



PENSION BENEFIT  
GUARANTY  
CORPORATION



# HELPING SECURE RETIREMENTS

P B G C   A N N U A L   R E P O R T   2 0 1 3

## A MESSAGE FROM OUR CHAIR

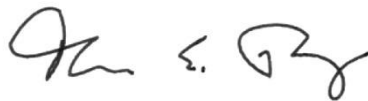


The Obama Administration is dedicated to safeguarding pension benefits and promoting the retirement security of the millions of America's workers, retirees, and their families. The Pension Benefit Guaranty Corporation plays a vital role in the Administration's efforts to ensure workers have opportunities for secure and dignified retirements. PBGC does this by working with employers to preserve their pension plans, insuring pension benefits, and paying guaranteed pension benefits to retirees.

On behalf of the PBGC Board of Directors, I am pleased to present the PBGC's FY 2013 Annual Report, which provides important information about the PBGC's operations and its finances. The report highlights many of the PBGC's accomplishments over this past fiscal year to preserve plans and protect pensioners, as well as the PBGC's future program challenges. In the near term, the PBGC's programs continue to have resources that are adequate to pay benefits for years, and participants and retirees can count on the PBGC to be there to protect their benefits.

To address the PBGC's longer-term challenges, the Administration has again proposed in its 2014 budget to strengthen the PBGC by reforming its premium authority to ensure that the PBGC has the funds to do its job. While legislation enacted in 2012 made some changes that improved PBGC's financial condition, reforms to PBGC's premium structure are still needed. At the same time, PBGC is working to strengthen the defined benefit plan system by encouraging employers to keep their existing plans and reducing regulatory burdens to better serve its customers.

Retirement security is critical to the long-term health of America's middle class. In September, the Board selected a Participant and Plan Sponsor Advocate who will serve as a liaison for plan sponsors and participants, and will advocate on behalf of retirees. My fellow Board members, Treasury Secretary Jack Lew and Commerce Secretary Penny Pritzker, and I are committed to providing strong oversight and leadership to help the PBGC strengthen its programs and work toward a more secure future for America's workers and retirees.

A handwritten signature in black ink, appearing to read 'Tom E. Perez'.

Thomas E. Perez  
Secretary of Labor  
Chair of the Board

## A MESSAGE FROM THE DIRECTOR



### **A GOOD AND COMPASSIONATE AGENCY PROVIDING HELP IN TROUBLED TIMES**

In my three years as Director, I have come to think PBGC is one of the most competent and compassionate agencies in the US government. PBGC has several very complex jobs: PBGC must learn and apply the specific rules of different pension plans of hundreds of companies to hundreds of thousands of people. It must decide whether many of the companies that say they cannot afford their pensions truly cannot. PBGC does these and other complicated jobs compassionately and well.

In the pages that follow, you'll read about some very good work.

- Serving the people who count on us: When we take responsibility for people's pensions, their lives have already been disrupted. We try to provide security — reliably — at a time when people need it.
- Serving the companies that sponsor plans: In the U.S., private pensions are a voluntary choice by employers. We're working to reduce unnecessary burdens on employers, and are making it easier for plan administrators to do their jobs.
- Working to improve retirement security: We work both to provide more options for a secure retirement, and to help people understand the options they have.

But that doesn't mean PBGC cannot improve. PBGC has not rested. We have worked tirelessly to preserve plans where possible and to cover pensions where not.

- 130,000 people at American Airlines were told by their management that their pensions would be terminated, that American couldn't afford to keep them. Thanks in important part to the dedicated and coordinated efforts of PBGC's financial analysts, lawyers, and actuaries, American agreed not to do so. We continued to work throughout 2013 to help solve many issues in the case.
- 10 years ago, more than 800 employees of New Jersey's Hospital Center at Orange found out their pensions were no longer insured by PBGC. This year, PBGC worked with the IRS to reverse that, so they will continue to receive benefits although their plan is almost exhausted.
- Faced with the possible collapse of multiemployer pension plans covering millions of workers, PBGC staff is working to understand diverse circumstances of the plans to find ways to preserve those plans and protect benefits.
- PBGC continued to work with pensioner advocacy groups to help ensure that people confronted with the option of giving up their pensions in exchange for lump-sum payments understand the perils of taking that choice.
- This past year, we became responsible for the pensions of an additional 57,000 people. We added these to the 1.5 million people we already serve — and never missed a payment.

## MAKING A GOOD AGENCY EVEN BETTER

One of my most important tasks as Director is to ensure that PBGC's very talented and committed professionals have equally talented and committed leaders. We are working hard to bring to PBGC a new generation of PBGC management. I'm pleased that we continue to find excellent leaders to advance PBGC's missions. In the past year, we've brought in new leaders in our benefits payment, IT, restructuring, and policy research departments. All are energized and have begun to take a fresh look at the agency's work. We followed up by improving the way we support and train our managers.

We're also making changes to the *way* we do our work.

- We're directly responding to comments on our website and our customer satisfaction scores remain high.
- We're proposing to exempt some 90 percent of plans and sponsors from burdens they'd otherwise have to undertake. In response to complaints from business that our regulatory and enforcement programs were treating all plans as risky, we studied past history and found that the financial strength of the sponsor, not plan funding levels, was the most important factor. As a result, we're focusing our efforts on large and financially risky sponsors and removing requirements on financially sound sponsors and small businesses.
- We formed an independent Quality Management Department to foster continuous improvements to our processes and performance.
- We're continuing to rethink and reform our basic benefit determination process and organization. We're changing many of our processes and training PBGC staff to meet ever higher standards. And we've begun to rethink and consolidate our use of real estate rental properties.

## PRESERVING MULTIEMPLOYER PLANS

Multiemployer pension plans protect more than 10 million people and their families. Unfortunately, due to economic changes and investment market declines, a minority of these plans are in trouble. Although the Employee Retirement Income Security Act (ERISA) allows some flexibility to avoid insolvency, for many plans that won't be enough. Without additional changes, we project that plans covering hundreds of thousands of people will fail. Sadly, PBGC's own funding is itself inadequate to pay benefits if their plans fail.

PBGC is working to develop ways to preserve these plans and the benefits they provide. Congress has made clear its interest in preserving pensions, and we are working with the plans, their unions and employers, other agencies, and the Congress to help find workable solutions. The next year will be critical to the success of these efforts.

## FUTURE RETIREES WORRY

One of PBGC's primary missions under ERISA is to "encourage the continuation and maintenance of voluntary private pension plans." It's an obligation we take seriously. The trends are ominous:

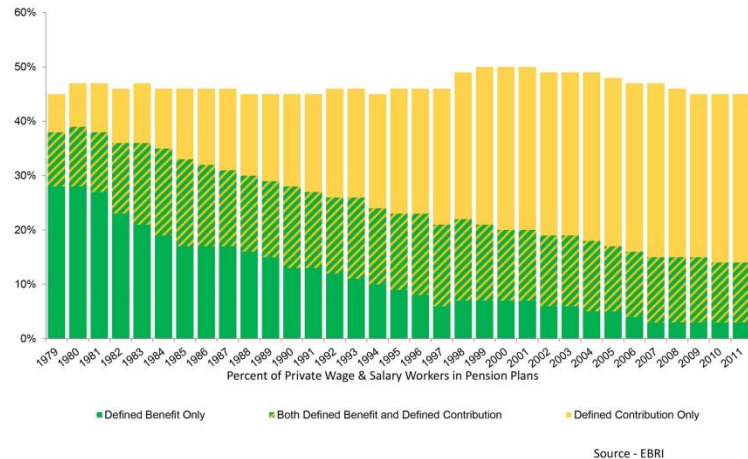
- Americans today are spending more years in retirement. They're healthier and more active. That's great news, but, unfortunately, pensions haven't kept up.

- Many businesses, for competitive and other reasons, continue to reduce their support for retirement plans. Some switch from a defined benefit (DB) plan to a defined contribution (DC) plan that costs less and comes with fewer obligations. Others offer lump-sum cash payments to employees or retirees to settle the employer's obligations.

- Left on their own, many people save less, invest less well, and plan less well. They invest less, they pay higher fees, and they get lower returns.

- Many employees defer retirement, but still don't have enough for retirement — and they're worried. One poll cited by the Senate Health, Education, Labor and Pensions Committee says that 92 percent of people think there is a retirement crisis. They're right to be concerned.

**45% of private workers have an employer-provided retirement plan, often only a DC plan. Most private workers have no plan.**



## WHAT CAN GOVERNMENT DO?

Our workplace retirement system is not provided by government — it's the shared responsibility of companies and individuals. But *government can help* — and at PBGC we're doing our part.

### ***Help Preserve the Plans We Have***

Defined benefit plans still cover over 35 million active workers in private and public sectors. Tens of thousands of companies continue to offer DB pensions. Many would like to continue to do so, and we're trying to help.

Even before troubled companies enter bankruptcy, we work to protect their plans. And when companies enter bankruptcy, we first seek to preserve their plans if possible — as in the case of American Airlines.

We also work with the other ERISA agencies to try to make law and regulations more flexible, so fewer companies feel the need to drop their plans.

### ***Allow More Options and Make Them Easier to Use***

One size does not fit all. Each company's situation is different. Some companies are willing to keep DB plans if they can share risks and costs with their employees; hybrid DB/DC approaches could help. Others would offer lifetime options if they didn't also come with permanent obligations.

In FY 2012, we published a proposed rule helping to clarify rules governing cash balance plans, which would help employers to choose them with confidence. We're working with the other ERISA agencies on these and other ways to increase flexibility and expand options for employers and employees.

There are a variety of proposals to expand retirement security options — some at the federal level and some at the state.

### **Recognize That Retirement Will Cost More, Not Less**

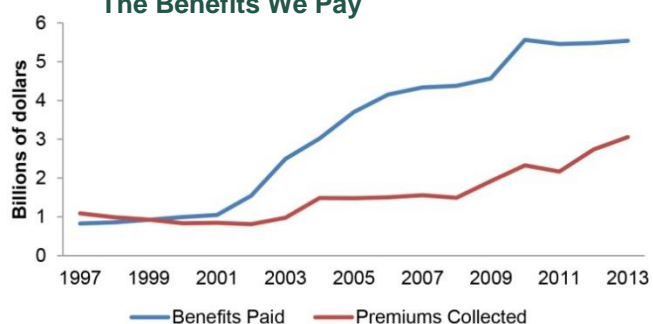
As more Americans age and live longer, healthier lives, both private and public retirement programs will necessarily cost more in the future. We must recognize this, and determine the steps that will be necessary to pay for them. That doesn't mean that employers will write blank checks to pay for everything. They won't. People will have to save more, too, both inside and outside their 401(k) plans.

### **PBGC'S OWN FINANCES MUST BE SOUND, TOO**

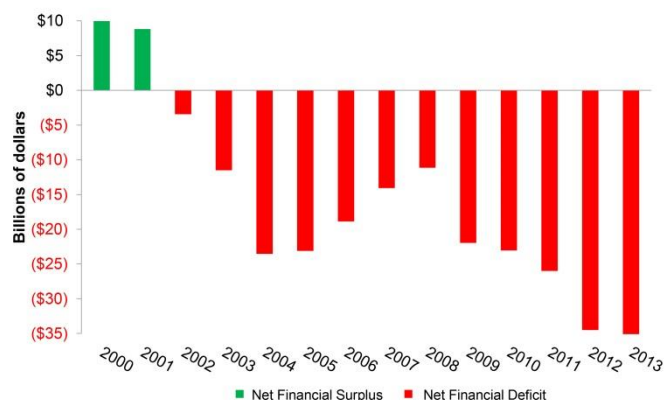
PBGC is funded by assets from trustee plans and premiums from plan sponsors, not by taxpayer dollars. Unfortunately, our premiums are set in law. They're both too inflexible — so that some plans are unfairly paying for the risks of others — and too low to cover PBGC's benefit guarantee levels.

In 2003, the Government Accountability Office added PBGC to its "High Risk" list of agencies, because we control neither the benefits we pay nor the premiums we charge. Congress has repeatedly raised PBGC's premiums, but they remain too low to fund our obligations. That's why, 10 years later, we remain on GAO's High Risk List.

#### **PBGC's Premiums Don't Cover The Benefits We Pay**



#### **PBGC's Deficit Continues to Worsen**



Although PBGC has a net financial deficit, PBGC still has very substantial assets, and the day when we run out of money is years away. We now project that, absent changes, our multiemployer program will be insolvent within 10-15 years. PBGC's projections are consistent with projections made by actuaries of large troubled plans. That date is being moved up by changes in pensions and the room for maneuvering is shrinking every year. Administrations of both parties have proposed putting PBGC finances on the same basis as other government insurance programs and

private insurance, by making PBGC's Board responsible for setting premiums.

Without the tools to set its financial house in order, PBGC may face for the first time the need for taxpayer funds. That's a situation no one wants.

\* \* \*

In 1974, Congress enacted and the President signed ERISA, landmark legislation designed to preserve and enhance retirement security. Over the four decades since, we've seen many changes. The retirement plans of 1974 will not meet the challenges of the 21<sup>st</sup> century. Congress has repeatedly recognized the need to adapt. It must do so again. We hope in the year ahead that Congress will again act to preserve the multiemployer plans on which tens of millions of people depend, and to allow PBGC to raise the funds it needs to protect the millions of pensioners who depend on us.

Much has changed. What has not changed, however, is the nation's desire for a secure retirement. Providing secure retirements remains a national goal. Achieving it will require the collaboration and cooperation of many, both inside and outside of government — employers, employees, pensioners, and their representatives, working with the ERISA agencies and members of Congress in both houses and on both sides of the aisle. The people of PBGC stand ready to help, and look forward to doing so — to find new ways to enhance the security of millions of retirees, and of the millions more who will retire in the future.

A handwritten signature in black ink that reads "Josh Gotbaum". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

Joshua Gotbaum  
Director  
November 15, 2013



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This annual report is prepared to meet applicable legal requirements and is in accordance with and pursuant to the provisions of: the Government Corporation Control Act, 31 U.S.C. section 9106; Circular No. A-11, "Preparation, Submission and Execution of the Budget" Office of Management and Budget, July 26, 2013; and, Circular No. A-136 Revised, "Financial Reporting Requirements," Office of Management and Budget, October 21, 2013. Section 4008 of the Employee Retirement Income Security Act, 29 U.S.C. section 1308, also requires an actuarial report evaluating expected operations and claims, which will be issued as soon as practicable.



# YEAR IN REVIEW



A large, stylized white quotation mark graphic on a light green background.

I can't express how fortunate retirees are having an organization like PBGC helping to secure our future and giving some insurance in a very unpredictable economy [so] we (retirees) can live and maintain a little dignity."

— *Customer comment,*  
*March 2013*

# YEAR IN REVIEW



WHEN A COMPANY FAILS AND ITS PENSION ENDS, WHEN A LIFETIME OF DREAMS SEEMS TO BE CRASHING, PBGC IS THERE AS A SAFETY NET TO CATCH A PERSON, A FAMILY, A COMMUNITY.

WE AT THE PENSION BENEFIT GUARANTY CORPORATION PROTECT MORE THAN 42 MILLION WORKERS AND RETIREES IN PRIVATE DEFINED BENEFIT PENSION PLANS. WE DO THAT BY ENCOURAGING COMPANIES TO KEEP THEIR PLANS, AND BY PAYING BENEFITS WHEN THEY CANNOT.

TO ENHANCE RETIREMENT SECURITY, WE PURSUE THREE OVERARCHING GOALS:

- PRESERVE PLANS AND PROTECT PENSIONERS,
- PAY PENSION BENEFITS ON TIME AND ACCURATELY, AND
- MAINTAIN HIGH STANDARDS OF STEWARDSHIP AND ACCOUNTABILITY

HERE IS OUR MISSION AND OUR OPERATION, HOW WE MEASURE OUR SUCCESS, AND OUR PROGRESS IN ACHIEVING OUR GOALS.

## OUR OPERATIONS IN BRIEF

We administer two insurance programs. Our single-employer program protects about 32 million workers and retirees in about 23,000 pension plans. Our multiemployer program protects about 10 million workers and retirees in about 1,400 pension plans.

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To preserve plans and protect pensioners we:

- Worked with media, Congressional staff, retiree groups, unions, and pension advocacy groups to help thousands to understand the lifetime consequences of accepting pensions as lump sum payments instead of lifetime income annuities.
- Helped to protect 161,000 people by encouraging companies to keep their plans when they emerged from bankruptcy.
- Negotiated \$15 million in financial assurance to protect 5,000 people in plans at risk from corporate transactions.
- Negotiated \$145 million in financial assurance to protect 9,000 people whose companies downsized.
- Continued to help protect 130,000 people in American Airlines' plans, as well as tens of thousands more in other plans in ongoing bankruptcies.

To pay timely and accurate benefits we:

- Assumed responsibility for 57,000 more people in 111 newly failed single-employer plans.
- Started paying benefits to the 14,000 retirees in those plans, on time and without missing a single payment.
- Paid \$5.5 billion to 900,000 retirees in more than 4,600 failed plans (an additional 620,000 workers will receive benefits when they retire).

## **PROMOTING EMPLOYER-PROVIDED RETIREMENT PLANS**

The foundation of our work is encouraging the continuation and maintenance of voluntary private pension plans. From that foundation, we work in these ways:

- We protect pensioners before companies are bankrupt.
- We respond to major shutdowns and layoffs.
- We protect pensioners in bankruptcy.
- We provide the safety net by paying benefits.
- We ensure people receive the law's full protection.

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### ***Helping Preserve Multiemployer Plans***

To support multiemployer plans, we work to keep employers in the pool while also attracting new ones.

We do this by being flexible when plans propose new rules governing employer withdrawal liability. To attract new employers, some plans have limited their liabilities to only those arising while they are in the plan — generally protecting these new employers from legacy liabilities. And to retain existing employers, some plans allow them to pay what they owe for old liabilities and then be treated as new employers for withdrawal liability purposes.

Where employers cannot continue in business and pay current contribution rates, we work with them and the other ERISA agencies to find solutions. We regularly discuss options for troubled plans with plan professionals. For example, if bargaining parties negotiate lower contributions and lower benefits, we may work to broaden the circumstances under which plans may accept such agreements. In addition to extending the life of the plan, we sometimes discuss merging multiemployer plans to improve economies of scale and increase the ratio of active participants to inactive participants.

If all of the contributing employers withdraw, a plan is terminated. When such a case looms, we discuss approaches that will offer maximum recovery by the plan.

We are always available to informally lend our expertise to plan professionals and provide technical assistance on difficult interpretation issues.

### ***Expanding Options to Preserve Plans***

Changing dynamics since ERISA was enacted 40 years ago require creative, flexible options to reflect real-life needs of the employers which sponsor pension plans. That flexibility is essential as, increasingly, companies are seeking ways to transfer risk from their balance sheets.

We recognize that not every company can offer a full-service defined benefit (DB) pension plan. For decades, some employers have been seeking ways to limit costs and risks by passing them on to employees. One way an employer can do so is to replace their DB plan with a defined contribution (DC) plan. There are, however, other ways — such as cash balance plans — that avoid putting all the responsibility and all the risk on the employee.

We're seeking to preserve those DB plans that employers still offer. Some employers with DB plans have told us they would consider hybrid DB options with some features of DC plans as an alternative to freezing their plans. Many expressed frustration with confusing regulations and redundant reporting, so we're making changes in regulations and enforcement actions. Similarly, many who offer DC plans are considering ways to generate the lifetime security of DB plans.

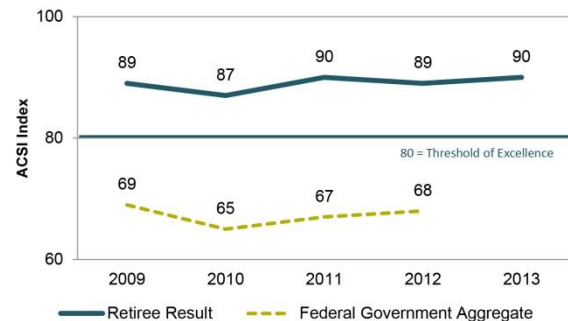
Being ready to offer flexible solutions is imperative. While employers have always had the option to leave the DB system for reasons relating to cost and risk, beginning in 2012 and continuing through FY 2013, employers have gone one step further, offering lump-sum payments even to those who have retired or no longer work for them. When companies offered their retirees one-time lump sums in place of their pensions, we worked with media, congressional staff, retiree groups, unions, and pension advocacy groups to help people understand the lifelong consequences of accepting such an offer.

Educating people about lump sums is a major focus for us. The choice whether to take an annuity providing lifetime income or a lump-sum cash payment has profound consequences for future retirement security. All too often, when lump sums are offered, the lure of a large amount is almost irresistible. Unfortunately, most people make that decision with little understanding of the financial consequences, without consultation with any financial advisor, and frequently without any analysis at all. We are diligent in outlining the potential consequences of a one-time payment without focused consideration of long-term risks and realities in an era where people are living longer after retirement.

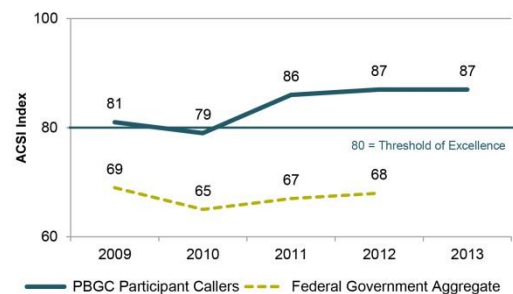
## OUR CUSTOMER FOCUS

PBGC's goals of protecting benefits and encouraging companies to continue to sponsor their plans define our two key customer groups: workers and retirees in insured pension plans and the companies and professionals who maintain those plans. Additionally, as citizens increasingly use the convenience of online government service tools, visitors to our website have become a key customer group. We maintain and build on our tradition of service by regular measurement of customer expectations and perceptions, coupled with focused efforts to use the feedback we receive to make improvements.

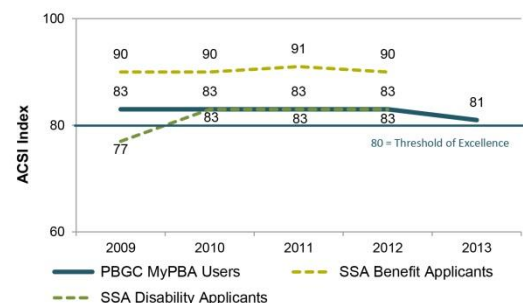
### Retirees Rate PBGC Service Among the Best in Government



### Callers to PBGC Customer Contact Center Continue to Rate Service Highly



### Satisfaction Steady with Improved Online Services



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### ***Strong Customer Satisfaction***

We surveyed each of our constituencies and in every area customer satisfaction remained strong. Our chief measure of customer satisfaction is the survey offered at our website, [pbgc.gov](http://pbgc.gov). Survey feedback is shared daily with all our employees. Customer satisfaction survey targets have been incorporated into our internal awards program.

### ***Highest Worker/Retiree Satisfaction Rate***

Retirees receiving monthly benefits rated us 90 on the American Customer Satisfaction Index (ACSI), more than 20 points above the government average; a score of 80 or higher is considered excellent, whether for a government agency or a private business.

Customers who used our toll-free number, whether retired or still working, rated us 87 with the highest marks offered for the respect shown by our representatives.

Our online application is called My Pension Benefit Account (MyPBA). It allows customers to access forms and information and to perform routine transactions 24 hours a day, 365 days a year. Based on customer feedback, we completely redesigned this system for improved user-friendliness.

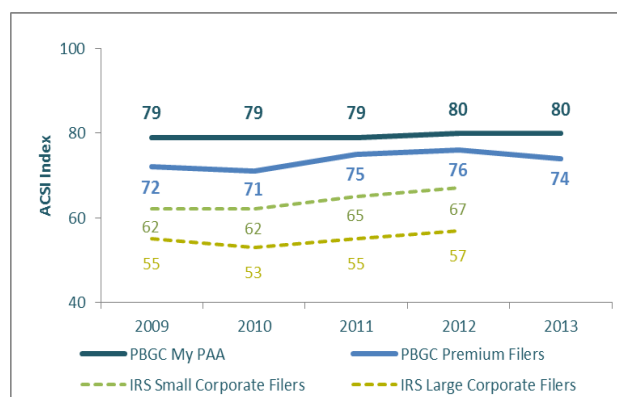
The ACSI rating for MyPBA was a strong 81 in FY 2013, down from 83 in FY 2012.

### ***Satisfaction Remains Strong Among Pension Plan Administrators***

Companies that sponsor defined benefit pension plans must file premiums and reports with us annually and sometimes multiple times per year. Because we regulate and collect money from these employers, maintaining and strengthening their satisfaction is vital.

In FY 2013, the satisfaction score for premium filers was 74. Satisfaction among those using the online premium filing application, My Plan Administration Account (My PAA) was 80.

#### **PBGC's Premium Filing Process and Service Superior to Similar Required Filings**



### ***Reaching Out In New Ways***

In FY 2013, we continued efforts to encourage conversations and collaborations to enhance retirement security. Much of our expanded efforts related to preserving existing pension plans, such as the Director's testimony before Congress on multiemployer plans and before the American Bankruptcy Institute and the ERISA Advisory Council on important technical issues.

We also continue to find ways to increase our transparency and make our resources more accessible to the public. Established in FY 2010, our open government Web page keeps current data of value to the public. We continue to post the [\*\*Pension Insurance Data Tables\*\*](#) online, providing the most recent statistics on the people and plans we protect.



Traffic to our website increased in FY 2013 to about 2.2 million visits compared with 1.6 million visits in FY 2012 — a 38 percent increase. Information about unclaimed pensions was the most reviewed topic. Unclaimed pension stories on *Yahoo!*, *Fox News*, and a mass AARP mailing, prompted several spikes with a 179 percent increase in pbgc.gov traffic. Blog activity drove up visits to the About PBGC section resulting in a 19 percent increase.

Finally, we shared information the old-fashioned way — face to face. In FY 2013, we spoke before 172 audiences, up from 90 in FY 2012, with audiences including pension professionals, plan sponsors, business groups, labor unions, retiree organizations, academics, business reporters and financial professionals.



### ***Listening to Our Customers to Improve our Website***

Many visitors compare our website favorably with leading commercial sites. The way we maintain our standing with users is by listening to what they have to say.

In FY 2013, we made hundreds of customer-recommended improvements to help visitors more easily find information, better understand what they find, and determine sooner whether PBGC is the right organization to help them. We added links in better locations, improved how search terms bring up relevant results, and made FAQs more prominent with clearer content so even first-time visitors could readily understand the information.

In addition, we boosted our social media outreach with expanded use of Facebook, Twitter, and our blog, *Retirement Matters*, using these tools to share information about PBGC as well as the larger picture of American retirement security. And, across all of our online platforms, we became increasingly robust in providing timely and relevant information.

## **BUILDING BETTER WAYS TO DO BUSINESS**

### ***Benefits Administration and Payment Department (BAPD) Vision for the Future***

Our Benefits Administration and Payment Department (BAPD) gets very high scores from our customers, but can and will take advantage of changes in technology and organization to improve.

In FY 2013, we entered a new phase of a multiyear effort to reform our benefits process to ensure the best possible quality, guided in part by an independent consulting firm hired to review our operating practices and to suggest improvements. The changes will continue over the next several years.

PBGC's greatest strength is our skilled team of pension professionals. To best use those skills, BAPD is organizing itself around functional teams of professionals, such as actuaries and auditors. This model will

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allow our skilled employees to develop centers of excellence where more experienced employees can mentor colleagues and work can be shifted seamlessly as needed to produce timely and accurate work products.

In FY 2013, we established our first such team, the Asset Evaluation Division (AED). Now fully operational, AED has developed and begun to use a modernized set of procedures for evaluating pension plan assets. These new procedures give our audit professionals the scope and guidance they need to evaluate the increasingly complex assets that come to PBGC.

In FY 2013, BAPD began sharing its performance data across the operation integrating those metrics into individual plans to better link individual performance with higher-level department goals.

Training is another key element in the new BAPD. All employees will be trained in new skills to keep pace with technology and best practices in benefits administration.

We are working to improve our use of contracted services and also reorganizing the work in our field offices. In FY 2013 we consolidated work in field offices and expect cost savings to be at least \$750,000. We have made great progress in addressing open OIG audit recommendations. The inventory of BAPD's open OIG audit recommendations at September 30, 2013 was 54. Of these, 13 were closed subsequent to that date. As we move forward, we will continue to add efficiency in operations by maintaining a skilled workforce capable of supporting our customers.

### ***Reducing Regulatory Burden***

In 2011, the President issued Executive Order 13563, "Improving Regulation and Regulatory Review," for agencies to give careful consideration to the benefits and costs of regulations. In response, we have focused on making regulations work better to protect people from risk to their pensions — and on eliminating burdens on pension plan sponsors where there is least risk.

In addition, we are responding to the business community's perception that our programs did not focus on risk to the pension insurance system. By focusing on companies that pose real risk, we hope to preserve and encourage companies to continue to offer traditional pensions.

As part of this initiative, in 2013 we published a new proposed rule to exempt financially sound companies and small plans with fewer than 100 people — 90 percent of businesses — from certain reporting requirements. The new proposal follows the same logic: insist on reporting where risk is greatest, and reduce the reporting burden elsewhere.

As a further result of our review, in FY 2013 we began work on a regulation that we expect to publish as a proposed rule in FY 2014 to streamline and reform multiemployer plan notice requirements to continue to reduce reporting requirements on businesses.

### ***Streamlining Premium Payments***

Another new proposal simplifies premium payments. Under that proposal, premiums would be due on the same day in the premium payment year, thus ending the need for plans with 500 or more participants to submit multiple filings; they would pay their flat-rate premium at the same time they pay their variable-rate premium. Plans with fewer than 100 participants already pay premiums once a year; however in response to comments about the difficulty in meeting the required due date, those plans would be able to use prior-year data to calculate and pay variable-rate premiums. Mid-sized plans are not affected by the changes.

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The sponsor and practitioner communities are enthusiastically supporting this proposal.

### ***Improving the Organization***

To further strengthen our management, this year we:

- encouraged the use of metrics to improve organizational performance;
- formed an independent Quality Management Department to foster continuous improvements to our processes and performance;
- increased training requirements for our supervisors, managers, and senior leadership; and
- hired a new Chief Information Officer to fill an important vacancy.

## **PRESERVING PLANS AND PROTECTING PENSIONERS**

Even as the overall economy showed improvements in FY 2013, surveys continued to show public concern about retirement. A recent Gallup poll found that, even among those aged 30-49 and far from retirement, 68 percent are worried or very worried about having enough to retire — more than they are concerned about health care or losing their jobs. Preserving plans and protecting pensioners are critical to American retirement security.

### ***Protecting Pensioners Before Companies are Bankrupt***

We continued to monitor more than 1,500 companies for transactions that could pose significant risks to underfunded plans and to arrange for sponsors to protect those plans. We also investigated those transactions to see if they posed risk to people's pensions, and negotiated agreements to strengthen them if they did. In FY 2013, we opened more than 50 such investigations.

PBGC started litigation to protect the retirement benefits of nearly 13,000 workers and retirees of Saint-Gobain Containers, Inc., a glass container manufacturer, in response to the company's announcement to move its pension obligations to a financially weaker sponsor. The case is pending.

Our most significant agreement, with Smart & Final Holdings, kept the promise to 5,000 employees and retirees.

### ***Responding to Shutdowns and Layoffs***

When companies close a facility, we may step in. A company may owe an additional liability when it ceases operations at a facility. In these circumstances, we can negotiate agreements that protect the plans through additional cash contributions or other means. During FY 2013, we reached settlements with 10 companies for \$145 million to protect almost 9,000 participants. This number decreased from FY 2012 due largely to the successful implementation of our pilot program enforcement approach, which focused on those companies presenting greater risk.

In our pilot program, we're changing how we protect beneficiaries in shutdowns and layoffs. We can require companies to make financial assurance in downsizing actions, typically through additional payments, a letter

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of credit, or other financial guarantees of future pension contributions. In the pilot, we have focused our enforcement of this provision on shutdowns or layoffs that pose a substantial threat to pensions.

The shift in policy exempted financially sound companies such as Anheuser-Busch InBev, Procter & Gamble Co., and Whirlpool Corp., from having to address pension liabilities after ending operations at some of their work sites. In sum, 30 financially sound companies were able to avoid pension costs of about \$475 million.

