



CUSTOMER SATISFACTION

89%

PBGC  
retirees

67%

federal government  
aggregate

2007 2008 2009 2010 2011 2012

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# excellence in customer service

PENSION BENEFIT GUARANTY CORPORATION | ANNUAL REPORT | 2012

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## A MESSAGE FROM OUR CHAIR



Making the private pension system work well is vital to the retirement security of the millions of workers and retirees who depend on pension benefits and is a priority of this Administration. The Pension Benefit Guaranty Corporation has a key role in these efforts and in safeguarding the pension benefits of America's workers. The PBGC does this by paying guaranteed benefits earned by workers on time, and by working with employers to encourage them to maintain their pension plans and keep their pension promises.

On behalf of the PBGC Board, I am pleased to present the PBGC's FY 2012 Annual Report, which provides important information on the PBGC's operations and its finances. It highlights many of the accomplishments of the PBGC over this past fiscal year and also future challenges and program risks. Although the PBGC faces challenges, in the near term the PBGC is fiscally sound, and participants and retirees can count on the PBGC's programs to be there to protect their benefits.

In the past year, the Administration has again proposed to strengthen the PBGC by reforming its premium authority. This proposal would ensure that the PBGC has the funds to do its job while providing incentives for employers to continue offering pension plans and to improve plan funding so that they keep their pension promises. At the same time, the PBGC is working to make it easier for employers to maintain plans by following President Obama's directive to review and reform regulations to reduce regulatory burdens. By making the pension system work better for employers, we help to provide a more secure future for workers and retirees.

I am proud of the work of the PBGC and its accomplishments in helping plan sponsors to preserve their pension plans and lifetime income for retirees. My fellow Board members and I remain committed to working with the PBGC Director to strengthen the PBGC to meet its future challenges.

A handwritten signature in black ink that reads "Hilda L. Solis".

Hilda L. Solis  
*Secretary of Labor*  
*Chair of the Board*



## A MESSAGE FROM OUR DIRECTOR:

### PROVIDING SERVICE IN TROUBLED TIMES

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

- ***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 and to serve them with competence and compassion.
- ***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.

### Renewing a Good Agency

In FY 2012, we continued as one of the best benefits agencies in government, stepping in to take responsibility for 47,000 people's pensions when their plans failed, including 17,000 who are already retired. *Not one of them missed a payment.*

The American Airlines bankruptcy reminded people that we first try to *preserve pensions*, not just pay for them if they fail. Our efforts on behalf of 130,000 people in American's four plans helped them keep the benefits they'd been promised.

Also in FY 2012, we began a transition to a new generation of PBGC management. They are experienced and talented, and share our commitment to PBGC's missions. Some came from outside the agency; others rose through the ranks. All are energized and have begun to take a fresh look at the agency's work.

We made changes to the way we do some of our most crucial work, in some cases to better meet today's challenges and in others to ensure that we don't repeat past errors. In FY 2012, we completed rework on plans of two companies where our Inspector General had questioned the original benefit determinations.

**PBGC's Customer Satisfaction Scores Are Among the Best in Government**



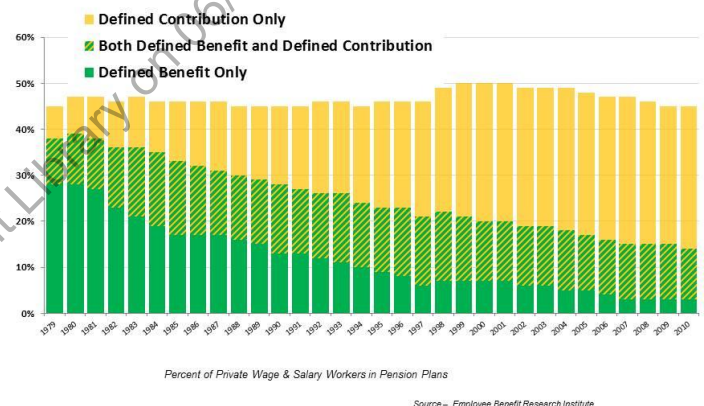
Although the benefit adjustments we made were very slight, errors of any size affect the public's trust. We are correcting them and making changes to ensure that they do not happen again.

## Future Retirees Worry

One of PBGC's primary missions under the Employee Retirement Income Security Act (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.
- They 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% 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*

DB 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.

At the President's direction, we've made changes to reform or reduce unnecessary regulatory requirements — and we're planning even more. For sound companies and plans, we're trying to reduce burdens (and premiums) and focus on companies and plans where there's risk. For example, ERISA sometimes requires companies to provide financial assurances for their pensions when they downsize.



Business said the way we enforced the law burdened companies that posed little actual risk — and we agreed. Now we’re focusing enforcement on the minority of cases where there really is a threat.

### ***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.

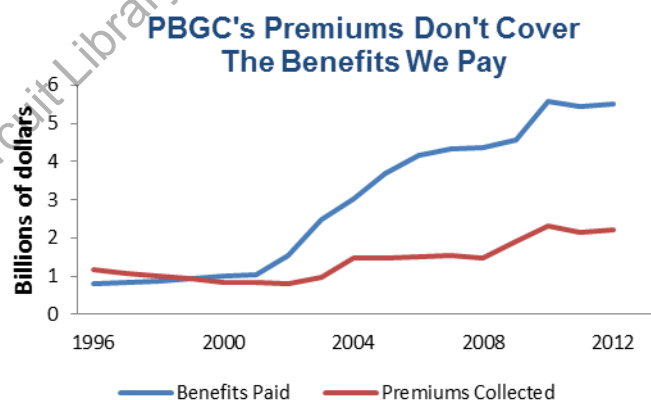
In FY 2012, we published a proposed rule helping to clarify rules governing cash balance plans, which would help employers to choose them with confidence. We’re working with the other ERISA agencies on these and other ways to increase flexibility and expand options for employers and employees.

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

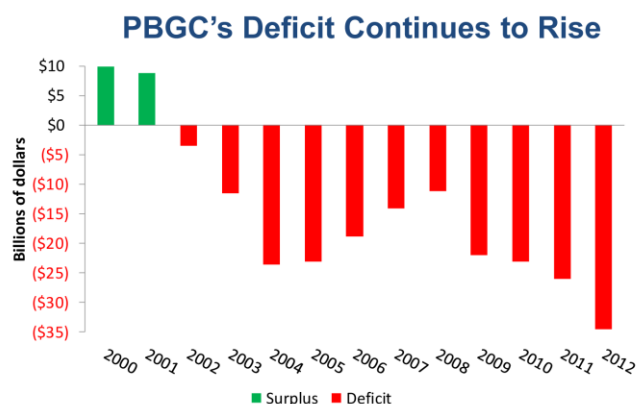
As more Americans age and live longer, healthier lives, both private and public retirement programs will necessarily cost more in the future. We must recognize this, and determine the steps that will be necessary to pay for them. That doesn’t mean that employers will write blank checks to pay for everything.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

## **PBGC’s Own Finances Must be Sound, Too**

PBGC is funded through insurance premiums paid by plan sponsors, assets from failed plans, investment earnings on our assets, and recoveries in bankruptcy. We don’t receive any taxpayer dollars. But that means that our own finances need to be in order. 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, nine years later, we remain on GAO’s High Risk List.



Administrations of both parties have proposed changing this, by making PBGC’s Board responsible for setting premiums. This administration has gone further and proposed both public processes and safeguards



to ensure that reformed premiums would not inadvertently discourage the very pension plans on which PBGC depends. Unlike previous premium increases, which forced the majority of companies to pay for the risky behavior of the minority, premiums would take into account the financial health of the employer and the circumstances of the individual plan. And, unlike the current variable rate premium, premiums would be designed not to rise just when the economy or markets are weak and companies can least afford to pay them.

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PBGC has enough funds to meet its obligations for years. But without the tools to set its financial house in order and to encourage responsible companies to keep their plans, 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, 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.



Josh Gotbaum  
Director  
November 14, 2012

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# 2012 ANNUAL REPORT

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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 nearly 43 million of America's workers and retirees participating in nearly 26,000 private-sector defined benefit pension plans. The Corporation receives no funds from general tax revenues. Operations are financed by insurance premiums paid by companies that sponsor defined benefit pension plans or from the plans' assets, investment income, and assets from terminated plans. 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, August 3, 2012; and, Circular No. A-136 Revised, "Financial Reporting Requirements," Office of Management and Budget, August 3, 2012. 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 that will be issued as soon as practicable.

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## PBGC PERFORMANCE REPORT

We protect some 43 million workers and retirees in private defined benefit pension plans, by encouraging companies to keep their plans, and by paying benefits when they cannot.

We have two overarching goals:

- *Preserve plans and protect pensioners, and*
- *Pay pension benefits on time and accurately.*

This performance report describes our mission and our operations, 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 nearly 33 million workers and retirees in about 24,000 pension plans. Our multiemployer program protects about 10 million workers and retirees in about 1,500 pension plans. During FY 2012:

To *preserve plans and protect pensioners*, we:

- Helped to protect 130,000 people in American Airlines' plans, and tens of thousands more in other plans in ongoing bankruptcies,
- Helped to protect 37,000 people in plans sponsored by companies that emerged from bankruptcy without terminating their plans,
- Negotiated \$31 million in financial assurance to protect more than 9,000 people in plans at risk from corporate transactions,
- Negotiated \$471 million in financial assurance to protect 50,000 people whose companies downsized, and
- Worked with media, Congressional staff, retiree groups, unions, and pension advocacy groups to help thousands to understand the lifetime consequences of accepting one-time cash payments instead of their pensions.

To *pay timely and accurate benefits*, we:

- Assumed responsibility for more than 47,000 people in 155 newly failed single-employer plans,
- Started paying benefits to the 17,000 retirees in those plans, on time and without missing a single payment,
- Paid \$5.5 billion to nearly 887,000 retirees in more than 4,500 failed plans (an additional 614,000 workers will receive benefits when they retire), and



- Re-evaluated the benefits of more than 223,000 pensioners at United Airlines, National Steel, and in other plans to correct possible errors in the original work over the past decade, and started changing our procedures and organization to avoid errors in the future.

## Our Customer Focus

We begin with the customers we are here to serve: the people who count on us and the companies which choose to sponsor defined benefit pension plans. PBGC has a strong and longstanding tradition of customer service. We continuously ask our customers how we perform, analyze our operational strengths and gaps, and follow through on customer concerns. When we make a mistake, we act quickly to correct it. And we never stop trying to improve.

Our people know how important our work is, and we reinforce it daily. In FY 2012, we established an ongoing survey to measure overall customer satisfaction and tied employee performance awards to how our customers rate their interactions with us. In the new survey, we ask customers for feedback on the information and services we provide and on how well we are achieving our mission. Every day we share feedback from this survey throughout the agency to better improve our service and respond to customer needs. The new survey also offers callbacks to people who say that they need more help or information. This allows us to not only hear their concerns, but also move to resolve them directly. Our high customer satisfaction scores reflect the success of our efforts to serve both the people who count on us, and the companies and professionals that maintain ongoing pension plans.

**Retirees Rate PBGC as One of the Best Agencies in Government.** Pensioners typically come to us in a time of great uncertainty: Through no fault of their own, they suddenly don't know the fate of the benefits they may have worked a lifetime to receive. They may have lost their health benefits and even their jobs. We aim to serve them with competence and compassion. For those who have already retired, we assure them that they will not miss a benefit payment — and then we make it happen. This year, we assumed responsibility for 47,000 new people, 17,000 of them already retired, and not one missed a single month's check during the transition process.

We use call monitoring, individual coaching, developmental opportunities, and recognition for star performers to maintain service at a high level.

Our emphasis on serving the people who count on us has led to exceptional customer satisfaction ratings.

