are made, as these could have an effect on defined benefit plans covered by PBGC. The primary accounting rule change that is being discussed is likely to move the disclosure of the funding status of pension plans from the footnotes to the balance sheet of the employer's financial statement. According to FASB, this change is intended to make an employer's pension obligations more visible on the balance sheet and income statement in order to increase the transparency of the plan sponsor's financial position. Financial analysts and others told us that there are many potential effects to this expected change that do not directly influence PBGC but are likely to indirectly affect PBGC's financial condition. For example, pension experts and analysts said that the new FASB changes could have a positive effect on PBGC's future financial condition by promoting greater contributions and higher funding levels from plan sponsors, thus reducing PBGC's exposure to financially troubled plans.

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<sup>21</sup>U.S. General Accounting Office, *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/AIMD-97-16 (Washington D.C.: Sept. 30, 1997) and U.S. Government Accountability Office, *Private Pensions: The Pension Benefit Guaranty Corporation and Long-Term Budgetary Challenges*, GAO-05-772T (Washington D.C.: June 9, 2005).

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## Conclusions

The information that PBGC reports on its probable claims and financial liabilities is the main source of information that policy makers and interested parties have to evaluate the financial condition of PBGC. The more transparent PBGC is about the impact of new terminations on PBGC's financial positions and the methodology it uses to determine its interest rate, the less ambiguity there will be about PBGC's financial condition and the more beneficial PBGC's financial reporting will be for policy makers and others. Public understanding of PBGC's financial condition will become even more important in the near future if the proposed changes to pension accounting rules are made, potentially affecting PBGC's financial condition.

The risks faced by PBGC when disclosing information about probable claims are not the same as those faced by public companies. PBGC must be careful not to release information that can negatively affect the sponsors of the plans it insures or its ability to recover assets from the sponsors of the plans that it takes over. Public companies' disclosures are aimed at providing necessary information to investors. Improving the transparency of the financial information released by PBGC will require finding a solution that does not hinder the agency's ability to make recoveries from plan sponsors for the losses it incurs.

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## Recommendations

We recognize that PBGC believes that there are reasons for withholding certain information about its probable claims. As we reported, PBGC does not disclose the names and liability amounts for newly terminated plans that were classified as probable claims because of its concerns of compromising PBGC's position during litigation and negatively affecting the economic health of plan sponsors. However, PBGC could better describe the impact of new claims on its reported net financial position when announcing new plan terminations in its press releases. Therefore, we recommend that PBGC consider disclosing, in its press releases, whether a newly terminated plan was classified as a probable and already included in its reported deficit in its annual financial statement.

To improve the transparency of the interest rate assumptions PBGC uses to calculate its liabilities, we recommend that PBGC makes its interest rate methodology more widely available to the public. In doing so, PBGC should consider making this information available on its Web site.

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## Agency Comments

We provided a draft of this report to PBGC, FDIC, the Department of Labor (Labor), SEC, and the Department of the Treasury (Treasury). PBGC provided written comments, which appear in appendix I. PBGC's comments agreed with the findings and conclusions of our report. SEC provided written comments which appear in appendix II. SEC's comments generally agreed with our findings related to SEC's Form 8-K and material liabilities. The agency's comments also provided additional information that is related to Form 8-K requirements and financial statement disclosure of loss contingencies. PBGC and FDIC also provided technical comments on the draft. We did not receive any comments from Labor and Treasury. We incorporated each agency's comments as appropriate.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the issue date. At that time, we will send copies of this report to the Secretary of Labor, the Secretary of the Treasury, and the Executive Director of the Pension Benefit Guaranty Corporation; appropriate congressional committees; and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you have any questions concerning this report, please contact me at (202) 512-7215. Other contacts and acknowledgments are listed in appendix IV.



Barbara D. Bovbjerg  
Director, Education, Workforce  
and Income Security Issues

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# Appendix I: Comments from the Pension Benefit Guaranty Corporation

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March 15, 2006

Barbara D. Bovbjerg, Director  
Education, Workforce and Income Security Issues  
U.S. Government Accountability Office  
Washington, D.C. 20548

Dear Ms. Bovbjerg:

Thank you for the opportunity to comment on the draft version of your report entitled, "Private Pensions: Opportunities Exist to Further Improve the Transparency of PBGC's Financial Disclosures."