### ***Protecting Pensioners in Bankruptcy***

We take an active role when a company enters bankruptcy to preserve pension plans when possible and to pursue claims on behalf of the plan participants and the pension insurance program. The number of new bankruptcy cases continued to drop in FY 2013. In each, we have been working to protect the interests of the participants. Examples include:

**American Airlines (AMR)** entered bankruptcy in November 2011 and immediately announced plans to terminate its four pension plans for its 130,000 workers and retirees. In response, PBGC worked with the company, its unions, and other creditors to show AMR that it could afford to maintain its pension plans.

American's plans are underfunded by \$12 billion. In 2012, AMR agreed with us and moved to freeze, rather than terminate, its pension plans. Throughout 2012 and 2013, PBGC worked with unions, the company, and with others in government to help solve many issues.

After **Eastman Kodak Company** entered bankruptcy, PBGC worked as a member of the unsecured creditors' committee to help the company maintain its plans and protect the benefits of workers and retirees. Kodak emerged from bankruptcy with its plans ongoing as of September 3, 2013. The 60,000 people covered by the plans still have their full benefits.

**Tribune Company** entered bankruptcy in December 2008. PBGC worked as a member of the unsecured creditors' committee to help the company maintain its plans and protect the benefits of workers and retirees. Tribune emerged from bankruptcy with all four of its plans ongoing in December 2012. The 36,000 people covered by the plans still have their full benefits.

Other companies that continued their pension plans following a bankruptcy emergence include NewPage Group (13,000 people), Dex Media (10,000 people), and Dynegey Inc. (3,000 people). All eligible individuals will receive the full benefits.

### ***Stepping In, Even When We Don't Have To***

Even when we are not legally required to find solutions, we act to protect retirement income. An example of this proactive effort was working with the Internal Revenue Service to reverse a prior position regarding the payment of pension benefits for more than 800 former employees of the Hospital Center at Orange, in Orange Township, N.J.

Originally, the Hospital's pension plan was covered by ERISA and protected by PBGC. When the hospital became affiliated with Cathedral Healthcare System Inc., the IRS determined its pension plan had become a "Church Plan" — removing it from our protection. Later, after the hospital closed down its operations and let employees go, the IRS agreed to set aside the "Church Plan" designation. That permitted us to step in and cover the pensions. If we had not intervened, benefit payments would have ended. That is what our mission

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includes: being a safety net. One newspaper hailed our work on this issue, saying that PBGC's action was a "triumph of justice."

### ***Protecting People in Standard Terminations***

A company can end a fully funded plan in a standard termination by paying all the benefits it owes with an annuity or another form of payment. In FY 2013, we received 1,481 filings, audited 234 filings, and took enforcement actions that resulted in additional payments of \$3.7 million to 1,539 workers and retirees. We also look for people who may be owed benefits when the plan sponsor cannot locate them.

## **PAYING TIMELY AND ACCURATE BENEFITS**

Although ideally it is always better for companies to keep their own pensions, the harsh reality is some companies and plans fail. When they do, we are there.

PBGC is currently responsible for the current and future pensions of about 1,500,000 people.

In FY 2013, we became responsible for an additional 57,000 workers and retirees in 111 terminated single-employer plans. Some of the largest plans were sponsored by Hawker Beechcraft Corporation, Ormet Aluminum Mill Products Corporation and Journal Register Company.

Crucial to our work is determining the individual benefits owed to each participant. This requires a unique calculation for each participant. Despite the complexity and the significant variation in yearly termination activity, we remain committed to delivering accurate and timely payments and benefit determinations, and to remaining responsive to participants' needs. Our ACSI survey results demonstrate continued excellence in providing clear communications and on-time payments.

### ***When Plans Fail, Benefits Continue Uninterrupted and On Time***

In FY 2013, we stepped in to pay nearly 14,000 retirees who were already receiving monthly checks. All these participants continued to receive their benefits without interruption.

During the year we processed nearly 35,000 new benefit applications, 88 percent of them within 45 days. The 45 days allows us to review applicant documentation, follow up to obtain missing information, and arrange to pay the retiree by the following month.

PBGC paid \$5.4 billion in benefits in FY 2013 to more than 851,000 retirees in single-employer plans. To promote timely payments, we encourage retirees to use direct deposit. Currently, 84 percent of PBGC benefits are paid electronically.

In FY 2013, we also paid \$89 million in financial assistance to 44 multiemployer pension plans covering the benefits of nearly 50,000 retirees. An additional 21,000 people in these plans will receive benefits when they retire. Our payments to insolvent multiemployer plans cover guaranteed benefits and reasonable administrative expenses.

### ***Paying Accurate Benefits***

Determining benefits is a complex process spelled out in Federal law. First, we collect plan, pensioner and plan asset data. Next, we use the data to calculate each participant's benefit according to each pension plan's

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distinct provisions. Then, we apply statutory and regulatory rules to determine how much we can pay. We have issued nearly 406,000 benefit determinations to pensioners since 2009.

It takes time to calculate an accurate benefit and in some cases we have slowed down to compensate for mistakes. For example, in response to an Inspector General's report, we eased our pace to address weaknesses in our processes. The average time to issue a final benefit determination is now four years, up from 3.5 years in FY 2012. We have nearly 269,000 people in our inventory who are due a final benefit determination.

In FY 2014, our average time to issue final benefit determinations is expected to rise as we tackle plans that are older and more complex. For instance, we are now working to complete benefit determinations for the pension plans of the Delphi Corporation, the second largest case in PBGC history. The Delphi Plans have presented unusual challenges in data collection, benefit structure and asset evaluation.

We also continue to address issues when problems arise. In FY 2013, we identified 15 plans that will require further review. For these plans, we have hired an independent certified public accounting firm to, as necessary, review and recalculate the plan asset evaluations.

In FY 2013, we issued 79,000 final benefit determination letters. Equally important, before we make a final benefit determination we pay estimated benefits to retirees. In FY 2013, 95 percent of the final benefit amounts were within 10 percent of the estimated amount.

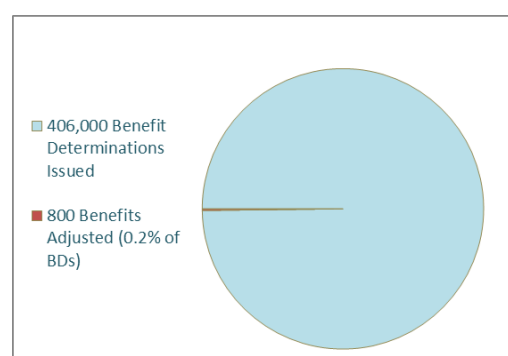
In completing the rework on the U.S. Airways plans, we reviewed the asset evaluations and calculated new benefits. In this case, we determined that the slight change in assets for the four plans did not have any impact on the benefits of plan participants. As a result, participant benefits remained unchanged.

### ***Reviews and Appeals***

The benefits we are allowed to pay under the law can be very different from those promised in a plan. That difference sometimes spurs appeals of our benefit determinations. Since 2009, we have issued nearly 406,000 benefit determinations. Only 1 percent were appealed and only 800 (0.2%) required a change.

The Appeals Board recently completed the largest consolidated appeal in our history, with nearly 1,500 airline pilot appellants raising 13 distinct issues in 2,000 pages of appeal documents. The issues were highly complex and technical yet only one error that affected six people was found. More information about the [Delta Pilots Retirement Plan](#) is posted on our website.

### **Few Determinations are Appealed Even Fewer are Changed**



## **MAINTAINING HIGH STANDARDS OF STEWARDSHIP AND ACCOUNTABILITY**

As a financial institution with responsibility for more than 42 million people and obligations of about \$120 billion, it is essential that we do our work in a way that maintains the trust of our customers and the public.



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Our employees hold themselves — and each other — to high standards of professionalism, accountability, and ethics. Our programs reinforce this culture.

***Accountability: Measuring and Monitoring Performance***

PBGC relies on a wide range of performance measures to measure how well we do our jobs and serve our customers. We measure how quickly and seamlessly we start paying retirees new to our system, how accurately we calculate their benefits and how well we invest assets from trusteed plans. We ask our customers directly about how well we serve them, using their feedback to improve our services.

In FY 2013, we worked to ensure that employees are serving each other well so that we can continue to meet our external customer service goals. This year our leadership continued to hold quarterly reviews to discuss our progress in five key areas:

- Pre-Trustee Operations
- Post-Trustee Operations
- Customer Satisfaction
- Model Workplace
- Stewardship and Accountability

To emphasize the importance of our quarterly performance data, we make it available to all employees. Additionally our leaders took steps to strengthen our performance culture by setting goals and priorities for fiscal years 2014 to 2018.

These steps improve our strategic use of performance data in planning, operations, and decision-making. We ensure the performance report is complete and the data contained within it is reliable.

Table 1 provides a summary of our FY 2013 key activities and performance data.



TABLE 1: SUMMARY OF PBGC MEASURES AND ACTIVITIES

	Target	2013	2012
<b>Preserve Plans and Protect Pensioners</b>			
People Protected in Plans Emerging from Bankruptcy <sup>1</sup>		<b>161,000</b>	33,000
Standard Termination Audits: Additional Payments		<b>\$3.7 M to 1,539 people</b>	\$3 M to 454 people
<b>Pay Timely and Accurate Benefits</b>			
People Receiving Benefits – Single-Employer		<b>851,000</b>	836,000
People to Receive Benefits in Future – Single-Employer		<b>596,000</b>	593,000
People Receiving Benefits – Multiemployer		<b>50,000</b>	51,000
People to Receive Benefits in Future – Multiemployer		<b>21,000</b>	21,000
New Retiree On-time Payments	100%	<b>100%</b>	100%
Estimated Benefits Within 10 percent of Final Calculation	95%	<b>96%</b>	95%
Average Time to Provide Benefit Determinations (years)	3.0	<b>4.0</b>	3.5
Improper Payment Rates within OMB Threshold <sup>2</sup>	<2.5%	<b>Yes</b>	Yes
Applications Processed in 45 days	87%	<b>88%</b>	90%
<b>Maintain High Standards of Stewardship and Accountability</b>			
Retiree Satisfaction – ACSI <sup>3</sup>	85	<b>90</b>	89
Caller Satisfaction – ACSI	81	<b>87</b>	87
Premium Filer Satisfaction – ACSI	72	<b>74</b>	76
Overall Customer Satisfaction – ACSI <sup>4</sup>	72	<b>71</b>	72
Contract Awards Fully Competed		<b>86%</b>	89%
Financial Surplus (Deficit) - Single-Employer		<b>(\$27.4 B)</b>	(\$29.1 B)
Financial Surplus (Deficit) - Multiemployer		<b>(\$8.3 B)</b>	(\$5.2 B)
“Clean” (Unqualified) Audit Opinion	Yes	<b>Yes</b>	Yes

<sup>1</sup> 2012 and 2013 do not include 130,000 people we helped protect in American Airlines and tens of thousands more in other plans in ongoing bankruptcies.

<sup>2</sup> OMB's threshold for improper payment reporting is 2.5% of total payments and more than \$10 million, or an amount more than \$100 million. See page 97 for more details.

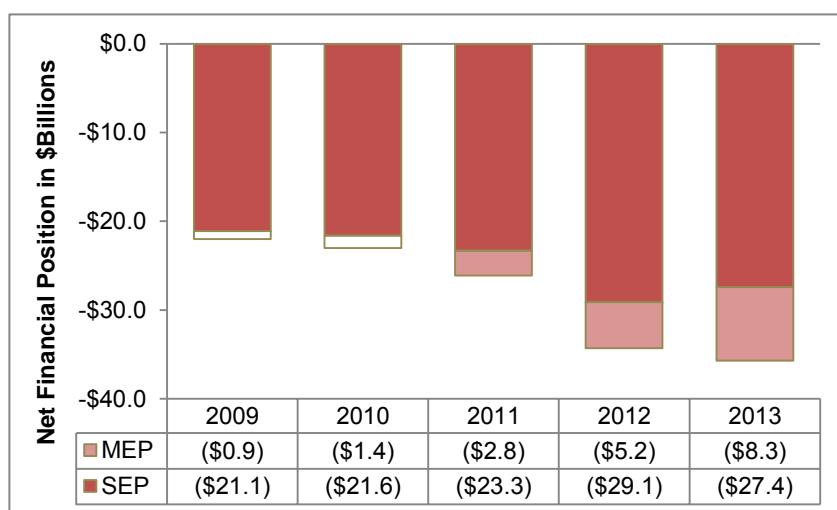
<sup>3</sup> The American Customer Satisfaction Index (ACSI) uses a 0-100 scale; 80 or above is considered excellent.

<sup>4</sup> Measures customer satisfaction with information and services provided by the agency.

## Financial Net Position

Our financial position remains in deficit for both single-employer and multiemployer programs. The primary reason is that premiums established by Congress that we are permitted to charge are inadequate to cover the benefits that, by law, we insure. Our programs remain on the Government Accountability Office's High Risk List with a net accumulated financial deficit of \$36 billion in FY 2013. The Administration again proposed risk-related premiums for PBGC in its 2014 budget. The proposal authorizes the PBGC Board to adjust premiums to better account for the risk the agency is insuring and make the premium structure fair to all premium payers. Absent changes, eventually we will have insufficient funds to pay benefits.

## Net Financial Position of Single-Employer and Multiemployer Insurance Programs



## Financial Soundness and Financial Integrity

The substance and the quality of the accounting of our finances are of critical importance to employers, employees and retirees. We are responsible for insuring the pensions of tens of millions of participants and their pension benefits valued at hundreds of billions of dollars. In addition to collecting premiums, exercising care in management of about \$85 billion in assets, and attaining our 21st consecutive unqualified audit opinion on PBGC's financial statements, we maintained our focus on improving management in a number of areas as outlined below.

## Collecting Premiums

Employers pay premiums to insure their defined benefit pension plans in both the single-employer and multiemployer programs. In 2012, Congress passed legislation that increases PBGC premiums, both single-employer and multiemployer, for plan year 2013 and thereafter. For the first time, the single-employer variable-rate premium is indexed. In FY 2013, we collected \$3.2 billion in premiums.

## Investing Prudently

Our investment assets are administered by private investment management firms, subject to our investment policy and our rigorous oversight procedures. Our procedures for internal controls, due diligence, and risk management are subject to periodic review. Regular communication with management firms enables us to stay updated on matters affecting our investment program, including the agency's portfolio, the portfolio's performance, and firm changes.

TABLE 2: FY 2013 INVESTMENT RETURNS VERSUS BENCHMARKS

	1-Year Period	3-Year Period	5-Year Period
<b>Total Fund Composite</b>	<b>2.6%</b>	<b>6.7%</b>	<b>9.0%</b>
<b>Total Fund Benchmark<sup>1</sup></b>	<b>2.1%</b>	<b>6.3%</b>	<b>8.2%</b>
<b>ERISA Benchmark<sup>2</sup></b>	<b>10.7%</b>	<b>11.2%</b>	<b>9.2%</b>
Total Global Bonds	-4.1%	4.4%	8.6%
Total Global Bonds Benchmark <sup>3</sup>	-4.6%	3.9%	7.4%
Total Global Public Stock	18.8%	11.3%	8.4%
Total Global Public Stock Benchmark <sup>4</sup>	18.4%	11.2%	8.1%

<sup>1</sup> The Total Fund Benchmark is a dynamic weighted benchmark based upon the weights of the Total Global Public Stock Benchmark, the Total Global Bonds Benchmark, and cash benchmarks. This benchmark is used to compare against the Total Fund Composite returns shown above.

<sup>2</sup> ERISA, as amended by the Pension Protection Act of 2006, prescribes a benchmark under which funds are invested 60% equity and 40% fixed income securities. See page 46 for a description of this reporting requirement.

<sup>3</sup> The Total Global Bonds Benchmark is a dynamic weighted benchmark based upon the weights of all bond managers and the returns of their respective benchmarks.

<sup>4</sup> The Total Global Public Stock Benchmark is a dynamic weighted benchmark based upon the weights of the Total U.S. Public Stock composite and the Total International Public Stock composite benchmarks.

### ***Strengthening Internal Controls***

We continue to work to strengthen our internal financial controls. There is nothing more essential for a financial institution that handles billions of dollars annually.

The Internal Control Committee (ICC) provides oversight and accountability for the internal controls program. Chaired by the Chief Financial Officer (CFO), the committee uses expertise from representatives throughout PBGC to manage corporate risk. Each year, we conduct an entity-wide risk assessment to support strategic planning and help improve controls across the corporation. Another key committee focus is ensuring that we take corrective action to address material weaknesses noted during our financial statement audit and agreed-upon recommendations, from both the Government Accountability Office and our Office of Inspector General (OIG).

We continue to make progress addressing the material weaknesses cited by our OIG and its external auditors, CliftonLarsonAllen LLP, in prior reports, targeting entity-wide security program planning and management, access controls and configuration management, and BAPD management and oversight.

This year, a new Chief Information Officer was hired to oversee Office of Information Technology (OIT) operations and to support implementation of the enterprise-wide corrective action plan. With his oversight, OIT implemented a number of improvements intended to address recommendations relating to the material weaknesses.

BAPD has reworked its plan asset evaluation policies and procedures, awarded plan asset support services and technical advisory contracts, trained BAPD auditors, managers, and support contractors and hired new

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plan asset valuation specialists, updated documentation and record retention processes, and incorporated new accountability language into performance management plans. With regard to system integration, we continue to build on progress made in past years, including the implementation of the Trust Accounting System during FY 2013. With the launch of the Premium and Practitioner System scheduled for FY 2014, PBGC anticipates this significant deficiency will be fully addressed.

PBGC also works actively both to detect and prevent improper payments. As part of our anti-fraud program, we use data analytics to regularly monitor outgoing payments and to identify payment anomalies to help detect and prevent erroneous payments. We also issue quarterly messages to agency staff to promote fraud awareness and encourage them to use the OIG's fraud hotline. We again reviewed our payment process and concluded that payments to contracting firms that provide PBGC goods and services were not susceptible to significant improper payments. We will assess benefit payments and other payment streams on a rotational basis in the coming years.

We also are participating in the Office of Management and Budget's Do-Not-Pay database initiative to electronically match our outgoing payments streams with lists of ineligible parties (e.g., deceased participants, contractors that have been barred from receiving federal contract awards) to help prevent or detect improper payments. In FY 2013, we worked with the Social Security Administration to use its Death Master File – the best source of its kind – as an additional control in helping to prevent improper payments. Our Procurement Department (PD) made significant progress towards closing out completed contracts and deobligating unliquidated funds. PD also contracted with an independent public accounting firm to audit cost-reimbursable contracts as mandated by the Federal Acquisition Regulation to determine whether the amounts invoiced were appropriately documented and in compliance with the contract terms and conditions.

These and other related control activities promote a strong control environment and help undergird the agency's Statement of Assurance under the Federal Managers Financial Integrity Act (FMFIA) provided later in this report.

## **MAINTAINING OUR QUALITY TEAM**

PBGC's performance is dependent on the coordinated actions of hundreds of very high quality professionals possessing skills in actuarial science, accounting, finance, and law. We have long been regarded as a good place to work — and we work to keep it that way.

### ***Strengthening Our Workforce and Leadership***

All supervisors, managers and Senior Level personnel are now required to take 32 hours of training and development. We used various learning methods, such as Harvard On-line, Harvard Simulations, The Center for Creative Leadership Webinars, classroom training and other learning events to offer managers numerous opportunities to successfully complete their requirements.

### ***Broadening Recruitment***

Late this fiscal year, PBGC initiated an automated recruitment process that allows applicants to rate themselves for vacant positions, eliminates Subject Matter Expert review and expedites the receipt of the Selection Certificates to the hiring manager. We succeeded in reducing the time to hire, on average, even though there were more applications per announcement with the automated process. From April to June, the

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time it took to hire new employees was reduced from 125 days using a manual process to 90 days using a new automated process, a time savings of 35 days.

### ***Performance Management***

Throughout FY 2013, we provided one-on-one assistance to managers and staff on writing performance plans, preparing for performance discussions, and many other performance-related matters. Our performance management training curriculum was recognized by the Office of Personnel Management (OPM) as a model program. OPM referred several agencies to PBGC to obtain information on our best practices. In addition, OPM also recognized our Senior Level program as a model for the federal government.

We reinforced the importance of employee performance evaluations through vigorous promotion in the last two months of the performance cycle. In addition, we introduced the first annual performance management day, allowing employees time to draft performance plans and self-evaluations. Employee feedback was overwhelmingly positive.

### ***Promoting Labor Partnerships, Cultural Diversity, Inclusion and Equal Employment Opportunity***

We take our labor obligations and commitments to equal employment opportunity seriously. They are an important part of our human capital strategy. To foster a positive work environment, this year we engaged in the following activities and monitored the following outcomes.

In August 2012, we took the first steps toward contract negotiations with our union. To date, no agreement has been reached. However, we did reach agreement on a more robust corporate-wide Reasonable Accommodation program. We also invited our union to participate in a labor-management forum to discuss workplace challenges and to develop joint solutions. To date, they have not accepted. In FY 2013, the union filed 21 unfair labor practice (ULP) charges against PBGC. Seven of these charges did not result in formal complaints by the Federal Labor Relations Authority (FLRA): five were dismissed and two were withdrawn. The FLRA issued one complaint against PBGC that is now in mediation. The remaining ULPs are pending.

To promote a culture of Diversity, Inclusion and Equal Opportunity, our new employees took Equal Employment Opportunity (EEO) training upon arrival and all supervisors were required to receive training on diversity, inclusion, and equal opportunity principles. We placed emphasis on enhancing communication skills in a diverse workplace and on retaining more persons with disabilities, especially veterans.

We continued to expand equal employment opportunity training initiatives. We offered Equal Employment Opportunity Commission (EEOC) Management Directive 715 and barrier analysis courses taught by EEOC professionals. Federal Mediation and Conciliation Service provided quarterly conflict resolution training sessions for managers and employees. Also, PBGC departments worked collaboratively to: (1) select and provide agency-wide diversity training; (2) submit and update EEO prevention of workplace harassment policy statements; (3) establish new supervisory and senior level performance elements for diversity and inclusion; (4) develop a Diversity Council framework; and (5) file timely annual reports with the EEOC.

In FY 2013, 30 informal EEO counselings were initiated and less than half resulted in formal complaints. This represents a five-year low in the number of informal counselings that resulted in formal complaints. Also, as a part of our continuing efforts to foster a discrimination-free work environment, in FY 2013 we updated our policy statement.

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## IMPROVING KEY AREAS

### ***Strengthening E-Government and Information Technology***

To address the findings of weaknesses in our information technology (IT) security, we brought in new leadership to galvanize and implement needed changes while enhancing performance of other operations. That new leadership is developing our long-term IT strategic plan – due in 2014 - that will examine cyber/IT security, cloud computing, shared services, customer service, social collaboration, mobility and strengthening the IT workforce.

During FY 2013 we worked to improve the infrastructure by upgrading hardware and software, building more network capacity, and addressing security-related weaknesses. This included making a complete change in our IT infrastructure support contractor with minimal operational impact to our users.

In FY 2013, we began acquiring services from other federal agencies and commercial service providers in support of the President's Digital Government Strategy and Open Government Directive.

### ***Federal Contracting and Acquisition***

Overseeing contractors is challenging. As in other areas, we have recruited new leadership to advance efforts to mitigate contract management risk. Under new management we:

- reorganized the Procurement Department to enhance efficiency, training, and compliance;
- expanded our training to focus on the certification of Contracting Officers and Contracting Officer Representatives (CORs);
- strengthened our internal controls to ensure that we receive quality goods and services;
- employed commercial off-the-shelf software to streamline the source selection process; and
- fully competed 86 percent of our contract spending, while 40 percent of our contracts were performance based.

### ***Promoting Green Practices***

In FY 2013, we updated our strategic sustainability plan, which outlines initiatives – such as robust recycling, mass transit, and telework. Additionally, hands-free devices were installed in all the restrooms at the headquarters facility.

### ***Ethical Practices***

Because we are both a government agency and a financial institution with the responsibility for the pension funds of people who find themselves in precarious situations, we must conduct ourselves with the highest ethical standards.

All managers and financial disclosure filers were given a guide on fiscal, and ethics training for PBGC managers. We continued our computer-based ethics training for financial disclosures filers, ethics, and social media, along with other topics. We updated technology and made significant progress improving transparency

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by making records available to the public online, and conforming to recent amendments to the Freedom of Information Act (FOIA) and open government policies.

## **INDEPENDENT EVALUATION OF PBGC PROGRAMS**

In FY 2013, we reviewed our regulations, the services we provided to customers, and how we conducted our operations to improve our benefit administration practices. We bolstered these reviews by actively engaging several independent views.

### ***American Customer Satisfaction Index***

We use ACSI survey methodology to get non-governmental third-party evaluation of our services. Because the ACSI is a recognized standard throughout government and industry, we can compare ourselves to how others perform and gauge the effectiveness of efforts to improve our customers' experiences. We use the information gained from these evaluations to help us strengthen our program operations.

### ***Office of Inspector General***

The Office of Inspector General plays an active oversight role at PBGC and helps to promote a culture of accountability and process improvement. In FY 2013 OIG completed the annual financial statement audit and a statutory review of our compliance with improper payment reporting requirements established by OMB. The OIG concluded we had instituted a systematic method to review our programs and activities for risk of improper payments and complied with improper payment implementing requirements.

The OIG also issued two reports, one on PBGC compliance with the Federal Information Security Management Act (FISMA), and one on PBGC's ability to prevent and detect attempts to penetrate PBGC's computer network. Both reports cited progress since prior reviews, but indicated additional work was required. We agreed to implement improvements in response to new findings.

PBGC also made progress in regard to completing audit follow-up actions on a significant number of open audit recommendations. As of the end of the fiscal year, the agency had submitted documentation to close 78 audit recommendations. The OIG has made decisions on 47, closing 30 and requesting further documentation on 17. We have plans in place to make significant progress on the remaining open recommendations in the coming year.

### ***Government Accountability Office***

GAO continues to include PBGC's single-employer and multiemployer insurance programs among its High-Risk series of 30 government programs because of long-term structural challenges relating to plan sponsor funding of defined benefit pension plans and the limited tools available to address PBGC's long-term financial stability. GAO completed two reviews that relate to these issues:

- In the report "Redesigned Premium Structure Could Better Align Rates with Risk from Plan Sponsors" (GAO-13-58), GAO concluded our premiums do not reflect the agency's risk from individual plans and sponsors. It recommended that Congress consider changes to PBGC's premium structure.
- GAO also studied multiemployer pension plan funding as part of "Timely Action Needed to Address Impending Multiemployer Plan Insolvencies" (GAO-13-240). GAO noted that our financial assistance



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payments to eligible multiemployer plans had increased significantly since 2009 and that plan insolvencies threaten PBGC's multiemployer insurance fund's ability to pay pension guarantees for retirees. GAO recommended that Congress consider comprehensive and balanced structural reforms to reinforce and stabilize the multiemployer system.

During the year, PBGC also completed corrective actions on a number of GAO recommendations, and looks forward to GAO's review of those steps. Visit [www.gao.gov](http://www.gao.gov) for more information about GAO.

### ***Participant and Plan Sponsor Advocate***

The Board of Directors selected a Participant and Plan Sponsor Advocate in September. This important new position was created by the Moving Ahead for Progress in the 21<sup>st</sup> Century Act of 2012. The Advocate will serve as a liaison for plan sponsors and participants, and help to resolve disputes between the PBGC and the pension community.

### ***NAPA Review of PBGC Governance***


The National Academy of Public Administration (NAPA) issued a report to Congress on PBGC's governance in late September 2013. The report was required by the Moving Ahead for Progress in the 21<sup>st</sup> Century Act of 2012. The report recommends changes to PBGC's governance and the responsibilities of the Director.

### ***Peer Review of Pension Insurance Modeling System (PIMS)***

The PIMS models inform PBGC leadership on important aspects of insurance program design. Peer review is an important part of how we improve our modeling efforts. As such, we periodically ask outside entities like Buck Consultants to review PIMS. This year, as mandated by Congress, the Social Security Administration (SSA) initiated an independent review by a team of researchers affiliated with the National Bureau of Economic Research (NBER) and the Brookings Institution. The review provides a number of recommendations regarding system governance as well as observations that could be used to guide future revisions to the models. We appreciate the diligence and insights of NBER and Brookings. The detailed report was issued in late September 2013, and we are considering our next steps. In addition to that review, this year, we also asked the Pension Research Council of the Wharton School at the University of Pennsylvania to review PIMS. The reviewers noted the importance and value of PIMS models in forecasting our liability risk stating that "there is no other model that can do a comparable job." This review also provided recommendations for improvements to our modeling approach.

FINANCES





As of September 30, 2013, the single-employer and multiemployer programs reported deficits of \$27.4 Billion and \$8.3 Billion, respectively. Notwithstanding these deficits, the corporation has approximately \$83.2 Billion in single-employer assets and \$1.7 Billion in multiemployer assets and will be able to meet its obligations for a significant number of years. However, neither program at present has the resources to fully satisfy PBGC'S obligations in future years.

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## FISCAL YEAR 2013 FINANCIAL STATEMENT HIGHLIGHTS

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation established under the Employee Retirement Income Security Act (ERISA) of 1974, as amended. It guarantees payment of basic pension benefits earned by more than 42 million of America's workers and retirees participating in nearly 25,000 private-sector defined benefit pension plans. The Corporation 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 trusted by PBGC, and recoveries from the companies formerly responsible for the plans.

### FINANCIAL POSITION

- PBGC's combined financial position declined by \$1,260 million, increasing the deficit to \$35,639 million as of September 30, 2013, from \$34,379 million as of September 30, 2012.
- The single-employer program's net position increased by \$1,761 million, decreasing the program's deficit to \$27,381 million.
- The multiemployer program's net position declined by \$3,021 million, increasing its deficit to \$8,258 million, an all-time record high for the multiemployer program.
- Pension liability valuation interest factors decreased by 3 basis points to 3.25% at September 30, 2013, from 3.28% at September 30, 2012. This resulted in a combined increase of \$69 million in actuarial charges due to a change in interest factors. The combined actuarial charges for expected interest on accrued liabilities amounted to \$3,432 million, and represents a \$549 million decrease from the prior fiscal year.
- The primary factors in the single-employer program's net income included \$2,981 million in net premium income and other income, \$2,741 million in investment income, and a credit of \$401 million from actuarial adjustments. These factors were offset by \$3,388 million in charges due to expected interest on accrued liabilities, \$468 million in losses from completed and probable terminations, \$439 million of administrative, investment, and other expenses, and a charge of \$67 million due to a reduction in interest factors (this represents a \$10,651 million decrease from the prior fiscal year).
- The primary reasons for the \$3,021 million increase in the multiemployer program's deficit included \$2,969 million in financial assistance losses from probable plans and insolvent plans, \$96 million in investment losses, a charge of \$44 million due to expected interest on accrued liabilities, administrative expenses of \$25 million, a charge of \$2 million due to a reduction of interest factors, offset by \$110 million in net premium income and a credit of \$5 million in actuarial adjustments. The losses from financial assistance were due to the decrease in interest factors and the net increase of 22 new plans to the multiemployer probables inventory (see Note 7).

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## OPERATIONS

- PBGC's combined benefit payments for participants were \$5,538 million in FY 2013 and \$5,479 million in FY 2012.
- Combined net premium income increased by \$319 million to \$3,053 million compared to FY 2012 premium income of \$2,734 million. The flat-rate premium generated income of \$1,385 million and the Variable-Rate Premium (VRP) income was \$1,580 million.
- PBGC's portfolio achieved a return on investment of 2.6% which is below the ERISA/Pension Protection Act (PPA) hypothetical portfolio benchmark return of 10.7%, but above the benchmark PBGC uses to conform with its investment policy (Total Fund Benchmark return of 2.1%).
- During FY 2013, PBGC assumed responsibility for approximately 57,000 participants in 111 underfunded single-employer plans that were terminated. Because of PBGC's previous efforts to evaluate its exposure to probable terminations, \$492 million of the net claims for these plans were already reflected in PBGC's FY 2012 results. These 111 plans had an average funded ratio of about 56%. Their terminations resulted in an aggregate net loss to PBGC of \$1,879 million (see Note 12).
- Two single-employer plans with underfunding of \$352 million were newly classified as probable terminations in FY 2013 and this represents PBGC's total single-employer probable inventory. Probable terminations represent PBGC's best estimate of claims for plans that are likely to terminate in a future year.
- The present value of nonrecoverable future financial assistance of \$9,931 million consists of 44 insolvent plans (\$1,352 million), 65 terminated plans not yet insolvent but probable (\$1,895 million), and 64 ongoing plans which are projected to exhaust plan assets within 10 years and are classified as probable (\$6,684 million) (see Note 7).