*“All of my interactions with PBGC have been both pleasant and professional. I believe that this agency has acted fairly and with my interests in mind.”*

— Customer comment, May 2012



Retirees receiving monthly benefits rated us 89 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). For retirees, the ease of applying for benefits and the reliability of monthly payments are of high importance, and they rated us highly in both categories.

People who reached us by phone, whether retired or still working, rated us 87, our highest caller score ever, and reported continued satisfaction with the respect our representatives showed and the accuracy with which we resolved their concerns. They also expressed confidence that we will continue to do a good job in the future.

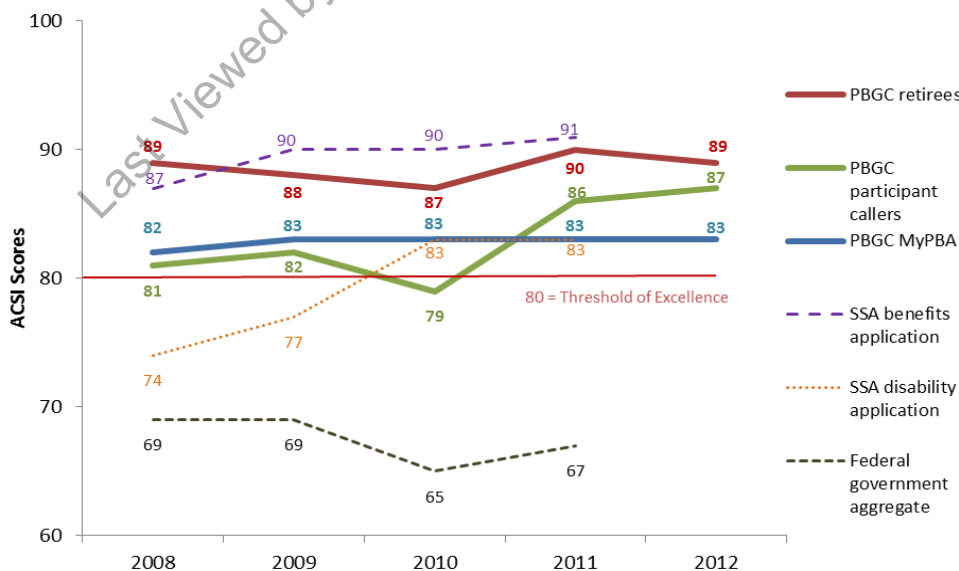
Our website, PBGC.gov, plays an increasingly important role in providing tools and information to customers. In FY 2012, we began rewriting the site's most popular pages in plain language to make them more accessible. We added information that customers demanded, for example, a list of plans that we insure, FAQ's on American Airlines and United Airlines plans, and explanations of the annual funding notices that employers send to their employees and retirees. We also increased our use of Facebook and Twitter, and we launched our blog, *Retirement Matters*, to provide our customers with the latest news on PBGC and pensions.

Our online application for workers and retirees, My Pension Benefit Account (MyPBA) allows customers to access forms and information, and to perform routine transactions any time of day or night. The ACSI rating for MyPBA was 83. During FY 2012, MyPBA users executed about 207,000 transactions, and more than 32,000 people established new accounts.

*"I dealt with two very efficient and well-informed employees who answered all questions promptly and helped me enroll for online services quickly. I expected long waits; I was quite surprised and impressed. This is my first contact with PBGC. I couldn't ask for any better service."*

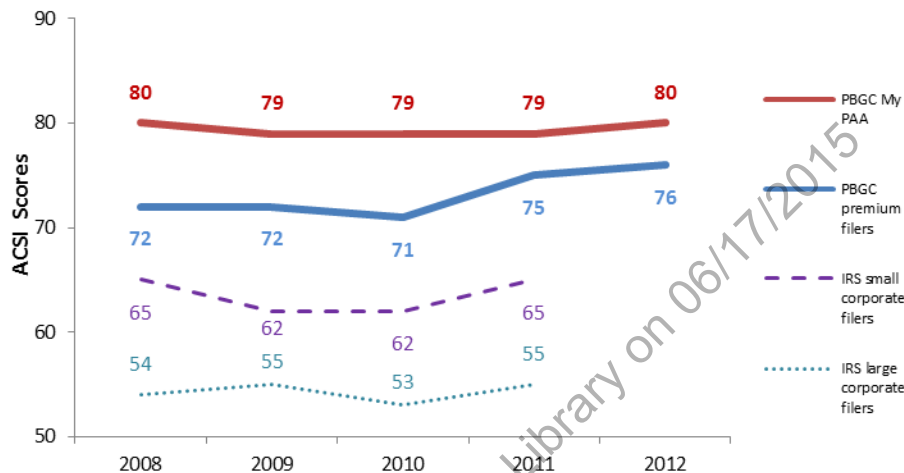
— Customer Comment, April 2012

### Pensioners Rate PBGC Very Highly



**Pension Plan Administrators Continue to Rate Services Highly.** Administering a pension plan can be frustratingly complex, so we aim to make employer and plan administrator experiences as straightforward as possible. This includes making continuous improvements to the services we offer and simplifying the plan-administration and premium-filing regulations. In FY 2012, plan professionals continued to express satisfaction with our services, even as we took steps to serve them better.

### Practitioner Satisfaction Remains High



We used both ongoing customer feedback and feedback from a focus group held early in the year to prioritize areas where we need to improve. In response to what we found, we clarified our payment methods and enhanced our system capabilities to make premium filing easier. For example, we added an option to print a draft filing that looks like a sample “premium form” which we provide, making it easier for filers to review the information before submission.

We’re also changing how we approach the companies that sponsor plans. Our 2011 *Plan for Regulatory Review*, under Executive Order 13563 on Improving Regulation and Regulatory Review, highlighted how we plan to work with our stakeholders. In FY 2012, we continued to review and rethink our regulations, as part of an open exchange of information among government officials, experts, stakeholders, and the public. In response to their input, we are making changes. *Progress reports* are posted on our website.

**Premium Penalty Relief:** In FY 2012, we announced a voluntary correction program that reduces penalty costs for some premium filers, and in some cases, eliminates penalties. By forgoing some penalties, we can expect more effective enforcement and earlier compliance, as well as timelier premium collection. About 50 plans took advantage of this relief. In return, we now have 50 additional premium-filing plans. In addition, premium payers continue to see the benefits of the premium-related relief that we announced late in FY 2011. This relief was in response to comments we heard from premium payers and pension professionals as a result of our regulatory review. We provided relief from some premium penalties, many involving alternative premium funding target elections. In FY 2013, we expect to publish a proposed rule further expanding premium penalty relief, as well as making other premium changes to reduce burden.

**Shutdowns and Layoffs:** In FY 2012, we rethought our approach to ERISA section 4062(e), which requires companies to make financial assurances whenever they cease operations at a facility and cause substantial job loss.

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We began to re-examine our approach to section 4062(e) when we saw the business community's comments on our 2010 proposed regulation on the section. Their response was clear: we should reduce burdens on companies in circumstances where there was little or no risk to plan participants or PBGC. After meeting with the business community, we decided they were right. We announced that PBGC would revise the proposal. We also focused enforcement resources on circumstances where there really is a threat to pensions, taking into account plan size and the financial health of the plan sponsor.

**Implementing the Pension Protection Act of 2006:** In FY 2012, we continued drafting rules to implement and comply with the Pension Protection Act of 2006 (PPA). We are simplifying employer compliance when feasible, taking into account the needs of small businesses and comments from stakeholders. We published a proposed rule implementing PPA changes to terminations of cash-balance plans. In FY 2013, we expect to re-propose amendments to the reportable events regulation implementing PPA, and reducing regulatory burden; propose regulations implementing PPA changes to the missing participants program; and publish a final rule implementing PPA changes to our guarantee of shutdown and similar benefits. These rule-makings, together with the nine final rules published in FY 2007-2012, will largely complete our PPA implementation plan.

**Other Rules:** In FY 2013, we expect to publish a proposed rule to streamline and reform multiemployer plan notice requirements, in order to reduce burdens on businesses. And as part of our efforts to enhance retirement security by promoting lifetime income options, we 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.

Our customer satisfaction scores for premium filers and for our online premium filing application, My Plan Administration Account (My PAA), reflect a high level of satisfaction in the business community, especially compared with other agencies engaged in collection activities. The scores are substantially higher than for corporate tax filers, the customer group most similar to our premium payers. Our survey results for premium filers nudged from 75 to an all-time high score of 76. The My PAA users rated their satisfaction at 80, meeting the ACSI "threshold of excellence."

*"It [e-filing] was easier than I thought it would be."*

*"I was very impressed with the timing, I think I heard back the next day on my request. I was very impressed by that."*

*— Customer comments, July 2012*

## **Preserving Plans and Protecting Pensioners**

Even as the overall economy showed improvements in FY 2012, pension plans continued to be at risk, and with them, the retirement security of the people who count on them. We continued our efforts to preserve plans and protect people:

- Even before troubled companies enter bankruptcy, we work with them to protect their plans, sometimes requiring additional funding to strengthen the plan.
- When companies enter bankruptcy, we first seek to preserve their plans if possible.
- If they cannot successfully restructure while maintaining their pensions, we step in and pay benefits.

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

**Early Warning:** We continued to monitor more than 1,000 companies for transactions that could pose significant risks to underfunded plans and to arrange for sponsors to protect those plans. We also investigated transactions to see if they posed risk to people's pensions, and negotiated agreements to strengthen them if they did. In FY 2012, we opened 37 such investigations and reached two agreements.

The larger of the two, with Bon-Ton stores, strengthened its pension promise to more than 8,000 employees and retirees.

**Responding to Major Shutdowns and Layoffs:** Under Section 4062(e) of ERISA, 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 2012, we reached settlements with 27 companies for \$471 million to protect almost 50,000 participants.

We also began to revise our enforcement of Section 4062(e) to focus on companies presenting greater risk.

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

Even after a company enters bankruptcy, we work to try and preserve its plans. We take an active role in bankruptcies to prevent unnecessary plan terminations, 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 2012. Nevertheless, four new bankruptcies presented very large exposures: American Airlines, Kodak, NewPage Group, and Hawker Beechcraft. In each, we have been working to protect the interests of the participants.

**American Airlines** entered bankruptcy in November 2011 and immediately announced plans to terminate its four pension plans. American's plans are underfunded by \$12 billion and cover 130,000 workers and retirees. We worked actively to revisit that decision. Our financial analysts found that American's plans were less costly than some of its competitors. We then worked with American's creditors, to show them the consequences of termination on their interests. We worked closely with stakeholders, with the press, with the Congress, with other government agencies, and in court. Eventually, American agreed to freeze rather than terminate its plans.

In **Hawker Beechcraft's** case, pension plans are underfunded by \$750 million. We have worked hard to try to preserve the pensions for the nearly 18,000 people in the plans. As a result of intensive negotiations, one plan is being preserved — it covers more than 8,000 people.

All told, in FY 2012 we opened 38 new bankruptcy cases. Companies that continued their pension plans following a bankruptcy filing include Great Atlantic & Pacific Tea Company (A&P), with more than 26,000 people, Lee Enterprises, with 4,200, and Houghton Mifflin Harcourt Publishing with 4,000, and the people will receive their full promised benefits.

*In FY 2012, our efforts kept more than \$12 billion in unfunded pension liabilities off our books and helped nearly 200,000 people keep the benefits they've accrued.*

### ***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. We received 1,415 such filings in FY 2012, audited 246, and took enforcement actions that resulted in additional payments of \$3.1 million to 454 workers and retirees. We also take in the benefits of people the plan sponsor cannot locate, undertake our own search efforts, and provide tools for those people to find unclaimed pensions *on our website*.

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## Encouraging Employer-Provided Retirement Plans

ERISA tasks PBGC with “encouraging the continuation and maintenance of voluntary private pension plans.” We do so in many ways: by working to preserve existing plans, facilitating new options, and helping individuals understand their retirement choices.