We place a significant emphasis on the accuracy of our financial reporting processes, especially reporting of probable claims as required by Statement of Financial Accounting Standard No. 5 under Generally Accepted Accounting Principles. Our financial statements and the notes to our financial statements meet disclosure requirements, and as the report notes, the amount of information disclosed has increased over the years. As evidence of the accuracy of our financial statements and the adequacy of our disclosures, the Independent Public Accountant, Clifton Gunderson, acting under the auspices of our Office of Inspector General, recently issued an unqualified opinion on PBGC's financial statements - our 13<sup>th</sup> straight "clean" opinion.

We understand the importance of financial reporting transparency, and believe that transparency has helped users of our financial statements to better understand the structural challenges facing the pension insurance program and the need for action. The report correctly notes that there are limitations on the nature and type of information we are able to disclose.

We have addressed our specific responses to the two recommendations included in the report below:

**GAO Recommendation: Disclose in its press releases whether a newly terminated plan was already included in its published deficit.**

**PBGC Response:**

We already provide details regarding total probable claims by industry. We have not released the amount of previously-booked claims for newly terminated plans in our press releases as a means of protecting the identity of other undisclosed plans that are part of our published deficit. Having said that, we can and will note in future media releases whether or not reserves have previously been made relating to the termination of the subject company's defined benefit plans. We believe that this level of disclosure will improve transparency without jeopardizing the identity of other undisclosed plans previously included in our reserves.

**GAO Recommendation: Make its interest rate methodology more widely available to the public.**

**PBGC Response:**

Our interest factor methodology has been made publicly available through presentations to professional conferences and industry associations as well as through meetings with interested analysts. Consistent with the GAO's recommendation, we will also post additional details regarding our interest methodology on our website, [www.pbgc.gov](http://www.pbgc.gov).

We appreciate GAO's efforts in highlighting the important challenges facing the Pension Benefit Guaranty Corporation as we work to safeguard America's pension insurance program.

Sincerely,



James C. Gerber  
Chief Financial Officer

# Appendix II: Comments from the Securities and Exchange Commission



DIVISION OF  
CORPORATION FINANCE  
Mail Stop 5546

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

March 23, 2006

Diana Brauner  
Analyst  
Education, Workforce, and Income Security  
U.S. Government Accountability Office  
Room 5A56B  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Brauner:

Thank you for your email dated March 7, 2006 and the opportunity to comment on excerpts from the draft report being prepared by the GAO entitled *Private Pensions: Opportunities Exist to Further Improve the Transparency of PBGC's Financial Disclosures (GAO-06-429)*. As you know, during preparation of the draft report, we had opportunity to meet with you and other members of your office to discuss the disclosure that is required for public companies related to liability settlements. We agree with your assertion that information related to the incurrence of a material liability should be reported in a current report on Form 8-K and we provide more specifics related to the form requirements below should you wish to expand your discussion. We also wanted to point out the disclosure that is required in financial statements related to loss contingencies, those considered to be either probable or reasonably possible, which may also be relevant to your consideration of PBGC's disclosure.

Aside from the items that are specifically required to be reported on Form 8-K, disclosure under Item 8.01 is required for events that a public company believes would be of importance for investors. For example, if a public company incurred a material loss by entering into a litigation settlement, the Company would disclose the event in a Form 8-K under Item 8.01. An example of a specific Form 8-K disclosure item related to a loss contingency is a potential or actual exposure to loss resulting from an obligation under a guarantee contract, which would require disclosure of the nature and amount of the obligation in a Form 8-K under Items 2.03 and 2.04.