## ESTIMATES OF REASONABLY POSSIBLE CONTINGENCIES

- At fiscal year-end, PBGC's estimate of its single-employer reasonably possible exposure totaled about \$292,207 million, a decrease compared to FY 2012 of \$294,963 million.
- PBGC's estimate of its multiemployer reasonably possible exposure increased to \$36,718 million in FY 2013, a \$9,909 million increase over the \$26,809 million in FY 2012. The increase was due primarily to the addition of 28 new plans to the reasonably possible list.

## KEY SINGLE-EMPLOYER AND MULTIEMPLOYER RESULTS

<i>(Dollars in millions)</i>	FY 2013	FY 2012
<b>Insurance Activity</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Benefits Paid	\$ 5,449	\$ 5,384
Financial Assistance Paid	\$ 89	\$ 95
Retirees Receiving Benefits (at end of year)	849,000	832,000
Total Participants Receiving or Owed Benefits (at end of year)	1,503,000	1,488,000
New Underfunded Terminations	111	155
Terminated/Trusteed Plans (Cumulative)	4,567	4,456
Plans That Have Received Financial Assistance	44	49
<b>Summary of Operations</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Premium Income, Net	\$ 3,053	\$ 2,734
Losses from Completed and Probable Terminations	\$ 468	\$ 2,006
Losses from Financial Assistance	\$ 2,969	\$ 2,466
Investment Income	\$ 2,645	\$ 8,883
Actuarial Charges and Adjustments	\$ 3,095	\$ 15,038
<b>Financial Position</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Total Assets	\$ 84,946	\$ 84,780
Total Liabilities	\$ 120,585	\$ 119,159
Net Income (Loss)	\$ (1,260)	\$ (8,343)
Net Position	\$ (35,639)	\$ (34,379)
SINGLE-EMPLOYER PROGRAM		
Total Assets	\$ 83,227	\$ 82,973
Total Liabilities	\$ 110,608	\$ 112,115
Net Income (Loss)	\$ 1,761	\$ (5,876)
Net Position	\$ (27,381)	\$ (29,142)
MULTIEMPLOYER PROGRAM		
Total Assets	\$ 1,719	\$ 1,807
Total Liabilities	\$ 9,977	\$ 7,044
Net Income (Loss)	\$ (3,021)	\$ (2,467)
Net Position	\$ (8,258)	\$ (5,237)

## FINANCIAL SUMMARY—SINGLE-EMPLOYER PROGRAM

(Dollars in millions)		Fiscal Year Ended September 30,									
		2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Insurance Activity:											
Benefits paid	\$	5,449	5,384	5,340	5,467	4,478	4,292	4,266	4,082	3,685	3,006
Participants receiving monthly benefits at end of year *		799,210	781,160	775,300	747,530	743,610	640,070	631,130	612,630	682,540	517,900
Plans trustee and pending trusteeship by PBGC		4,557	4,446**	4,292	4,140	3,993	3,850	3,783	3,673	3,585	3,469
Summary of Operations:											
Premium income, net ***	\$	2,943	2,642	2,072	2,231	1,822	1,340	1,476	1,442	1,451	1,458
Other income	\$	38	13	17	30	16	23	55	79	44	24
Investment income (loss)	\$	2,741	8,792	3,446	7,594	6,330	(4,164)	4,737	2,184	3,897	3,197
Actuarial charges and adjustments (credits)	\$	3,054	14,874	6,561	9,421	13,901	(4,813)	346	4,819	490	1,787
Losses (credits) from completed and probable terminations	\$	468	2,006	201	509	4,234	(826)	399	(6,155)	3,954	14,707
Administrative and investment expenses	\$	434	443	424	449	417	400	378	405	342	288
Other expenses	\$	5	0	21	(7)	15	5	114	2	77	(36)
Net income (loss)	\$	1,761	(5,876)	(1,672)	(517)	(10,399)	2,433	5,031	4,634	529	(12,067)
Summary of Financial Position:											
Cash and investments	\$	77,881	76,941	71,292	69,150	62,062	51,722	61,122	57,728	54,387	36,254
Total assets	\$	83,227	82,973	78,960	77,463	68,736	64,612	67,241	59,972	56,470	38,993
Present value of future benefits	\$	105,018	105,635	92,953	90,022	83,035	59,996	69,235	69,143	69,737	60,836
Net position	\$	(27,381)	(29,142)	(23,266)	(21,594)	(21,077)	(10,678)	(13,111)	(18,142)	(22,776)	(23,305)

\* This measure may differ from yearly performance numbers reported in PBGC's Year In Review, which also include participants whose benefit payments ended during the year (for example, due to death or a final lump-sum payout).

\*\* A plan that had terminated in FY 2012 was subsequently removed from the plan termination inventory in FY 2013.

\*\*\* Beginning in FY 2009, PBGC started to reflect premium income net of bad debt expense for premium, interest and penalties.



## FINANCIAL SUMMARY—MULTIEMPLOYER PROGRAM

(Dollars in millions)	Fiscal Year Ended September 30,									
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
<b>Insurance Activity:</b>										
Financial assistance paid	\$ 89	95	115	97	86	85	71	70	14	10
Plans that have received financial assistance	44	49	49	50	43	42	36	33	29	27
<b>Summary of Operations:</b>										
Premium Income, net *	\$ 110	92	92	93	95	90	81	58	26	27
Other income	\$ 0	0	0	0	2	0	0	0	0	0
Investment income (loss)	\$ (96)	91	148	183	121	121	23	(1)	79	54
Actuarial charges and adjustments (credits)	\$ 41	164	99	0	0	(1)	0	0	0	1
Losses (gains) from insolvent and probable plans - financial assistance	\$ 2,969	2,466	1,461	831	614	(271)	319	461	204	55
Administrative and investment expenses	\$ 25	20	14	12	0	0	0	0	0	0
Net income (loss)	\$ (3,021)	(2,467)	(1,334)	(567)	(396)	482	(216)	(404)	(99)	25
<b>Summary of Financial Position:</b>										
Cash and investments	\$ 1,715	1,804	1,725	1,613	1,441	1,318	1,196	1,164	1,147	1,057
Total assets	\$ 1,719	1,807	1,739	1,628	1,459	1,327	1,197	1,166	1,160	1,070
Present value of future benefits	\$ 0	1	1	1	1	1	2	2	2	3
Nonrecoverable future financial assistance, present value	\$ 9,931	7,010	4,475	3,030	2,296	1,768	2,124	1,876	1,485	1,295
Net position	\$ (8,258)	(5,237)	(2,770)	(1,436)	(869)	(473)	(955)	(739)	(335)	(236)

\* Beginning in FY 2009, PBGC started to reflect premium income net of bad debt expense for premium, interest and penalties.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL POSITION

### I. INTRODUCTION

PBGC management believes its discussion and analysis of our financial statements and other statistical data will help all interested parties and readers better understand our financial condition and results of operations. Readers should consider this material in conjunction with the Year In Review section (i.e., PBGC's Annual Performance Report) on page 4, the financial statements beginning on page 53, and the accompanying notes beginning on page 57.

### II. FINANCIAL AND PROGRAM RISKS

As of September 30, 2013, the single-employer and multiemployer programs reported deficits of \$27,381 million and \$8,258 million, respectively. Notwithstanding these deficits, the Corporation has about \$83,227 million in single-employer assets and \$1,719 million in multiemployer assets and will be able to meet its obligations for a significant number of years. However, neither program at present has the resources to fully satisfy PBGC's obligations in future years.

In FY 2013, significant factors beyond PBGC's control (including the financial markets, changes in interest rates, plan contributions made by sponsors, and recently enacted statutory changes) will continue to influence PBGC's underwriting income and investment gains or losses. PBGC's best estimate of FY 2014 premium receipts ranges between \$2,200 million and \$2,400 million. No reasonable estimate can be made of FY 2014 terminations, effects of changes in interest rates, or investment income.

PBGC's operating results can change markedly from year to year depending on the severity of losses from plan terminations, investment performance, changes in the interest factors used to discount future benefit payments, general economic conditions, changes in law, and other factors. PBGC's operating results may vary more than those of most private insurers, in part because PBGC must insure against catastrophic risk without all the tools private insurers use to address risk. Most private insurers can diversify or reinsure their catastrophic risks or apply traditional insurance underwriting methods to these risks. Unlike private insurers, the Corporation cannot decline insurance coverage regardless of the potential risk posed by an insured. Private insurers can also adjust premiums in response to risk. PBGC cannot. PBGC's premiums are defined by statute and the Congress must approve any premium changes.

Claims against PBGC's insurance programs vary greatly from year to year. A single large pension plan termination may result in a larger claim against the Corporation than the termination of many smaller plans. So future results will continue to depend largely on the rare and unpredictable failures of a few very large plans. Additionally, PBGC's risks are concentrated in certain industries. Finally, PBGC's financial condition

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is also sensitive to market risk. Interest rates and equity returns affect not only PBGC's own assets and liabilities but also those of PBGC-insured plans.

### **III. LEGISLATIVE AND REGULATORY DEVELOPMENTS**

#### **MULTIEMPLOYER PENSIONS**

The Pension Protection Act of 2006 (PPA) includes key plan funding provisions to help severely distressed plans improve their funding status; these will generally expire for plan years beginning after December 31, 2014. PPA required the ERISA agencies to report to Congress on the effect on multiemployer plans of these and certain other PPA funding provisions.<sup>5</sup> This report and a report on the adequacy of multiemployer premiums were submitted to Congress on January 29, 2013. The agency also issued the FY 2012 Exposure Report, which projects financial outcomes for the multiemployer insurance program over the next 10 to 20 years.

The reports show that over the next decade or so, even before any new obligations are added, there is a substantial risk that, absent changes to the multiemployer plan system and PBGC's program, the multiemployer insurance program will become insolvent and not be able to pay plans the financial assistance they need to pay guaranteed benefits.

We are analyzing various policy proposals, including proposals made by the Retirement Security Review Commission (established by the National Coordinating Committee for Multiemployer Plans) to preserve multiemployer plans and the PBGC safety net for these plans. Congress has already held several hearings on multiemployer plans as it also examines policy options.

#### **ADMINISTRATION PREMIUM PROPOSAL**

In the FY 2014 budget proposal the Administration once again proposed premium reforms to shore up the insurance program and encourage companies to preserve sound pensions. Since PBGC does not receive taxpayer funds, we rely on premiums as our primary source of support. Premiums are currently much lower than rates charged by private financial institutions for insuring the same risk. Currently, Congress has the authority to set premiums, and does so across-the-board without taking the risk of the plan into account. The Administration's proposal gives the PBGC Board the authority to set premiums by taking risk into account. Giving the Board the authority to set risk-based premiums has been supported by administrations of both parties since 2005.

Consistent with the Administration's previous proposals, this proposal requires study and public comment before any implementation. In addition, premium increases would be gradually phased in to give sponsors time to prepare for new rates. The Board would be required to consult with stakeholders prior to setting a new premium schedule and to establish a hardship waiver and other limitations on plan-specific increases, and PBGC is directed to try to make the premiums counter-cyclical, so that premiums don't increase when companies can least afford them.

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<sup>5</sup> The report is required by section 221 of PPA.

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The proposal would ensure that PBGC has the funds to do its job while providing incentives for companies both to continue offering pensions and to improve plan funding so they can keep their pension promises. The proposal is estimated to generate \$25 billion to shore up the insurance program over the next decade.

## REGULATORY REVIEW AND REFORM

The President has directed agencies to review and rethink current regulations, as part of an “open exchange” of information among government officials, experts, stakeholders, and the public, and in response we have been changing our emphasis. Our [Plan for Regulatory Review](#) highlights our approach to working with our stakeholders to reduce burdens in various areas, including reportable events, premiums, reporting of plan underfunding, and business shutdowns and layoffs. We have posted [progress reports](#) on our website.

In FY 2013, we published a new proposal, Reportable Events, to exempt more than 90 percent of plans and sponsors from many reporting requirements and to target reporting to companies and plans that pose the greatest risk. We held our first-ever public hearing on the proposed regulation and received constructive comments from stakeholders. We are working to finalize the regulation.

Our enforcement of ERISA section 4062(e) is another example of our new approach. The statute requires companies to make financial assurance whenever they cease operations at a facility resulting in more than 20 percent of the active pension plan participants losing their jobs. Typically, financial assurance is made through additional payments, a letter of credit, or other financial guarantee of future pension contributions.

In 2010, PBGC proposed regulations on the applicability and enforcement of 4062(e). The business community felt the proposed regulations imposed unwarranted burdens on companies in circumstances where there was little or no risk to plan participants or PBGC. After meeting with the business community and reviewing the matter, we decided they were right.

As a result, this year, PBGC announced an enforcement program that focuses on circumstances where there really is a threat to pensions. We now look beyond measures that focus on plan funding levels. Instead we are examining more reliable measures of plan sponsor financial soundness like those widely used in the business community. We are also not enforcing the statute where the plan has fewer than 100 participants.

Also as a result of our regulatory review, we developed a proposed rule that would reform the reporting, disclosure, and valuation requirements for certain terminated multiemployer plans or multiemployer plans involved in mergers. We expect to publish this proposal in FY 2014.

As part of our efforts to enhance retirement security by promoting lifetime income options, in FY 2014 we also expect to publish a proposed rule on Title IV treatment of benefits resulting from a rollover distribution from a defined contribution plan or other qualified trust to a defined benefit plan.

The PPA made many changes to the pension insurance system, including changes to premiums, guarantee rules, reporting and disclosure, multiemployer plan withdrawal liability, and the missing participants program. In FY 2013, we continued drafting rules necessary to implement and comply with PPA. In developing these regulations, we seek to simplify employer compliance when feasible, taking into account the needs of small businesses and comments from stakeholders.

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Once IRS and Treasury finalize their cash balance regulations, we expect to finalize our proposal implementing PPA changes to terminations of cash-balance plans. In addition, we expect to finalize our proposal implementing PPA changes to our guarantee of shutdown and similar benefits in FY 2014.

This year we published a request for information (RFI) soliciting information from the public to assist us in making decisions about implementing a new program to deal with benefits of missing participants in terminating individual account plans. We were interested in stakeholders' views on such topics as the extent of demand for such a program, demand for a database of missing participants, availability of private-sector missing participant services, potential program costs and fees, electronic filing, and diligent search requirements. The RFI generated much positive feedback, and we were invited to discuss it at the ERISA Advisory Council meeting on Locating Missing and Lost Participants. We are currently developing proposed regulations, taking into account the 21 comments received in response to the RFI.

## **IV. DISCUSSION OF INSURANCE PROGRAMS**

PBGC operates two separate insurance programs for defined benefit plans. PBGC's single-employer program guarantees basic pension benefits when underfunded plans terminate. By contrast, in the multiemployer program, the insured event is plan insolvency. PBGC's multiemployer program financially assists insolvent covered plans to pay benefits at the level the law guarantees.

By law, the two programs are funded and administered separately and their financial conditions, results of operations, and cash flows are reported separately. The accompanying financial statements for both programs, which appear on pages 53-56, have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Please refer to Note 2: "Significant Accounting Policies" for further detail including a description of PBGC's valuation method used in determining benefit liabilities.

### **IV.A SINGLE-EMPLOYER PROGRAM RESULTS OF ACTIVITIES AND TRENDS**

The single-employer program covers about 31.9 million people (excluding those in plans that PBGC has trustee), slightly down from 32.5 million people PBGC covered in 2012. The number of covered ongoing plans decreased from about 24,200 in 2012 to about 23,400 in 2013.

Most plans that were terminated had sufficient funding to cover future benefits and distributed all plan benefits as insurance company annuities or lump sums pursuant to the standard termination rules of ERISA. In these cases PBGC's activities are limited to ensuring compliance.

In contrast, when a covered underfunded plan terminates, PBGC becomes trustee. PBGC applies legal limits to payouts and pays the benefits. To determine the amount to pay each person PBGC takes into account (a) the benefit that the participant had accrued in the terminated plan, (b) the availability of assets from the terminated plan to cover benefits, (c) how much PBGC recovers from employers for plan underfunding, and (d) the legal, maximum benefits provided under ERISA. In 2013, the maximum annual payment guaranteed under the single-employer program was almost \$57,500 for a retiree aged 65, up from about \$55,800 in 2012. The maximum guarantee for 2014 will increase to just over \$59,300. The applicable maximum guarantee is

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determined by the year the retiree's plan terminated (or, if the plan terminated during the plan sponsor's bankruptcy, the year the sponsor entered bankruptcy), even if the retiree does not begin collecting benefits until a future year. In some cases, retirees can receive more than the maximum guarantee.

In FY 2013 the primary drivers of the net income of \$1,761 million included the following: net premium income of \$2,943 million, investment income of \$2,741 million, and a credit for actuarial adjustments of \$401 million. These amounts were partially offset by \$3,388 million actuarial charge due to expected interest on accrued liabilities, a charge due to completed and probable terminations of \$468 million, a charge of \$351 million in administrative and other expenses, investment expenses of \$88 million, and a charge of \$67 million due to a reduction in interest factors (which has the effect of increasing benefit liabilities and actuarial charges).

PBGC's single-employer program realized a net gain of \$1,761 million compared with a net loss in FY 2012 of \$5,876 million. The \$7,637 million decrease to net loss was primarily attributable to (1) a \$10,651 million decrease in actuarial charges due to change in interest factors, (2) a decrease of \$1,538 million in losses from completed and probable terminations, (3) a \$630 million decrease in charges for underwriting actuarial adjustments, (4) a \$539 million decrease in charges due to expected interest, (5) an increase in net premium income of \$301 million, partially offset by (6) a decrease in investment income of \$6,051 million (a gain of \$2,741 million compared to a gain of \$8,792 million in FY 2012). Actuarial charges and adjustments arise from gains and losses from mortality and retirement assumptions, changes in interest factor, and expected interest. Expected interest refers to the interest that PBGC expects to accrue during the current fiscal year based on PBGC's liability and interest rates at the end of the prior year with adjustments made for new plans and benefit payments made during the year.

## UNDERWRITING ACTIVITY

PBGC's single-employer program realized a net underwriting gain of \$2,563 million in FY 2013, \$2,503 million more than the FY 2012 gain of \$60 million. This \$2,503 million increase from the previous year was mainly due to the decrease of \$1,538 million in losses from completed and probable terminations, a \$630 million decrease in charges for underwriting actuarial adjustments, and \$301 million increase in single-employer net premium income.

Premium and other income from underwriting activity increased (from \$2,655 million in FY 2012 to \$2,981 million in FY 2013), largely due to an increase in net premium income from plan sponsors (from \$2,642 million in FY 2012 to \$2,943 million in FY 2013). Other income, consisting of interest on recoveries from sponsors, increased from \$13 million in FY 2012 to \$38 million in FY 2013.

Annual flat-rate premiums for the single-employer program increased from \$35 to \$42 per participant in FY 2013, contributing to an increase in flat-rate premium income of \$151 million to a total of \$1,274 million. Annual variable-rate premium income, paid by underfunded single-employer plans, increased by \$84 million to a total of \$1,580 million mainly due to a decrease in interest rates during FY 2013 which contributed to plan underfunding. The Variable-Rate Premium (VRP) rate of \$9 per \$1,000 of underfunding remained unchanged.

Beginning with calendar-year 2008 plans, the Pension Protection Act (PPA) eliminated the full-funding VRP exemption and changed the interest rate rules for determining a plan's present value of vested benefits for VRP purposes. Under PPA, the present value is determined using three "segment" rates. The first of these

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applies to benefits expected to be paid within five years of the first day of the plan year, the second applies to the following 15 years, and the third applies to benefits expected to be paid after that.

The Department of the Treasury determines each segment rate monthly using the portion of a corporate bond yield curve that is based on corporate bonds maturing during that segment rate period. The corporate bond yield curve is also prescribed every month by the Department of the Treasury. It reflects the yields for the previous month on investment-grade corporate bonds with varying maturities that are in the top three quality levels. The January 2013 segment rates for calendar-year plans were 1.00%, 3.57%, and 4.77% for the first, second, and third segments, respectively.

The Corporation's losses from completed and probable plan terminations decreased from a loss of \$2,006 million in FY 2012 to a loss of \$468 million in FY 2013. This was mainly due to a \$1,290 million decrease in probable claims and because charges related to new plans that terminated (\$1,879 million) were offset by a credit of \$121 million from revaluations of plans that had terminated in prior years. (see "Subtotal terminated plans" in Note 12).

The net claim for probable terminations as of September 30, 2013, is \$745 million, while the net claim as of September 30, 2012, was \$2,035 million. This \$1,290 million decrease resulted primarily from a decrease in net claims of \$1,245 million for three plans that were deleted and the transfer of \$492 million of previously accrued claims to a termination status. These factors were offset by the addition of two new probables with net claims of \$352 million and an increase in the reserve for small unidentified probables of \$95 million (see Note 6). The actual amount of future losses remains unpredictable.

Single-employer administrative expenses decreased \$14 million from \$360 million in FY 2012 to \$346 million in FY 2013.

## FINANCIAL ACTIVITY

In FY 2013 all of the \$2,741 million of the single-employer net investment gains were absorbed by the net actuarial charges of \$3,455 million for the expected interest and changes in interest rates. Single-employer financial net loss decreased from a loss of \$5,936 million in FY 2012 to a loss of \$802 million in FY 2013. The Corporation had investment income of \$2,741 million in FY 2013, compared with investment income of \$8,792 million in FY 2012. This gain was offset by an increase of \$3,455 million in actuarial charges. PBGC marks its assets to market, which is consistent with the Financial Accounting Standards Board (FASB) Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures* (see Note 5).

Actuarial charges under financial activity represent the effects of changes in interest rates and the expected interest accrued on the present value of future benefits. The expected interest refers to the interest that PBGC expects to accrue during the fiscal year on PBGC's liability at the end of the prior year. The decrease in expected interest charges is due primarily to the lower interest rate in effect at the beginning of FY 2013 compared to FY 2012 (the expected interest charge is \$3,388 million in FY 2013 and was \$3,927 million in FY 2012). Charges due to the change in interest factors decreased substantially due to the decrease in change in the applicable interest factors in current fiscal year.



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PBGC discounts its liabilities for future benefits with interest factors<sup>6</sup> that, together with the mortality table used by PBGC, approximate the price in the private-sector annuity market at which a plan sponsor or PBGC could settle its obligations. In 2013 PBGC's select interest factor decreased to 3.25% (for the first 20 years after the valuation date) at September 30, 2013, from 3.28% (for the first 25 years) at September 30, 2012. The ultimate factor increased to 3.32% at September 30, 2013 (after the first 20 years) from 2.97% at September 30, 2012 (after the first 25 years).

PBGC's single-employer Present Value of Future Benefits (PVFB) decreased from \$105,635 million at September 30, 2012 to \$105,018 million at September 30, 2013. PVFB comprises the vast majority of PBGC's combined total liabilities on its Statements of Financial Position of \$120,585 million.

## **IV.B MULTIEMPLOYER PROGRAM RESULTS OF ACTIVITIES AND TRENDS**

During Fiscal Year 2013, PBGC's obligations for future financial assistance to multiemployer plans increased from \$7,010 million at September 30, 2012 to \$9,931 million at September 30, 2013, an increase of \$2,921 million (42%). This increase is mainly due to the net addition of 22 new probables. However, it is also due, in part, to actuarial adjustments that combine the effects of a lower interest factor with new mortality table assumptions that project longer lives for participants. PBGC paid \$89 million in financial assistance to 44 insolvent plans that cover approximately 71,000 participants.

PBGC's multiemployer program covers about 10.4 million participants (unchanged from FY 2012) in about 1,435 insured plans. The multiemployer flat-rate premium increased from \$9 per participant in 2012 to \$12 per participant in FY 2013, contributing to an increase in flat-rate premium income of \$19 million to a total of about \$111 million.

A multiemployer plan is a pension plan maintained by two or more unrelated employers under collective bargaining agreements with one or more unions. Multiemployer plans cover most unionized workers in the trucking, retail food, construction, mining, and garment industries. A person doing work for any employer contributing to the plan is usually eligible for benefits. Workers accrue pension credits in the plan even when they change employment from one contributing employer to another.

Multiemployer plans are typically governed by a board of trustees appointed in equal numbers by labor and management. Under ERISA, the trustees have a fiduciary duty to act in the best interest of participants. Multiemployer plans are subject to ERISA minimum funding requirements. Although bargaining parties negotiate over plan contributions, they usually delegate plan design to the trustees.

Most collective bargaining agreements that cover multiemployer plans provide for contributions based on time worked in a covered job. Some plans base contributions on "units of production," such as number of items produced, tons of coal mined, or gross sales achieved. In some plans, benefits depend on the level of contributions that employers make to the plan for the participant's work.

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<sup>6</sup> PBGC surveys life insurance industry annuity prices through the American Council of Life Insurers (ACLI) to obtain input needed to determine interest factors and then derives interest factors that will best match the private-sector prices from the surveys. The interest factors are often referred to as select and ultimate interest factors. Any pair of interest factors will generate liability amounts that differ from the survey prices, which cover 14 different ages or benefit timings. The PBGC process derives the interest factor pair that differs least over the range of prices in the survey.

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Contributions are held in a trust fund that is managed and invested by the board of trustees in accordance with ERISA's fiduciary standards. All plan assets in the trust are available to pay all benefit claims. Assets do not revert to contributing employers.

Employers in multiemployer plans generally remain in the plan unless they go out of business, bargain out of the plan, or move their business out of the plan coverage area. If an employer withdraws from the plan, it may be assessed withdrawal liability. Withdrawal liability is generally based on the plan's unfunded vested benefits and the employer's share of contributions to the plan made by all contributing employers. In some instances, the employer may be assessed partial withdrawal liability.

PBGC does not trustee multiemployer plans. In the multiemployer program, the event triggering PBGC's guarantee is plan insolvency – the inability to pay guaranteed benefits when due.

Insolvency usually occurs after all contributing employers have withdrawn from the plan, leaving the plan without a source of income. PBGC provides insolvent multiemployer plans with financial assistance, in the statutorily-required form of loans, sufficient to pay PBGC guaranteed benefits and reasonable administrative expenses. These loans generally continue until the plan no longer needs assistance or has paid all promised benefits at the guaranteed level. These loans are rarely repaid (and for that reason are fully reserved).

Benefits under the multiemployer program are calculated based on (a) the benefit a participant would have received under the insolvent plan, subject to (b) the legal multiemployer maximum under ERISA. The maximum guaranteed amount depends on the participant's years of service. In 2013, for example, the maximum annual payment for a participant with 30 years of service was approximately \$12,870.

The multiemployer program reported a net loss of \$3,021 million in FY 2013 compared with a net loss of \$2,467 million in FY 2012. This resulted in a negative net position of \$8,258 million in FY 2013 compared with a negative net position of \$5,237 million in FY 2012. The change in net loss was mainly due to the increase in expected loss from future financial assistance of \$503 million, a decrease in net investment income of \$187 million, and a decrease in actuarial charges and adjustment of \$123 million. This deficit is an all-time record high for the multiemployer program.

The multiemployer program reported a net loss from underwriting activity of \$2,879 million in FY 2013 compared with a net loss of \$2,388 million in FY 2012. This decline of \$491 million was mainly due to the increase in financial assistance losses from insolvent and probable plans of \$503 million (due to a net increase of 22 plans to the multiemployer probable inventory and by the decrease in interest factors), the increase in administrative expenses of \$5 million, and a decrease in credit to actuarial adjustments of \$1 million, offset by an increase in premium income of \$18 million. Financial activity reflected financial loss of \$96 million from earnings on fixed income investments in FY 2013, compared with income of \$91 million in FY 2012.

Multiemployer program investments originate mainly from the cash receipts for premiums due from insured plans. By law, PBGC is required to invest these premiums in obligations issued or guaranteed by the United States Government. Multiemployer investable assets at year-end were 95.5 percent in Treasury securities, as compared with 98.6 percent in Treasury securities in FY 2012.

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## V. OVERALL CAPITAL AND LIQUIDITY

PBGC's obligations include monthly payments to participants and beneficiaries in terminated defined benefit plans, financial assistance to multiemployer plans, and PBGC's operating expenses. The financial resources available to pay these obligations are underwriting income received from insured plan sponsors (largely premiums), the income earned on PBGC's investments, and the assets taken over from failed plans.

The Corporation has sufficient liquidity to meet its obligations for a significant number of years; however, barring changes, neither program will be able to fully satisfy PBGC's obligations to plan participants in future years.

FY 2013 combined premium cash receipts totaled \$3,163 million, an increase of \$992 million from \$2,171 million in FY 2012. Net cash flow provided by investment activity increased to \$1,196 million versus \$265 million provided in FY 2012. In FY 2013, PBGC's cash receipts of \$5,383 million from operating activities of the single-employer program were insufficient to cover its operating cash obligations of \$6,069 million. This resulted in net cash underperformance from operating activities of \$686 million (as compared to the underperformance of \$1,531 million in FY 2012). When the single-employer cash provided through investing activities of about \$1,201 million is added to this net cash underperformance, the single-employer program in the aggregate experienced a net cash increase of \$521 million.

In the multiemployer program, cash receipts of \$182 million from operating activities were sufficient to cover its operating cash obligations of \$122 million, resulting in net cash provided by operations of \$60 million. When this net cash performance is added to net cash underperformance through investing activities of \$11 million, the multiemployer program in the aggregate experienced an overall net cash increase of \$49 million.

During FY 2013, PBGC recovered about \$223 million through agreements with sponsors of terminated plans for unpaid contributions and unfunded benefits. A portion of those recovered funds are paid out as additional benefits to plan participants with nonguaranteed benefits according to statutory priorities.

In FY 2013, PBGC's combined net increase in cash and cash equivalents amounted to \$570 million, arising from an increase of \$521 million for the single-employer program and an increase of \$49 million for the multiemployer program.

## VI. SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAM EXPOSURE

PBGC estimates its single-employer loss exposure to reasonably possible terminations (e.g., underfunded plans sponsored by companies with credit ratings below investment grade) at about \$292,207 million on September 30, 2013, and \$294,963 million on September 30, 2012. The comparable estimate of reasonably possible exposure for FY 2011 was about \$227,127 million. PBGC's exposure to loss may be less than these amounts because of the statutory guarantee limits on insured pensions, but PBGC is unable to estimate prospectively the extent and effect of the guarantee limitations. These estimates are measured as of December 31 of the previous year (see Note 9). For FY 2013, this exposure was concentrated in the following sectors: manufacturing (primarily automobile/auto parts, and primary and fabricated metals), transportation (primarily airlines), services, and wholesale and retail trade.

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PBGC estimates that, as of September 30, 2013, it is reasonably possible that multiemployer plans may require future financial assistance of about \$36,718 million. As of September 30, 2012 and 2011, these exposures were estimated at about \$26,809 million and \$23,097 million, respectively. The increase in FY 2013 from prior years is due mainly to 28 new plans (net) added to the reasonably possible list.

The significant volatility in plan underfunding and sponsor credit quality over time makes long-term estimates of PBGC's expected claims uncertain. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized PBGC'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.

PBGC's sources of information on plan underfunding are the most recent Section 4010 and PBGC premium filings, Form 5500, and other submissions to the Corporation. PBGC publishes Table S-49, "Various Measures of Underfunding in PBGC-Insured Plans," in its *Pension Insurance Data Book*. In that table the limitations of the estimates are fully and appropriately described.

## VII. INVESTMENT ACTIVITIES

PBGC uses institutional investment management firms to invest its assets, subject to PBGC's oversight and consistent with the investment policy statement approved by our Board. PBGC does not determine the specific investments to be made but instead relies on PBGC's investment managers' discretion in executing investments appropriate for their assigned investment mandates. PBGC does ensure that each investment manager adheres to PBGC's prescribed investment guidelines associated with each investment mandate and measures each investment manager's performance in comparison with agreed upon benchmarks.