### *Helping Preserve the Plans We Have*

DB plans still cover over 35 million active workers in private and public sectors. We preserve existing plans both inside and outside of bankruptcy by a range of activities (*see page 7*).

**Reducing Administrative and Regulatory Burdens.** We also work to preserve plans by reducing the administrative and regulatory burdens of sponsors. We’ve made simple filing tasks easier (*see page 14*), and are reviewing and reforming our regulatory and enforcement focus (*see pages 5-6*).

**Working with Multiemployer Plans to Attract and Retain Employers:** To keep multiemployer plans solvent, it is crucial to keep employers in the pool and attract new ones.

One way we do this is by remaining flexible when plans propose new rules governing employer liability:

- To attract new employers, some plans have limited their liabilities to those arising while they are in the plan—generally protecting new employers from legacy liabilities.
- 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, under certain circumstances.

Where employers cannot continue in business and pay current contribution rates, we work with them and the other ERISA agencies to find solutions. For example, if bargaining parties negotiate lower contributions and lower benefits, we may broaden the circumstances under which plans may accept such agreements.

We regularly discuss options for troubled plans with plan professionals. In addition to the alternative and special rules described above, we sometimes discuss merging multiemployer plans to improve economies of scale and increase the ratio of active participants (for whom employers owe contributions) to inactive participants (for whom they don’t).

When mass withdrawal termination is inevitable, we engage plans and withdrawing employers to discuss approaches that will offer maximum recovery by the plan. And we are always available to informally lend our expertise to plan professionals and provide technical assistance on difficult interpretation issues.

### *Facilitating New Options*

One size does not fit all. Some employers are looking for ways to limit costs and risks, and share them with employees. Some who have shifted to DC plans are considering ways to get some of the benefits common in DB plans. 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. We’re working with the other ERISA agencies to increase flexibility and expand options for employers and employees.

PBGC also held a forum on the future of retirement security: We invited panelists from business, retiree groups, labor, universities, and throughout the pension community to discuss the present and future of retirement security, including the place of defined benefit plans.

### *Helping People Understand Their Retirement Choices*

In FY 2012, both General Motors and Ford offered tens of thousands of retirees one-time lump sums in place of their pensions. We worked with media, Congressional staff, retiree groups, unions, and pension



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advocacy groups to help thousands to understand the lifelong consequences of accepting such an offer, so they would recognize the important protections that would be forfeited.

We also shared information face-to-face, through our speakers bureau. Our audiences included pension professionals and plan sponsors, business groups, labor unions, retiree organizations, academics, and financial professionals. Topics included retirement security, the administration's premium reform proposal, our efforts to strengthen and protect pension plans, and what administrators need to know to comply with PBGC regulations.

## **Paying Timely and Accurate Benefits**

Although it's always better for companies to keep their own pension promises, some companies and plans fail. When they do, we are there. We're currently responsible for the pensions of some 1,500,000 people. PBGC remains one of the best benefit payment organizations in the Federal government and is committed to further improvements in service and reliability.

In FY 2012, we became responsible for an additional 47,000 workers and retirees in 155 terminated single-employer plans. Some of the largest failures were plans sponsored by Friendly Ice Cream Corporation, Christ Hospital, Dewey & LeBoeuf LLP, and Olan Mills, Inc.

We must determine the individual benefits owed to each participant, which requires a unique calculation for each participant. Despite this complexity and the significant variation in termination activity from year to year, we remain committed to delivering accurate and timely payments and benefit determinations, and remaining responsive to participants' needs. Our ACSI survey results demonstrate continued excellence in providing clear communications and on-time payments.

*"I want to thank PBGC for stepping in to help save my future retirement. My company failed me, but PBGC came through."*

*— Customer comment, July 2012*

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

When a company can no longer keep its pension promises, our first priority is to ensure that people keep getting their benefit payments without interruption. In FY 2012, we stepped in to pay nearly 17,000 retirees already receiving monthly checks. All continued to receive their benefits without interruption.

### ***Paying Benefits on Time***

PBGC paid \$5.4 billion in benefits in FY 2012 to more than 836,000 retirees in single-employer plans. Each and every month, we process and pay these benefits on time. We monitor all of our activities to make sure we are paying people on time.

We also process new applications quickly. For those who become eligible during the time we are assuming a plan, we generally process their applications within 45 days. In 2012, we processed nearly 37,000 new benefit applications, 90 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.

We promote use of electronic direct deposit for faster and more secure payments. Currently, 82 percent of payments are electronic.

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## ***Paying Accurate Benefits***

We calculate benefits using a complex process spelled out in federal law. Actuaries calculate each participant's benefit according to the provisions of the particular pension plan; then they must apply statutory and regulatory rules to determine how much we can pay.

- When a plan fails, we continue the payments that are already being made, on time and without interruption.
- Within a few months, using whatever documentation that is readily available, we estimate the benefits that would be owed under Federal law. We pay these estimated benefits until we can determine final benefits.
- After we gather all the necessary information and documentation, we make a final benefit determination. If a participant disagrees with the final benefit determination, they can appeal.

Retirees already receiving estimated payments may see adjustments to their benefits when they become final. For benefits we finalized in FY 2012, 95 percent of estimated payments were within 10 percent of the final benefit determination amount.

We place a high value on the accuracy of our benefit determination process. During FY 2012, we slowed the pace of our final determination process in order to address concerns about our quality. This has increased people's wait time for a final calculation of their benefits. Although we are concerned about the delay in making final benefit determinations, we place a higher priority on ensuring that the determinations are accurate. It's important to note that we pay estimated benefits in the interim, so people *are* receiving benefits. During FY 2012, we issued nearly 24,000 final benefit determinations at an average completion time of 3.5 years. While we are working to improve timeliness of benefit determinations, our average time to issue them will increase in FY 2013 as reevaluations continue and we take up plans that are more complex and take up old plans. We have nearly 310,000 people in our inventory who are due their final benefit determinations.

Our payments to insolvent multiemployer plans cover guaranteed benefits and reasonable administrative expenses. In FY 2012, we paid \$95 million in financial assistance to 49 multiemployer pension plans covering the benefits of nearly 51,000 retirees, down slightly from the \$115 million we paid to 49 plans in FY 2011. An additional 21,000 people in these plans will receive benefits when they retire. We helped five small insolvent multiemployer plans close out through the payout of participants' guaranteed benefits.

## ***Reviews and Appeals***

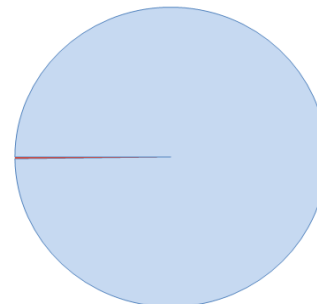
Our goal is to ensure that beneficiaries get every penny to which they are entitled. Unfortunately, the benefits we are allowed to pay under the law can be very different from the benefits that a plan itself promised, so it is not surprising that our decisions are occasionally appealed or litigated. Since 2008, we have issued nearly 464,000 benefit determinations. Less than one percent of them have been appealed. Over the same period, only 900 people's benefits required a change after an appeal filing, two-tenths of one percent.

Appeals are often based on the participant presenting new information. The PBGC Appeals Board carefully examines the issues raised and makes a decision. In FY 2012, the average time to close appeals increased to just over one year due to the large influx

**Our Goal is Accuracy.  
Few Determinations are Appealed.  
Even Fewer are Changed.**

■ 464,000 Benefit  
Determinations Issued

■ 900 Benefits Adjusted  
(0.2% of BDs)



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of complicated appeals in the Bethlehem Steel, United Airlines, and Delta pilot plans. We post significant appeal decisions on our website for public access.

In a large and complex program, disputes can arise. When we believe our decision is correct, we defend it in court.

### ***Looking for Systematic Errors and Correcting Them***

We do not rely solely on the actions of others to find improvements in accuracy. In FY 2012, we continued to assess the risk of improper payments under the Improper Payment Elimination and Recovery Act (IPERA) of 2010. We are pleased to report that our payment streams, which include benefit payments, are not susceptible to significant improper payment risk. For benefit payments, we performed a statistical sample of payments made to participants and beneficiaries and determined that we are well under the Office of Management and Budget threshold for significant improper payments — less than 1 percent. Nonetheless, we will continue to monitor benefit payments and other payments for improper payment risks, and we are considering additional actions to prevent and detect improper payments. For more information regarding IPERA, see page 89.

When pensioners meet us, their lives are already in turmoil. We work hard to help them with compassion and professionalism. However, the benefit determination process is complex, and sometimes we do make mistakes. When we do, we restore, with interest, what is due to the participant as quickly as possible, whether the error is small or large, and whether it affects many people or just one. We also find the cause of the error and make changes to prevent such errors in the future. We know that any error, even if small and affecting only a few people, undermines the confidence and security of others we serve.

In FY 2012, we completed rework on plans of two companies where our Inspector General had raised concerns about the accuracy of the original benefit determinations — United Airlines (whose benefit determinations were made in 2005) and National Steel (for which benefit determinations were made in 2009). We hired independent certified public accounting firms to redo those asset evaluations and then recalculated participants' benefits based on their results. At United, most people were not affected at all, but about 34,500 people's benefits increased very slightly — on average, by less than one percent. We are re-issuing the benefit determination letters to those participants who were affected, with an apology.

In the National Steel plans, we also redid the asset evaluations and calculated new benefits. In this case, it appeared that the asset values were slightly lower than originally reported, which would have produced benefit decreases for some participants. However, our policy is that there should be a higher standard of certainty before making changes that would reduce benefits. Since many years had passed and less documentation remained, we decided not to change the original benefit determinations.

In addition to redoing the original work and correcting errors, we continued our strategic review and began making changes throughout the entire benefits operation, including processes, organization, and personnel. To date, we have:

- recruited new leadership,
- introduced additional training,
- established a new group of specialists in asset evaluation and improved evaluation procedures, and
- formed an independent quality management department to sharpen focus on quality and accountability.

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## Maintaining High Standards of Stewardship and Accountability

As a financial institution with responsibility for more than 43 million people and obligations of nearly \$120 billion, it is essential that we do our work in a way that maintains the trust of our customers and the public. 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 engages in many complex tasks that affect many people, businesses, and other organizations. For that reason, we rely on a wide range of performance measures: We measure our performance by how well we do our work and serve our customers — from how quickly and seamlessly we start paying retirees new to our system, to how accurately we calculate their benefits and how well we invest assets from trusteed plans. We measure customer satisfaction directly, by asking them how well we serve them, and then using their feedback to improve our services. And in FY 2012, we administered the agency's first internal satisfaction survey to ensure that employees are serving each other well so that we can continue to meet our external customer service goals.

This year, we also updated our *strategic plan*, clarified our priorities, and held quarterly reviews to discuss our progress. Our leadership took steps to strengthen our performance culture by setting goals and priorities for fiscal years 2012-2016, updating performance measures to ensure that they align with those goals, focusing on improving service quality and customer satisfaction, and basing awards on those measures.

These are steps to improve our strategic use of performance data in planning, operations, and decision-making. Throughout this performance report, we provide information about our progress toward achievement of agency goals and priorities and the steps we have taken to address our challenges. The performance report is complete and the data contained within it is reliable.

Table 1 provides a summary of our FY 2012 activity volumes and performance data. The measures are supported with program metrics that demonstrate progress and achievement of agency priorities. The activity volumes provide information and insight to our programs. Collectively, the data reflects how well we are achieving our goals to preserve plans and protect pensioners, pay pension benefits on time and accurately to retirees and beneficiaries, and maintain trust with our customers and stakeholders.