The disclosure that a company provides in the financial statements that are included in its public filings related to loss contingencies is governed by generally accepted accounting principles. GAAP requires a company to record an estimated loss related to a loss contingency if both of the following conditions are met: (a) it is probable that a liability has been incurred and (b) the amount of loss can be reasonably estimated. Disclosure is required in the financial statements of the nature of the loss and the amount recorded. If no loss has been recorded because one or both of the conditions are not met (the loss is not probable or can't be reasonably estimated), disclosure is still required if it is reasonably possible that a loss has been

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**Appendix II: Comments from the Securities  
and Exchange Commission**

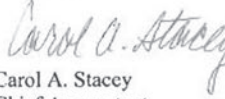
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Ms. Diana Brauner  
Page 2

incurred, and would include the nature of the contingency and an estimate of the possible loss or range of loss, or a statement that an estimate cannot be made. See FASB Statement of Financial Accounting Standards No. 5 *Accounting for Contingencies* for the GAAP requirements.

We appreciate the opportunity to provide comments on the draft report. Please call me at 202-551-3405 if you have any questions or comments.

Sincerely,



Carol A. Stacey  
Chief Accountant

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# Appendix III: Other Concerns Regarding the Information PBGC Discloses about Its Financial Condition

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Pension experts and others had additional concerns about the Pension Benefit Guaranty Corporation's (PBGC) methodology and practices that have been addressed by PBGC. Pension experts and industry association representatives told us they are also concerned that PBGC's practices and disclosures overstate its economic distress by (1) including estimated probable claim liabilities in its deficit, (2) not publishing a projected date of insolvency, and (3) using a low interest rate. Each of these concerns has already been addressed by PBGC.

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## Estimated Probable Claim Liabilities in Its Deficit

PBGC includes estimated net losses incurred from probable terminations in its liabilities when calculating its deficit. Some experts are concerned that PBGC's deficit is largely composed of liabilities from probable claims that might never terminate. In addition, these parties told us that by only booking the net claim, instead of booking the assets and liabilities separately, PBGC is making its own funded ratio look worse. PBGC officials agreed that this practice may make their funded ratio lower but said it has no impact on the size of its deficit. However, PBGC officials said that according to FAS 5, PBGC is required to include the expected net claims from probable claims in its financial statement if the loss is probable and the amount of the loss can be reasonably estimated. Furthermore, the accounting standards do not permit PBGC to separately book plan assets and liabilities of probable claims until PBGC takes over the plan.

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## Projected Date of Insolvency

Pension experts and industry association representatives also told us that PBGC publicizes its large financial deficit without publishing an estimated date of insolvency. While some experts we spoke to understand that PBGC has enough assets to pay its promised obligations for a number of years, they are concerned that by not announcing a date of insolvency, PBGC leaves the impression that participants are at imminent risk of not receiving their benefits. PBGC officials told us that a projected date of insolvency for the single-employer program is not calculated because there are many uncertain variables that will affect PBGC's future cash flows, and it is not possible to reasonably project a date of insolvency with any accuracy. The uncertainty of when PBGC will trustee new plans, how those claims will affect PBGC's future cash flows, and of PBGC's revenue from investment returns make it impossible to make reasonable predictions of the date of PBGC's insolvency. However, PBGC officials reported that the agency's analysis has shown that there is less than a 10 percent chance that its single-employer program will not have sufficient assets to pay guaranteed benefits through 2020.



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**Interest Rate Level**

Some pension experts, industry association representatives, and financial analysts disagree with PBGC's choice of interest rate used when calculating the value of its liabilities and argue that this interest rate is unrealistically low, thereby overstating the value of its reported deficit. These experts said that PBGC should be using a higher interest rate that is more in line with current corporate economic conditions. According to PBGC officials, the agency's interest factors are based on the rate at which a private insurance company would charge plan sponsors to take on a plan's promised benefits. The survey ensures that PBGC's termination values reflect the current market price of terminating a plan. PBGC officials also noted that its auditors have issued unqualified opinions on its financial statements, which include its liabilities for probable losses and the interest factors used to calculate these liabilities. In addition, the American Academy of Actuaries conducted a study that found its procedures accurately reflected annuity prices.

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# Appendix IV: GAO Staff Acknowledgments

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## Staff Acknowledgments

Tamara Cross, Assistant Director; Raun Lazier, Analyst-in-Charge; Diana Blumenfeld; Joseph Applebaum; Richard Burkard; Robert Dacey; Kimberly McGatlin; Jonathan McMurray; James McTigue Jr.; and Roger J. Thomas made important contributions to this report.

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