PBGC's investment assets consist of premium revenues, which are accounted for in the revolving funds, and assets from trustee plans and their sponsors, which are accounted for in the trust funds. By law, PBGC is required to invest certain revolving funds (i.e., Funds 1 and 2) in obligations issued or guaranteed by the United States of America. Portions of the other revolving fund (i.e., Fund 7) can be invested in other debt obligations, but under PBGC's current investment policy these revolving funds are invested solely in Treasury securities.

Total revolving fund investments, including cash and investment income, at September 30, 2013, were \$19,143 million (\$1,034 million for Fund 1, \$1,714 million for Fund 2, and \$16,395 million for Fund 7). PBGC has never established funds 3, 4, 5 or 6, which ERISA authorized for special discretionary purposes. Trust fund investments totaled \$60,453 million as of September 30, 2013. At the end of FY 2013, PBGC's total investments consisting of cash and cash equivalents, investments, and investment income receivable as shown on the Statements of Financial Position were \$79,596 million.

Our Board adopted the current investment policy in May 2011. The objective is to maximize total return within a prudent risk framework that incorporates PBGC's fixed obligations and asset composition of potential trustee plans. The investment policy establishes a 30 percent target asset allocation for equities and other non-fixed income assets, and a 70 percent asset allocation for fixed income.

PBGC's investment program had assets under performance management of about \$77,066 million as of September 30, 2013. Of the \$2,500 million difference between the September 30, 2013 assets reported on the

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Statements of Financial Position and the assets within the PBGC's investment performance portfolio, about \$1,000 million represent net unsettled purchases, about \$500 million for funds available for the following month's benefit payments, and \$1,000 million are newly trustee assets that have not yet been commingled. Asset allocation percentages refer to the investments within PBGC's investment program that are subject to the Corporation's investment policy, as described below.

Cash and fixed income securities totaled about 66 percent of total assets under performance management invested at the end of FY 2013, compared with approximately 69 percent for FY 2012. Equity securities (i.e., public equities), which performed well in FY 2013, represented about 31 percent of total assets under performance management invested at the end of FY 2013, compared with approximately 28 percent for FY 2012. The fiscal year to date Total Fund Composite return (excluding private market assets and transition accounts) for FY 2013 was 2.6% compared with 12.6% in FY 2012. A small percentage of PBGC's investments (1.2 percent of total investment assets at FY 2013 compared with 0.1 percent at FY 2012) predominantly represent assets that are in the process of moving out of one of the manager portfolios either for liquidation or for transfer to another manager. The fiscal year to date return of the Total Fund Composite including these transition accounts was 2.5% in FY 2013 compared to 12.6% in FY 2012. Private markets assets, comprised largely of private equity, private debt, and private real estate that are currently part of the investment portfolio, represented about 2.4% of total investments at the end of FY 2013, compared with 2.8% of total investments at the end of FY 2012.

Due to the cyclical nature of capital markets, PBGC reports one-year, three-year, and five-year returns for its investment program. For the five-year period ending September 30, 2013, PBGC's return on total invested funds excluding transition accounts was 9.0% compared with a total fund benchmark return of 8.2%, a benchmark PBGC uses to conform with its investment policy. Including the transition accounts, the five year annualized return was 8.9%. Separately, the ERISA/PPA hypothetical portfolio benchmark return for the five-year period ending September 30, 2013 was 9.1%. (Please refer to Table 3 on page 47 for additional information).

The table below summarizes the performance of PBGC's investment program.

## INVESTMENT PERFORMANCE

(Annual Rates of Return)

	September 30, 2013	September 30, 2012	Three and Five Years Ended September 30, 2013	
			<u>3 yrs</u>	<u>5 yrs</u>
Total Fund Composite	<b>2.6%</b>	12.6%	6.7%	9.0%
Total Fund Benchmark <sup>1</sup>	<b>2.1</b>	11.8	6.3	8.2
ERISA/PPA Portfolio Benchmark <sup>2</sup>	<b>10.7</b>	20.0	11.2	9.2
Total Global Public Stock	<b>18.8</b>	22.6	11.3	8.4
Total Global Public Stock Benchmark <sup>3</sup>	<b>18.4</b>	22.3	11.2	8.1
Total Global Bonds	<b>(4.1)</b>	9.8	4.4	8.6
Total Global Bonds Benchmark <sup>4</sup>	<b>(4.6)</b>	8.7	3.9	7.4
Trust Funds	<b>5.4</b>	15.5	8.0	10.0
Revolving Funds	<b>(5.3)</b>	5.2	2.8	6.0
<b>Indices</b>				
Russell 3000 Index	<b>21.6</b>	30.2	16.8	10.6
MSCI ACWI ex-U.S. Standard Index	<b>16.5</b>	14.5	6.0	6.3
S&P 500 Index	<b>19.3</b>	30.2	16.3	10.0
Barclays Capital Treasury Index	<b>(2.1)</b>	3.0	2.2	4.0
Barclays Capital Aggregate Bond Index	<b>(1.7)</b>	5.2	2.9	5.4
Barclays Capital Global Aggregate ex-US Index, Hedged	<b>2.1</b>	5.9	3.1	4.7

<sup>1</sup> The Total Fund Benchmark is a dynamic weighted benchmark based upon the weights of the Total Global Public Stock Benchmark and the Total Global Bonds Benchmark. This benchmark is utilized to compare against the Total Fund Composite returns shown above.

<sup>2</sup> The ERISA/PPA Portfolio benchmark is based upon a hypothetical portfolio with a 60% allocation to the Standard & Poor's 500 equity index and a 40% allocation to the Barclays Capital Aggregate fixed income index. See page 46 for a description of this reporting requirement.

<sup>3</sup> The Total Global Public Stock Benchmark is a dynamic weighted benchmark based upon the weights of the U.S. Public Stock composite and the International Public Stock composite and the returns of their respective benchmarks.

<sup>4</sup> The Total Global Bonds Benchmark is a dynamic weighted benchmark based upon the weights of PBGC's fixed income managers and the returns of their respective benchmarks.



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## FIXED INCOME

As described below, PBGC fixed income investment managers use a number of different benchmarks. Where applicable, the relative percentage that each index or benchmark represents for its respective asset class is provided. The percentage invested under each benchmark(s), in aggregate, for each asset class relative to the overall PBGC investment program at September 30, 2013 is also provided below.

The Total Global Bonds Benchmark is a dynamic weighted benchmark based on the weights of the underlying fixed income managers and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the Revolving Fund Treasuries Custom Benchmark (31.3%), the Barclays Capital U.S. TIPS index (7.0%), the Total Long Duration Bonds Benchmark (24.1%), the Barclays Capital Aggregate Bond index (10.0%), the Total Developed Market Bonds Benchmark (11.3%), the Barclays Capital U.S. High Yield Ba/B 1% Constrained index (5.1%), and the Total Emerging Market Bonds Benchmark (11.2%). The overall Total Global Bonds composite equals 62.8 percent of the total PBGC portfolio.

Treasuries: This category includes investments in United States Dollar (USD) denominated fixed income securities managed by outside professional asset managers, and applies to 19.7 percent of PBGC's investment program assets at year-end. The Long Treasury Benchmark is the Revolving Fund Treasuries Custom Benchmark. The Revolving Fund Treasuries Custom Benchmark is a customized index made up of U.S. Treasury notes and bonds. While PBGC is able to redeem composite assets upon request, the composite assets are part of the Revolving Fund and can only be redeemed to meet pension benefit obligations or administrative expenses.

U.S. Treasury Inflation Protected Securities (TIPS): This category includes investments in USD denominated fixed income securities managed by outside professional asset managers, and applies to 4.4 percent of PBGC's investment program assets at year-end. The TIPS Benchmark is the Barclays Capital U.S. TIPS index. While PBGC is able to redeem composite assets upon request, the composite assets are part of the Revolving Fund and can only be redeemed to meet pension benefit obligations or administrative expenses.

Long Duration: This category includes investments mainly in USD-denominated fixed income securities managed by outside professional asset managers, and applies to 15.2 percent of PBGC's investment program assets at year-end. The Total Long Duration Bonds Benchmark is a dynamic weighted benchmark based on the weights of the underlying Trust Fund long duration fixed income managers and the returns of their respective benchmarks. As of September 30, 2013, the Total Long Duration Bonds Benchmark encompasses the Barclays Capital Long U.S. Government/Credit index (21.3%) and Custom Benchmarks (78.7%). The Barclays Capital Long U.S. Government/Credit index includes both government and credit securities. The Government component includes public obligations of the U.S. Treasury that have remaining maturities of more than one year and publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government. The credit component of the index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality (investment grade) requirements. The custom benchmarks include similar securities and are weighted combinations of sub-sector benchmarks. PBGC is able to redeem composite assets upon request.

Core: This category includes investments primarily in USD-denominated fixed income securities managed by outside professional asset managers, and applies to 6.2 percent of PBGC's investment program assets at year-



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end. The Core Fixed Income Benchmark is the Barclays Capital Aggregate Bond index. The Barclays Capital Aggregate Bond index includes securities that are SEC-registered, taxable, and dollar-denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, asset-backed securities, and foreign securities. PBGC is able to redeem composite assets upon request.

Developed Markets: This category includes investments in USD-based fixed income securities and income securities based on other foreign currencies managed by outside professional asset managers. This applies to 7.1 percent of PBGC's investment program assets at year-end. The Total Developed Market Bonds Benchmark is a dynamic weighted benchmark based on the weights of all developed market bond managers and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the Barclays Capital Global Aggregate index hedged (50.1%), Barclays Capital Global Aggregate ex-US index hedged (18.6%), and Custom Benchmarks (31.3%). The Barclays Capital Global Aggregate index provides a broad-based measure of the global investment-grade fixed income markets. The three major components of this index are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities, and USD-denominated investment grade 144A securities. The hedged index negates exposure to foreign currencies by hedging currency exposure back to the U.S. dollar. The custom benchmarks include similar securities and are weighted combinations of sub-sector benchmarks. PBGC is able to redeem composite assets upon request.

High Yield: This category includes investments primarily in USD-denominated fixed income securities managed by outside professional asset managers, and applies to 3.2 percent of PBGC's investment program assets at year-end. The High Yield Benchmark is the Barclays Capital U.S. High Yield Ba/B 1% Issuer Constrained index. The Barclays Capital U.S. High Yield Ba/B 1% Issuer Constrained index includes the universe of fixed rate, non-investment grade debt securities rated Ba or B. The index also includes Canadian and global bonds (SEC registered) of issuers in non-Emerging Market countries. The index limits the size of an individual issuer to 1% of the index. PBGC is able to redeem composite assets upon request.

Emerging Market Bonds: This category includes fixed income securities denominated in either U.S. dollars or foreign currencies, and managed by outside professional asset managers. It comprises 7.0 percent of PBGC's investment program assets at year-end. The Total Emerging Market Bonds Benchmark is a dynamic weighted benchmark based on the weights of all emerging market bond managers and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the JP Morgan EMBIG Diversified index (39.9%) and Custom Benchmarks (60.1%). The custom benchmarks are weighted combinations of the JP Morgan EMBIG Diversified and the JP Morgan GBI EM Global Diversified or the JP Morgan CEMBI Broad benchmarks. The JP Morgan EMBIG Diversified index includes U.S. dollar-denominated debt instruments issued by Emerging Market countries. The index also includes U.S. dollar-denominated Brady bonds, Eurobonds, and traded loans issued by sovereign and quasi-sovereign entities. The JP Morgan GBI EM Global Diversified index includes local currency/non-U.S. dollar-denominated debt instruments issued by Emerging Market countries. The JP Morgan CEMBI Broad index includes U.S. dollar-denominated Emerging Market corporate bonds. PBGC is able to redeem composite assets upon request.

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## MONEY MARKET SECURITIES

This category includes investments in money market instruments managed by an outside professional asset manager that invests in a diversified portfolio of short-term obligations and deposits, including, but not limited to, U.S. Treasury and agency obligations, certificates of deposits, commercial paper, and repurchase agreements (Trust Fund Cash). In addition, the category includes overnight investments in U.S. Treasury securities held at the U.S. Treasury (Revolving Fund Cash). The Total Money Market Securities Benchmark is a dynamic weighted benchmark based on the weights of the Trust Fund Cash and the Revolving Fund Cash and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the 3-Month Treasury Bill (68.7%) and the 4-Week Treasury Bill (31.3%). The cash composite represents 3.4 percent of PBGC's investment program as of September 30, 2013.

## GLOBAL PUBLIC STOCK

This category includes investments in the U.S. Public Stock composite and the International Public Stock composite, and applies to 30.2 percent of PBGC's investment program assets at fiscal year-end. The Total Global Public Stock Benchmark is a dynamic weighted benchmark based upon the weights of the U.S. Public Stock composite and the International Public Stock composite and the returns of their respective benchmarks. PBGC is able to redeem composite assets upon request.

As of September 30, 2013, the Total Global Public Stock Benchmark is comprised of the Total U.S. Public Stock Benchmark (55.4%), and the Total International Public Stock Benchmark (44.6%).

U.S. Public Stock: This category includes investments in U.S. Equity securities and U.S. publicly traded Real Estate Investment Trusts (REITs) managed by outside professional asset managers, and applies to 16.7 percent of PBGC's investment program assets at year-end. The Total U.S. Public Stock Benchmark is a dynamic weighted benchmark based upon the weights of the U.S. Public Stock composite and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the Russell 3000 index (81.4%), the Dow Jones U.S. Total Stock Market Index (3.9%), and the Dow Jones U.S. Select Real Estate Securities index (14.7%). PBGC is able to redeem composite assets upon request.

International Public Stock: This category includes investments in International Equity securities managed by outside professional asset managers, and applies to 13.5 percent of PBGC's investment program assets at year-end. The Total International Public Stock Benchmark is a dynamic weighted benchmark based upon the weights of all the international funds and the returns of their respective benchmarks. As of September 30, 2013, the weighted benchmark encompasses the MSCI EAFE index (60.8%), the MSCI EAFE Small Cap index (9.1%), the MSCI Emerging Markets index (22.2%), and the MSCI Canada index (7.9%). The MSCI EAFE index (Europe, Australasia, Far East) is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The MSCI EAFE Small Cap index is designed to measure the developed markets small capitalization equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets index is designed to measure equity market performance of emerging markets and the MSCI Canada index is designed to measure the equity market performance of Canada. PBGC is able to redeem composite assets upon request.

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## PRIVATE MARKETS

This category includes private equity, private debt, and private real estate funds that invest mainly in buyouts, venture capital, distressed debt, and commercial real estate, and applies to 2.4 percent of PBGC's investment program assets at year-end. Private investments are difficult to benchmark due to their illiquid nature. Typical benchmarks utilized for private equity include universe comparisons where funds which have the same original investment date are compared against the performance of a similar fund. For direct private real estate investments, many institutions use the National Council of Real Estate Investment Funds (NCREIF) index, which includes U.S. commercial real estate properties acquired in the private market for investment purposes. For investments in private equity real estate, peer universe comparisons based on similar funds with the same original investment date are often utilized. Private Market investments do not have redemption provisions. Instead, the nature of the investments in this category is that distributions are received through the liquidation of the underlying assets of the funds. It is estimated that the majority of the underlying assets of the funds will be liquidated over the next ten years. The fair values of the investments in this category have been estimated using the net asset value of the PBGC's ownership interest in partners' capital.

## THE PENSION PROTECTION ACT OF 2006 REPORTING REQUIREMENT

The Pension Protection Act of 2006 requires PBGC to estimate the effect of an asset allocation based on a combination of two commonly used market benchmarks. This hypothetical portfolio, with a 60 percent allocation to the Standard & Poor's 500 equity index and a 40 percent allocation to the Barclays Capital Aggregate Bond index (used as a benchmark for a typical pension plan, rather than an insurer), would have increased the assets of the Corporation by about \$6.9 billion (10.7% return compared with PBGC's Total Fund Composite return including transition accounts of 2.5%) for the one-year period ending September 30, 2013, and increased the assets of the Corporation by about \$0.1 billion (9.2% return compared with PBGC's Total Fund Composite return including transition accounts of 8.9%) over the five-year period ending September 30, 2013. For further analysis of PBGC's Investment Activities please refer to page 40 of the MD&A of Financial Condition and Results of Operations. As reported in last year's FY 2012 Annual Report, the same "60/40 portfolio" would have increased the assets of the Corporation by about \$6.7 billion (20.0% return compared with PBGC's Total Fund Composite return including transition accounts of 12.6%) for the one-year period and decreased the assets of the Corporation by about \$9.1 billion (4.3% return compared with PBGC's Total Fund Composite return including transition accounts of 6.9%) for the five-year period ending September 30, 2012.

These results are summarized in the following table.

#### INVESTMENT PORTFOLIO ANALYSIS

60/40 Hypothetical Portfolio Analysis versus PBGC Fiscal Year Actual Return (60/40 is comprised of S&P 500 Index/Barclays Capital Aggregate Bond Index)						
Fiscal Year	1 Year Period Ending			5 Year Period Ending		
	60/40 Incremental \$ Billions	60/40 % Return	PBGC Actual Return <sup>1</sup>	60/40 Incremental \$ Billions	60/40 % Return	PBGC Actual Return <sup>1</sup>
9/30/2012	\$6.7	20.0%	12.6%	(\$9.1)	4.3%	6.9%
9/30/2013	\$6.9	10.7%	2.5%	\$0.1	9.2%	8.9%

<sup>1</sup> PBGC Actual Return is the PBGC's Total Fund Composite return including transition accounts. If transition accounts were excluded, the Total Fund Composite returns are 2.6% and 9.0% on an annualized basis for the one and five year periods ending September 30, 2013, respectively.

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## **PBGC MANAGEMENT ASSURANCES AND INTERNAL CONTROLS PROGRAM**

The PBGC's Internal Controls Program is designed to support compliance with the Federal Managers' Financial Integrity Act (FMFIA) and Office of Management and Budget (OMB) Circular A-123 requirements. The Internal Controls Program and the other related activities described below undergird PBGC's FMFIA Assurance Statement. For FY 2013, PBGC provided a qualified Statement of Assurance due to two material weaknesses relating to a) System Security and IT Operational Effectiveness, and b) Operational Audit Processes and Records Management.

### **FMFIA ASSURANCE STATEMENT PROCESS**

Members of PBGC's executive management prepared annual assurance statements regarding compliance with the FMFIA. These representations are based on their knowledge of PBGC operations, the results of reviews conducted by the Office of Inspector General (OIG) and the Government Accountability Office (GAO), internal management assessments and evaluations, and consideration of other factors affecting the PBGC control environment.

### **INTERNAL CONTROL COMMITTEE**

The PBGC Internal Control Committee (ICC) provided corporate oversight and accountability regarding internal controls over the PBGC operations, financial reporting, and compliance with laws and regulations. Chaired by the Chief Financial Officer, the committee includes members from each major area of the agency, including a representative of the PBGC's OIG as a non-voting member. The ICC approves major changes to key financial reporting controls and PBGC systems, monitors the status of internal control deficiencies and related corrective actions, and considers other matters, including controls designed to prevent or detect fraud.

### **DOCUMENTATION AND TESTING OF CONTROLS**

PBGC's Internal Control Program is primarily focused on documenting and testing controls within the following areas: financial reporting, entity-wide, and information technology. During the year, selected controls were evaluated for the adequacy of control design and tested to determine operating effectiveness of the controls. Reports regarding results of testing were provided to PBGC management and ICC members for consideration under FMFIA.

*Financial Reporting Controls:* The PBGC has identified 12 major business process cycles which have a significant impact on the PBGC's financial reporting processes: Benefit Payments, Benefit Determinations, Budget, Financial Reporting, Human Resources/Payroll, Investments, Losses on Completed and Probable Terminations, Non-Recoverable Future Financial Assistance, Payables, Premiums, Single-Employer Contingent Liability, and Present Value of Future Benefits. As of the end of FY 2013, PBGC had identified 157 key controls over financial reporting for testing within these major business cycles. Employees responsible for performance of these controls maintained logs documenting control execution, and provided quarterly representations regarding the performance of those controls.

*Entity-Wide Controls:* These controls are overarching controls which support the overall effectiveness of PBGC's internal control environment. As of the end of FY 2013, PBGC had identified 46 key entity-wide controls for testing within the following six components of its internal control environment: control environment, risk assessment, control activities, information and communication, monitoring, and anti-fraud.

*Information Technology Controls:* In order to protect the confidentiality, integrity, and availability of PBGC information systems and the information processed, stored, and transmitted by those systems, PBGC implements the controls required by National Institute of Standards and Technology Special Publication No.

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800-53 Revision No. 3 (NIST 800-53), Recommended Security Controls for Federal Information Systems and Organizations. During FY 2013, PBGC performed testing of 134 controls related to its General Support Systems, the Present Value Future Benefit (PVFB) valuation system, and Risk Management Early Warning (RMEW) system.

## **ASSESSMENT OF IMPROPER PAYMENT RISK**

Based on the requirements of OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments and related improper payment legislation, PBGC performed a risk assessment of payments made to contractors for goods and services for FY 2013. Please refer to the Improper Payment Assessment section of this report for additional information.

## **AUDIT COORDINATION AND FOLLOW-UP PROGRAM**

In implementing OMB Circular A-50, PBGC has established its Audit Coordination and Follow-up Directive. It is PBGC policy to fully cooperate with audits of PBGC operations and ensure the efficient tracking, resolution, and implementation of agreed-upon audit recommendations contained in audit reports issued by the OIG and the GAO. PBGC has dedicated staff to coordinate with OIG and GAO audit representatives in providing access to records and information needed to complete audits and ensure that management responses to draft reports are provided in a timely manner. To facilitate timely completion and closure of audit recommendations, staff regularly monitors implementation efforts, including regular distribution of audit follow-up status reports to executive management via a corporate-wide portal and formal submission of documentation evidencing completion of required corrective actions. Status reports document planned corrective actions and estimated completion dates, and also indicate those recommendations for which work has been completed and reported as such to the OIG and GAO.

## **COMPLIANCE WITH LAWS, REGULATIONS, AND OTHER REQUIREMENTS**

To foster an environment that promotes compliance with laws and regulations, PBGC maintains two legal compendia: the *Compendium of Legal Authority* lists laws which may have a significant impact on PBGC's financial statements or PBGC operations, and the *Compendium of Executive Orders and OMB Requirements* lists other requirements applicable to PBGC. These documents provide brief descriptions of each applicable requirement and identify the PBGC department or other component with primary compliance responsibility. PBGC updates and maintains these lists to help ensure compliance with applicable laws, regulations, and other requirements.

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## FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT STATEMENT OF ASSURANCE

PBGC's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). In accordance with OMB Circular A-123, Management's Responsibility for Internal Control, the agency conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations (FMFIA Section 2) and conformance with financial management system requirements (FMFIA Section 4). Based on the results of this evaluation for the period ending September 30, 2013, PBGC is providing a qualified statement of assurance that the agency met all the objectives of FMFIA. The results of that assessment provided reasonable assurance that, except for the two noted material weaknesses discussed below, PBGC's internal control over the effectiveness and efficiency of operations and compliance with laws and regulations was operating effectively. Further, the assessment did not identify any non-conformances with financial management system requirements.

In addition, PBGC conducted its assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, PBGC can provide reasonable assurance that its internal control over financial reporting as of September 30, 2013, was operating effectively, and no material weaknesses were found in the design or operation of the internal control over financial reporting.

## SUMMARY OF THE MATERIAL WEAKNESS RELATING TO SYSTEM SECURITY AND IT OPERATIONAL EFFECTIVENESS AND CORRECTIVE ACTION PLANS

PBGC continues to address the material weakness relating to System Security and IT Operational Effectiveness first reported for FY 2009. PBGC continues to make progress in regard to its enterprise-wide corrective action plan (CAP) issued in FY 2010 and based on the NIST 800-53 rev. 3 control framework. During FY 2013, we have taken the following actions:

- hired a new Chief Information Officer;
- initiated development of a System Registration Process designed to meet NIST 800-53 requirements and to document the related system boundaries, including those relating to subsystems;
- took actions to improve PBGC's user account recertification process to ensure there is continuing need for users to access systems for which they have been granted access in the past;
- made progress in enhancing OIT's software patch and update procedures, implemented a configuration management software that produces regular reports regarding nearly 100 configuration settings, and implemented enhanced password protocols for access to PBGC systems;
- moved to acquire a security management tool and database to assist OIT in managing its plan of action and milestone process and to serve as a repository of NIST 800-53 documentation and artifacts; and
- worked towards implementing a procedure to ensure that data on backup tapes are appropriately encrypted using advanced encryption standards.



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## **SUMMARY OF MATERIAL WEAKNESS RELATED TO OPERATIONAL AUDIT PROCESSES AND RECORDS MANAGEMENT**

Both OIG and management have conducted reviews that have underscored the need for improvement in how PBGC audits its plan assets and participant data, and particularly, how PBGC manages its contractors and its records collection and retention processes. During FY 2013, Benefits Administration and Payment Department (BAPD) continued to make progress on the Strategic Review initiative that is intended to transform BAPD operations. With a new departmental leadership team in place and building on progress from the prior year, BAPD has taken the following actions:

- reworked its plan asset evaluation policies and procedures;
  - trained BAPD auditors, managers, and support contractors on those procedures;
  - hired new plan asset valuation specialists;
  - awarded plan asset support services and technical advisory contracts;
  - updated documentation and record retention processes; and
  - incorporated new accountability language into performance management plans.
- In addition, a new department, the Quality Management Department, has been established within PBGC. This department will assess work processes and employ business analytics to support continuous process improvements throughout PBGC.

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## MANAGEMENT REPRESENTATION

PBGC's management is responsible for the accompanying Statements of Financial Position of the Single-Employer and Multiemployer Funds as of September 30, 2013, and 2012, the related Statements of Operations and Changes in Net Position, and the Statements of Cash Flows for the years then ended.

PBGC's management is also responsible for establishing and maintaining systems of internal accounting and administrative controls that provide reasonable assurance that the control objectives, i.e., preparing reliable financial statements, safeguarding assets, and complying with laws and regulations, are achieved.

In the opinion of management, the financial statements of the Single-Employer and Multiemployer Program Funds present fairly the financial position of PBGC as September 30, 2013, and September 30, 2012, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and actuarial standards applied on a consistent basis. As noted in the FMFIA Statement of Assurance above, except for two material weaknesses: a) system security and IT operational effectiveness, and b) benefits administration audit processes and records management, PBGC's accounting systems and internal controls comply with the provisions of FMFIA. In addition, PBGC has sufficient compensating controls in place to ensure the reliability of the Corporation's financial statements and its notes.

Estimates of probable terminations, nonrecoverable future financial assistance, amounts due from employers and the present value of future benefits have a material effect on the financial results being reported.

Litigation has been disclosed and reported in accordance with U.S. GAAP.

As a result of the aforementioned, PBGC has based these statements, in part, upon informed judgments and estimates for those transactions not yet complete or for which the ultimate effects cannot be precisely measured, or for those that are subject to the effects of any pending litigation.

The Inspector General engaged CliftonLarsonAllen LLP to conduct the audit of the Corporation's fiscal years 2013 and 2012 financial statements, and CliftonLarsonAllen LLP issued an unqualified opinion on those financial statements.

  
Director



Chief Financial Officer

November 15, 2013

## PENSION BENEFIT GUARANTY CORPORATION

### STATEMENTS OF FINANCIAL POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
<i>(Dollars in Millions)</i>	September 30, 2013	2012	September 30, 2013	2012	September 30, 2013	2012
<b>ASSETS</b>						
Cash and cash equivalents	\$4,303	\$ 3,782	\$74	\$ 25	\$4,377	\$ 3,807
Securities lending collateral (Notes 3 and 5)	3,322	3,425	-	-	3,322	3,425
Investments, at market (Notes 3 and 5):						
Fixed maturity securities	47,196	48,950	1,632	1,767	48,828	50,717
Equity securities	22,317	21,463	-	-	22,317	21,463
Private equity	1,228	1,339	-	-	1,228	1,339
Real estate and real estate investment trusts	2,373	878	-	-	2,373	878
Other	28	77	-	-	28	77
Total investments	73,142	72,707	1,632	1,767	74,774	74,474
Receivables, net:						
Sponsors of terminated plans	60	41	-	-	60	41
Premiums	1,036	1,086	1	1	1,037	1,087
Sale of securities	601	1,353	-	-	601	1,353
Derivative contracts (Note 4)	276	83	-	-	276	83
Investment income	436	452	9	12	445	464
Other	4	4	0	0	4	4
Total receivables	2,413	3,019	10	13	2,423	3,032
Capitalized assets, net	47	40	3	2	50	42
Total assets	\$83,227	\$82,973	\$1,719	\$1,807	\$84,946	\$84,780

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION  
STATEMENTS OF FINANCIAL POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
<i>(Dollars in Millions)</i>	2013	2012	2013	2012	2013	2012

**LIABILITIES**

Present value of future benefits, net (Note 6):

Trusted plans	\$103,125	\$ 103,126	\$0	\$ 1	\$103,125	\$ 103,127
Plans pending termination and trusteeship	1,091	418	-	-	1,091	418
Settlements and judgments	57	56	-	-	57	56
Claims for probable terminations	745	2,035	-	-	745	2,035
Total present value of future benefits, net	105,018	105,635	0	1	105,018	105,636

Present value of nonrecoverable future  
financial assistance (Note 7):

Insolvent plans	-	-	1,352	1,388	1,352	1,388
Probable insolvent plans	-	-	8,579	5,622	8,579	5,622
Total present value of nonrecoverable future financial assistance	-	-	9,931	7,010	9,931	7,010

Payables, net:

Derivative contracts (Note 4):	210	94	-	-	210	94
Due for purchases of securities	1,608	2,557	-	-	1,608	2,557
Payable upon return of securities loaned	3,322	3,425	-	-	3,322	3,425
Unearned premiums	377	328	42	30	419	358
Accounts payable and accrued expenses (Note 8):	73	76	4	3	77	79
Total payables	5,590	6,480	46	33	5,636	6,513

Total liabilities 110,608 112,115 9,977 7,044 120,585 119,159

**Net position** (27,381) (29,142) (8,258) (5,237) (35,639) (34,379)

Total liabilities and net position \$83,227 \$ 82,973 \$1,719 \$1,807 \$84,946 \$ 84,780

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION  
**STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION**

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
(Dollars in Millions)	2013	2012	2013	2012	2013	2012
<b>UNDERWRITING</b>						
Income:						
Premium, net (Note 11)	\$2,943	\$ 2,642	\$110	\$ 92	\$3,053	\$ 2,734
Other	38	13	-	0	38	13
Total	2,981	2,655	110	92	3,091	2,747
Expenses:						
Administrative	346	360	25	20	371	380
Other	5	-	-	0	5	0
Total	351	360	25	20	376	380
Other underwriting activity:						
Losses from completed and probable terminations (Note 12)	468	2,006	-	-	468	2,006
Losses from insolvent and probable plans- financial assistance (Note 7)			2,969	2,466	2,969	2,466
Actuarial adjustments (credits) (Note 6)	(401)	229	(5)	(6)	(406)	223
Total	67	2,235	2,964	2,460	3,031	4,695
Underwriting gain (loss)	2,563	60	(2,879)	(2,388)	(316)	(2,328)
<b>FINANCIAL:</b>						
Investment income (loss) (Note 13):						
Fixed	(1,629)	4,699	(96)	91	(1,725)	4,790
Equity	4,157	4,073	-	0	4,157	4,073
Private equity	272	42	-	0	272	42
Real estate	(70)	(21)	-	0	(70)	(21)
Other	11	(1)	-	0	11	(1)
Total	2,741	8,792	(96)	91	2,645	8,883
Expenses:						
Investment	88	83	-	0	88	83
Actuarial charges (Note 6):						
Due to expected interest	3,388	3,927	44	54	3,432	3,981
Due to change in interest factors	67	10,718	2	116	69	10,834
Total	3,543	14,728	46	170	3,589	14,898
Financial loss	(802)	(5,936)	(142)	(79)	(944)	(6,015)
Net income (loss)	1,761	(5,876)	(3,021)	(2,467)	(1,260)	(8,343)
Net position, beginning of year	(29,142)	(23,266)	(5,237)	(2,770)	(34,379)	(26,036)
Net position, end of year	\$ (27,381)	\$ (29,142)	\$ (8,258)	\$ (5,237)	\$ (35,639)	\$ (34,379)

The accompanying notes are an integral part of these financial statements.