**Table 1: Summary of PBGC Measures and Activities**

	Target <sup>1</sup>	2012	2011
<b>Preserve Plans and Protect Pensioners</b>			
People Protected in Bankruptcy, Layoffs, and Early Warning		<b>96,000<sup>2</sup></b>	316,000
Additional Payments from Audits of Standard Termination Filings		<b>\$3 M to 454 people</b>	\$2 M to 920 people
Premium Filer Satisfaction - ACSI <sup>3</sup>	72	<b>76</b>	75
<b>Pay Timely and Accurate Benefits</b>			
People Receiving Benefits - Single-Employer Plans		<b>836,000</b>	819,000
People to Receive Benefits in Future - Single-Employer Plans		<b>593,000</b>	574,000
People Receiving Benefits - Multiemployer Plans		<b>51,000</b>	54,000
New Retiree Payments Undertaken Without Interruption	100%	<b>100%</b>	100%
Estimated Benefits Within 10% of Final Calculation	95%	<b>95%</b>	92%
Average Time to Provide Benefit Determinations (years)	3.0	<b>3.5</b>	2.9
Benefit Payment Error Rate <sup>4</sup>	<2.5%	<b>0.95%</b>	na
Applications Processed in 45 days	67%	<b>90%</b>	85%
Caller Satisfaction – ACSI	81	<b>87</b>	86
Retiree Satisfaction – ACSI	85	<b>89</b>	90
<b>Maintain High Standards of Stewardship and Accountability</b>			
Overall Customer Satisfaction – ACSI	72	<b>72</b>	na
Financial Surplus (Deficit) - Single-employer Program		<b>\$ (29.1 B)</b>	<b>\$ (23.3 B)</b>
Financial Surplus (Deficit) - Multiemployer Program		<b>\$ (5.2 B)</b>	<b>\$ (2.8 B)</b>
Unqualified Audit Opinion	Yes	<b>Yes</b>	Yes
Contract Awards Fully Competed <sup>5</sup>		<b>89%</b>	87%

<sup>1</sup> Targets are not applicable to work activities and some measures.

<sup>2</sup> In addition, we helped protect 130,000 people in American Airlines and tens of thousands more in other plans in ongoing bankruptcies.

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

<sup>4</sup> The result measures gross improper payment rate; 2.5% is OMB's threshold for significant improper payment rates. As detailed further on pages 91 and 92 of the Annual Report, benefit payments were determined to be not susceptible to significant improper payments based on the reported 0.95% gross improper payment rate.

<sup>5</sup> Weighted by dollars.

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## ***Financial Soundness and Financial Integrity***

As a financial institution responsible for insuring the pensions of tens of millions of participants and pension benefits of hundreds of billions, both the substance and the quality of accounting of our finances matter. Throughout FY 2012, we were careful stewards of the Corporation's resources and investments. In addition to collecting premiums, exercising care in management of more than \$80 billion in assets, and attaining our 20<sup>th</sup> consecutive unqualified audit opinion on PBGC's financial statements, we maintained our focus on improving management in a number of areas as outlined below.

Nonetheless, PBGC's financial position remains in deficit for both single-employer and multiemployer programs. The premiums that PBGC is permitted to charge are inadequate to cover the benefits that, by law, PBGC insures. Absent changes, eventually PBGC will have insufficient funds to pay benefits.

### ***Collecting Premiums***

Employers pay premiums to insure their defined benefit pension plans in both the single-employer and multiemployer programs. In FY 2012, we collected \$2.2 billion in premiums.

Pension plan administrators file premiums with us online using My Plan Administration Account (My PAA). In FY 2012, we enhanced system validations that improved the accuracy of online transactions. We also made the login screen more user-friendly, improved online filing instructions, and strengthened password requirements.

Congress passed legislation that will increase PBGC premiums, both single-employer and multiemployer, for plan year 2013 and thereafter. Also, for the first time the single-employer variable-rate premium is indexed (under current law only the flat-rate premiums are indexed).










### ***Investing Prudently***

Our investment assets are managed 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. Throughout the year, we conduct due diligence on our processes and the investment management firms. Our due diligence includes regular communication with the management firms, enabling us to stay updated on matters affecting the agency's investment program, including the agency's portfolio, the portfolio's performance, and firm changes.

As of September 30, 2012, we had an investment performance portfolio of about \$76.1 billion. Our funds come from premiums, assets of trustee plans, and payments from plan sponsors as settlements in bankruptcy. In FY 2012, the total return on PBGC's investment performance portfolio was 12.6 percent, excluding transition accounts. Roughly two-thirds of PBGC investment managers outperformed their respective portfolio benchmarks and the portfolio as a whole performed above the benchmark level. See Table 2 for detail.



**Table 2: FY 2012 Investment Returns Versus Benchmarks**

	1-Year Period	3-Year Period	5-Year Period
<b>ERISA Benchmark<sup>1</sup></b>	<b>20.0%</b>	<b>10.9%</b>	<b>4.3%</b>
<b>Total Fund Composite</b>	<b>12.6%</b> 	<b>9.9%</b> 	<b>7.1%</b> 
PBGC Total Fund Benchmark <sup>2</sup>	11.8%	9.3%	6.2%
Total Global Bonds	9.8% 	10.6% 	9.8% 
Total Global Bonds Benchmark <sup>3</sup>	8.7%	9.7%	8.6%
Total Global Public Stock	22.6% 	8.6% 	-0.7% 
Total Global Public Stock Benchmark <sup>4</sup>	22.3%	8.3%	-0.6%

<sup>1</sup>ERISA prescribes a benchmark under which funds are invested 60% equity and 40% fixed-income securities for 1- and 5-year periods.

<sup>2</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>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.

For further analysis of PBGC's investment activities please refer to page 35 of Management's Discussion and Analysis of Results of Operations and Financial Condition.

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

For a financial institution that handles billions of dollars annually, strong internal financial controls are essential. Everyone here at PBGC has responsibility for the effectiveness of our internal controls. We comply with the Federal Manager's Financial Integrity Act (FMFIA) and OMB Circular A-123 reporting requirements. As part of this, we follow the strengthened requirements for internal control over financial reporting (outlined in Appendix A), the guidance for improved management of government charge card programs, and the requirements for measuring and remediating improper payments.

The Internal Control Committee (ICC) provides oversight and accountability for the internal controls program. Chaired by the CFO, the membership includes voting members from each major area of the agency, and a non-voting member from the Office of Inspector General. The committee oversees management testing of financial reporting, information technology and entity wide controls across the corporation. We use the reports, with other agency information, to make decisions about risk mitigation, control design, and organizational effectiveness. 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.

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*PBGC also works actively both to detect and prevent improper payments.* As part of our anti-fraud program, we also 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. Under the Improper Payments Elimination and Recovery Act of 2010, we conducted a detailed assessment of our outgoing payment streams. Based on statistical sampling of selected payments and consideration of other relevant risk factors, we are not susceptible to significant improper payments. Still there is more that can be done and that is why we began implementation of OMB's Do Not Pay List initiative to help us ensure that we only issue payments to eligible parties.

These and other related control activities promote a strong control environment and help undergird the agency's Statement of Assurance under FMFIA, provided later in this report.

### ***Improving PBGC's Governance***

In FY 2012, the President signed the Moving Ahead for Progress in the 21st Century Act (MAP-21), which makes certain changes in our governance. Highlights under the new law include the following:

- the PBGC Board will meet at least four times per year, and the PBGC Advisory Committee, Office of Inspector General, and General Counsel will have direct access to the Board;
- the PBGC pension modeling systems will undergo annual peer reviews; and
- the National Academy of Public Administration will do a review of PBGC's governance structure and study governance structures of other governmental and non-governmental organizations.

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

Our information technology (IT) infrastructure continues to support paying benefits and performing other operations. During FY 2012, we improved the infrastructure by upgrading hardware and software, building more network capacity, and addressing security-related weaknesses. We revamped IT security policies and procedures, improved our account authorization and management, continued to aggressively identify and remediate vulnerabilities, and continued progress on security assessment and authorizations. In FY 2012, we took steps to comply with FISMA reporting requirements and during FY 2013, we will continue to correct weaknesses with a specific focus on improved continuous monitoring and on completing our configuration management improvement plans.

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

We have built a strong culture of serving the people who rely on us. We are able to meet their needs through the combined efforts of our federal workforce and the private sector contractors who support us. We work to make sure that our contractors are both efficient and compassionate, but like other federal agencies, ensuring proper oversight remains a challenge. Throughout FY 2012, we continued to make improvements to the way we acquire goods and services and to the overall administration of our contracts. We are focusing not just on our procurement department but on our total acquisition community—anyone involved in developing requirements, source selection, contract administration, or the inspection and acceptance of deliverables. We also expanded our training to focus on the certification needs of program managers, contracting officer representatives, and contracting officers. We strengthened our internal controls to ensure that we receive quality goods and services. Our goal is to mitigate contract management risk by developing a highly knowledgeable acquisition workforce.

To ensure we get the best value for our dollars spent, we emphasized *acquisition excellence* through:

- increased management engagement in acquisition planning and contractor administration,
- familiarity with governing documents, and

- 
- stronger collaboration.

In FY 2012, we fully competed 89 percent of our contract spending, up from 87 percent in FY 2011; 42 percent of our contracts were performance based, up from 40 percent in FY 2011.

### ***Improving Communication***

In FY 2012, we continued efforts to encourage conversations and collaboration to enhance retirement security. Our December 2011 forum on the future of retirement security (*see page 8*) was an opportunity to do just that. We have begun preparations to host a follow-up forum in 2013.

Other communication efforts related to preserving plans. When American Airlines publicly announced it would terminate its pensions in bankruptcy (*see page 7*) we worked with the media, the Congress, and many constituencies to make sure the facts were known and understood. We met with the editorial boards of *The New York Times*, *Newsday*, *The Chicago Tribune*, *Tulsa World*, *The Dallas Morning News*, *The Fort Worth Star-Telegram*, *The Miami Herald*, and *The Washington Post*. All ran stories accurately capturing the issue, as did the *Wall Street Journal*, *Business Insurance*, and *Pensions and Investments*. Our communications efforts complemented our engagement with AMR's creditors and other stakeholders to help encourage American to keep its plans, thereby preventing 130,000 people from losing the pension benefits they had earned.

We also worked to increase the agency's transparency and make our resources more accessible to the public. Our open government web page, established in FY 2010, is kept current with data considered of value to the public. Last year, we began posting the Pension Insurance Data Tables online, providing the most recent statistics on the plans and people we protect. Throughout FY 2012, we continued to improve our website, primarily using customer feedback (*see page 5*). Each year, we post our *Freedom of Information Act* reports to our website. In FY 2012, we processed and tracked more than 5,600 requests, most from people whose plans we trustee, and ended the year with no backlog.

Finally, we shared information the old-fashioned way — face to face. In FY 2012, PBGC speakers continued to reach more and more diverse audiences (*see page 8*). Requests for our speakers were up 17 percent from FY 2011, totaling 90 engagements.

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

In FY 2012, we updated our strategic sustainability plan, which outlines initiatives from the executive memo on Leadership in Environmental, Energy, and Economic Performance. The plan includes initiatives such as robust recycling, mass transit and telework programs. Last year, our headquarters building obtained its first Leadership in Energy and Environmental Design Gold certification, and in FY 2012 we continued to demonstrate energy savings and a reduced carbon footprint.

### ***Ethical Practices***

We continue to enhance the role of ethics in our daily work. In FY 2012, we rolled out computer-based ethics training addressing Ethics and Social Media, along with a few other topics, for financial disclosure filers. We are also working to deliver "How to Succeed in Government without Really Trying: Fiscal and Ethics Training for PBGC Managers" to all managers and financial disclosure filers. We expanded our online financial disclosure system, which allows employees to enter their information into a system using guided questions, and which carries over their information from year to year; it now serves both confidential and public filers. In addition, we are implementing the Stop Trading on Congressional Knowledge Act, which was signed into law on April 4, 2012, and providing guidance to those employees who must comply with the provisions.