**PENSION BENEFIT GUARANTY CORPORATION**  
**STATEMENTS OF CASH FLOWS**

<i>(Dollars in millions)</i>	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
	2013	2012	2013	2012	2013	2012
<b>OPERATING ACTIVITIES:</b>						
Premium receipts	\$ 3,042	\$ 2,079	\$ 121	\$ 92	\$ 3,163	\$ 2,171
Interest and dividends received	2,310	2,122	61	58	2,371	2,180
Cash received from plans upon trusteeship	24	126	0	0	24	126
Receipts from sponsors/non-sponsors	(1)	114	0	0	(1)	114
Receipts from the missing participant program	7	7	0	0	7	7
Other receipts	0	1	0	0	0	1
Benefit payments – trustee plans	(5,374)	(5,333)	0	0	(5,374)	(5,333)
Financial assistance payments			(89)	(95)	(89)	(95)
Settlements and judgments	0	0	0	0	0	0
Payments for administrative and other expenses	(418)	(413)	(27)	(20)	(445)	(433)
Accrued interest paid on securities purchased	(276)	(234)	(6)	(3)	(282)	(237)
Net cash provided (used) by operating activities (Note 15)	(686)	(1,531)	60	32	(626)	(1,499)
<b>INVESTING ACTIVITIES:</b>						
Proceeds from sales of investments	88,821	77,382	1,398	667	90,219	78,049
Payments for purchases of investments	(87,614)	(77,090)	(1,409)	(679)	(89,023)	(77,769)
Net change in investment of securities lending collateral	(103)	(1,162)	0	0	(103)	(1,162)
Net change in securities lending payable	103	1,162	0	0	103	1,162
Net cash provided (used) by investing activities	1,207	292	(11)	(12)	1,196	280
Net increase (decrease) in cash and cash equivalents	521	(1,239)	49	20	570	(1,219)
Cash and cash equivalents, beginning of year	3,782	5,021	25	5	3,807	5,026
Cash and cash equivalents, end of year	\$ 4,303	\$ 3,782	\$ 74	\$ 25	\$ 4,377	\$ 3,807

The above cash flows are for trustee plans and do not include non-trustee plans.  
The accompanying notes are an integral part of these financial statements

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## NOTES TO FINANCIAL STATEMENTS

*September 30, 2013 and 2012*

### NOTE 1: ORGANIZATION AND PURPOSE

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and is subject to the provisions of the Government Corporation Control Act. Its activities are defined by ERISA, as that act has been amended over the years. The Corporation insures the pension benefits, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans.

ERISA requires that PBGC programs be self-financing. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

For financial statement purposes, PBGC divides its business activity into two broad areas — “Underwriting Activity” and “Financial Activity” — covering both single-employer and multiemployer program segments. PBGC’s Underwriting Activity provides financial guaranty insurance in return for insurance premiums (whether actually paid or not). Actual and expected probable losses that result from the termination of underfunded pension plans are included in this category, as are actuarial adjustments based on changes in actuarial assumptions, such as mortality. Financial Activity consists of the performance of PBGC’s assets and liabilities. PBGC’s assets consist of premiums collected from defined benefit plan sponsors, assets from distress or involuntarily terminated plans that PBGC has insured, and recoveries from the former sponsors of those terminated plans. PBGC’s future benefit liabilities consist of those future benefits, under statutory limits, that PBGC has assumed following distress or involuntary terminations. Gains and losses on PBGC’s investments and changes in the value of PBGC’s future benefit liabilities (e.g., actuarial charges such as changes in interest rates and expected interest) are included in this area.

As of September 30, 2013, the single-employer and multiemployer programs reported net positions of \$(27,381) million and \$(8,258) million, respectively. The single-employer program had assets of \$83,227 million offset by total liabilities of \$110,608 million, which include a total present value of future benefits (PVFB) of about \$105,018 million. As of September 30, 2013, the multiemployer program had assets of \$1,719 million offset by \$9,931 million in present value of nonrecoverable future financial assistance. Notwithstanding these deficits, the Corporation has sufficient liquidity to meet its obligations (liabilities) for a significant number of years; however, neither program at present has the resources to fully satisfy PBGC’s long-term obligations to plan participants.

PBGC’s \$79,596 million of total investments (including cash and investment income receivable) represents the largest component of PBGC’s Statements of Financial Position combined assets of \$84,946 million at September 30, 2013. This amount of \$79,596 million (as compared to investments under management of \$77,066 million, as reported on page 40) reflects the fact that PBGC experiences a recurring inflow of trusted plan assets that have not yet been incorporated into the PBGC investment program. For total investments (i.e., not the investment program), cash and fixed-income securities (\$53,646 million) represent 67 percent of the total investments, while equity securities (\$22,321 million) represent 28 percent of total investments. Private market assets, real estate, and other investments (\$3,629 million), represent five percent of the total investments.



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## SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAM EXPOSURE

PBGC's estimate of the total underfunding in single-employer plans was \$292,207 million for those sponsored by companies with credit ratings below investment grade and that PBGC classified as reasonably possible of termination as of September 30, 2013. The comparable estimates for FY 2012 and FY 2011 were \$294,963 million and \$227,117 million, respectively. These estimates are measured as of December 31 of the previous year (see Note 9). For FY 2013, this exposure is concentrated in the following sectors: manufacturing (primarily automobile/auto parts and primary and fabricated metals), transportation (primarily airlines), services, and wholesale and retail trade.

PBGC estimates that, as of September 30, 2013, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of \$36,718 million (see Note 9). The comparable estimates for FY 2012 and FY 2011 were \$26,809 million and \$23,097 million, respectively. The increase in FY 2013 is mainly due to the addition of 28 new plans to the reasonably possible inventory. The total reasonably possible exposure is dominated by two large multiemployer plans. The sponsor of one plan, now with net liability of \$20,186 million, is in the "transportation, communication, and utilities" industry category; the other, now with net liability of \$5,781 million, is in the "agriculture, mining, and construction" industry category.

There is significant volatility in plan underfunding and sponsor credit quality over time, which makes long-term estimation of PBGC's expected claims difficult. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized PBGC's experience to date and will likely continue. Among the factors that will influence PBGC's claims going forward are economic conditions affecting interest rates, financial markets, and the rate of business failures.

PBGC's sources of information on plan underfunding are the most recent Section 4010 and PBGC premium filings, and other submissions to the Corporation. PBGC publishes Table S-49, "Various Measures of Underfunding in PBGC-Insured Plans," in its *Pension Insurance Data Tables* where the limitations of the estimates are fully and appropriately described.

Under the single-employer program, PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by PBGC is generally equal to the present value of the future benefits payable by PBGC less amounts provided by the plan's assets and amounts recoverable by PBGC from the plan sponsor and members of the plan sponsor's controlled group, as defined by ERISA.

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from PBGC to allow the plan to continue to pay participants their guaranteed benefits. PBGC recognizes assistance as a loss to the extent that the plan is not expected to be able to repay these amounts from future plan contributions, employer withdrawal liability or investment earnings. Since multiemployer plans do not receive PBGC assistance until fully insolvent, financial assistance is almost never repaid; for this reason such assistance is fully reserved.

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## NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PRESENTATION

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from those estimates.

### RECENT ACCOUNTING DEVELOPMENTS

During FY 2012, PBGC implemented FASB Accounting Standards update No. 2011-04, Fair Value Measurement (Topic 820), *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs)*. This Update includes disclosure of the valuation techniques to price Level 3 fair value measurements, as well as disclosure of the sensitivity of different inputs into the valuation process. In addition, PBGC implemented FASB Accounting Standards Update No. 2011-03, Transfers and Servicing (Topic 860), *Reconsideration of Effective Control for Repurchase Agreements*. This Update, effective in FY 2012, addresses the rescission of financial reporting disclosure requirements to eliminate the collateral maintenance implementation guidance. See Note 3 for disclosures of Repurchase Agreements.

### VALUATION METHOD

A primary objective of PBGC's financial statements is to provide information that is useful in assessing PBGC's present and future ability to ensure that its plan beneficiaries receive benefits when due. Accordingly, PBGC values its financial assets at estimated fair value, consistent with the standards for pension plans contained in the FASB Accounting Standards Codification Section 960, *Defined Benefit Pension Plans*. PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from market-based (fair value) annuity prices from insurance companies, as described in the Statement of Actuarial Opinion. As described in Section 960, the assumptions are "those assumptions that are inherent in the estimated cost at the (valuation) date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." Also, in accordance with Section 960, PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.

The FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosures about fair value measurements. Section 820 applies to accounting pronouncements that require or permit fair value measurements.

### REVOLVING AND TRUST FUNDS

PBGC accounts for its single-employer and multiemployer programs' revolving and trust funds on an accrual basis. Each fund is charged its portion of the benefits paid each year. PBGC includes totals for both the revolving and trust funds for presentation purposes in the financial statements; however, the single-employer and multiemployer programs are separate programs by law and, therefore, PBGC also reports them separately.

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ERISA provides for the establishment of the revolving fund where premiums are collected and held. The assets in the revolving fund are used to cover deficits incurred by plans trustee and to provide funds for financial assistance. The Pension Protection Act of 1987 created a single-employer revolving fund (fund 7) that is credited with all premiums in excess of \$8.50 per participant, including all penalties and interest charged on these amounts, and its share of earnings from investments. This fund may not be used to pay PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

The trust funds include assets (e.g., pension plan investments) PBGC assumes (or expects to assume) once a terminated plan has been trustee, and related investment income. These assets generally are held by custodian banks. The trust funds support the operational functions of PBGC.

The trust funds reflect accounting activity associated with:

- 1) trustee plans — plans for which PBGC has legal responsibility — the assets and liabilities are reflected separately on PBGC's Statements of Financial Position, the income and expenses are included in the Statements of Operations and Changes in Net Position, and the cash flows from these plans are included in the Statements of Cash Flows.
- 2) plans pending termination and trusteeship — plans for which PBGC has begun the process for termination and trusteeship by fiscal year-end — the assets and liabilities for these plans are reported as a net amount on the liability side of the Statements of Financial Position under "Present value of future benefits, net." For these plans, the income and expenses are included in the Statements of Operations and Changes in Net Position, but the cash flows are not included in the Statements of Cash Flows.
- 3) probable terminations — plans that PBGC determines are likely to terminate and be trustee by PBGC — the assets and liabilities for these plans are reported as a net amount on the liability side of the Statements of Financial Position under "Present value of future benefits, net." The accrued loss from these plans is included in the Statements of Operations and Changes in Net Position as part of "Losses from completed and probable terminations." The cash flows from these plans are not included in the Statements of Cash Flows. PBGC cannot exercise legal control over a plan's assets until it becomes trustee.

## **ALLOCATION OF REVOLVING AND TRUST FUNDS**

PBGC allocates assets, liabilities, income and expenses to the single-employer and multiemployer programs' revolving and trust funds to the extent that such amounts are not directly attributable to a specific fund. Revolving fund investment income is allocated on the basis of each program's average cash and investments available during the year, while the expenses are allocated on the basis of each program's number of ongoing plans. Revolving fund assets and liabilities are allocated according to the year-end equity of each program's revolving funds. Plan assets acquired by PBGC and commingled at PBGC's custodian bank are credited directly to the appropriate fund, while the earnings and expenses on the commingled assets are allocated to each program's trust funds on the basis of each trust fund's value, relative to the total value of the commingled fund.

## **CASH AND CASH EQUIVALENTS**

Cash includes cash on hand and demand deposits. Cash equivalents are investments with original maturities of one business day and highly liquid investments that are readily convertible into cash within one business day.

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## SECURITIES LENDING COLLATERAL

PBGC participates in a securities lending program administered by its custodian bank. The custodian bank requires initial collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank or its agent. The custodian bank either receives cash or non-cash as collateral or returns collateral to cover mark-to-market changes. Any cash collateral received is invested by PBGC's investment agent. In addition to the lending program managed by the custodian bank, some of PBGC's investment managers are authorized to invest in securities purchased under resale agreements (an agreement with a commitment by the seller to buy a security back from the purchaser at a specified price at a designated future date), and securities sold under repurchase agreements.

## INVESTMENT VALUATION AND INCOME

PBGC bases market values on the last sale of a listed security, on the mean of the "bid-and-ask" for nonlisted securities, or on a valuation model in the case of fixed income securities that are not actively traded. These valuations are determined as of the end of each fiscal year. Purchases and sales of securities are recorded on the trade date. In addition, PBGC invests in and discloses its derivative investments in accordance with the guidance contained in the FASB Accounting Standards Codification Section 815, *Derivatives and Hedging*. Investment income is accrued as earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are calculated using first-in, first-out for the revolving fund and weighted average cost for the trust fund. PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC.

## SECURITIES PURCHASED UNDER RESALE AGREEMENTS

Securities purchased under resale agreements are agreements whereby the purchaser agrees to buy securities from the seller, and subsequently sell them back at a pre-agreed price and date. Those greater than one day are reported under "Fixed maturity securities" as "Securities purchased under resale agreements" in the Note 3 table entitled "Investments of Single-Employer Revolving Funds and Single-Employer Trusteed Plans," on page 68. Resale agreements that mature in one day are included in "Cash and cash equivalents" which are reported on the Statements of Financial Position.

## SPONSORS OF TERMINATED PLANS

The amounts due from sponsors of terminated plans or members of their controlled group represent the settled, but uncollected, claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for estimated uncollectible amounts. PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. The Corporation will report any such future amounts in the period they are realizable. Income and expenses related to amounts due from sponsors are reported in the underwriting section of the Statements of Operations and Changes in Net Position. Interest earned on settled claims for employer liability and due and unpaid employer contributions (DUEC) is reported as "Income: Other." The change in the allowances for uncollectible employer liability and DUEC is reported as "Expenses: Other."

## PREMIUMS

Premiums receivable represent the plan reported premiums owed, and the PBGC estimated amounts not collected, for plans that have a plan year commencing before the end of PBGC's fiscal year and past due

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premiums deemed collectible, including penalties and interest. The liability for unearned premiums represents annual premium fees which have been received in advance of the period in which they will be earned by PBGC. They remain as liabilities until such time as they are ratably earned over the period of time to which the premium applies. “Premium income, net” represents actual and estimated revenue generated from defined benefit pension plan premium filings as required by Title IV of ERISA less bad debt expense for premiums, interest, and penalties (see Note 11).

## CAPITALIZED ASSETS

Capitalized assets include furniture and fixtures, electronic processing equipment and internal-use software. This includes costs for internally developed software incurred during the application development stage (system design including software configuration and software interface, coding, testing including parallel processing phase). These costs are shown net of accumulated depreciation and amortization.

## PRESENT VALUE OF FUTURE BENEFITS (PVFB)

The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay the participants of trustee plans and the net liability for plans pending termination and trusteeship. The PVFB liability (including trustee plans as well as plans pending termination and trusteeship) is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and members of their controlled group and the assets of plans pending termination and trusteeship as of the date of the financial statements. PBGC also includes the estimated liabilities attributable to plans classified as probable terminations as a separate line item in the PVFB (net of estimated recoveries and plan assets). PBGC uses assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). PBGC also includes anticipated expenses to settle the benefit obligation in the determination of the PVFB. PBGC's benefit payments to participants reduce the PVFB liability.

The values of the PVFB are particularly sensitive to changes in underlying estimates and assumptions. These estimates and assumptions could change and the impact of these changes may be material to PBGC's financial statements (see Note 6).

- (1) **Trustee Plans** – represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trustee by PBGC prior to fiscal year-end. Assets are shown separately from liabilities for trustee plans.
- (2) **Pending Termination and Trusteeship** – represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans for which termination action has been initiated and/or completed prior to fiscal year-end. Unlike trustee plans, the liability for plans pending termination and trusteeship is shown net of plan assets.
- (3) **Settlements and Judgments** – represents estimated liabilities related to settled litigation.
- (4) **Net Claims for Probable Terminations** – In accordance with the FASB Accounting Standards Codification Section 450, *Contingencies*, PBGC recognizes net claims for probable terminations which represent PBGC's best estimate of the losses, net of plan assets, and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in the future. The PBGC threshold for recognition of net claims for probable termination is \$50 million or more of underfunding. These estimated losses are based on conditions that existed as of PBGC's fiscal year-end.

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Management believes it is likely that one or more events subsequent to PBGC's fiscal year-end will occur, confirming the loss.

Criteria used for classifying a specific single-employer plan as a probable termination include, but are not limited to, one or more of the following conditions: the plan sponsor is in liquidation or comparable state insolvency proceeding with no known solvent controlled group member; sponsor has filed or intends to file for distress plan termination and the criteria will likely be met; or PBGC is considering the plan for involuntary termination. In addition, management takes into account other economic events and factors in making judgments regarding the classification of a plan as a probable termination. These events and factors may include, but are not limited to: the plan sponsor is in bankruptcy or has indicated that a bankruptcy filing is imminent; the plan sponsor has stated that plan termination is likely; the plan sponsor has received a going concern opinion from its independent auditors; or the plan sponsor is in default under existing credit agreement(s).

In addition, a reserve for small unidentified probable losses and incurred but not reported (IBNR) claims is recorded based on an actuarial loss development methodology (ratio method) (see Note 6).

(5) PBGC identifies certain plans as high-risk if the plan sponsor is in Chapter 11 proceedings or the sponsor's senior unsecured debt is rated CCC+/Caa1 or lower by S&P or Moody's respectively. PBGC specifically reviews each plan identified as high-risk and classifies those plans as probable if, based on available evidence, PBGC concludes that plan termination is likely (based on criteria described in (4) above). Otherwise, high-risk plans are classified as reasonably possible.

(6) In accordance with the FASB Accounting Standards Codification Section 450, PBGC's exposure to losses from plans of companies that are classified as reasonably possible is disclosed in the footnotes. In order for a plan sponsor to be specifically classified as reasonably possible, it must first have \$5 million or more of underfunding, as well as meet additional criteria. Criteria used for classifying a company as reasonably possible include, but are not limited to, one or more of the following conditions: the plan sponsor is in Chapter 11 reorganization; funding waiver pending or outstanding with the Internal Revenue Service; sponsor missed minimum funding contribution; sponsor's bond rating is below-investment-grade for Standard & Poor's (BB+) or Moody's (Ba1); or sponsor has no bond rating but the Dun & Bradstreet Financial Stress Score is below the threshold considered to be investment grade (see Note 9).

## **PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE**

In accordance with Title IV of ERISA, PBGC provides financial assistance to multiemployer plans, in the form of loans, to enable the plans to pay guaranteed benefits to participants and reasonable administrative expenses. These loans, issued in exchange for interest-bearing promissory notes, constitute an obligation of each plan.

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by PBGC in the future to multiemployer plans that will not be able to meet their benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future guaranteed benefits and expenses and the market value of plan assets, including the present value of future amounts expected to be paid by employers, for those plans that are expected to require future assistance. The amount reflects the rates at which, in the opinion of management, these liabilities (net of expenses) could be settled in the market for single-premium nonparticipating group annuities issued by private insurers (see Note 7).

A liability for a particular plan is included in the "Present Value of Nonrecoverable Future Financial Assistance" when it is determined that the plan is currently, or will likely become in the future, insolvent and will require assistance to pay the participants their guaranteed benefit. In accordance with the FASB Accounting Standards Codification Section 450, *Contingencies*, PBGC recognizes net claims for probable



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insolvencies for plans that are likely to become insolvent and may require future financial assistance. Projecting a future insolvency requires considering several complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status.

Each year, PBGC analyzes insured multiemployer plans to identify those plans that are at risk of becoming claims on the insurance program. Regulatory filings with PBGC and the other ERISA agencies are important to this analysis and determination of risk. In general, if a terminated plan's assets are less than the present value of its liabilities, PBGC considers the plan a probable risk of requiring financial assistance in the future.

PBGC also analyzes ongoing multiemployer plans (i.e., plans that continue to have employers making regular contributions for covered work) to determine whether any such plans may be probable or possible claims on the insurance program. In conducting this analysis each year, PBGC examines plans that are chronically underfunded, have poor cash flow trends, a falling contribution base, and that may lack a sufficient asset cushion to weather income losses. A combination of these factors, or any one factor that is of sufficient concern, leads to a more detailed analysis of the plan's funding and the likelihood that the contributing employers will be willing and able to maintain the plan.

PBGC utilizes specific criteria for insolvent (PBGC's insurable event for multiemployer plans), probable, and reasonably possible classification of multiemployer plans. The criteria are as follows:

- Any multiemployer plans currently receiving financial assistance are classified as insolvent.
- Terminated, underfunded multiemployer plans (i.e., "wasting trusts") are classified as probable.
- Ongoing multiemployer plans projected to become insolvent:
  - within ten years are classified as probable,
  - from ten to twenty years are classified as reasonably possible.

In general, the date of insolvency is estimated by projecting plan cash flows using PBGC's actuarial assumptions for terminated plans, but also considered are projections based on other assumptions, such as those used by the plan actuary.

PBGC periodically reviews important accounting policies. Given the complexities and changes in the economy and in multiemployer plans in recent years, PBGC decided to re-examine the policy and procedures used to quantify the level of liability under the ME guarantee program, to determine whether any changes should be made. After a review that involved a national independent financial advisory firm and included possible alternatives, PBGC decided to retain our current policy and procedures. PBGC will continue to review multiemployer policy and procedures in the future.

The present value of nonrecoverable future financial assistance is presented in the Liability section of the Statements of Financial Position (see Note 7).

## **SECURITIES SOLD UNDER REPURCHASE AGREEMENTS**

Securities sold under repurchase agreements are agreements with a commitment by the seller to buy a security back from the purchaser at a specified price and designated future date. These agreements represent collateralized short-term loans for which the collateral may be a treasury security, money market instrument, federal agency security, or mortgage-backed security. On the Statements of Financial Position, securities sold under repurchase agreements are reported as a liability, "Securities sold under repurchase agreements" at the amounts at which the securities will be subsequently reacquired.



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## **ADMINISTRATIVE EXPENSES**

These operating expenses (for either the single-employer or multiemployer insurance programs) are amounts paid and accrued for services rendered or while carrying out other activities that constitute PBGC's ongoing operations, e.g., payroll, contractual services, office space, material and supplies, etc. The expense allocation methodology fully captures the administrative expenses attributable to either the single-employer or multiemployer insurance programs. In Fiscal Year 2013, PBGC has revised its administrative expense allocation methodology to ensure each insurance program continues to receive its fair share of administrative expenses. This revision was made to capture a more consistent and reliable allocation. All indirect administrative expenses associated with the SE and ME programs are being allocated using the number of ongoing plans in each program.

## **OTHER EXPENSES**

These expenses represent an estimate of the net amount of receivables deemed to be uncollectible during the period. The estimate is based on the most recent status of the debtor (e.g., sponsor), the age of the receivables and other factors that indicate the element of uncollectibility in the receivables outstanding.

## **LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS**

Amounts reported as losses from completed and probable terminations represent the difference as of the actual or expected date of plan termination (DOPT) between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 12). When a plan terminates, the previously recorded probable net claim is reversed and newly estimated DOPT plan assets, recoveries and PVFB are netted and reported on the line "PVFB - Plans pending termination and trusteeship" (this value is usually different than the amount previously reported), with any change in the estimate being recorded in the Statements of Operations and Changes in Net Position. In addition, the plan's net income from date of plan termination to the beginning of PBGC's fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to PBGC's inventory of terminated plans.

## **ACTUARIAL ADJUSTMENTS AND CHARGES (CREDITS)**

PBGC classifies actuarial adjustments related to insurance based changes in method and the effect of experience as underwriting activity; actuarial adjustments are the result of the movement of plans from one valuation methodology to another, e.g., nonseriatim (calculating the liability for the group) to seriatim (calculating separate liability for each person), and of new updated data (e.g., deaths, revised participant data). Actuarial charges (credits) are related to changes in interest rates and expected interest is classified as financial activity. These adjustments and charges (credits) represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 6).

## **DEPRECIATION AND AMORTIZATION**

PBGC calculates depreciation on the straight-line basis over estimated useful lives of 5 years for equipment and 10 years for furniture and fixtures. PBGC calculates amortization for capitalized software, which includes certain costs incurred for purchasing and developing software for internal use, on the straight-line basis over estimated useful lives not to exceed 5 years, commencing on the date that the Corporation determines that the internal-use software is implemented. Routine maintenance and leasehold improvements (the amounts of which are not material) are charged to operations as incurred. Capitalization of software cost

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occurs during the development stage and costs incurred during the preliminary project and post-implementation stages are expensed as incurred.

## PRIOR YEAR RECLASSIFICATION

In FY 2012, cash associated with the foreign currency exchange was recorded to Fixed maturity securities on the Statements of Financial Position, and the Payments for purchases of investments on the Statements of Cash Flows. Beginning FY 2013, PBGC adopted a new policy for cash associated with foreign currency exchange is to be recorded to Cash and cash equivalents. This resulted in an immaterial increase to Cash and cash equivalents of \$15 million and a corresponding decrease to Fixed maturity securities from what was previously reported in the FY 2012 Statements of Financial Position. This resulted in an increase of \$15 million and a corresponding net decrease to Payments for purchases of investments from what was previously reported in the FY 2012 Statements of Cash Flows. These changes were reclassified within the FY 2012 Statements of Financial Position and FY 2012 Statements of Cash Flows, and have no impact on FY 2012 net position.

## NOTE 3: INVESTMENTS

Premium receipts are invested through the revolving fund in U.S. Treasury securities. The trust funds include assets PBGC assumes or expects to assume with respect to terminated plans (e.g., recoveries from sponsors) and investment income thereon. These assets generally are held by custodian banks. The basis and market value of the investments by type are detailed below as well as related investment profile data. The basis indicated is cost of the asset if assumed after the date of plan termination or the market value at date of plan termination if the asset was assumed as a result of a plan's termination. PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC. Investment securities denominated in foreign currency are translated into U.S. dollars at the prevailing exchange rates at period end. Purchases and sales of investment securities, income, and expenses are translated into U.S. dollars at the prevailing exchange rates on the respective dates of the transactions. The portfolio does not isolate that portion of the results of operations resulting from changes in foreign exchange rates of investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gain or loss on investments. For PBGC's securities, unrealized holding gains and losses are both recognized by including them in earnings. Unrealized holding gains and losses measure the total change in fair value – consisting of unpaid interest income earned or unpaid accrued dividend and the remaining change in fair value from holding the security.

To Be Announced (TBA) and Bond Forward transactions are recorded as regular buys and sells of investments and not as derivatives. TBA is a contract for the purchase or sale of mortgage-backed securities to be delivered on a future date. The term TBA is derived from the fact that the actual mortgage-backed security that will be delivered to fulfill a TBA trade is not designated at the time the trade is made. The securities are to be announced 48 hours prior to the established trade settlement date. TBAs are issued by FHLMC, FNMA, and GNMA. In accordance with FASB Accounting Standards Codification Section 815, *Derivatives and Hedging*, TBA and Bond Forward contracts are deemed regular way trades as they are completed within the time frame generally established by regulations and conventions in the market place or by the exchange on which they are executed. Thus, recording of TBA and Bond Forward contracts recognizes the acquisition or disposition of the securities at the full contract amounts on day one of the trade.

Bond forwards and TBAs are reported to "Receivables, net – Sale of securities" and "Due for purchases of securities" from derivative contracts receivables and payables. As of September 30, 2013, Bond Forwards receivable was approximately \$133 million and TBA's receivable was approximately \$175 million. In

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addition, as of September 30, 2013, Bond Forwards payable was approximately \$145 million and TBA's were approximately \$576 million.

## INVESTMENTS OF SINGLE-EMPLOYER REVOLVING FUNDS AND SINGLE-EMPLOYER TRUSTEED PLANS

(Dollars in millions)	September 30, 2013		September 30, 2012	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$22,141	\$22,132	\$21,122	\$23,629
Commercial paper/securities purchased under resale agreements	54	54	442	442
Asset backed securities	2,937	2,999	3,350	3,509
Pooled funds				
Domestic	1,239	1,131	1,138	1,197
International	495	503	0 *	0 *
Global/other	0	0	0 *	0 *
Corporate bonds and other	9,840	10,309	9,798	11,073
International securities	10,211	10,068	8,429	9,100
Subtotal	46,917	47,196	44,279	48,950
Equity securities:				
Domestic	2,168	2,719	2,047	2,417
International	1,291	1,469	575	670
Pooled funds				
Domestic	5,519	8,740	7,440	9,642
International	5,731	9,389	5,805	8,733
Global/other	0 *	0 *	1	1
Subtotal	14,709	22,317	15,868	21,463
Private equity	1,355	1,228	1,398	1,339
Real estate and real estate investment trusts	2,364	2,373	445	878
Insurance contracts and other investments	35	28	84	77
Total**	\$65,380	\$73,142 ***	\$62,074	\$72,707

\* Less than \$500,000

\*\* Total includes securities on loan at September 30, 2013, and September 30, 2012, with a market value of \$4,230 million and \$4,298 million, respectively.

\*\*\* This total of \$73,142 million of investments at market value represents the single-employer assets only.

## INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

(Dollars in millions)	September 30, 2013		September 30, 2012	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$1,626	\$1,632	\$1,568	\$1,767
Equity securities	0	0	0	0
Total	\$1,626	\$1,632	\$1,568	\$1,767

## INVESTMENT PROFILE

	September 30,	
	2013	2012
Fixed Income Assets		
Average Quality	AA	AA
Average Maturity (years)	13.3	14.0
Duration (years)	8.5	9.3
Yield to Maturity (%)	3.4	2.7
Equity Assets		
Average Price/Earnings Ratio	20.1	15.6
Dividend Yield (%)	2.6	2.6
Beta	1.06	1.03

## DERIVATIVE INSTRUMENTS

PBGC assigns investment discretion and grants specific authority to all of its investment managers to invest according to specific portfolio investment guidelines PBGC has established. PBGC further limits the use of derivatives by investment managers through tailored provisions in the investment guidelines with investment managers consistent with PBGC's investment policy statement and overall risk tolerance. These investment managers, who act as fiduciaries to PBGC, determine when it may or may not be appropriate to utilize derivatives in the portfolio(s) for which they are responsible. Investments in derivatives carry many of the same risks of the underlying instruments and carry additional risks that are not associated with direct investments in the securities underlying the derivatives.

Risks may arise from the potential inability to terminate or sell derivative positions, although derivative instruments are generally more liquid than physical market instruments. A liquid secondary market may not always exist for certain derivative positions. Over-the-counter derivative instruments also involve counterparty risk that the other party to the derivative instrument will not meet its obligations.

The use of derivatives by PBGC investment managers is restricted in-so-far as portfolios cannot utilize derivatives to create leverage in the portfolios for which they are responsible. Thus, the portfolios shall not utilize derivatives to leverage the portfolio beyond the maximum risk level associated with a fully invested portfolio of physical securities.

Derivative instruments are used to mitigate risk (e.g., adjust duration or currency exposures), enhance investment returns, and/or as liquid and cost-efficient substitutes for positions in physical securities. These derivative instruments are not designated as accounting hedges consistent with FASB Accounting Standards Codification Section 815, *Derivatives and Hedging*, which requires an active designation as a prerequisite for any hedge accounting. PBGC utilizes a no hedging designation which results in the gain or loss on a derivative instrument to be recognized currently in earnings. Derivatives are accounted for at fair market value in accordance with the FASB Accounting Standards Codification Section 815, *Derivatives and Hedging*. Derivatives are marked to market with changes in value reported as a component of financial income on the Statements of Operations and Changes in Net Position. PBGC presents all derivatives at fair value on the Statements of Financial Position.

During fiscal years 2013 and 2012, PBGC, through its investment managers, invested in investment products that used various U.S. and non-U.S. derivative instruments. Those products included, but are not limited to, equity index futures, options, money market futures, government bond futures, interest rate, credit default and total return swaps and swaption contracts, stock warrants and rights, debt option contracts, and foreign

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currency forward and option contracts. Some of these derivatives are traded on organized exchanges and thus bear minimal counterparty risk. The counterparties to PBGC's non-exchange-traded derivative contracts are major financial institutions subject to ISDA (International Swaps and Derivatives Association, Inc.) master agreements. PBGC monitors PBGC's counterparty risk and exchanges collateral under most contracts to further support performance by counterparties. Some of PBGC's non-exchange traded derivative contracts are centrally cleared through a CFTC-recognized clearinghouse and the required margin (collateral) is maintained by the clearinghouse to support the performance by counterparties, which are members of the clearinghouse. A clearinghouse reduces the settlement risks by netting offsetting transactions between multiple counterparties, by requiring higher levels of collateral deposits or margin requirements compared to bilateral arrangements. Settlement risks are reduced also by the clearinghouse providing independent valuation of trades and margin, monitoring the credit worthiness of the clearing firms, and providing a guarantee fund, which could be used to cover losses that exceed a defaulting clearing firm's margin on deposit.

A futures contract is an agreement between a buyer or seller and an established futures exchange clearinghouse in which the buyer or seller agrees to take or make a delivery of a specific amount of a financial instrument at a specified price on a specific date (settlement date) in the future. The futures exchanges and clearinghouses clear, settle, and guarantee transactions occurring through their facilities. Upon entering into a futures contract, an "initial margin" amount (in cash or liquid securities) of generally one to six percent of the face value indicated in the futures contract is required to be deposited with the broker. Open futures positions are marked to market daily. Subsequent payments known as "variation margin" are made or received by the portfolio dependent upon the daily fluctuations in value of the underlying contract. PBGC maintains adequate liquidity in its portfolio to meet these margin calls.

PBGC also invests in forward contracts. A forward foreign currency contract is a commitment to purchase or sell a foreign currency at the settlement date (in the future) at a negotiated rate. Foreign currency forward, futures, and option contracts may be used as a substitute for cash currency holdings. This is in order to minimize currency risk exposure to changes in foreign currency exchange rates and to adjust overall currency exposure to reflect the investment views of the fixed income and equity portfolio managers regarding relationships between currencies.

A swap is an agreement between two parties to exchange different financial returns on a notional investment amount. The major forms of swaps traded are interest rate swaps, credit default swaps, and total return swaps. These swaps are netted for reporting purposes. PBGC uses swap and swaption (an option on a swap) contracts to adjust exposure to interest rates, fixed income securities exposure, credit exposure, and equity exposure, and to generate income based on the investment views of the portfolio managers regarding interest rates, indices and individual issues.

Interest rate swaps involve exchanges of fixed rate and floating rate interest. Interest rate swaps are often used to alter exposure to interest rate fluctuations, by swapping fixed rate obligations for floating rate obligations, or vice versa. The counterparties to the swap agree to exchange interest payments on specific dates, according to a predetermined formula. The payment flows are usually netted against each other, with one party paying the difference to the other.

A credit default swap is a contract between a buyer and seller of protection against pre-defined credit events. PBGC may buy or sell credit default swap contracts to seek to increase the portfolio's income or to mitigate the risk of default on portfolio securities.

A total return swap is a contract between a buyer and seller of exposures to certain asset classes such as equities. PBGC may buy or sell total return contracts to seek to increase or reduce the portfolio's exposure to certain asset classes.

An option contract is a contract in which the writer of the option grants the buyer of the option the right to purchase from (call option) or sell to (put option) the writer a designated instrument at a specified price within a specified period of time.

Stock warrants and rights allow PBGC to purchase securities at a stipulated price within a specified time limit.

For the fiscal years ended September 30, 2013 and 2012, gains and losses from settled margin calls are reported in Investment income on the Statements of Operations and Changes in Net Position. Securities and cash are pledged as collateral for derivative contracts (e.g., futures and swaps) are recorded as a receivable or payable.

Pursuant to the provisions of the FASB Accounting Standards Codification Section 815, *Derivatives and Hedging*, this standard requires the disclosure of fair values of derivative instruments and their gains and losses in its financial statements of both the derivative positions existing at period end and the effect of using derivatives during the reporting period. The first table below identifies the location of derivative fair market values (FMV) on the Statements of Financial Position, as well as the notional amounts. The second table identifies the location of derivative gains and losses on the Statements of Operations and Changes in Net Position as of September 30, 2013, and September 30, 2012.

#### FAIR VALUES OF DERIVATIVE INSTRUMENTS

(Dollars in millions)	Asset Derivative					
	September 30, 2013					
	Statements of Financial Position Location	Notional	FMV	Statements of Financial Position Location	Notional	FMV
Futures	Derivative Contracts	\$1,859	\$17	Derivative Contracts	\$1,323	\$4
Swap agreements						
Interest rate swaps	Investments-Fixed	6,536	19	Investments-Fixed	1,904	12
Credit default swaps	Investments-Fixed	1,702	(6)	Investments-Fixed	2,180	14
Option contracts	Investments-Fixed	46	1	Investments-Fixed	146	2
Forwards - foreign exchange	Investments-Fixed	8,759	(65)	Investments-Fixed	4,650	(27)
	Investments-Equity	0	0	Investments-Equity	0 *	0 *

(Dollars in millions)	Liability Derivative					
	September 30, 2013					
	Statements of Financial Position Location	Notional	FMV	Statements of Financial Position Location	Notional	FMV
Futures	Derivative Contracts	\$2,016	\$ (13)	Derivative Contracts	\$2,283	\$ (9)
Option contracts	Derivative Contracts	107	0 *	Derivative Contracts	1,042	(11)

\* Less than \$500,000

Additional information specific to derivative instruments is disclosed in Note 4 – Derivative Contracts, and Note 5 – Fair Value Measurements.



## EFFECT OF DERIVATIVE CONTRACTS ON THE STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
		Sept. 30, 2013	Sept. 30, 2012
<i>(Dollars in millions)</i>			
Futures			
Contracts in a receivable position	Investment Income-Fixed	(\$142)	\$9
Contracts in a receivable position	Investment Income-Equity	0	0
Contracts in a payable position	Investment Income-Fixed	75	69
Contracts in a payable position	Investment Income-Equity	0	0
Swap agreements			
Interest rate swaps	Investment Income-Fixed	36	14
Credit default swaps	Investment Income-Fixed	(16)	38
Option contracts			
Options purchased (long)	Investment Income-Fixed	17	(14)
Options purchased (long)	Investment Income-Equity	0	0
Options written (sold short)	Investment Income-Fixed	(7)	4
Options written (sold short)	Investment Income-Equity	0	0
Forward contracts			
Forwards - foreign exchange	Investment Income-Fixed	(94)	14
	Investment Income-Equity	0	0

\* Less than \$500,000

Additional information specific to derivative instruments is disclosed in Note 4 - Derivative Contracts and Note 5 - Fair Value Measurements.

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## SECURITIES LENDING

PBGC participates in a securities lending program administered by its custodian bank. The custodian bank requires initial collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank or its agent. The custodian bank either receives cash or non-cash as collateral or returns collateral to cover mark-to-market changes. Any cash collateral received is invested by PBGC's investment agent. In addition to the lending program managed by the custodian bank, some of PBGC's investment managers are authorized to invest in securities purchased under resale agreements (an agreement with a commitment by the seller to buy a security back from the purchaser at a specified price at a designated future date), and securities sold under repurchase agreements.

The total value of securities on loan at September 30, 2013, and September 30, 2012, was \$4,230 million and \$4,298 million, respectively. The total amount of securities available for loan were \$26,311 million as of September 30, 2013 and \$26,934 million as of September 30, 2012. The ratio of the market value of the securities on loan and the market value of the lendable securities is the utilization rate which was relatively unchanged year over year, moving from 15.9% in September 30, 2012 to 16.1% in September 30, 2013.

U.S. Government securities continue to represent PBGC's largest amount of assets on loan; of the \$4,230 million market value of securities on loan at September 30, 2013, approximately 57 percent are lent U.S. Government securities. The 2013 year-end lendable balance for U.S. Government securities was approximately \$6,151 million or 23 percent of PBGC's overall lendable securities balance; while the September 30, 2012 balance for U.S. Government securities was approximately \$7,011 million or 26 percent of PBGC's overall lendable security balance. Utilization of U.S. Government securities increased year over year from 32.7% to 39.2%.

The amount of cash collateral received for these loaned securities was \$3,322 million at September 30, 2013, and \$3,425 million at September 30, 2012. These amounts are recorded as assets and are offset with a corresponding liability. For lending agreements collateralized by securities, no accompanying asset or liability is recorded, as PBGC does not sell or re-pledge the associated collateral. For those securities lending activities that PBGC directs through its custodian manager, the corporation chooses to invest proceeds from securities lending in the Quality A cash collateral pool. PBGC earned \$19 million from its agency securities lending programs as of September 30, 2013. Also contributing to PBGC's securities lending income is its participation in certain pooled index funds. Net income from securities lending is included in "Investment income – Fixed" on the Statements of Operations and Changes in Net Position.

PBGC does not have the right by contract or custom to sell or re-pledge non-cash collateral; it is no longer reported on the Statements of Financial Position. Non-cash collateral, which consists of highly rated debt instruments, remains at material levels.

## REPURCHASE AGREEMENTS

PBGC's repurchase agreements entitle and obligate us to repurchase or redeem the same or substantially the same securities that were previously transferred as collateralized securities. In addition, its repurchase agreements require us to redeem the collateralized securities, before maturity at a fixed determinable price.

As of September 30, 2013, PBGC had \$19 million in Repurchase Agreements. This amount represents maturities of one day and is reported as an asset and included in the "Cash and cash equivalents" balance. There was no associated liability for these secured borrowings reported as "Securities sold under repurchase agreements." PBGC has no restrictions placed on the cash received for all of its outstanding repurchase agreements as of September 30, 2013.

## NOTE 4: DERIVATIVE CONTRACTS

PBGC's derivative financial instruments are recorded at fair value and are included on the Statements of Financial Position as investments and derivative contracts. Foreign exchange forwards are included in "Fixed maturity securities". Swaps are netted for the individual contracts as "Receivables, net – Derivative contracts" and "Derivative contracts" (liabilities). Bond forwards and TBAs are reclassified as "Receivables, net – Sale of securities" and "Due for purchases of securities" from derivative contracts receivables and payables. The amounts subject to credit risk related to derivative instruments are generally limited to the amounts, if any, by which the counterparty's obligations exceed our obligations with that counterparty. PBGC considers this risk remote and does not expect the settlement of these transactions to have a material effect in our Statements of Operations or Changes in Net Position and Statements of Financial Position.

Amounts in the table below represent the derivative contracts in a receivable position at financial statement date. Collateral deposits of \$103 million, which represent cash paid as collateral on certain derivative contracts, are shown below.

### DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2013	September 30, 2012
Open receivable trades on derivatives:		
Collateral deposits	\$103	\$79
Futures contracts	16	4
Interest rate swaps	77	0 *
Credit default swaps	80	0
Total	<u>\$276</u>	<u>\$83</u>

\* Less than \$500,000

Amounts in the Derivative Contracts table below represent derivative contracts in a payable position at financial statement date which PBGC reflects as a liability. Collateral deposits of \$51 million, which represent cash received as collateral on certain derivative contracts, are included.

### DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2013	September 30, 2012
Open payable trades on derivatives:		
Collateral deposits	\$51	\$72
Futures contracts	13	9
Interest rate swaps	66	0
Credit default swaps	80	2
Options-fixed income	0 *	11
Total	<u>\$210</u>	<u>\$94</u>

\* Less than \$500,000

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## NOTE 5: FAIR VALUE MEASUREMENTS

Pursuant to the provisions of the FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures*, the standard provides a consistent definition of fair value and establishes a framework for measuring fair value in accordance with U.S. GAAP. It does not require the measurement of financial assets and liabilities at fair value. The standard is intended to increase consistency and comparability in, and disclosures about, fair value measurements, by giving users better information about how extensively PBGC uses fair value to measure financial assets and liabilities, the inputs PBGC used to develop those measurements and the effect of the measurements, if any, on financial condition, results of operations, liquidity and capital.

Section 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an “exit price”) in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date. When PBGC measures fair value for its financial assets and liabilities, PBGC considers the principal or most advantageous market in which we would transact. PBGC also considers assumptions that market participants would use when pricing the asset or liability. When possible, PBGC looks to active and observable markets to measure the fair value of identical, or similar, financial assets or liabilities. When identical financial assets and liabilities are not traded in active markets, PBGC looks to market observable data for similar assets and liabilities. In some instances, certain assets and liabilities are not actively traded in observable markets, and as a result PBGC uses alternative valuation techniques to measure their fair value.

In addition, Section 820 establishes a hierarchy for measuring fair value. That hierarchy is based on the observability of inputs to the valuation of a financial asset or liability as of the measurement date. The standard also requires the recognition of trading gains or losses related to certain derivative transactions whose fair value has been determined using unobservable market inputs.

PBGC believes that its valuation techniques and underlying assumptions used to measure fair value conform to the provisions of Section 820. PBGC has categorized the financial assets and liabilities that PBGC carries at fair value in the Statements of Financial Position based upon the standard’s valuation hierarchy. The hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), the next highest priority to pricing methods with significant observable market inputs (Level 2), and the lowest priority to significant unobservable valuation inputs (Level 3).

If the inputs used to measure a financial asset or liability cross different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement. Management’s assessment of the significance of a particular input to the overall fair value measurement of a financial asset or liability requires judgment, and considers factors specific to that asset or liability, as follows:

*Level 1* - Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market. PBGC’s Level 1 investments primarily included are exchange-traded equity securities and certain U.S. Government securities.

*Level 2* - Financial assets and liabilities whose values are based on quoted prices for similar assets and liabilities in active markets. PBGC also considers inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability. Level 2 inputs to the valuation methodology include:

- a. Quoted prices for similar assets or liabilities in active markets. This includes cash equivalents, securities lending collateral, U.S. Government securities, asset backed securities, fixed foreign investments, corporate bonds, repos, bond forwards, and swaps
- b. Quoted prices for identical or similar assets or liabilities in non-active markets. This includes corporate stock, pooled funds fixed income, pooled funds equity, and foreign investments equity

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- c. Pricing models whose inputs are observable for substantially the full term of the asset or liability – included are insurance contracts and bank loans
  - d. Pricing models whose inputs are derived principally from or are corroborated by observable market information through correlation or other means for substantially the full term of the asset or liability

*Level 3* - Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable in the market and significant to the overall fair value measurement. These inputs reflect PBGC's judgment about the assumptions that a market participant would use in pricing the asset or liability, and based on the best available information. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. PBGC includes instruments whose values are based on a single source such as a broker, pricing service, or dealer which cannot be corroborated by recent market transactions. These include fixed maturity securities such as corporate bonds that are comprised of securities that are no longer traded on the active market and/or not managed by any asset manager. Equity securities such as corporate stocks are also included, comprised of securities that are no longer traded on the active market and/or not managed by any asset manager. Real estate funds that invest primarily in U.S. commercial real estate, are valued based on each underlying investment within the fund/account; they incorporate valuations that consider the evaluation of financing and sale transactions with third parties, expected cash flows and market-based information, including comparable transactions, and performance multiples, among other factors.

The assets and liabilities that PBGC carries at fair value are summarized by the three levels required by Section 820 in the following table. The fair value of the asset or liability represents the “exit price” – the price that would be received to sell the asset or paid to transfer the liability.

FAIR VALUE MEASUREMENTS ON A RECURRING BASIS AS OF SEPTEMBER 30, 2013

<i>(Dollars in millions)</i>	Quoted Market Prices in Active Markets (Level 1)	Pricing Methods with Significant Observable Market Inputs (Level 2)	Pricing Methods with Significant Unobservable Market Inputs (Level 3)	Total Net Carrying Value in Statements of Financial Position
<b>Assets</b>				
Cash and cash equivalents	\$ 559	\$ 3,818		\$ 4,377
Securities lending collateral		3,322		3,322
Investments:				
Fixed maturity securities		23,764		
U.S. Government securities				
Commercial paper/securities purchased under resale agreements		54		
Asset backed/Mortgage backed securities		2,999		
Pooled funds				
Domestic	2	897	232	
International		503		
Global/other				
Corporate bonds and other	1	10,308		
International securities	(65)	10,133		
Total fixed maturity securities	(62)	48,658	232	48,828
Equity securities:				
Domestic	2,604	115	0***	
International	1,465	4		
Pooled funds				
Domestic	16	8,724		
International	2	9,387		
Global/other	0***	-	0	
Total equity securities	4,087	18,230	0***	22,317
Private equity			1,228	1,228
Real estate and real estate investment trusts	10	1,904	459	2,373
Insurance contracts and other Investments		21	7	28
Receivables:				
Derivative contracts*	16	260		276
<b>Liabilities</b>				
Payables:				
Derivative contracts**	13	197		210

\* Derivative contracts receivables are comprised of open receivable trades on futures, swaps, and collateral deposits. See the Derivative Contracts table under Note 4.

\*\* Derivative contracts payables are comprised of open payable trades on futures, swaps, options, and collateral deposits. See the Derivative Contracts table under Note 4.

\*\*\* Less than \$500,000.

As of September 30, 2013, there were no significant transfers between Level 1 and Level 2. The end of the reporting period is the date used to recognize transfers between levels.

CHANGES IN LEVEL 3 ASSETS AND LIABILITIES MEASURED AT FAIR VALUE ON A RECURRING BASIS FOR THE YEAR ENDED SEPTEMBER 30, 2013

<i>(Dollars in millions)</i>	Fair Value at September 30, 2012	Total Realized and Unrealized Gains (Losses) included in Income	Purchases	Sales	Transfers Into Level 3	Transfers Out of Level 3	Fair Value at September 30, 2013	Change in Unrealized Gains (Losses) Related to Financial Instruments held at September 30, 2013 **
<b>Assets:</b>								
Pooled funds (fixed) Corporate bonds and other *	\$ 277	\$(45)					\$ 232	\$ (45)
Domestic/Int'l equity *	0	0	0	0			0	0
Private equity	7	(1)	4	(15)	5		0***	1
	1,339	(79)	54	(86)	0***		1,228	(68)
Real estate & real estate investment trusts	508	(55)	15	(9)			459	(55)
Other *	2	0***	6	(1)			7	0***

\*Assets which are not actively traded in the market place.

\*\* Amounts included in this column solely represent unrealized gains and losses and cannot be derived from other columns in this table.

\*\*\* Less than \$500,000.



Pursuant to FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures – Investments in Certain Entities That Calculate Net Asset Value per Share*; additional disclosures for Investments priced at Net Asset Value are discussed below.

INVESTMENTS IN CERTAIN ENTITIES THAT CALCULATE NET ASSET VALUE PER SHARE  
(OR ITS EQUIVALENT) FOR THE YEAR ENDED  
SEPTEMBER 30, 2013

	Fair Value (in millions)	Unfunded Commitments <sup>1</sup>	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Real estate (a)	\$ 2,373	\$ 92	n/a	n/a
Private equity (b)	1,228	246	n/a	n/a
Pooled funds (c)	<u>19,763</u>	<u>0</u>	n/a	n/a
Total	<u>\$ 23,364</u>	<u>\$338</u>		

<sup>1</sup> Unfunded amounts include recallable distributions. A substantial portion of the unfunded commitments is unlikely to be called.

- a. This class includes 150 real estate investments that invest primarily in U.S. commercial real estate, and to a lesser extent, U.S. residential real estate. The fair value of each individual investment in this class has been estimated using the net asset value of the PBGC's ownership interest in partners' capital. Generally, these investments do not have redemption provisions. Distributions from each fund will be received as the underlying assets of the fund will be liquidated over the next ten years or so. In addition, distributions will also include any periodic income distributions received. No fund investments in this class are planned to be sold. Individual portfolio investments will be sold over time, however, those have not yet been determined.
- b. This class includes 602 private market investments that invest primarily in U.S. buyout and U.S. venture capital funds. A small number of those focus on natural resources. These investments do not have redemption provisions. Instead, the nature of the investments in this class is that distributions are received through the liquidation of the underlying assets of the funds. If these investments were held, it is estimated that the underlying assets of the fund would be liquidated over the next twelve years. However, the individual investments that will be sold have not yet been determined. The fair value of each individual investment has been estimated using the net asset value of the PBGC's ownership interest in partners' capital.
- c. This class includes investments in unit trusts that are intended to match returns of domestic and international indices. Units reflect a pro-rata share of the fund's investments. The per unit net asset value is determined each business day based on the fair value of the fund's investments. Issuances and redemptions are possible daily when a per unit value is determined and are based upon the closing per unit net asset value.

PBGC uses recent prices of group annuities to derive the interest factors used to calculate the present value of future benefit-payment obligations. PBGC determines the interest-factor set that, when combined with a specified mortality table, produces present values that approximate the prices private insurers would charge to annuitize the same benefit-payment obligations.

Based on this valuation and in accordance with the provisions of the FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures*, the significant unobservable inputs for the liability is the interest rate risk for Level 3 fair value measurements. A change in interest factors has an impact to the calculation of PBGC's present value of future benefits (PVFB) and the impact will be reflected in the Change due to interest factors. The table below summarizes the hypothetical results of using a 100 basis point difference causing the PVFB liability to increase (decrease) with a corresponding decrease (increase) in the interest rates. Furthermore, any such hypothetical change in the PVFB liability would have a corresponding effect on "Due to change in interest factors" expense.

**HYPOTHETICAL AND ACTUAL INTEREST RATE SENSITIVITY CALCULATIONS OF PVFB  
SINGLE-EMPLOYER TRUSTEED PLANS AND THE MULTIEMPLOYER PROGRAM\***

<b>September 30, 2013</b> <i>(Dollars in millions)</i>	<b>Hypothetical Rates</b> <b>2.25% for 20 years,</b> <b>2.32% thereafter</b>	<b>Actual Rates**</b> <b>3.25% for 20 years,</b> <b>3.32% thereafter</b>	<b>Hypothetical Rates</b> <b>4.25% for 20 years,</b> <b>4.32% thereafter</b>
Single-Employer Program	\$115,375	<b>\$103,170</b>	\$93,062
Multiemployer Program	11,527	<b>9,931</b>	8,599
Total	\$126,902	<b>\$113,101</b>	\$101,661

\*Level 3 Fair Value Measurements

\*\*Actual rates and PVFB amounts calculated for September 30, 2013 quarterly financial statements.

## NOTE 6: PRESENT VALUE OF FUTURE BENEFITS

The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay for trustee plans and plans pending termination and trusteeship. For financial statement purposes, the net assets of plans pending termination and trusteeship (including estimated recoveries, assets, and miscellaneous liabilities) are included in the line item "Plans Pending Termination and Trusteeship." The estimated losses on probable future plan terminations are also included in the PVFB. The PVFB liability is stated at the actuarial present value of estimated future benefit payments.

For FY 2013, PBGC used a 20 year select interest factor of 3.25% followed by an ultimate factor of 3.32% for as long as benefits are to be paid. In FY 2012, PBGC used a 25-year select interest factor of 3.28% followed by an ultimate factor of 2.97% for the remaining years. These factors were determined to be those needed (given the mortality assumptions), to continue to match the survey of annuity prices provided by the American Council of Life Insurers (ACLI). Both the interest factor and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in PBGC's opinion, the liabilities (net of administrative expenses) could be settled in the market at September 30, for the respective year, for single-premium nonparticipating group annuities issued by private insurers. Many factors may affect

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these rates, including Federal Reserve policy, changing expectations about longevity risk, and competitive market conditions.

For FY 2013, PBGC used the Retirement Plan-2000 Combined Healthy (RP-2000 CH) Male and Female Tables, each set back one year and projected 24 years to 2024 using Scale AA. For September 30, 2012, PBGC used the same table, set back one year and projected 22 years to 2022 using Scale AA. The number of years that PBGC projects the mortality table reflects the number of years from the 2000 base year of the table to the end of the fiscal year (13 years in FY 2013, 12 years in FY 2012) plus PBGC's calculated duration of its liabilities (11 years in FY 2013 and 10 years in FY 2012).

The ACLI survey of annuity prices, when combined with the mortality table, provides the basis for determining the interest factors used in calculating the PVFB. The insurance company prices, when combined with the stronger mortality table, results in a higher interest factor.

The expense reserve factor for administrative expenses beginning with the FY 2007 valuation is 1.37 percent plus additional reserves for cases in which plan asset determinations, participant database audits and actuarial valuations were not yet complete. In addition to the completion of these milestones, PBGC continues to base the reserve on case size, number of participants and time since trusteeship.

PBGC has in place a policy that allows the Corporation to not decrease a final benefit determination that is overstated by \$5 or less. The effect of this policy is carried through to the calculation of the PVFB liability.

The present values of future benefits for trustee multiemployer plans for FY 2013 and FY 2012 reflect the payment of benefits and the changes in interest and mortality assumptions, expected interest and the effect of experience.

The resulting liability represents PBGC's best estimate of the measure of anticipated experience under these programs.

The table on the following page summarizes the actuarial adjustments, charges and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 2013 and for the fiscal year ended September 30, 2012.

**RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS  
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012**

	September 30,	
<i>(Dollars in millions)</i>	2013	2012
Present value of future benefits, at beginning		
of year -- Single-Employer, net	\$105,635	\$92,953
Estimated recoveries, prior year	243	205
Assets of terminated plans pending trusteeship, net, prior year	271	280
Present value of future benefits at beginning of year, gross	<u>106,150</u>	<u>93,438</u>
Settlements and judgments, prior year	(56)	(56)
Net claims for probable terminations, prior year	(2,035)	(833)
Actuarial adjustments -- underwriting:		
Changes in method and assumptions	\$ 332	\$ 76
Effect of experience	(733)	153
Total actuarial adjustments -- underwriting	<u>(401)</u>	<u>229</u>
Actuarial charges -- financial:		
Expected interest	3,388	3,927
Change in interest factors	67	10,718
Total actuarial charges -- financial	<u>3,455</u>	<u>14,645</u>
Total actuarial charges, current year	3,054	14,874
Terminations:		
Current year	4,246	2,035
Changes in prior year	(132)	(16)
Total terminations	<u>4,114</u>	<u>2,019</u>
Benefit payments, current year*	(5,449)	(5,384)
Estimated recoveries, current year**	(44)	(243)
Assets of terminated plans pending trusteeship, net, current year	(1,517)	(271)
Settlements and judgments, current year	57	56
Net claims for probable terminations:		
Future benefits***	1,166	7,686
Estimated plan assets and recoveries from sponsors	(421)	(5,651)
Total net claims, current year	<u>745</u>	<u>2,035</u>
Present value of future benefits, at end of year -- Single-Employer, net	<u>105,018</u>	<u>105,635</u>
Present value of future benefits, at end of year -- Multiemployer	<u>0</u>	<u>1</u>
Total present value of future benefits, at end of year, net	<u>\$105,018</u>	<u>\$105,636</u>

\* The benefit payments of \$5,449 million and \$5,384 million include \$75 million in FY 2013 and \$51 million in FY 2012 for benefits paid from plan assets by plans prior to trusteeship.

\*\* On December 31, 2012, PBGC entered into an agreement with United Continental Holdings, Inc. (UAL) providing for, among other things, the replacement of (i) UAL's contingent obligation to issue up to \$500 million principal amount of 8% Contingent Senior Notes if certain financial triggers were met, of which \$188 million had been incurred as of December 31, 2012, with \$400 million principal amount of new 8% Notes due 2024 and (ii) the \$652 million outstanding of UAL's 6% Senior Notes due 2031 with \$326 million principal amount of new 6% Notes due 2026 and \$326 million principal amount of new 6% Notes due 2028.

\*\*\* The future benefits for probable terminations of \$1,166 million and \$7,686 million for fiscal years 2013 and 2012, respectively, include \$394 million and \$299 million, respectively, for probable terminations not specifically identified and \$772 million and \$7,387 million, respectively, for specifically identified probables.

The following table details the assets that make up single-employer terminated plans pending termination and trusteeship:

### ASSETS OF SINGLE-EMPLOYER PLANS PENDING TERMINATION AND TRUSTEESHIP, NET

	September 30, 2013		September 30, 2012	
	Basis	Market Value	Basis	Market Value
<i>(Dollars in millions)</i>				
U.S. Government securities	\$ 0	\$ 0	\$ 0	\$ 0
Corporate and other bonds	703	701	108	109
Equity securities	825	840	164	170
Private equity	0	0	0	0
Insurance contracts	1	1	0 *	0 *
Other	(52)	(25)	(8)	(8)
Total, net	<b>\$1,477</b>	<b>\$1,517</b>	<b>\$264</b>	<b>\$271</b>

\* Less than \$500,000

### NET CLAIMS FOR PROBABLE TERMINATIONS

Factors that are presently not fully determinable may be responsible for these claim estimates differing from actual experience. Included in net claims for probable terminations is a provision for future benefit liabilities for plans not specifically identified.

The values recorded in the following reconciliation table have been adjusted to the expected dates of termination.

### RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS

<i>(Dollars in millions)</i>	September 30,	
	2013	2012
Net claims for probable terminations, at beginning of year	\$ 2,035	\$ 833
New claims	\$ 352	\$ 1,736
Actual terminations	(492)	(150)
Deleted probables	(1,245)	(394)
Change in benefit liabilities	95	10
Change in plan assets	0	0
Loss (credit) on probables	(1,290)	1,202
Net claims for probable terminations, at end of year	<b>\$ 745</b>	<b>\$ 2,035</b>

The following table itemizes the single-employer probable exposure by industry:

#### PROBABLES EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

<i>(Dollars in millions)</i>	FY 2013	FY 2012
Manufacturing	\$ 268	\$ 1,900
Health Care	83	135
Wholesale and Retail Services	-	-
Services	-	-
Total	<u>\$ 351</u>	<u>\$ 2,035</u>

For further detail, see Note 2 subpoint (4).

The following table shows what has happened to plans classified as probables. This table does not capture or include those plans that were not previously classified as probable before they terminated.

#### ACTUAL PROBABLES EXPERIENCE

##### As Initially Recorded Beginning in 1987

<i>(Dollars in millions)</i>	Status of Probables from 1987-2012 at September 30, 2013			
	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Beginning in 1987, number of plans reported as Probable:				
Probables terminated	367	78%	\$29,113	71%
Probables not yet terminated or deleted	0	0	0	0
Probables deleted	101	22	11,974	29
Total	<u>468</u>	<u>100%</u>	<u>\$41,087</u>	<u>100%</u>

## NOTE 7: MULTIEMPLOYER FINANCIAL ASSISTANCE

PBGC provides financial assistance to multiemployer defined benefit pension plans in the form of loans. Since these loans are not generally repaid, an allowance is set up to the extent that repayment of these loans is not expected.

#### NOTES RECEIVABLE MULTIEMPLOYER FINANCIAL ASSISTANCE

<i>(Dollars in millions)</i>	September 30, 2013	September 30, 2012
Gross balance at beginning of year	\$694	\$599
Financial assistance payments - current year	89	95
Write-offs related to settlement agreements	<u>0</u>	<u>0</u>
Subtotal	783	694
Allowance for uncollectible amounts	<u>(783)</u>	<u>(694)</u>
Net balance at end of year	<u>\$ 0</u>	<u>\$ 0</u>

Losses from financial assistance and probable financial assistance are reflected in the Statements of Operations and Changes in Net Position and include period changes in the estimated present value of nonrecoverable future financial assistance. Losses from financial assistance are presented as actuarial charges, credits, and adjustments for plans that are known to be insolvent as of the valuation date and/or have or

about to begin receiving financial assistance. In addition, a change in the valuation of the liability due to new data received (e.g., new plan expenses, more recent valuation liabilities, and new withdrawal payment schedules) is included as financial assistance from insolvent and probable plans on the Statements of Operations and Changes in Net Position. This valuation data change is a separate line item from actuarial adjustments and actuarial charges.

As of September 30, 2013, the Corporation expects 173 multiemployer plans will exhaust plan assets and need financial assistance from PBGC to pay guaranteed benefits and plan administrative expenses. The present value of nonrecoverable future financial assistance for these 173 plans is \$9,931 million. The 173 plans fall into three categories: (1) plans currently receiving financial assistance; (2) plans that have terminated but have not yet started receiving financial assistance from PBGC; and (3) ongoing plans (not terminated) that the Corporation expects will require financial assistance in the future. The latter two categories are comprised of multiemployer probables as defined by the following classification criteria:

- Probable insolvent plan-terminated future probables – A plan that may still have assets but the combination of plan assets and collectible payments of withdrawal liability are projected to be insufficient to cover plan benefits plus expenses.
- Probable insolvent plan-ongoing future probables – An ongoing plan with a projected date of insolvency within 10 years.