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## ***Transforming the Federal Workforce***

PBGC's performance is dependent on the coordinated actions of hundreds of professionals from many disciplines, including actuarial science, accounting, finance, and law. PBGC has long been regarded as a good place to work—and we work to keep it that way.

**Strengthening Our Workforce and Leadership:** We strengthened the training requirements for supervisors and managers and broadened training offerings to include briefings on Harvard ManageMentor and Harvard online training tools for supervisors. Other efforts in FY 2012 included a new and advanced Talent Management System that allows employees to take real-time online training, manage individual training plans, and schedule classes. We quadrupled the number of persons participating in our Leadership/Executive Coaching Program and implemented the FY 2012 Disabled Veterans' Affirmative Action Plan.

**Broadening Recruitment:** In FY 2012, we used multiple recruitment tools to reach a broad pool of candidates. We launched our first social media recruitment endeavor using Facebook, Twitter, and LinkedIn to announce job openings. We increased participation in the Hispanic Association of Colleges and Universities Internship Program. We also continued to participate in job fairs to reach candidates from diverse talent pools.

**Promoting Diversity and Inclusion:** In response to the government-wide initiative to promote diversity and inclusion in the federal work place, we prepared our first Diversity and Inclusion Strategic Plan and developed a framework to carry it out. We also hosted an OPM-sponsored diversity workshop to introduce senior leaders to the initiative. We hired an independent evaluator to review our diversity and inclusion programs, and based on their recommendations, decided to integrate our special emphasis programs into our broader human capital and diversity efforts.

**Hiring and Keeping More People with Disabilities:** Throughout FY 2012, we continued to implement plans to attract and retain more people with disabilities. We raised awareness of disability programs and recruitment strategies through a series of briefings and workshops in collaboration with the Office of Personnel Management and the Equal Employment Opportunity Commission (EEOC). Following these workshops, we adopted promising practices and targeted outreach opportunities with organizations that help people with disabilities.

**Getting Employee Viewpoints Directly (FedView):** Since 2006, we have used FedView results to gather employees' perceptions of workforce management. In FY 2012, we again were rated as among the better federal agencies. We will continue to use the detailed FedView results to monitor the work environment and to improve our human capital practices.

## **Independent Evaluation of PBGC Programs**

We conduct and undergo program evaluations to identify opportunities to improve program and support operations. In FY 2012, these included reviews of our regulations and the services we provided to our customers, and a strategic review of our operations area to improve our benefit administration practices.

We followed up on these reviews by actively engaging with the Government Accountability Office (GAO) and our Office of Inspector General (OIG) to ensure that our programs are operating effectively, efficiently, and with integrity. This year, we also underwent a review by the Office of Personnel Management (OPM) to assess our hiring practices. As a learning organization, we use the information gained from these evaluations to help us strengthen our program operations.

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## The American Customer Satisfaction Index

We use the ACSI survey methodology to get objective third-party evaluation of our services. Because the ACSI is a recognized standard throughout government and industry, we can compare ourselves to other government and private organizations, as well as gauge the effectiveness of efforts to improve our customers' experiences. We use the survey feedback as input to key decisions affecting our operations and resource needs.

## Review and Reform of Benefits Operations

In FY 2012, we continued to address serious weaknesses in our benefit operations reported by our Inspector General in 2011. We hired an independent CPA firm to review our operating practices and to suggest improvements. As a result of that work and other analyses performed by management, we are working to update our operational procedures, improve contractor oversight, and improve quality assurance. We also identified organizational changes needed to meet future challenges and are focused on ways to enhance existing controls over the accuracy and quality of work in benefits operations. These efforts are described in more detail on page 11.

## Equal Employment Opportunity Commission

To further promote a model program of equal opportunity, we updated our strategic plan to include goals for diversity and inclusion and completed reasonable accommodation procedures. We also retained a consulting firm to objectively evaluate PBGC and recommend ways to promote equal opportunity and a supportive working environment for all. Following the consultants' advice, we are working to better integrate diversity activities with our other human capital efforts, including hiring, training, and performance management.

We also met with EEOC, at their request. In that meeting, EEOC acknowledged our actions, and noted that our informal resolution program has already resulted in fewer formal complaints.

## Office of Personnel Management

In FY 2012, the Office of Personnel Management (OPM) selected PBGC's human resource systems and programs for evaluation in its Small Agency Compliance Reviews. OPM reported significant improvement from a similar study conducted in FY 2008, especially in Talent Management. As a result, there was a 90 percent decrease in actions considered systemic deficiencies and a 59 percent decrease in actions requiring process improvement. We are very pleased with the outcome of this evaluation and will continue to work on the remaining items.

In January 2012, OPM introduced the new government-wide performance program for Senior Executives, along with new requirements for achieving Senior Level (SL) certification. We quickly modified our SL program to comply with the new program requirements. As a result, for the first time in many years, OPM granted full certification to our SL appraisal system. We continue to work diligently to maintain this status by providing training and guidance to further strengthen our results-oriented performance culture.

## Government Accountability Office

GAO continues to include our single-employer and multiemployer insurance programs among its High-Risk series of 30 government programs. GAO included PBGC on this list because of long-term structural challenges relating to pension plan funding. The Director of PBGC and the Comptroller General met in September 2012 to discuss PBGC's inclusion on the list and the need for action to address the long-term solvency of PBGC. During the year, GAO completed field work on a review of the Administration's proposal to allow PBGC to set premiums using a risk-based structure. On November 7, 2012, GAO issued



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its final report on this important proposal, *Pension Benefit Guaranty Corporation: Redesigned Premium Structure Could Better Align Rates with Risk from Plan Sponsors*.

During the year, GAO completed several reviews as follows:

- GAO studied how we came to terminate the six underfunded Delphi pension plans in 2009 and whether treatment for hourly employees could be considered preferential. GAO concluded that our processing was consistent with our handling of other terminating plans and that no Delphi plan or group of employees was treated differently from any other.
- GAO also studied the reliability of our IT cost-estimating policies and practices of a group of mostly larger federal agencies. Our benefit administration system was among the 16 major IT investments included in the study. We were pleased that PBGC compared well to much larger agencies with much larger IT staffs. As recommended by GAO, we will update future life-cycle cost estimates in the benefit administration systems area and work to improve our cost-estimating practices further.

## 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. A key component of that work is the annual financial statement audit. Other work performed by the OIG during the year included:

- Completing a statutory review of our compliance with implementation of the Improper Payment Elimination and Reporting Act of 2010 (IPERA). The OIG reported that we were in general compliance with statutory requirements for the prior fiscal year, FY 2011. We have continually worked with our Inspector General to develop a process that is reliable and accountable. For FY 2012, PBGC concluded that its payment streams, including benefit payments and multiemployer plan financial assistance payments, are not susceptible to significant risk of improper payments. As detailed further on page 11 of this report, PBGC performed statistical sampling of selected payments and considered relevant risk factors in complying with OMB improper payment guidance. PBGC looks forward to receiving the results of the OIG's IPERA compliance review for FY 2012 in the coming months.
- Responding to a whistleblower complaint about our policies and procedures for estimating the present value of financial assistance payments. The OIG concluded that our FY 2010 Annual Exposure Report had errors and inconsistencies. The OIG recommended a number of actions, including developing, documenting, and enforcing policies and procedures for quality review of actuarial work in the policy and research area. We retracted the old report, made the corrections, and will reissue it. We believe that PBGC's analysis is among the best available, and are committed to strengthening and improving the documentation of our analytic reports to avoid questions about the procedures used to prepare them.
- Reporting on our compliance with the Federal Information Security Management Act (FISMA). The OIG noted findings that support the two material weaknesses in internal control relating to information technology (IT); specifically, entity-wide IT security program planning and management, and access controls and configuration management. During the year, management continued to implement corrective actions, including the following: issued new directives and procedures relating to IT security, improved the system registration process, made progress in system security and authorization, improved vulnerability scanning, and provided role-based security training. As this is a key corporate priority, management continues to perform supplemental IT control testing, and to closely monitor progress towards corrective action plans.
- Reporting on its findings related to PBGC's administration of the United Airlines pension plans. The OIG identified a number of recommendations and we are actively working to improve our



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processes. As part of that effort, we revalued, with the assistance of CPA firms, the plan asset evaluations and determined that we had earlier undervalued United's pension assets by about three-fourths of one percent. As a result, PBGC will increase slightly the benefits of some United retirees and will be making back payments with interest to those who have already been underpaid.

We appreciate the assistance of the OIG and remain committed to implementing corrective actions. Visit <http://oig.pbgc.gov> for more information about these and other OIG reports. The OIG also maintains a fraud hotline at 1-800-303-9737.

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## FINANCIAL SUMMARY—SINGLE-EMPLOYER PROGRAM

(Dollars in millions)	Fiscal Year Ended September 30,									
	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
<b>Insurance Activity:</b>										
Benefits paid	\$ 5,384	5,340	5,467	4,478	4,292	4,266	4,082	3,685	3,006	2,488
Participants receiving monthly benefits at end of year *	781,160	775,300	747,530	743,610	640,070	631,130	612,630	682,540	517,900	458,800
Plans trustee and pending trusteeship by PBGC	4,447	4,292	4,140	3,993	3,850	3,783	3,673	3,585	3,469	3,277
<b>Summary of Operations:</b>										
Premium income, net **	\$ 2,642	2,072	2,231	1,822	1,340	1,476	1,442	1,451	1,458	948
Other income	\$ 13	17	30	16	23	55	79	44	24	28
Investment income (loss)	\$ 8,792	3,446	7,594	6,330	(4,164)	4,737	2,184	3,897	3,197	3,349
Actuarial charges and adjustments (credits)	\$ 14,874	6,561	9,421	13,901	(4,813)	346	4,819	490	1,787	6,161
Losses (credits) from completed and probable terminations	\$ 2,006	201	509	4,234	(826)	399	(6,155)	3,954	14,707	5,377
Administrative and investment expenses	\$ 443	424	449	417	400	378	405	342	288	290
Other expenses	\$ 0	21	(7)	15	5	114	2	77	(36)	97
Net income (loss)	\$ (5,876)	(1,672)	(517)	(10,399)	2,433	5,031	4,634	529	(12,067)	(7,600)
<b>Summary of Financial Position:</b>										
Cash and investments	\$ 76,941	71,292	69,150	62,062	51,722	61,122	57,728	54,387	36,254	33,215
Total assets	\$ 82,973	78,960	77,463	68,736	64,612	67,241	59,972	56,470	38,993	34,016
Present value of future benefits	\$ 105,635	92,953	90,022	83,035	59,996	69,235	69,143	69,737	60,836	44,641
Net position	\$ (29,142)	(23,266)	(21,594)	(21,077)	(10,678)	(13,111)	(18,142)	(22,776)	(23,305)	(11,238)

\* This measure may differ from numbers reported in the Annual Performance Report, which also include participants whose benefit payments ended during the year (for example, due to death or a final lump-sum payout).