#### MULTIEMPLOYER FINANCIAL ASSISTANCE

(Dollars in millions)	September 30, 2013		September 30, 2012	
	Number of Plans	Net Liability	Number of Plans	Net Liability
Plans currently receiving financial assistance	44	\$1,352	41	\$1,388
Plans that have terminated but have not yet started receiving financial assistance (classified as probable)	65	1,895	61	1,725
Ongoing plans (not terminated) that the Corporation expects will require financial assistance in the future (classified as probable)	64	6,684	46	3,897
Total	173	\$9,931	148	\$7,010

Of the 173 plans:

- 1) 44 have exhausted plan assets and are currently receiving financial assistance payments from PBGC. The present value of future financial assistance payments for these insolvent 44 plans is \$1,352 million.
- 2) 65 plans have terminated but have not yet started receiving financial assistance payments from PBGC. Terminated multiemployer plans no longer have employers making regular contributions for covered work, though some plans continue to receive withdrawal liability payments from withdrawn employers. In general, PBGC records a loss for future financial assistance for any underfunded multiemployer plan that has terminated. The present value of future financial assistance payments to these 65 terminated plans is \$1,895 million.



- 3) 64 plans are ongoing (i.e., have not terminated), but PBGC expects they will exhaust plan assets and need financial assistance within 10 years. In this analysis, PBGC takes into account the current plan assets, future income to the plan, the statutory funding rules, and the possibility for future increases in contributions. The present value of future financial assistance payments for these 64 ongoing plans is \$6,684 million.

## PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE

<i>(Dollars in millions)</i>	September 30, 2013	September 30, 2012
Balance at beginning of year	\$7,010	\$4,475
Changes in allowance:		
Losses from insolvent and probable plans - financial assistance	2,969	2,466
Actuarial adjustments	(5)	(6)
Actuarial charges (credits):		
Due to expected interest	44	54
Due to change in interest factors	2	116
Financial assistance granted (previously accrued)	<u>(89)</u>	<u>(95)</u>
Balance at end of period	<u>\$9,931</u>	<u>\$7,010</u>

In the table above, actuarial charges are reported separately from Losses from insolvent and probable plans-financial assistance. As a result, the table includes the following new lines: Actuarial adjustments, Due to expected interest, and Due to change in interest factors. Insolvent plans are presented within these three new actuarial charges (credits) lines. Losses from insolvent and probable plans-financial assistance include plans that terminated but have not yet received financial assistance, ongoing plans that PBGC expects will require financial assistance in the future, and those insolvent plans that have a change in liability due to new plan data included in the valuation.

## NOTE 8: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The following table itemizes accounts payable and accrued expenses reported in the Statements of Financial Position:

### ACCOUNTS PAYABLE AND ACCRUED EXPENSES

(Dollars in millions)	September 30, 2013	September 30, 2012
Annual leave	\$9	\$ 9
Other payables and accrued expenses	68	70
Accounts payable and accrued expenses	<u>\$77</u>	<u>\$ 79</u>

## NOTE 9: REASONABLY POSSIBLE CONTINGENCIES

### SINGLE-EMPLOYER PLANS

Single-employer plans sponsored by companies whose credit quality is below investment grade pose a greater risk of being terminated. The estimated unfunded vested benefits exposure amounts disclosed below represent PBGC's estimates of the reasonably possible exposure to loss given the inherent uncertainties about these plans. In rare circumstances for certain large companies, the reasonably possible exposure calculation reflects the estimated unfunded guaranteed benefit determination rather than the estimated unfunded vested benefit determination.

In accordance with the FASB Accounting Standards Codification Section 450, *Contingencies*, PBGC classified a number of these companies as reasonably possible rather than probable terminations, reflecting the sponsors' financial condition and other factors did not indicate that termination of their plans was likely. This classification was done based upon information about the companies as of September 30, 2013. PBGC criteria for a single-employer plan sponsor to be classified as Reasonably Possible are:

- The sponsor(s) or significant member(s) of its controlled group (e.g., a parent or major subsidiary) is in reorganization under Title 11 of the United States code.
- An application for a funding waiver is pending or outstanding with the IRS.
- A minimum funding contribution has been missed.
- The sponsor(s) has an S&P senior unsecured credit rating or an issuer credit rating less two notches of BB+ or below, or a Moody's senior unsecured credit rating or a corporate family rating less one notch of Ba1 or below. If the controlled group is not rated by Moody's and S&P, PBGC will use the Dun & Bradstreet Financial Stress Score (if available) to classify the controlled group as Reasonably Possible or Remote.
- The sponsor(s) has no bond rating, but analysis indicates that its unsecured debt would be below investment grade.
- The sponsor(s) meet at least one of the PBGC "high risk" criteria.
- Other (detailed explanation must be provided and be approved by PBGC's Contingency Working Group).

The estimate of unfunded vested benefits exposure to loss for the single-employer plans of these companies was measured as of December 31, 2012. The reasonably possible exposure to loss in these plans was \$292,207 million for FY 2013. This is a slight decrease of \$2,756 million from the reasonably possible

exposure of \$294,963 million in FY 2012. This decrease is primarily due to a decline in the aggregate liability for plans classified as reasonably possible.

Except in the rare circumstances as indicated earlier in this footnote, the estimate of unfunded vested benefits exposure to loss is not generally based on PBGC-guaranteed benefit levels, since data is not available to determine an estimate at this level of precision. PBGC calculated this estimate, as in previous years, by using the most recent data available from filings and submissions to us for plan years ended on or after December 31, 2011. PBGC adjusted the value reported for liabilities to December 31, 2012, using a select rate of 2.47% for the first 20 years and 3.22% thereafter and applying the expense load as defined in 29 CFR Part 4044, Appendix C. The rates were derived in conjunction with the 1994 Group Annuity Mortality Static Table (with margins) projected to 2022 using Scale AA to approximate annuity prices as of December 31, 2012. The underfunding associated with these plans could be substantially different at September 30, 2013, because of the economic conditions that changed between December 31, 2012 and September 30, 2013. PBGC did not adjust the estimate for events that occurred between December 31, 2012, and September 30, 2013.

The following table by industry itemizes the single-employer reasonably possible exposure to loss:

#### REASONABLY POSSIBLE EXPOSURE TO LOSS BY INDUSTRY (PRINCIPAL CATEGORIES)

<i>(Dollars in millions)</i>	FY 2013	FY 2012
Manufacturing *	\$150,564	\$155,857
Transportation, Communication and Utilities **	67,419	67,355
Services	34,740	29,795
Wholesale and Retail Trade	16,721	17,199
Health Care	9,576	12,089
Finance, Insurance, and Real Estate	8,495	8,463
Agriculture, Mining, and Construction	4,692	4,205
Total	<u>\$292,207</u>	<u>\$294,963</u>

\* Primarily automobile/auto parts and primary and fabricated metals

\*\* Primarily airline

## MULTIEMPLOYER PLANS

There are some multiemployer plans that may require future financial assistance. PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 7) for multiemployer plans that PBGC estimated may require future financial assistance. In addition, PBGC estimated as of September 30, 2013, that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of \$36,718 million.

PBGC calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 7), or reasonably possible. PBGC used a formula taking the present value of guaranteed future benefits and expense payments net of any future contributions or withdrawal liability payments. These amounts were as of the later of September 30, 2013, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2013. PBGC's identification of plans that are likely to require such assistance and estimation of related amounts required consideration of many complex factors, including estimating future cash flows, future mortality rates, and age of participants not in pay status. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond PBGC's control. Reasonably possible multiemployer classification is defined as an ongoing plan with a projected insolvency date between 10 and 20 years from the valuation date.

## NOTE 10: COMMITMENTS

PBGC leases its office facility under a commitment that began on January 1, 2005, and expires December 10, 2018. This lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, PBGC is leasing space for field benefit administrators. These leases began in 1996 and expire in 2018. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2013, are:

### COMMITMENTS: FUTURE LEASE PAYMENTS

<i>(Dollars in millions)</i>	
Years Ending	Operating Leases
2014	\$ 21.7
2015	21.7
2016	21.6
2017	21.5
2018	19.4
Thereafter	6.0
Minimum lease payments	<u>\$111.9</u>

Lease expenses were \$19.4 million in FY 2013 and \$17.6 million in FY 2012.

## NOTE 11: PREMIUMS

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and penalties on the unpaid portion of or underpayment of premiums. Interest continues to accrue until the premium and the interest due are paid. For plan year 2013, the flat-rate premium for single-employer pension plans was \$42 per participant and for multiemployer plans, \$12 per participant. For plan years 2012 and 2011, the flat-rate premiums for single-employer pension plans were \$35 per participant and for multiemployer plans, \$9 per participant. PBGC recorded net premium income of \$3,053 million that consisted mainly of \$1,385 million in flat-rate premiums, \$1,580 million in variable-rate premiums, and \$177 million in termination premiums.

Those amounts were offset by a bad debt expense of \$94 million. Bad debt expenses include a reserve for uncollectible premium receivables (including flat, variable, and termination premiums), interest, and penalties. Net premium income for FY 2012 was \$2,734 million and consisted mainly of about \$1,215 million in flat-rate premiums, \$1,495 million in variable-rate premiums, and \$33 million in termination premiums, offset by a bad debt expense of \$14 million. The termination premium applies to certain plan terminations occurring after 2005. If a pension plan terminates in a distress termination pursuant to ERISA section 4041(c)(2)(B)(ii) or (iii), or in a PBGC-initiated termination under ERISA section 4042, the plan sponsor and its controlled group are liable to PBGC for a termination premium at the rate of \$1,250 per plan participant per year for three years.

The following table presents a year-to-year comparison of key premium information.

## PREMIUMS

<i>(Dollars in millions)</i>	September 30, 2013	September 30, 2012
Flat-Rate Premium:		
Single-Employer	\$1,274	\$1,123
Multiemployer	<u>111</u>	<u>92</u>
Total Flat-Rate Premium	1,385	1,215
Variable-Rate Premium	1,580	1,495
Interest and Penalty Income	5	5
Termination Premium	177	33
Less Changes in the Allowance Reserve for Bad Debts for Interest, Penalties, and Premiums	<u>(94)</u>	<u>(14)</u>
<b>Total</b>	<b><u>\$3,053</u></b>	<b><u>\$2,734</u></b>
Single-Employer	\$2,859	\$2,623
Termination Premium	177	33
Less Changes in the Allowance Reserve for Bad Debts for Interest, Penalties, and Premiums	<u>(93)</u>	<u>(14)</u>
Total Single-Employer	<u>2,943</u>	<u>2,642</u>
Multiemployer	111	92
Less Changes in the Allowance Reserve for Bad Debts for Interest and Penalties	<u>(1)</u>	<u>0*</u>
Total Multiemployer	<u>110</u>	<u>92</u>
<b>Total</b>	<b><u>\$3,053</u></b>	<b><u>\$2,734</u></b>

\* Less than \$500,000

## NOTE 12: LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS

Amounts reported as losses are the present value of future benefits less related plan assets and the present value of expected recoveries from sponsors. The following table details the components that make up the losses:

### LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS SINGLE-EMPLOYER PROGRAM

(Dollars in millions)	For the Years Ended September 30,					
	New Terminations	2013 Changes in Prior Year Terminations	Total	New Terminations	2012 Changes in Prior Year Terminations	Total
Present value of future benefits	\$4,246	\$ (132)	\$ 4,114	\$2,035	\$ (16)	\$2,019
Less plan assets	2,367	87	2,454	1,027	228	1,255
Plan asset insufficiency	1,879	(219)	1,660	1,008	(244)	764
Less estimated recoveries	0	(98)	(98)	0	(39)	(39)
Subtotal	1,879 <sup>1</sup>	(121)	1,758	1,008 <sup>1</sup>	(205)	803
Settlements and judgments		0*	0*		1	1
Loss (credit) on probables	(492) <sup>2</sup>	(798) <sup>3</sup>	(1,290) <sup>4</sup>	(150) <sup>2</sup>	1,352 <sup>3</sup>	1,202 <sup>4</sup>
Total	\$1,387	\$ (919)	\$ 468	\$ 858	\$1,148	\$2,006

\* Less than \$500,000

<sup>1</sup> Gross amounts for plans terminated during the period, including plans previously recorded as probables.

<sup>2</sup> Net claims for plans previously recorded as probables that terminated.

<sup>3</sup> Includes changes to old and new probables.

<sup>4</sup> See Note 6 - includes \$492 million at September 30, 2013, and \$150 million at September 30, 2012, previously recorded relating to plans that terminated during the period ("Actual terminations").

## NOTE 13: FINANCIAL INCOME

The following table details the combined financial income by type of investment for both the single-employer and multiemployer programs:

INVESTMENT INCOME SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS						
	Single-Employer Program	Multiemployer Program	Memorandum Total	Single-Employer Program	Multiemployer Program	Memorandum Total
<i>(Dollars in millions)</i>	Sept. 30, 2013	Sept. 30, 2013	Sept. 30, 2013	Sept. 30, 2012	Sept. 30, 2012	Sept. 30, 2012
Fixed maturity securities:						
Interest earned	\$1,781	\$40	\$1,821	\$1,800	\$44	\$1,844
Realized gain	859	58	917	2,005	36	2,041
Unrealized gain	(4,269)	(194)	(4,463)	894	11	905
Total fixed maturity securities	(1,629)	(96)	(1,725)	4,699	91	4,790
Equity securities:						
Dividends earned	84	0	84	66	0	66
Realized gain	2,476	0	2,476	1,385	0	1,385
Unrealized gain (loss)	1,597	0	1,597	2,622	0	2,622
Total equity securities	4,157	0	4,157	4,073	0	4,073
Private equity:						
Distributions earned	24	0	24	27	0	27
Realized gain (loss)	315	0	315	81	0	81
Unrealized gain	(67)	0	(67)	(66)	0	(66)
Total private equity	272	0	272	42	0	42
Real estate:						
Distributions earned	0	0	0	0	0	0
Realized gain (loss)	(12)	0	(12)	2	0	2
Unrealized gain	(58)	0	(58)	(23)	0	(23)
Total real estate	(70)	0	(70)	(21)	0	(21)



## NOTE 14: EMPLOYEE BENEFIT PLANS

All of PBGC's permanent full-time and part-time employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years of service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984, participate in CSRS unless they elected and qualified to transfer to FERS.

PBGC's contribution to the CSRS plan for both FY 2013 and FY 2012 was 7.0 percent of base pay for those employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 11.9 percent of base pay for FY 2013, up from 11.7 percent for FY 2012. In addition, for FERS-covered employees, PBGC automatically contributes one percent of base pay to the employee's Thrift Savings account, matches the first three percent contributed by the employee and matches one-half of the next two percent contributed by the employee. Total retirement plan expenses amounted to \$21 million in FY 2013 and \$20 million in FY 2012. These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to PBGC's employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM accounts for federal health and life insurance programs for those eligible retired PBGC employees who had selected federal government-sponsored plans. PBGC does not offer other supplemental health and life insurance benefits to its employees.

## NOTE 15: CASH FLOWS

The following table consists of detailed cash flows from the sales and purchases of investment activity. Sales and purchases of investments are driven by the level of newly trustee plans, the unique investment strategies implemented by PBGC's investment managers, and the varying capital market conditions in which they invest during the year. These cash flow numbers can vary significantly from year to year based on the fluctuation in these three variables.

### INVESTING ACTIVITIES (SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED)

(Dollars in millions)	September 30,	
	2013	2012
Proceeds from sales of investments:		
Fixed maturity securities	\$74,456	\$70,055
Equity securities	12,904	6,120
Other/uncategorized	2,859	1,874
Memorandum total	<u>\$90,219</u>	<u>\$78,049</u>
Payments for purchases of investments:		
Fixed maturity securities	\$(76,266)	\$(69,841)
Equity securities	(10,988)	(6,681)
Other/uncategorized	(1,769)	(1,262)
Memorandum total	<u>\$(89,023)</u>	<u>\$(77,784)</u>

The following is a reconciliation between the net income as reported in the Statements of Operations and Changes in Net Position and net cash provided by operating activities as reported in the Statements of Cash Flows.

#### RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	2013	2012	2013	2012	2013	2012
Net income (loss)	\$ 1,761	\$(5,876)	\$(3,021)	\$(2,467)	\$(1,260)	\$(8,343)
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	(808)	(6,958)	131	(46)	(677)	(7,004)
Net gain (loss) of plans pending termination and trusteeship	(49)	(27)	0	0	(49)	(27)
Losses (credits) on completed and probable terminations	468	2,006	0	0	468	2,006
Actuarial charges (credits)	3,054	14,874	0	0	3,054	14,874
Benefit payments - trustee plans	(5,374)	(5,333)	0*	0*	(5,374)	(5,333)
Settlements and judgments	0*	0*	0	0	0*	0*
Cash received from plans upon trusteeship	24	126	0	0	24	126
Receipts from sponsors/non-sponsors	(1)	114	0	0	(1)	114
Amortization of discounts/premiums	131	99	13	10	144	109
Changes in assets and liabilities, net of effects of trustee and pending plans:						
(Increase) decrease in receivables	62	(510)	3	0*	65	(510)
Increase in present value of nonrecoverable future financial assistance			2,921	2,535	2,921	2,535
Increase in unearned premiums	49	(38)	12	(1)	61	(39)
Increase (decrease) in accounts payable	(3)	(8)	1	1	(2)	(7)
Net cash provided (used) by operating activities	\$ (686)	\$(1,531)	\$ 60	\$ 32	\$ (626)	\$(1,499)

\*Less than \$500,000

## NOTE 16: LITIGATION

Legal challenges to PBGC's policies and positions continued in FY 2013. At the end of the fiscal year, PBGC had 53 active cases in state and federal courts and 350 bankruptcy and state receivership cases.

PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. PBGC cannot estimate with any degree of certainty the possible losses it could incur in the event it does not prevail in these matters.

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## NOTE 17: SUBSEQUENT EVENTS

Management evaluated subsequent events through publication on November 15, 2013, the date the financial statements were available to be issued. Events or transactions for either the single-employer or multiemployer program, occurring after September 30, 2013 and before the financial statements were available to be issued, that provided additional evidence about conditions that existed at September 30, 2013 have been recognized in the financial statements.

For the fiscal year ended September 30, 2013, there were no nonrecognized subsequent events or transactions to report for both the single-employer and multiemployer programs that provided evidence about conditions that did not exist at September 30, 2013, and which arose before the financial statements were available to be issued.

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## IMPROPER PAYMENT REPORTING

### INTRODUCTION

OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments and related improper payment statutes<sup>1</sup> require Federal agencies to conduct a risk assessment of their programs and activities to identify programs that are susceptible to significant improper payments.

OMB's Memorandum No. M-11-16, dated April 14, 2011, specifies that in performing a Step 1 risk assessment of improper payments, agencies must institute a systematic method of reviewing all programs or payment streams and identify those that may be susceptible to significant improper payments. In compliance with Executive Order 13520, the PBGC Director serves as the agency official accountable for improper payment reporting purposes.

As detailed further below, PBGC has not identified any of its payment streams as being susceptible to significant risk of improper payments.

### PRIOR IMPROPER PAYMENT RISK ASSESSMENTS

#### *FY 2012 Improper Payment Risk Assessment Results*

As a follow-up to a pilot risk assessment that was coordinated with OMB in FY 2011, PBGC conducted formal risk assessments of all of its payment streams in FY 2012, including the following major payment streams:

- Benefit payments to participants in “final pay” status for plans trusted by PBGC under Title IV of ERISA (Benefit Payments);
- Financial assistance payments to insolvent multiemployer plans that are unable to pay benefits when due under the requirements of Title IV of ERISA (Multiemployer Plan Financial Assistance Payments); and
- Payments to contractors for goods and services, including government credit card transactions (Payments to Contractors).

Consistent with the OMB guidance on Step 1 risk assessments, PBGC concluded that none of its payment streams were susceptible to significant improper payment risk for FY 2012.

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<sup>1</sup> This references the Improper Payments Information Act of 2002 (IPIA), the Improper Payments Elimination and Recovery Act of 2010 (IPERA), and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA).

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### ***Follow-up on Corrective Actions***

Prior improper payment risk assessments identified areas of potential improvement. PBGC is implementing corrective actions to address noted issues, including:

- For Benefit Payments, PBGC continues to implement corrective actions to address legacy documentation issues associated with terminated pension plans that were noted in the FY 2011 pilot risk assessment. At that time, OMB advised that PBGC should focus its improper payment testing on payment accuracy and to implement strategies to improve pension documentation over time. The Benefits Administration and Payment Department (BAPD) has implemented a new data acquisition working group to focus on the quality of participant data obtained during the plan termination process. It also established a new asset evaluation division, and redesigned workflows that will help ensure that audits and actuarial analyses underlying PBGC benefit determinations are fully reviewed, appropriately documented, and retained as PBGC records. Further, a new Quality Management Department has been established under the Office of the Chief Operating Officer.
- For the Multiemployer Future Financial Assistance Payments, the Multiemployer Program Division (MEPD) has instituted new procedures addressing updated processes for reviewing requests for financial assistance as well as file organization and documentation retention practices.

### **FY 2013 IMPROPER PAYMENT RISK ASSESSMENT PROCESS**

Based on the results of its FY 2012 improper payment risk assessments and the three-year cycle referenced as part of OMB's Step 1 risk assessment guidance, PBGC would not be required to perform any additional risk assessments until FY 2015. However, given the agency focus on preventing and detecting improper payments and the nature of PBGC operations, PBGC set a more aggressive schedule to assess the major payment streams referenced above on a rotational basis. As a result, for FY 2013, PBGC assessed Payments to Contractors for susceptibility for significant improper payment risk with the support of an international public accounting and consulting firm.

### ***Scope and Methodology***

In performing its risk assessment, PBGC considered a number of qualitative factors, including the complexity of the payment stream, the volume of payments, recent major changes in program funding, authorities, practices, or procedures; the level, experience, and quality of training for personnel responsible for making program eligibility determinations or certifying that payments are accurate; and any significant deficiencies in the audit reports issued by the PBGC Office of Inspector General (OIG) and the Government Accountability Office (GAO), and results from prior risk assessments. In order to be considered as susceptible to significant risk of improper payments, OMB guidance specifies that gross annual improper payments (i.e., the total amount of overpayments plus underpayments) within a payment stream would have to exceed (1) both 2.5 percent of program outlays and \$10,000,000 of payments made during the reporting period or (2) \$100,000,000 (regardless of the improper payment percentage of total program outlays).

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In addition to assessing the quantitative and qualitative factors referenced above, PBGC supplemented its analysis with optional statistical sampling performed during the period April – September 2013.

### ***Statistical Sampling and Testing Information***

The sampling universe for Contractor Payments represented payments that occurred in last six months of FY 2012 and the first half of FY 2013. For the 12 months ended March 31, 2012, PBGC issued 4,680 payments totaling \$319,427,188 to contractors and other entities that provided goods and services to PBGC. In designing the sampling plan, PBGC followed OMB statistical sampling guidance regarding minimum sample sizes and took steps to ensure that the resulting sample would be representative of the payment population being tested, including the use of sample stratification techniques. PBGC provided the OIG with copies of the error definitions applicable to the Payments to Contractors payment stream as well as our sampling plan.

Of the 4,680 payments issued, PBGC selected 109 payments, totaling \$48,125,816, for detailed testing. PBGC performed tests of these selected payments to assess whether payments complied with the improper payment definitions applicable to the Contractor Payments payment stream. For example, we tested whether PBGC officials approved the payment, whether there was documentation supporting that goods or services were received or performed, and whether billed amounts were consistent with contractual terms, including whether unallowable costs, as defined in the Federal Acquisition Regulation (FAR), were excluded.

### ***Statistical Sampling Results***

Of the 109 payments and \$48,125,816 tested as part of the sample, actual gross improper payments noted totaled \$371,724, and primarily related to limited instances of unallowable costs and lack of approval relating to a subcontractor. As detailed further below, the estimated improper payments for Contractor Payments, was 1.86 percent and \$5,945,563, based on a sampling projection of total gross improper payments. These amounts are below OMB thresholds for improper payment reporting. In addition, the achieved precision or accuracy levels were within the levels specified by OMB in its statistical sampling guidance.

Additional details regarding the sampling projections are presented in the following three tables:

- a) Estimated Gross Improper Payments for Contractor Payments,
- b) Estimated Net Improper Payments for Contractor Payments, and
- c) Estimated Gross Improper Payments by OMB Error Type.

ESTIMATED GROSS IMPROPER PAYMENTS FOR CONTRACTOR PAYMENTS <sup>2</sup>						
FY 2013 Outlays <sup>3</sup>	Gross IP %	Gross IP \$	Over-payments IP %	Over-Payments IP \$	Under-payments IP %	Under-payments IP \$
\$ 319,427,188	1.86%	\$ 5,945,563	1.85%	\$ 5,910,211	0.01%	\$ 35,352

ESTIMATED NET IMPROPER PAYMENTS FOR CONTRACTOR PAYMENTS <sup>4</sup>		
FY 2013 Outlays <sup>3</sup>	Net IP %	Net IP \$
\$319,427,188	1.84%	\$ 5,874,859

ESTIMATED GROSS IMPROPER PAYMENTS BY OMB ERROR TYPE <sup>5</sup>			
FY 2013 Type of Error	Actual Gross IP \$	Estimated Gross IP %	Estimated Gross IP \$
Incorrect Amount	\$ 28,740	0.05%	\$ 160,277
Ineligible Recipient	\$ 320,752	1.52%	\$ 4,847,139
Lack of Sufficient Documentation	\$ 31,756	0.32%	\$ 1,027,358
<b>All Issues Noted</b>	<b>\$ 371,724</b>	<b>1.86%</b>	<b>\$ 5,945,563</b>

<sup>2</sup> The “Gross IP %” figure represents the ‘gross improper payment (IP) rate’ and is calculated by dividing “Gross IP \$” by the “FY 13 Outlays” figure. In accordance with OMB guidance, the “Gross IP \$” or ‘gross improper payment dollars’ is equal to the sum of gross overpayments plus underpayments.

<sup>3</sup> FY 2013 Outlays represents payments issued during the period April 1, 2012, through March 31, 2013, to facilitate testing.

<sup>4</sup> The ‘net improper payment rate’ or “Net IP %” is calculated in a manner similar to “Gross IP %”, except that the numerator is the difference between gross overpayments and underpayments.

<sup>5</sup> Figures included in the “All Issues Noted” row do not necessarily sum. This would be due to the existence of multiple or overlapping errors affecting individual payments both on actual and estimated basis.



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## **FY 2013 IMPROPER PAYMENT RISK ASSESSMENT CONCLUSION**

Based on the results of its Step 1 risk assessment and the related statistical sampling, the payment stream selected for assessment for FY 2013, Contractor Payments, is not susceptible to significant improper payment risk. PBGC informed OMB and OIG of this conclusion prior to finalizing its improper payment reporting.

## **PLANS FOR FUTURE IMPROPER PAYMENT RISK ASSESSMENTS**

As referenced above, PBGC set a more aggressive schedule for its Step 1 risk assessments of the major payment streams, given the nature of PBGC operations and the agency's commitment to prevent and detect improper payments. Accordingly, the following represents the rotational schedule PBGC intends to follow in terms of Step 1 Risk Assessments:

FY 2014: Multiemployer Plan Financial Assistance Payments

FY 2015: Benefit Payments (and non-major payment streams)

FY 2016: Contractor Payments

Further, PBGC is committed to supplementing its Step 1 risk assessment with optional statistical sampling for its major payment streams through FY 2015. PBGC will use the results from each risk assessment to assess whether it is cost beneficial to continue optional statistical sampling beyond this time period. Preventing and detecting improper payments is an important corporate priority, and PBGC will continue to explore cost-effective methods to further enhance its existing processes.

## 2013 ACTUARIAL VALUATION

PBGC calculated and validated the present value of future PBGC-payable benefits (PVFB) for both the single-employer and multiemployer programs and of nonrecoverable future financial assistance under the multiemployer program. Generally, we used the same methods and procedures as in 2012.

### PRESENT VALUE OF FUTURE BENEFITS AND NONRECOVERABLE FINANCIAL ASSISTANCE – 2013

	Number of Plans	Number of Participants (in thousands)	Liability (in millions)
<b>I. SINGLE-EMPLOYER PROGRAM</b>			
A. Terminated plans			
1. Seriatim at fiscal year-end (FYE)	4,086	965	\$65,365
2. Seriatim at DOPT, adjusted to FYE	28	110	7,865
3. Nonseriatim <sup>1</sup>	443	331	32,543
4. Missing Participants Program (seriatim) <sup>2</sup>	<u>      </u>	<u>23</u>	<u>61</u>
Subtotal	4,557	1,429	\$105,834
B. Probable terminations (nonseriatim) <sup>3</sup>	<u>2</u>	<u>21</u>	<u>1,166</u>
Total <sup>4</sup>	4,559	1,450	\$107,000
<b>II. MULTIEMPLOYER PROGRAM</b>			
A. Pre-MPPAA terminations (seriatim)	10	*	\$0
B. Post-MPPAA liability (net of plan assets)			
1. Currently Receiving Assistance	44	74	1,352
2. Probable for Assistance	<u>129</u>	<u>230</u>	<u>8,579</u>
Total	183	304	\$9,931

\* Fewer than 500 participants

#### Notes:

- 1) The liability for terminated plans has been increased by \$57 million for settlements.
- 2) The Missing Participants Program refers to a liability that PBGC assumed for unlocated participants in standard plan terminations.
- 3) The net claims for probable plans reported in the financial statements include \$394 million for not-yet-identified probable terminations. The assets for the probable plans, including the expected value of recoveries on employer liability and due-and-unpaid employer contributions claims, are \$421 million. Thus, the net claims for probable terminations as reported in the financial statements are \$1,166 million less \$421 million, or \$745 million.
- 4) The PVFB in the financial statements (\$105,018 million) is net of estimated plan assets and recoveries on probable terminations (\$421 million), estimated recoveries on terminated plans (\$44 million), and estimated assets for plans pending trusteeship (\$1,517 million), or, \$107,000 million less \$421 million less \$44 million less \$1,517 million = \$105,018 million.

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## SINGLE-EMPLOYER PROGRAM

PBGC calculated the single-employer program's liability for benefits in the terminated plans and probable terminations, as defined in Note 2 to the financial statements, using a combination of two methods: seriatim and nonseriatim. For 4,086 plans, representing about 90 percent of the total number of single-employer terminated plans (68 percent of the total participants in single-employer terminated plans), PBGC had sufficiently accurate data to calculate the liability separately for each participant's benefit (seriatim method). This was an increase of 77 plans over the 4,009 plans valued seriatim last year. For 28 plans whose data were not yet fully automated, PBGC calculated the benefits and liability seriatim as of the date of plan termination (DOPT) and brought the total amounts forward to the end of fiscal year 2013 on a nonseriatim basis. For 443 other terminated plans, PBGC did not have sufficiently accurate or complete data to value individual benefits. Instead, the Corporation used a "nonseriatim" method that brought the plan liabilities from the plan's most recent actuarial valuation forward to the end of fiscal year 2013 using certain assumptions and adjustment factors.

For the actuarial valuation, PBGC used a select and ultimate interest rate assumption of 3.25% for the first 20 years after the valuation date and 3.32% thereafter. The mortality tables used for valuing healthy lives were the RP-2000 Combined Healthy Male and Female Tables, each projected 24 years to 2024 using Scale AA and set back one year. The projection period is determined as the sum of the elapsed time from the date of the table (2000) to the valuation date plus the period of time from the valuation date to the average date of payment of future benefits. In fiscal year 2012, the mortality table used for valuing healthy lives were the RP-2000 Combined Healthy Male and Female Tables, each projected 22 years to 2022 using Scale AA and set back one year.

For non-pay-status participants, PBGC used expected retirement ages, as explained in subpart B of the Allocation of Assets in Single-Employer Plans regulation. PBGC assumed that participants who had attained their expected retirement age were in pay status. In seriatim plans, for participants who were older than age 65, were not in pay status, and were unlocated at the valuation date, PBGC reduced the value of their future benefits to zero over the three years succeeding age 65 to reflect the lower likelihood of payment. Similarly, for located participants over age 70 and not in pay status, PBGC reduced the value of their future benefits to zero. For deferred participants who were older than age 70 in the Missing Participant Program, PBGC reduced the value of their future benefits to zero over the ten years succeeding age 70 to reflect the lower likelihood of payment.

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## MULTIEMPLOYER PROGRAM

PBGC calculated the liability for the 10 pre-MPPAA terminations using the same assumptions and methods applied to the single-employer program.

PBGC based its valuation of the post-MPPAA liability for nonrecoverable future financial assistance on the most recent available actuarial reports, Form 5500 Schedule B or Schedule MB, as applicable, and information provided by representatives of the affected plans. The Corporation expected 173 plans to need financial assistance because severe industrial declines have left them with inadequate contribution bases and they had insufficient assets for current payments or were expected to run out of assets in the foreseeable future.

## STATEMENT OF ACTUARIAL OPINION

This valuation has been prepared in accordance with generally accepted actuarial principles and practices and, to the best of my knowledge, fairly reflects the actuarial present value of the Corporation's liabilities for the single-employer and multiemployer plan insurance programs as of September 30, 2013.

In preparing this valuation, I have relied upon information provided to me regarding plan provisions, plan participants, plan assets, and other matters, some of which are detailed in a complete Actuarial Report available from PBGC.

In my opinion, (1) the techniques and methodology used for valuing these liabilities are generally acceptable within the actuarial profession; (2) the assumptions used are appropriate for the purposes of this statement and are individually my best estimate of expected future experience, discounted using current settlement rates from insurance companies as determined by PBGC's Policy Research and Analysis Department; and (3) the resulting total liability represents my best estimate of anticipated experience under these programs.

I, Scott Young, am the Chief Valuation Actuary of the PBGC. I am a Member of the American Academy of Actuaries, a Fellow of the Society of Actuaries and an Enrolled Actuary. I meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.



Scott G. Young, FSA, EA, MAAA

*Fellow of the Society of Actuaries*

*Enrolled Actuary*

*Member of the American Academy of Actuaries*

*Chief Valuation Actuary*

*Actuarial Services Division, Benefits Administration and Payment Department*

*Pension Benefit Guaranty Corporation*

# INDEPENDENT AUDIT AND MANAGEMENT'S RESPONSE





## Pension Benefit Guaranty Corporation

Office of Inspector General

1200 K Street, N.W., Washington, D.C. 20005-4026

To the Board of Directors  
Pension Benefit Guaranty Corporation

The Office of Inspector General (OIG) contracted with CliftonLarsonAllen LLP, an independent certified public accounting firm, to audit the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the years ended September 30, 2013 and 2012. They conducted their audit in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards* issued by the Comptroller General of the United States; attestation standards established by the American Institute of Certified Public Accountants; and OMB Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.

In the audit, CliftonLarsonAllen found:

- The financial statements were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- PBGC did not have effective internal control over financial reporting as of September 30, 2013. Serious internal control weaknesses in PBGC's programs and operations resulted in three material weaknesses: (1) Benefits Administration and Payment Department management and oversight, (2) entity-wide security program planning and management, and (3) access controls and configuration management, and one significant deficiency related to integration of financial management systems.
- PBGC had one instance of noncompliance. It did not determine the fair market value of plan assets at the date of plan termination in accordance with the regulation established at 29 C.F.R. § 4044.41(b).

The following provides context for the two opinions on PBGC's financial statements and internal control. Only a small number of Federal entities receive an opinion on internal control as part of their financial statement audit. To express an opinion, the auditors must apply a high level of scrutiny to the agency's controls. From the inception of its audited financial statements, PBGC has always received this higher-standard opinion on internal control. For PBGC, the auditors have concluded that the financial statement audit opinion is unmodified – that is, the highest opinion – however, they have also concluded that the opinion on internal control over financial reporting is adverse.

The three material weaknesses and the significant deficiency are critical deficiencies. The existence of a material weakness is an indication that there is more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by management. The material weaknesses also preclude the auditors from concluding that PBGC has effective internal controls. Because PBGC has an ineffective system of controls, it may not be

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able to report accurate financial results. Because of PBGC's weak control environment, the auditors cannot rely on management's control activities; they must conduct a greater amount of substantive testing to gain assurance that the financial information is fairly presented in all material respects. Consequently, this results in a change in the nature, timing and extent of their substantive procedures. However, PBGC management was able to provide sufficient evidence in response to the auditor's substantive procedures to support the amounts reported on the financial statements and the related footnotes.

CliftonLarsonAllen is responsible for the accompanying auditor's report dated November 15, 2013 and the conclusions expressed in the report. The OIG does not express opinions on PBGC's financial statements or internal control, nor do we draw conclusions on compliance with laws and regulations.

The financial statement audit report (AUD-2014-2 / FA-13-93-1) is also available on our website at <http://oig.pbgc.gov>.

Sincerely,

A handwritten signature in blue ink that reads "Deborah Stover-Springer". The signature is fluid and cursive, with the last name "Springer" being more prominent.

Deborah Stover-Springer  
Acting Inspector General

November 15, 2013



## **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors, Management  
and the Inspector General of the  
Pension Benefit Guaranty Corporation

In our audits of the Single-Employer and Multiemployer Funds administered by the Pension Benefit Guaranty Corporation (PBGC or the Corporation) for fiscal years (FY) 2013 and 2012, we found:

- The financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America (U.S.);
- PBGC did not have effective internal control over financial reporting; and
- One instance of noncompliance with certain provisions of laws and regulations tested.

The following sections and Exhibits discuss in more detail: (1) these conclusions, (2) other information included with the financial statements, (3) management's responsibility, (4) our responsibility, (5) the current status of prior year findings, and (6) management's response to findings.

### **Reports on the Financial Statements and Internal Control**

We have audited the accompanying financial statements of the Pension Benefit Guaranty Corporation (PBGC), which comprise the financial position of the Single-Employer and Multiemployer Funds administered by the PBGC as of September 30, 2013 and 2012, and the results of their operations and cash flows for the years then ended, and the related notes to the financial statements. The objective of our audits was to express an opinion on the fairness of these financial statements. We have also audited PBGC's internal control over financial reporting as of September 30, 2013.

### ***Management's Responsibility***

PBGC management is responsible for the (1) preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the U.S.; (2) preparation and presentation of other information in documents containing the audited financial statements and auditors' report, and consistency of that information with the audited financial statements; (3) design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, including to provide reasonable assurance that the broad control objectives of FMFIA are met; and (4) compliance with other applicable laws

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and regulations. PBGC management evaluated the effectiveness of PBGC's internal control over financial reporting as of September 30, 2013 based on criteria established under the Federal Managers' Financial Integrity Act of 1982 (FMFIA). PBGC management's assertion based on its evaluation is included in the Annual Report.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements and an opinion on the PBGC's internal control over financial reporting based on our audits. We conducted our audit of the financial statements in accordance with auditing standards generally accepted in the U.S. and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. We conducted our audit of internal control over financial reporting referred to above in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to audits of internal control contained in *Government Auditing Standards*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and that effective internal control over financial reporting was maintained in all material respects, respectively. We also conducted our audits in accordance with OMB Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*, (OMB Bulletin 14-02).

In order to fulfill these responsibilities, we (1) obtained an understanding of PBGC and its operations, including its internal control over financial reporting; (2) assessed the risk of financial statement misstatement and the risk that a material weakness exists in internal control over financial reporting; (3) evaluated the design and operating effectiveness of internal control based on the assessed risk; (4) considered PBGC's process for evaluating and reporting on internal control under FMFIA; (5) tested compliance with certain provisions of laws and regulations; (6) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (7) evaluated the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management; (8) evaluated the overall presentation of the financial statements; (9) read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements; and (10) performed such other procedures as we considered necessary in the circumstances. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions.

We did not evaluate all internal controls relevant to operating objectives as broadly established by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes.

### ***Definition of Internal Control and Inherent Limitations***

An entity's internal control over financial reporting is a process effected by those charged by governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with accounting principles generally accepted in the U.S.; (2) assets are

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safeguarded against loss from unauthorized acquisition, use, or disposition; and (3) transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements.

Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

### ***Opinion on the Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by the PBGC as of September 30, 2013 and 2012, and the results of their operations and cash flows for the years then ended, in accordance with accounting principles generally accepted in the U.S.

### ***Emphasis of Matter***

By law, PBGC's Single-Employer and Multiemployer Program Funds must be self-sustaining. As of September 30, 2013, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of \$27.4 billion and \$8.3 billion, respectively. As discussed in Note 9 to the financial statements, loss exposure for the Single-Employer and Multiemployer Programs that are reasonably possible as a result of unfunded vested benefits are estimated to be \$292 billion and \$37 billion, respectively. Management calculated the Single-Employer reasonably possible exposure based on the most recent data available from filings and submissions for plan years ended on or after December 31, 2011 and adjusted the value reported for liabilities to December 31, 2012 using actuarial assumptions. PBGC did not make a subsequent adjustment for economic conditions that occurred between December 31, 2012 and September 30, 2013, and as a result the exposure to loss for the Single-Employer Program, as of September 30, 2013, could be substantially different. In addition, PBGC's net deficit and long-term viability could be further impacted by losses from plans classified as reasonably possible (or from other plans not yet identified as potential losses) as a result of deteriorating economic conditions, the insolvency of a large plan sponsor, or other factors. PBGC has been able to meet its short-term benefit obligations; however, as discussed in Note 1 to the financial statements, management believes that neither program at present has the resources to fully satisfy PBGC's long-term obligations to plan participants. Our opinion is not modified with respect to this matter.

### ***Opinion on Internal Control over Financial Reporting***

In our opinion, because of the effect of material weaknesses described in Exhibit I, the PBGC has not maintained effective internal control over financial reporting as of September 30, 2013. Our opinion on internal control is based on criteria established under 31 U.S.C. 3512 (c), (d), commonly known as the FMFIA.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of

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deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the PBGC's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies listed below and described in Exhibit I to be material weaknesses:

1. Benefits Administration and Payment Department (BAPD) Management and Oversight
2. Entity-wide Security Program Planning and Management
3. Access Controls and Configuration Management

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency, which is described in Exhibit I, to be a significant deficiency:

4. Integrated Financial Management Systems

### ***Other Information***

The Chair's message, Director's message, year in review, financial statement highlights, management's discussion and analysis, management representation, improper payment reporting, actuarial valuation, letter of the Inspector General, management's response and organization contains a wide range of data, some of which is not directly related to the financial statements. This information is presented by PBGC for use by readers of the annual report and is not a required part of the financial statements. Also, this information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

## **REPORT ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

### **Report on Compliance with Laws and Regulations**

In connection with our audits, we considered PBGC's compliance with certain provisions of laws and regulations. We performed tests of the PBGC's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests for the year ended September 30, 2013, disclosed one instance of noncompliance to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In material weakness number one, we noted instances where PBGC failed to determine the fair market value of plan assets at date of plan termination as required by regulation. Title 29 of the *Code of Federal Regulation* §4044.41(b), General valuation rules, states: "Plan assets shall be valued at their fair market value, based on the method of valuation that most accurately reflects such fair market value."

### ***Management's Responsibility***

Management is responsible for ensuring PBGC's compliance with applicable laws and regulations.

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### ***Auditors' Responsibility***

We are responsible for (1) testing compliance with certain provisions of laws and regulations that have a direct and material effect on the financial statements and applicable laws for which OMB Bulletin 14-02 requires testing, and (2) applying certain limited procedures with respect to other information included with the financial statements.

We did not test compliance with all laws and regulations applicable to PBGC. We limited our tests of compliance to certain provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB Bulletin 14-02 that we deemed applicable to PBGC's financial statements for the fiscal year ended September 30, 2013. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

### ***Purpose of the Report on Compliance with Laws and Regulations***

The purpose of the Report on Compliance with Laws and Regulations is solely to describe the scope of our testing of compliance with laws and regulations and the result of that testing, and not to provide an opinion on the PBGC's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PBGC's compliance. Accordingly, this report is not suitable for any other purpose.

### ***Status of Prior Year's Control Deficiencies and Noncompliance Issues***

We have reviewed the status of PBGC's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 14, 2012. The status of prior year findings is presented in Exhibit II.

### ***Management's Response to Findings***

Management's response to the findings identified in our report is presented in Exhibit III. We did not audit PBGC's response and, accordingly, we express no opinion on it.



Calverton, Maryland  
November 15, 2013

**PENSION BENEFIT GUARANTY CORPORATION**  
**OPINION ON INTERNAL CONTROL**  
**September 30, 2013**

## **Background**

PBGC protects the pensions of approximately 42 million workers and retirees in nearly 25 thousand private defined benefit pension plans. Under Title IV of the Employee Retirement Income Security Act of 1974, PBGC insures, subject to statutory limits, pension benefits of participants in covered private defined benefit pension plans in the United States. To accomplish its mission and prepare its financial statements, PBGC relies extensively on the effective operation of the Benefits Administration and Payment Department (BAPD) and information technology (IT). Internal controls over these operations are essential to ensure the confidentiality, integrity, and availability of critical data while reducing the risk of errors, fraud, and other illegal acts.

The establishment and implementation of the appropriate internal controls are critical to PBGC operations. Furthermore, reliable internal controls ensure that the programs achieve their intended results; resources are used consistent with agency mission, programs and resources are protected from waste, fraud, and mismanagement; laws and regulations are followed; and reliable and timely information is obtained, maintained, reported, and used for decision-making as stated in the OMB Circular A-123, *Management's Responsibility for Internal Control*. In order to mitigate operational and financial reporting risks to PBGC as a whole, active involvement from PBGC's senior leadership in the monitoring and response to such risks is warranted on a continuous basis. Based on our findings, we are reporting that the deficiencies in the following areas constitute three material weaknesses for FY 2013:

1. BAPD Management and Oversight
2. Entity-wide Security Program Planning and Management
3. Access Controls and Configuration Management

We are also reporting the deficiencies in the following area to be a significant deficiency for FY 2013:

4. Integrated Financial Management Systems

The serious weaknesses in BAPD's internal controls such as inadequate documentation to support the benefit and liability calculations, errors in liability calculations and valuing plan assets, as well as the limited progress of mitigating PBGC's systemic IT security control weaknesses, create an environment that could lead to improper application of benefits to plan participations, inaccurate financial reporting and fraud, waste, and abuse.

### **1. BAPD Management and Oversight**

BAPD manages the termination process for defined benefit plans, provides participant services (including calculation and payment of benefits) for PBGC-trusted plans, provides actuarial support for PBGC, and carries out PBGC's responsibilities under settlement agreements. BAPD has several distinct

divisions including Trusteeship Processing Divisions (TPDs), the Actuarial Services Division (ASD), and the newly formed Asset Evaluation Division (AED). The TPDs are responsible for capturing the participant data for benefit determinations, managing the benefit payments to participants and beneficiaries, and maintaining the pension plan and participant files that includes underlying documentation used to support the calculation of benefit amounts for the participant and the pension liabilities recorded on PBGC financial statements. The AED will be responsible for ensuring that the plan asset valuations meet the regulatory requirements standard for determining the fair market value of assets. The ASD is responsible for calculating the Present Value of Future Benefits (PVFB) liability, based on actuarial assumptions and methods. ASD uses the underlying documentation maintained by the TPD, as well as mortality tables and interest rate factors, as key inputs to calculate pension plan liabilities recorded on PBGC's financial statements.

In response to weaknesses previously identified, BAPD implemented corrective actions to address control weaknesses within its department. These corrective actions consisted of modifying the BAPD operations manual, issuing a records management manual, developing staff training materials, and updating technical reference guides. BAPD also took steps to improve its operations and internal control processes over the PVFB liability. Furthermore, the BAPD Director restructured the department divisions and created the AED to better align staff core competencies and skills with the intent to mitigate operational and financial reporting risks.

Even with these corrective actions, BAPD continues to have control weaknesses that increase PBGC's operational and financial reporting risks. These weaknesses are attributed to BAPD's management and oversight over the processes needed to calculate and value participant's benefits and the related liabilities, as well as to value plan assets. Such weaknesses pose significant risks to PBGC's operations including accurate calculation of plan participants' benefits, accurate financial reporting, and compliance with prescribed laws and regulations. During FY 2013, we continued to identify deficiencies in BAPD controls that included errors in their liability calculations, inadequate documentation to support the calculation of participants' benefits and liabilities, and errors in valuing plan assets.

#### Calculation of the Present Value of Future Benefits Liability

We continued to identify errors in the calculation of participant benefits and the related PVFB liability. During our testing of the PVFB liability reported at June 30 and September 30, we noted:

- errors in valuing participant benefits and associated liability that were caused by system capability limitations or programming flaws;
- archival procedures for documentation maintenance in place at the time of certain plan terminations were not adequate; and
- data entry errors and inaccurate use of plan data.

These long standing deficiencies in BAPD processes continue to impede management's ability to accurately calculate and value benefits and related future liabilities for some participants. Using a statistically based sampling technique, we noted approximately 20% of the samples tested in which the liability calculated for a plan participant was either overstated or understated. The projected value of



the error to the entire PVFB liability of approximately \$105 billion at September 30, 2013, had an estimated range of approximately \$728 million understatement to \$414 million overstatement and a point estimate of \$157 million overstatement.

In addition, BAPD's maintenance of underlying documentation used to support the calculation of the PVFB continued to be a significant challenge. The information system that maintains the participant documentation needed to calculate benefits such as birth certificates, marriage certificates, participant benefit applications, plan provisions, and salary data is the Image Viewer System. During our testing at June 30 and September 30, BAPD was not able to provide the documentation needed to support liability calculations for some samples. The lack of appropriate documentation results in limited physical and financial controls, and could lead to improper benefit payment and participant liability calculations by PBGC. As a result, we could not determine whether the benefits or the associated liability was calculated properly for those selected samples at June 30 and September 30.

Last year we reported several deficiencies in BAPD related to documentation, including the need to require archival of source documents, implementation of controls to ensure monitoring and enforcement of procedures requiring document maintenance, and to improve the training of persons tasked with calculating and reviewing benefit determinations. These deficiencies have not yet been fully corrected.

Because of errors in the liability calculations and the lack of supporting documentation, PBGC is at risk for inaccurately valuing the plan liabilities reported in its financial statements. Also, these deficiencies could impact PBGC management's ability to provide meaningful and accurate information to its key stakeholders such as the plan participants, the Board, Congress, and OMB.

#### Valuation of Plan Assets and Benefits

BAPD has undertaken significant efforts to revalue assets for certain pension plans trusted by PBGC. These efforts have yet to be fully implemented and the internal control weaknesses continue to merit focus.

The fair market value of a pension plan's assets at the date a plan is terminated is an essential factor needed to determine the retirement benefit amounts owed to plan participants. BAPD's ineffective oversight of contracted reviews of asset valuations in the past continued to pose significant risks to the participants' benefit determinations. In FY 2013, BAPD hired a contractor to develop new plan asset valuation procedures for the newly formed AED. As a test, these procedures were used by the contractor to value the assets of two terminated plans. The contractor evaluated the operating effectiveness of its procedures and provided its assessment to BAPD management.

Currently, BAPD management has yet to conduct an independent evaluation of the contractor's procedures to determine their sufficiency and adequacy on valuing pension plan assets. Furthermore, BAPD did not complete the re-work of certain plan asset valuations based on its risk based approach to determine whether participant's benefits require an adjustment in FY 2013. The plan asset revaluations are expected to be completed in FY 2014.

**Recommendations:** We recommend that PBGC management:

Develop and/or implement the following:

- improvements to BAPD systems used to calculate benefits and liabilities (Spectrum and the Integrated Present Value of Futures Benefit Systems);
- procedures to verify that future contracts for plan asset valuations clearly outline expectations and deliverables in the statement of work.

Refine BAPD operating policies and procedures for processing plans and archiving benefit plan documentation.

Improve training for all levels of staff tasked with the calculation of benefits and the PVFB as well as the review of benefit determinations.

## 2. Entity-wide Security Program Planning and Management

In prior years, we reported that PBGC's entity-wide security program lacked focus and a coordinated effort to adequately resolve control deficiencies. Though progress was made as highlighted below, deficiencies persisted in FY 2013, which prevented PBGC from implementing effective security controls to protect its information from unauthorized access, modification, and disclosure. An entity-wide information security management program is the foundation of a security control structure and is a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and a continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures.

PBGC has now established the foundation for implementing a more effective entity-wide security program. The *IT Security Architectural Analysis Recommendations Report* dated June 19, 2013, provides a blueprint for implementing entity-wide controls and addressing PBGC's security program's strengths, weaknesses, threats, and opportunities. PBGC also completed work on a long-standing weakness relating to Interconnection Security Agreements with all external organizations whose systems connect with PBGC systems. While the *IT Security Architectural Analysis Report* represents progress, much remains to be done to implement and ensure adequate operation of controls. PBGC is still in the process of implementing a continuous monitoring program through the implementation of automated and manual tools, processes and procedures. Without a well-designed and fully implemented information security management program, there is increased risk that security controls are inadequate; responsibilities are unclear, misunderstood, and improperly implemented; and controls are inconsistently applied or no longer operate as intended. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

The specific weaknesses we found that contributed to the material weakness are as follows:

- Security Assessments and Authorizations (SA&As) for several major applications not completed. SA&A serves as a control to verify and validate that system security controls are properly implemented and working correctly. While a majority of SA&As have been completed by the Bureau of Public Debt through an interagency agreement with PBGC, this long-standing weakness is critical to complete.
- Less than one-half of security controls for general support systems implemented. Using NIST SP 800-53, *Recommended Security Controls for Federal Information Systems*, PBGC identified 208 common security controls. PBGC stated that 93 of these controls have been implemented. While PBGC anticipates completion of their corrective actions in early 2015, as of the end of FY 2013, they have not documented the details of the specific actions needed to complete and confirm the design, implementation, and operating effectiveness of the remaining 115 identified common security controls.
- Security infrastructure design and implementation weaknesses continue. PBGC's ability to effectively implement common security controls across its systems and applications was adversely affected because there are weaknesses in its infrastructure design and deployment strategy for systems and applications.
- Information security policies and procedures not fully disseminated and implemented. PBGC is not able to effectively enforce compliance for all needed security awareness training. PBGC will be using an automated tool, Talent Management System , to provide security awareness and role-based training.

**Recommendations:** We recommend that PBGC management:

Complete the process to validate the completion of SA&A packages for all major applications.

Develop and implement a well-designed security management program that will provide security to the information and information systems that support the operations and assets of PBGC, including those managed by contractors or other federal agencies.

Complete the development and implementation of the redesign of PBGC's IT infrastructure and the procurement and implementation of technologies to support a more coherent approach to providing information services and information system management controls.

Effectively communicate to key decision-makers the state of PBGC's IT infrastructure and environment to facilitate the prioritization of resources to address fundamental weaknesses.

### 3. Access Controls and Configuration Management

Although access controls and configuration management controls are an integral part of an effective information security management program, access controls remain a systemic problem throughout PBGC. PBGC's past decentralized approach to system development, system deployments, and configuration management created an environment that lacks a cohesive structure in which to

implement controls and best practices. Weaknesses in the IT environment contributed significantly to deficiencies in system configuration, segregation of duties, role-based access controls, and monitoring.

PBGC realizes these challenges and is implementing a disciplined and integrated approach through development of *Configuration, Change and Release Management (CCRM) Process and Procedures* consistent with NIST SP 800-53, Rev 3. PBGC has developed and is implementing additional policies and procedures, including deploying technical and configuration management tools. PBGC is in the process of procuring, implementing and deploying technical tools to better manage configuration of common operating platforms. Once these tools are fully operational in the infrastructure, they will help ensure that controls related to the configuration of infrastructure components remain consistent and provide alerting capabilities when components are changed. Other complementary processes, such as the Patch and Vulnerability Management Group (PVMG, formerly the Tiger Team) focused on system scanning and vulnerability management, supported PBGC's capability to carefully document and validate system vulnerabilities, and provided evidence as to the operating effectiveness of some technical common controls.

Without appropriate access and configuration management controls, PBGC does not have assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction.

Among the specific weaknesses we found that contributed to the material weakness were due to a lack of following:

- Infrastructure and Configuration Management. PBGC configuration management controls are labor intensive and ineffective. PBGC's three IT environments (develop, test, and production) do not share common server configurations.
- Security configuration settings. Controls are not consistently applied to ensure that authentication parameters for general support systems and applications comply with PBGC's Information Security Policy.
- Segregation of duties-restriction of access to production environment. Some developers have access to the production environment, which exposes PBGC to the risk of unauthorized modification of the application and circumvention of critical controls, and unnecessary access to sensitive data.
- Recertification of user and system access. The OIT re-certification process remains incomplete and does not include all user and system access accounts.
- Management of user, generic and dormant accounts. PBGC's policies and practices have not effectively restricted the addition of unnecessary and generic accounts to systems in production.
- Business process controls. The Policy, Research and Analysis Department (PRAD) uses spreadsheets in the determination of the interest rate factor used for calculating PBGC's liabilities for future benefits, that do not have adequate controls over access to data, information security and changes. A contributing factor that sets the stage for this deficiency is PRAD's lack of adequate documentation of its process and procedures to ensure that spreadsheet calculations and other activities can be repeated by unassociated officials.

**Recommendations:** We recommend that PBGC management:

Develop and implement the following:

- a coherent strategy for correcting IT infrastructure deficiencies.
- a framework for implementing common security controls and mitigating the systemic issues related to access control by strengthening system configurations and user account management for all of PBGC's information systems.

Implement controls to remedy vulnerabilities noted in key databases and applications such as weaknesses in configuration, roles, privileges, auditing, file permissions and operating system access. Also implement controls to remedy weaknesses in the deployment of servers, applications, and databases in the development, test and production environments.

Complete the recertification processes for all user and system accounts.

Complete an inventory of spreadsheets used by PRAD in its determination of the interest rate factor used for calculating PBGC's liabilities for future benefits. For these spreadsheets implement controls over access to the data, information security and change to the spreadsheets.

#### 4. Integrated Financial Management Systems

The risk of inaccurate, inconsistent, and redundant data exists because PBGC lacks a single integrated financial management system. Part of the system requires manipulation and the use of manual procedures to upload: (1) plan PVFB liabilities; (2) the commingled funds monthly trial balance summary journal; and (3) the monthly journal entry for the premium financial activity.

OMB Circular A-127, *Financial Management Systems*, requires that federal financial management systems be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. OMB's *Core Financial System Requirements* establishes mandatory financial management system performance goals applicable to all financial management systems. These goals include providing timely, reliable, and complete financial management information for decision making at all levels of government; and providing for "one-time" data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements.

If managed effectively, IT investments can have a dramatic impact on an organization's performance and accountability. If not correctly managed, they can result in wasteful spending and lost opportunities for achieving mission goals and improving mission performance. PBGC had several false starts in modernizing its systems and applications that either have been abandoned (such as the suspension of work on the Premium and Practitioner System to replace the Premium Accounting System or have been ineffective in leading to the integration of its financially significant systems.

PBGC has made progress in implementing an integrated financial system. However, the implementation has not been completed. The specific weaknesses that contributed to the significant deficiency are as follows:

- Implementation of the Premium and Practitioner System (PPS). Major work remains to be completed to provide PBGC with integrated financial management capabilities. By December 2013, PBGC plans to implement the Premium and Practitioner System. With PPS, the Corporation will be integrated with the Oracle eBusiness Suite COTS solution used for PBGC's Consolidated Financial Systems.
- Lack of automated interface. Manual intervention is required to import the IPVFB plan liabilities into the Trust Accounting System (TAS). Within TAS, the plan liabilities comma separated values (CSV) file is manually uploaded into TAS for processing. A similar procedure is applied for uploading the State Street Commingled Plans monthly trial balance summary journal into TAS.

PBGC's FY 2013 accomplishments included implementation of the Trust Accounting System (TAS), an externally-hosted, commercial-off-the-shelf investment accounting package. PBGC also upgraded the current PAS by completing unique enhancements for Pension Protection Act legislative changes and high priority functions. PBGC has also identified areas of focus for its future financial management architecture, including a procurement system and an online budgeting system.

**Recommendation:** We recommend that PBGC management:

Implement and execute a plan to integrate its financial management systems in accordance with OMB Circular A-127.

**PENSION BENEFIT GUARANTY CORPORATION**  
**INDEPENDENT AUDITOR'S REPORT**  
**STATUS OF PRIOR YEAR'S CONTROL DEFICIENCIES AND NONCOMPLIANCE ISSUES**  
**September 30, 2013**

Prior Year Condition	Status As Reported at September 30, 2012	Status as of September 30, 2013
1. Benefit Administration and Payment Department Management and Oversight	<p><b><u>Material Weakness:</u></b> PBGC has weaknesses in the following:</p> <ul style="list-style-type: none"> <li>• Calculation of the Present Value of Future Benefits Liability</li> <li>• Valuation of Plan Assets</li> </ul>	Repeated as a Material Weakness number 1 and included in Exhibit I.
2. Entity-wide Security Program Planning and Management	<p><b><u>Material Weakness:</u></b> PBGC has weaknesses in the following:</p> <ul style="list-style-type: none"> <li>• PBGC had not completed SA&amp;As for its major applications.</li> <li>• Weaknesses in PBGC's infrastructure design and deployment strategy for systems and applications adversely affected its ability to effectively implement common security controls across its systems and applications.</li> </ul>	Repeated as a Material Weakness number 2 and included in Exhibit I.
3. Access Controls and Configuration Management	<p><b><u>Material Weakness:</u></b> Weaknesses in the IT contributed to deficiencies in system configuration, segregation of duties, role-based access controls, and monitoring.</p>	Repeated as a Material Weakness number 3 and included in Exhibit I.
4. Integration Financial Management Systems	<p><b><u>Significant Deficiency:</u></b> PBGC lacks a single integrated financial management system which increases the risk of inaccurate, inconsistent and redundant data.</p>	Repeated as a Significant Deficiency and included in Exhibit I.
<b>Compliance and Other Matters</b>		
1. Noncompliance with Title 29 of the <i>Code of Federal Regulation (C.F.R.)</i> , Part 4044.41, Subpart (b), General valuation rules	Plan assets shall be based on the method of valuation that most accurately reflects such fair market value.	Repeated as a noncompliance violation.




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

Office of the Director

#### MEMORANDUM

To: Deborah Stover-Springer  
Acting Inspector General

From: Josh Gotbaum 

Subject: Response to the Independent Auditor's Combined Audit Report for the  
FY 2013 Financial Statement Audit

Thank you for the opportunity to comment on the Office of Inspector General's FY 2013 audit results regarding the agency's financial statements, internal controls, and compliance with laws and regulations. As PBGC is responsible for issuing payments of over \$5 billion in benefits each year, managing over \$70 billion in investments, and undergirding America's pension system, we are pleased that our financial statements have once again received an unqualified opinion. Audited financial statements are a cornerstone of accountability.

We agree with your opinion on internal controls, and are committed to addressing the issues raised in your report. Work continues on the implementation of the corrective action plans that were developed to address the three material weaknesses and one significant deficiency. We appreciate your report highlighting areas where we have made progress. Clearly, much remains to be done. As we continue to make progress, we will of course keep your office informed.

cc: Patricia Kelly  
Alice Maroni  
Ann Orr  
J. Jioni Palmer  
Sanford Rich  
Judith Starr  
Martin Boehm  
Theodore Winter



# ORGANIZATION



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## ORGANIZATION

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*Secretary of the Treasury*

Penny Pritzker  
*Secretary of Commerce*

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*Acting Chief Policy Officer*

Sanford Rich  
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*General Counsel*

Josh Gotbaum  
*Acting Chief Operating Officer*

### Office of Inspector General

Deborah Stover-Springer  
*Acting Inspector General*

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Employee Benefits Security Administration*

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*Under Secretary of the Treasury  
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Mark Doms  
*Under Secretary of Commerce  
for Economic Affairs*

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Budget Department

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Workplace Solutions  
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Office of Equal  
Employment Opportunity

J. Jioni Palmer  
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Communications and  
Public Affairs Department/  
Deputy Chief Policy Officer

Michael Rae  
*Deputy Chief*  
*of Negotiations and Restructuring*  
Office of Negotiations  
and Restructuring

Vidhya Shyamsunder  
*Director*  
IT & Business Modernization

Barry West  
*Chief Information Officer*  
Office of Information  
Technology

Theodore J. Winter, Jr.  
*Director*  
Financial Operations  
Department

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## The PBGC Advisory Committee

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Bismarck, North Dakota

Dallas L. Salisbury  
Washington, DC

Harry J. Wilson  
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Cheryl Alston  
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*Vacant*

### *Representing the Interests of Employee Organizations*

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Washington, DC

Joyce Mader  
Washington, DC