\*\* 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,									
	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
<b>Insurance Activity:</b>										
Financial assistance paid	\$ 95	115	97	86	85	71	70	14	10	5
Plans that have received financial assistance	49	49	50	43	42	36	33	29	27	24
<b>Summary of Operations:</b>										
Premium Income, net *	\$ 92	92	93	95	90	81	58	26	27	25
Other income	\$ 0	0	0	2	0	0	0	0	0	0
Investment income (loss)	\$ 91	148	183	121	121	23	(1)	79	54	37
Actuarial charges and adjustments (credits)	\$ 164	99	0	0	(1)	0	0	0	1	1
Losses (gains) from insolvent and probable plans - financial assistance	\$ 2,466	1,461	831	614	(271)	319	461	204	55	480
Administrative and investment expenses	\$ 20	14	12	0	0	0	0	0	0	0
Net income (loss)	\$ (2,467)	(1,334)	(567)	(396)	482	(216)	(404)	(99)	25	(419)
<b>Summary of Financial Position:</b>										
Cash and investments	\$ 1,804	1,725	1,613	1,441	1,318	1,196	1,164	1,147	1,057	984
Total assets	\$ 1,807	1,739	1,628	1,459	1,327	1,197	1,166	1,160	1,070	1,000
Present value of future benefits	\$ 1	1	1	1	1	2	2	2	3	3
Nonrecoverable future financial assistance, present value	\$ 7,010	4,475	3,030	2,296	1,768	2,124	1,876	1,485	1,295	1,250
Net position	\$ (5,237)	(2,770)	(1,436)	(869)	(473)	(955)	(739)	(335)	(236)	(261)

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

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## Fiscal Year 2012 Financial Statement Highlights

### Financial Position

- PBGC's combined financial position declined by \$8.34 billion, increasing the deficit to \$34.38 billion as of September 30, 2012, from \$26.04 billion as of September 30, 2011. The single-employer program's net position declined by \$5.88 billion, increasing the program's deficit to \$29.14 billion. The multiemployer program's net position declined by \$2.47 billion, increasing its deficit to \$5.24 billion. These deficits are all time record highs at year-end for both the single-employer and multiemployer programs.
- Pension liability valuation interest factors decreased by 103 basis points to 3.28% at September 30, 2012, from 4.31% at September 30, 2011. This resulted in an increase of \$10.83 billion in actuarial charges due to change in interest rates. The actuarial charges for expected interest on accrued liabilities amounted to \$3.98 billion.
- The primary factors in the single-employer program's net loss included a charge of \$10.72 billion due to a substantial reduction in interest factors, \$3.93 billion in charges due to expected interest on accrued liabilities, \$2.01 billion in losses from completed and probable terminations, \$0.44 billion of administrative, investment, and other expenses, and a charge of \$0.23 billion from actuarial adjustments. These factors were offset by \$8.79 billion in investment income and \$2.64 billion in net premium income.
- The primary reasons for the \$2.47 billion increase in the multiemployer program's deficit included \$2.47 billion in financial assistance losses from probable plans and insolvent plans, a charge of \$0.12 billion due to a reduction of interest factors, a charge of \$0.05 billion due to expected interest on accrued liabilities, partially offset by \$0.09 billion in net premium income and \$0.09 billion in investment income. The losses from financial assistance were due to the decrease in interest factors and the net increase of 13 new plans to the multiemployer probables inventory.

### Operations in FY 2012

- PBGC's combined benefit payments for participants were \$5.48 billion in FY 2012 and \$5.46 billion in FY 2011.
- Combined net premium income increased by \$0.57 billion to \$2.73 billion compared to FY 2011 premium income of \$2.16 billion. The flat-rate premium generated income of \$1.22 billion and the Variable Rate Premium (VRP) income was \$1.50 billion.
- PBGC's portfolio achieved a return on investment of 12.6% which is below the ERISA/PPA hypothetical portfolio benchmark return of 20.0%, but above the benchmark PBGC uses to conform with its investment policy (Total Fund Benchmark return of 11.8%).
- During FY 2012, PBGC assumed responsibility for more than 47,000 participants in 155 underfunded single-employer plans that were terminated. Because of PBGC's previous efforts to evaluate its exposure to probable terminations, \$0.15 billion of the net claims for these plans were already reflected in PBGC's FY 2011 results. The 155 plans had an average funded ratio of approximately 50%. Their terminations resulted in an aggregate net loss to PBGC of \$1.01 billion (see Note 12).
- Six single-employer plans with underfunding of \$1.74 billion were newly classified as probable terminations in FY 2012. Probable terminations represent PBGC's best estimate of claims for plans that are likely to terminate in a future year.

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- The present value of nonrecoverable future financial assistance of \$7.010 billion consists of 41 insolvent plans (\$1.388 billion), 61 terminated plans not yet insolvent but probable (\$1.725 billion), and 46 ongoing plans which are projected to exhaust plan assets within 10 years and are classified as probable (\$3.897 billion). (See Note 7)

### **Estimates of Reasonably Possible Contingencies**

- At year-end, PBGC's estimate of its single-employer reasonably possible exposure totaled approximately \$295 billion, a significant increase compared to FY 2011 of \$227 billion. This exposure increased primarily due to the growth in the number of companies meeting the reasonably possible criteria and the decrease in the interest rates used for valuing liabilities.
- PBGC's estimate of its multiemployer reasonably possible exposure increased to \$27 billion in FY 2012, a \$4 billion increase over the \$23 billion in FY 2011. The increase was due primarily to the decrease in interest rates for valuing liabilities.

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## KEY SINGLE-EMPLOYER AND MULTIEMPLOYER RESULTS

<i>(Dollars in millions)</i>	FY 2012	FY 2011
<b>Insurance Activity</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Benefits Paid	\$ 5,384	\$ 5,340
Financial Assistance Paid	\$ 95	\$ 115
Retirees Receiving Benefits (at end of year)*	832,000	829,000
Total Participants Receiving or Owed Benefits (at end of year)*	1,488,000	1,479,000
New Underfunded Terminations	155	152
Terminated/Trusteed Plans (Cumulative)	4,457	4,302
Plans That Have Received Financial Assistance	49	49
<b>Summary of Operations</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Premium Income, Net	\$ 2,734	\$ 2,164
Losses from Completed and Probable Terminations	\$ 2,006	\$ 201
Losses from Financial Assistance	\$ 2,466	\$ 1,461
Investment Income	\$ 8,883	\$ 3,594
Actuarial Charges and Adjustments	\$ 15,038	\$ 6,561
<b>Financial Position</b>		
SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED		
Total Assets	\$ 84,780	\$ 80,699
Total Liabilities	\$ 119,159	\$ 106,735
Net Income (Loss)	\$ (8,343)	\$ (3,006)
Net Position	\$ (34,379)	\$ (26,036)
SINGLE-EMPLOYER PROGRAM		
Total Assets	\$ 82,973	\$ 78,960
Total Liabilities	\$ 112,115	\$ 102,226
Net Income (Loss)	\$ (5,876)	\$ (1,672)
Net Position	\$ (29,142)	\$ (23,266)
MULTIEMPLOYER PROGRAM		
Total Assets	\$ 1,807	\$ 1,739
Total Liabilities	\$ 7,044	\$ 4,509
Net Income (Loss)	\$ (2,467)	\$ (1,334)
Net Position	\$ (5,237)	\$ (2,770)

\* This measure may differ from numbers reported in the Annual Performance Report, which also include participants whose benefit payments ended during the year (for example, due to death or a final lump-sum payout).



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# FINANCIAL STATEMENTS

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

### I. Introduction

PBGC management believes that the following discussion and analysis of the Corporation's financial statements and other statistical data will enhance the reader's understanding of PBGC's financial condition and results of operations. This discussion should be read in conjunction with the annual performance report beginning on page 2 and the financial statements beginning on page 46 and with the accompanying notes.

### II. Financial and Program Risks

In FY 2013, significant factors beyond PBGC's control (including changes in interest rates, the financial markets, plan contributions made by sponsors, and recently enacted statutory changes) will continue to influence PBGC's underwriting income and investment gains or losses. PBGC's best estimate of FY 2013 premium receipts ranges between \$2.8 billion and \$3.2 billion. No reasonable estimate can be made of FY 2013 terminations, effects of changes in interest rates, or investment income.

As of September 30, 2012, the single-employer and multiemployer programs reported deficits of \$29.1 billion and \$5.2 billion, respectively. Notwithstanding these deficits, the Corporation has approximately \$83.0 billion in single-employer assets and \$1.8 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 the long run.

PBGC's operating results can change markedly from year to year depending on the severity of losses from plan terminations, changes in the interest factors used to discount future benefit payments, investment performance, general economic conditions, and other factors such as changes in law. Operating results may be more variable than those of most private insurers, in part because PBGC must provide insurance of 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 actual or expected claims exposure. In contrast, PBGC's premiums are defined by statute and the Congress must approve any premium changes.

Claims against PBGC's insurance programs are highly variable. A single large pension plan termination may result in a larger claim against the Corporation than the termination of many smaller plans. Future results will continue to depend largely on the infrequent and unpredictable termination of a limited number of very large plans. Additionally, PBGC's risks are concentrated in certain industries. Finally, PBGC's financial condition is also sensitive to market risk associated with interest rates and equity returns, as those risks apply both to PBGC's own assets and liabilities and to those of PBGC-insured plans.

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### III. Legislative and Regulatory Developments

#### *Legislative Changes in FY 2012*

##### ***Moving Ahead for Progress in the 21<sup>st</sup> Century Act (MAP-21)***

MAP-21, signed July 6, 2012, limits the volatility of discount rates for funding single-employer plans (“stabilization”), increases PBGC premiums for both single-employer and multiemployer plans, and makes certain changes in PBGC governance.

Beginning in 2012, MAP-21 creates a corridor that constrains the interest rates used to value pension liabilities for minimum funding of single-employer plans. While market interest rates are low, the corridor will create a floor under the funding interest rate, thereby reducing liabilities, making plans appear better funded, and reducing required contributions. Because plans appear better funded, fewer plans will be subject to benefit restrictions. The corridor expands from 10% to 30% over the next few years, in effect phasing out the relief. The stabilization rules are not used to calculate liabilities for the variable-rate premium or for determining whether reporting to PBGC is required under ERISA Section 4010 (annual reporting to PBGC for certain underfunded plans).

Flat-rate premiums for single-employer plans will increase to \$42 for 2013, \$49 for 2014, and will be indexed thereafter. Variable-rate premiums will be indexed for the first time and consequently are expected to increase to \$13 or \$14 per \$1000 of underfunding for 2014 and to \$18 or \$19 for 2015. The variable-rate premium will be capped in filing year 2013 at \$400 times the number of plan participants. The cap will be indexed thereafter. In filing year 2014, it will be \$13 plus the inflation factor, and in filing year 2015 it will be the filing year 2014 rate plus \$5 plus inflation adjustment. Flat-rate premiums for multiemployer plans will increase to \$12 for 2013, and will be indexed thereafter. PBGC has issued guidance on the effect of MAP-21 on premiums and 4010 reporting, and is revising its premium regulations to implement changes to premium rates resulting from MAP-21.

MAP-21 requires the PBGC Board of Directors to meet at least four times a year. The PBGC Advisory Committee will be required to attend at least one such Board meeting a year and the PBGC’s Inspector General will be required to attend at least two. The PBGC’s General Counsel will have overall responsibility for all legal matters of the corporation and will continue as Secretary to the Board. The Director’s term is set at five years. A new Risk Management Officer position and a new Participant and Plan Sponsor Advocate position are created. The National Academy of Public Administration has been engaged by PBGC to study the Corporation’s governance structure and report its findings to Congress. PBGC is required to contract with an independent organization, such as the Social Security Administration, to conduct an annual peer review of the Corporation’s single-employer and multiemployer Pension Insurance Modeling Systems. The PBGC is required to develop written quality review policies for all modeling and actuarial work performed by the Corporation’s Policy, Research, and Analysis Department.

##### ***Administration Premium Proposal***

The Administration has again put forth a proposal to alter PBGC’s premium authority and ensure that PBGC has the funds to do its job while providing incentives for firms both to continue offering pensions and to improve plan funding so they can keep their pension promises. Proposals similar to this one have also been offered by prior administrations. The proposal was included in both the President’s FY 2013 Budget and *The President’s Plan for Economic Growth and Deficit Reduction*, which was sent to the Congress in September 2011. These reforms would both strengthen PBGC’s finances and encourage companies to preserve sound pensions.

The proposal consists of two parts: 1) a gradual increase in the single-employer flat-rate premium that will raise approximately \$4 billion by 2021, and 2) granting PBGC’s Board discretion to increase the single-employer variable-rate premium to raise \$12 billion by 2021. The Board would be required to consult with

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stakeholders prior to setting a new premium schedule and would also establish a hardship waiver and other limitations on plan-specific premium increases. PBGC would be directed to try to make the premiums counter-cyclical and any increase also would be phased-in gradually so companies are not hit all at once and at a time when they can least afford the increases. In determining variable-rate premiums, the Board would consider a number of factors, including a plan's risk of losses to PBGC, the amount of a plan's underfunding, and other factors the Board determined appropriate.

The program has other safeguards to prevent undue hardship on plan sponsors. The total target premium revenue for fiscal years 2014-2021 would be capped at \$17 billion above the current baseline, and the total premium amount paid by any single-employer plan would be capped at four times the amount that the employer paid for the 2010 plan year.

### ***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 2011 Plan for Regulatory Review highlighted how we planned to work 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 implementing the plan on our website.

A good example of our new approach can be seen in our enforcement of ERISA section 4062(e), which 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 and announced that PBGC would revise the proposal.

PBGC announced that it is now focusing enforcement on circumstances where there really is a threat to pensions. Historically, this requirement has been enforced regardless of the financial health of the plan sponsor or the size of the plan. Our review found that financially sound companies rarely terminated their pensions, even if those plans were significantly underfunded. This is why we're looking 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 where the plan involved has fewer than 100 participants. Once we have enough experience to redesign the regulatory proposal, we will do so. In the interim, we are not using the 2010 proposal, but are generally maintaining our historical practices.

As part of our efforts to enhance retirement security by promoting lifetime income options, we 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.

Implementation of the Pension Protection Act of 2006 (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 2012, we continued drafting rules necessary to implement and comply with the Pension Protection Act of 2006 (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. We published a proposed rule implementing PPA changes to terminations of cash-balance plans. In FY 2013, we expect to re-propose amendments to the reportable events regulation implementing PPA, as well as reducing regulatory burden. Also in FY 2013, we expect to

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publish a final rule implementing PPA changes to our guarantee of shutdown and similar benefits. We also expect to propose regulations implementing PPA changes to the missing participants program. These rule-makings, together with the nine final rules published in FY 2007-2012, will largely complete our PPA implementation plan.

## **IV. Discussion of Insurance Programs**

PBGC operates two separate insurance programs for defined benefit plans. PBGC's single-employer program guarantees payment of basic pension benefits when underfunded plans terminate. The insured event in the single-employer program is plan termination. 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 statutorily guaranteed level. 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 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 32.52 million participants (excluding plans that PBGC has trustee), slightly down from 33.39 million participants in 2011. The number of covered ongoing plans decreased from about 25,607 in 2011 to about 24,200 in 2012. 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; PBGC's activities related to standard terminations are limited to ensuring compliance.

In contrast, when a covered underfunded plan terminates, PBGC becomes trustee of the plan, applies legal limits on payouts, and pays benefits. The amount of benefit paid is determined after taking into account (a) the benefit that a beneficiary had accrued in the terminated plan, (b) the availability of assets from the terminated plan to cover benefits, and (c) the legal maximum benefits provided under ERISA. In 2012, the maximum annual payment guaranteed under the single-employer program was \$55,840.92 for a retiree aged 65, up from \$54,000 in 2011.

In FY 2012 the primary drivers of the net loss of \$5.876 billion included the following: \$10.718 billion due to a reduction in interest factors (which has the effect of increasing benefit liabilities and actuarial charges); \$3.927 billion actuarial charge due to expected interest on accrued liabilities; a charge due to completed and probable terminations of \$2.006 billion; a charge of \$0.360 billion in administrative and other expenses; and a charge for actuarial adjustments of \$0.229 billion. These amounts were partially offset by investment income of \$8.792 billion and net premium income of \$2.642 billion.

PBGC's single-employer program realized a net loss of \$5.876 billion compared with a net loss in FY 2011 of \$1.672 billion. The \$4.204 billion increase in net loss was primarily attributable to (1) a \$9.709 billion increase in actuarial charges due to change in interest rates, (2) an increase of \$1.805 billion in losses from completed and probable terminations, partially offset by (3) an increase in investment income of \$5.346 billion (a gain of \$8.792 billion compared to a gain of \$3.446 billion in FY 2011), (4) a \$1.443 billion decrease in charges for actuarial adjustments, and (5) an increase in net premium income of \$0.570 billion. The resulting accumulated deficit of \$29.142 billion is an all-time record high for the single-employer program. 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 we expect to

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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 \$0.060 billion in FY 2012, an increase compared to the FY 2011 loss of \$0.158 billion. This \$0.218 billion increase from the previous year was primarily due to the decrease in charges from underwriting actuarial adjustments of \$1.443 billion, as well as a \$0.570 billion increase in single-employer net premium income, partially offset by an increase of \$1.805 billion in losses from completed and probable terminations.

Premium and other income from underwriting activity increased (from \$2.089 billion in FY 2011 to \$2.655 billion in FY 2012), largely due to an increase in net premium income from plan sponsors (from \$2.072 billion in FY 2011 to \$2.642 billion in FY 2012). Other income, consisting of interest on recoveries from sponsors, decreased from \$0.017 billion in FY 2011 to \$0.013 billion in FY 2012.

Annual flat-rate premiums for the single-employer program remained unchanged at \$35 per participant in FY 2012. Flat-rate premium income decreased by \$0.020 billion to a total of about \$1.123 billion. Annual variable rate premium income, paid by underfunded single-employer plans, increased by \$0.566 billion to a total of \$1.495 billion primarily due to a decrease in interest rates during FY 2012 which contributed to plan underfunding. The VRP rate of \$9 per \$1,000 of underfunding remained unchanged.

Beginning with calendar-year 2008 plans, 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 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, also prescribed on a monthly basis by the Department of the Treasury, 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 2012 segment rates for calendar-year plans were 2.07%, 4.45%, and 5.24% for the first, second, and third segments, respectively.

The Corporation's losses from completed and probable plan terminations increased from a loss of \$0.201 billion in FY 2011 to a loss of \$2.006 billion in FY 2012. This was primarily due to a \$1.202 billion increase in probable claims and because charges related to new plans that terminated fiscal year to date (FYTD) (\$1.008 billion) were offset by a credit of \$0.205 billion 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, 2012, is \$2.035 billion, while the net claim as of September 30, 2011, was \$0.833 billion. This \$1.202 billion increase resulted primarily from the addition of six new probables with net claims of \$1.736 billion and an increase in the reserve for small unidentified probables of \$0.010 billion. These factors were offset by a decrease in net claims of \$0.394 billion for four plans that were deleted and the transfer of \$0.150 billion of previously accrued claims to a termination status (see Note 6). The actual amount of future losses remains unpredictable.

Single-employer administrative expenses increased \$0.007 billion from \$0.353 billion in FY 2011 to \$0.360 billion in FY 2012.

### ***Financial Activity***

In FY 2012 all of the \$8.792 billion of the single-employer net investment gains were absorbed by the net actuarial charges of \$14.645 billion for the expected interest and changes in interest rates. Single-employer



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financial net loss increased from a loss of \$1.514 billion in FY 2011 to a loss of \$5.936 billion in FY 2012. The Corporation had investment income of \$8.792 billion in FY 2012, compared with investment income of \$3.446 billion in FY 2011. This gain was offset by an increase of \$9.756 billion in actuarial charges. PBGC marks its assets to market, which is consistent with the 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 slight increase in expected interest charges, despite the lower interest rate, is due primarily to the increase in liabilities in effect at the beginning of FY 2012 compared to FY 2011 (the expected interest charge is \$3.927 billion in FY 2012 and was \$3.880 billion in FY 2011). Charges due to the change in interest rates increased substantially due to the decrease in the applicable interest factors.

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. PBGC's select interest factor decreased to 3.28% (for the first 25 years after the valuation date) at September 30, 2012, from 4.31% (for the first 20 years) at September 30, 2011. The ultimate factor decreased to 2.97% at September 30, 2012 (after the first 25 years) from 4.26% at September 30, 2011 (after the first 20 years).

PBGC's single-employer PVFB (Present Value of Future Benefits) increased from \$92.953 billion at September 30, 2011 to \$105.635 billion at September 30, 2012. PVFB comprises the vast majority of PBGC's combined total liabilities on its Statements of Financial Condition of \$119.159 billion.

## IV.B Multiemployer Program Results of Activities and Trends

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, garment, and other industries. Benefit eligibility under a multiemployer plan is usually based on covered employment with any employer contributing to that plan. 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 the minimum funding requirements of ERISA. While bargaining parties will 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. 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 in the plan do not revert to contributing employers.

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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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Benefits in most multiemployer plans are based on a “unit benefit” formula that establishes a monthly benefit as a dollar amount times years of service. In some plans, benefits are a function of the level of contributions made to the plan for the participant’s work.

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. Any withdrawal liability that is assessed will generally be 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’s multiemployer program covers about 10.37 million participants (slightly up from the FY 2011 count of 10.31 million participants) in about 1,450 insured plans. The multiemployer flat-rate premium remained unchanged at \$9.00 per participant in FY 2012. 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. Once begun, these loans generally continue year after year 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 2012, for example, the maximum annual payment for a participant with 30 years of service was \$12,870.

PBGC’s obligations for future financial assistance to multiemployer plans increased from \$4.48 billion at September 30, 2011 to \$7.01 billion at September 30, 2012; an increase of approximately \$2.53 billion (56%). The increase is primarily due to the addition of 18 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. During the fiscal year, PBGC paid \$0.095 billion in financial assistance to 49 insolvent plans that cover 51,000 participants.

The multiemployer program reported a net loss of \$2.467 billion in FY 2012 compared with a net loss of \$1.334 billion in FY 2011. This resulted in a negative net position of \$5.237 billion in FY 2012 compared with a negative net position of \$2.770 billion in FY 2011. The change in net loss was primarily due to the increase in expected loss from future financial assistance of \$1.005 billion, an increase in actuarial charges and adjustment of \$0.065 billion, and by a decrease in net investment income of \$0.057 billion. This deficit is an all-time record high for the multiemployer program.

The multiemployer program reported a net loss from underwriting activity of \$2.388 billion in FY 2012 compared with a net loss of \$1.420 billion in FY 2011. This decline of \$0.968 billion was primarily attributable to the increase in financial assistance losses from insolvent and probable plans of \$1.005 billion (due to the decrease in interest factors and the addition of 18 plans to the multiemployer probable inventory, offset by the deletion of five plans), the increase in administrative expenses of \$0.006 billion, offset by a decrease in actuarial adjustments of \$0.043 billion. Financial activity reflected financial income of \$0.091 billion from earnings on fixed income investments in FY 2012, compared to income of \$0.148 billion in FY 2011. Multiemployer program investments originate primarily 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 98.6 percent in Treasury securities, as compared with 99.6 percent in Treasury securities in FY2011.

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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 the operating expenses of the Corporation. 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, neither program at present has the resources to fully satisfy PBGC's long-term obligations to plan participants.

FY 2012 combined premium cash receipts totaled \$2.2 billion, a decrease of \$0.2 billion from \$2.4 billion in FY 2011. Net cash flow provided by investment activity decreased to \$0.2 billion versus \$2.1 billion provided in FY 2011. Furthermore, the deficit for both insurance programs has grown substantially over the past decade, reaching all time historic highs for each program.

In FY 2012, PBGC's cash receipts of \$4.5 billion from operating activities of the single-employer program were insufficient to cover its operating cash obligations of \$6.0 billion. This resulted in net cash underperformance from operating activities of \$1.5 billion (as compared to the underperformance of \$1.6 billion in FY 2011). When the single-employer cash provided through investing activities of approximately \$0.2 billion is added to this net cash underperformance, the single-employer program in the aggregate experienced a net cash decrease of \$1.3 billion. In the multiemployer program, cash receipts of \$150 million from operating activities were sufficient to cover its operating cash obligations of \$118 million, resulting in net cash provided by operations of \$32 million. When this net cash performance is added to net cash underperformance through investing activities of \$12 million, the multiemployer program in the aggregate experienced an overall net cash increase of \$20 million.

During FY 2012, PBGC recovered approximately \$0.190 billion through agreements with sponsors of terminated plans for unpaid contributions and unfunded benefits. A portion of PBGC's recoveries is paid out as additional benefits to plan participants with nonguaranteed benefits according to statutory priorities.

In FY 2012, PBGC's combined net decrease in cash and cash equivalents amounted to \$1.234 billion, arising from a decrease of \$1.254 billion for the single-employer program and an increase of \$0.020 billion for the multiemployer program.

## VI. Single-Employer and Multiemployer Program Exposure

PBGC estimates its loss exposure to reasonably possible terminations (e.g., underfunded plans sponsored by companies with credit ratings below investment grade) at approximately \$295 billion on September 30, 2012, and \$227 billion on September 30, 2011. The comparable estimate of reasonably possible exposure for 2010 was approximately \$170 billion. 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 2012, 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.

The Corporation estimates that, as of September 30, 2012, it is reasonably possible that multiemployer plans may require future financial assistance of approximately \$27 billion. As of September 30, 2011 and

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2010, these exposures were estimated at approximately \$23 billion and \$20 billion, respectively. The increase in FY 2012 from prior years is due primarily to new data received for two particularly large plans, and the decrease in interest rates for valuing liabilities. (The sponsor of one plan, with a net liability of \$20 billion, is in the “transportation, communication, and utilities” industry category; the other, with a net liability of \$6 billion, is in the “agriculture, mining, and construction” industry category.)

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* where 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 Corporation’s investment policy statement approved by its Board. PBGC does not determine the specific investments to be made but instead relies entirely on its investment managers’ discretion in executing investments appropriate for their assigned investment mandates. PBGC does ensure that each investment manager adheres to PBGC 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, 2012, were approximately \$19.62 billion (\$0.93 billion for Fund 1, \$1.80 billion for Fund 2, and \$16.89 billion for Fund 7). PBGC has never established funds 3, 4, 5 or 6, which ERISA authorized for special discretionary purposes. Trust fund investments totaled \$59.12 billion as of September 30, 2012. At the end of FY 2012, PBGC’s total investments consisting of cash and cash equivalents, investments, and investment income receivable as shown on the Statements of Financial Condition were \$78.74 billion.

The Board adopted a new investment policy in May 2011. The investment policy 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, with assets under performance management of approximately \$76.1 billion as of September 30, 2012, is responsible for managing the vast majority of PBGC’s assets. Of the approximately \$2.6 billion difference between the September 30, 2012 assets reported on the Statements of Financial Condition and the assets within the PBGC’s investment performance portfolio, approximately \$1.2 billion represent net unsettled purchases, approximately \$0.5 billion for funds available for the following month’s benefit payments, and \$0.7 billion represent 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.

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Cash and fixed income securities totaled approximately 69 percent of total assets under performance management invested at the end of FY 2012, compared with 74 percent for FY 2011. Equity securities (i.e., public equities) represented approximately 28 percent of total assets under performance management invested at the end of FY 2012, compared with 23 percent for FY 2011. The fiscal year to date Total Fund Composite return (excluding private market assets and transition accounts) for FY 2012 was 12.6% compared with 5.1% in FY 2011. A small percentage of PBGC's investments (0.1 percent of total investment assets at FY 2012 compared with 1.1 percent at FY 2011) 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 12.6% in FY 2012 compared to 5.0% in FY 2011. Private markets assets, comprised largely of private equity, private debt, and private real estate that are currently part of the investment portfolio, represented approximately 3% of total investments at the end of FY 2012, unchanged from the prior year.

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, 2012, PBGC's return on total invested funds excluding transition accounts was 7.1% compared with a total fund benchmark return of 6.2%, a benchmark PBGC uses to conform with its investment policy. Including the transition accounts, the five year annualized return was 6.9%. Separately, the ERISA/PPA hypothetical portfolio benchmark return for the five-year period ending September 30, 2012 was 4.3%. (Please refer to Table 3 on page 41 for additional information).

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

<b>INVESTMENT PERFORMANCE</b> (Annual Rates of Return)				
	September 30, 2012      2011		Three and Five Years Ended September 30, 2012	
			<u>3 yrs</u>	<u>5 yrs</u>
<b>Total Fund Composite</b>	<b>12.6%</b>	5.1%	9.9%	7.1%
<b>Total Fund Benchmark<sup>1</sup></b>	<b>11.8</b>	5.1	9.3	6.2
<b>ERISA/PPA Portfolio Benchmark<sup>2</sup></b>	<b>20.0</b>	3.6	10.9	4.3
<b>Total Global Public Stock</b>	<b>22.6</b>	(5.2)	8.6	(0.7)
<b>Total Global Public Stock Benchmark<sup>3</sup></b>	<b>22.3</b>	(5.1)	8.3	(0.6)
<b>Total Global Bonds</b>	<b>9.8</b>	8.3	10.6	9.8
<b>Total Global Bonds Benchmark<sup>4</sup></b>	<b>8.7</b>	8.3	9.7	8.6
<b>Trust Funds</b>	<b>15.5</b>	3.6	10.1	6.1
<b>Revolving Funds</b>	<b>5.2</b>	8.9	8.8	8.9
<b>Indices</b>				
<b>Dow Jones U.S.Total Stock Market Index</b>	<b>30.2</b>	0.7	13.4	1.5
<b>MSCI ACWI ex-U.S. Standard Index</b>	<b>14.5</b>	(10.8)	3.2	(4.1)
<b>S&amp;P 500 Index</b>	<b>30.2</b>	1.1	13.2	1.1
<b>Barclays Capital Treasury Index</b>	<b>3.0</b>	6.0	5.4	6.2
<b>Barclays Capital Aggregate Bond Index</b>	<b>5.2</b>	5.3	6.2	6.5
<b>Barclays Capital Global Aggregate ex-US Index, Hedged</b>	<b>5.9</b>	1.3	4.2	4.8

<sup>1</sup> The Total Fund Benchmark is a dynamic weighted benchmark based upon the weights of the equity, fixed income and cash benchmarks. 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 of 60% equity and 40% fixed income.

<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 utilize 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, 2012 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, 2012, the weighted benchmark encompasses the Revolving Fund Treasuries Custom Benchmark (32.7%), the Barclays Capital U.S. TIPS index (6.1%), the Total Long Duration Bonds Benchmark (28.9%), the Barclays Capital U.S. Aggregate Bond index (9.7%), the Total Developed Market Bonds Benchmark (6.9%), the Barclays Capital U.S. High Yield Ba/B 1% Constrained index (4.6%), and the Total Emerging Market Bonds Benchmark (11.1%). The overall Total Global Bonds composite equals 66.0 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 21.6 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.

**TIPS:** This category includes investments in USD denominated fixed income securities managed by outside professional asset managers, and applies to 4.0 percent of PBGC's investment program assets at year-end. The TIPS Benchmark is the Barclays Capital U.S. TIPS index. The Barclays Capital U.S. TIPS index includes U.S. Treasury Inflation Protected Securities ("TIPS"). 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 primarily in USD denominated fixed income securities managed by outside professional asset managers, and applies to 19.1 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, 2012, the Total Long Duration Bonds Benchmark encompasses the Barclays Capital Long U.S. Government/Credit index (51.9%) and Custom Benchmarks (48.1%). 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 6.4 percent of PBGC's investment program assets at year-end. The Core Fixed Income Benchmark is the Barclays Capital U.S. Aggregate Bond index. The Barclays Capital U.S. 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



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components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. PBGC is able to redeem composite assets upon request.

**Developed Market:** This category includes investments in USD denominated and International/Non-USD denominated fixed income securities managed by outside professional asset managers, and applies to 4.6 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, 2012, the weighted benchmark encompasses the Barclays Capital Global Aggregate index hedged (63.8%) and un-hedged (36.2%). 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 investment grade 144A securities. The hedged index negates exposure to foreign currencies by hedging currency exposure back to the USD. The un-hedged index is exposed to the foreign currency returns of the underlying securities. 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 3.0 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 investments in USD denominated and International/Non-USD denominated fixed income securities managed by outside professional asset managers, and applies to 7.3 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, 2012, the weighted benchmark encompasses the JP Morgan EMBIG Diversified index (40.0%) and Custom Benchmarks (60.0%). 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.

### ***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, 2012, the weighted benchmark encompasses the 3-Month Treasury Bill (88.2%) and the 4-Week Treasury Bill (11.8%). The cash composite represents 3.0 percent of PBGC's investment program as of September 30, 2012.

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## ***Global Public Stock***

As described below, PBGC's Global Public Stock investment managers utilize 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, 2012 is also provided below.

**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 15.7 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, 2012, the weighted benchmark encompasses the Russell 3000 index (79.7%), the Dow Jones U.S. Total Stock Market Index (17.2%), and the Dow Jones U.S. Select Real Estate Securities index (3.1%). 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 12.5 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, 2012, the weighted benchmark encompasses the MSCI EAFE index (67.9%), the MSCI Emerging Markets index (23.8%), and the MSCI Canada index (8.3%). 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 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.

**Global Public Stock:** This category includes investments in the U.S. Public Stock composite and the International Public Stock composite, and applies to 28.2 percent of PBGC's investment program assets at 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, 2012, the Total Global Public Stock Benchmark is comprised of the Total U.S. Public Stock Benchmark (55.6%), and the Total International Public Stock Benchmark (44.4%).

## ***Private Markets***

This category includes private equity, private debt, and private real estate funds that invest primarily in buyouts, venture capital, distressed debt, and commercial real estate, and applies to 2.8 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 twelve 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 fixed income index, while presenting a risk-return profile different from PBGC's current allocation, would have increased the assets of the Corporation by approximately \$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 ending September 30, 2012, and decreased the assets of the Corporation by approximately \$9.1 billion (4.3% return compared with PBGC's Total Fund Composite return including transition accounts of 6.9%) over the five-year period ending September 30, 2012. For further analysis of PBGC's Investment Activities please refer to page 35 of the MD&A of Financial Condition and Results of Operations. As reported in last year's FY 2011 Annual Report, the same "60/40 portfolio" would have decreased the assets of the Corporation by approximately \$1.0 billion (3.6% return compared with PBGC's Total Fund Composite return including transition accounts of 5.0%) for the one-year period and decreased the assets of the Corporation by approximately \$12 billion (2.9% return compared with PBGC's Total Fund Composite return including transition accounts of 5.9%) for the five-year period ending September 30, 2011. These results are summarized in the following table.

TABLE 3: INVESTMENT PORTFOLIO ANALYSIS

60/40 Hypothetical Portfolio Analysis versus PBGC Fiscal Year Actual Return (60/40 is comprised of S&P 500/Barclays Capital Aggregate)						
Fiscal Year	1 Year Period Ending			5 Year Period Ending		
	60/40 Incremental \$ Billions	60/40 % Return	PBGC Actual Return	60/40 Incremental \$ Billions	60/40 % Return	PBGC Actual Return
9/30/2011	(\$1.0)	3.6%	5.0%	(\$12.0)	2.9%	5.9%
9/30/2012	\$6.7	20.0%	12.6%	(\$9.1)	4.3%	6.9%

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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 2012, PBGC provided a qualified Statement of Assurance due to two material weaknesses relating to a) System Security and IT Operational Effectiveness, and b) Benefits Administration 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's membership 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 2012, PBGC had identified 155 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 2012, PBGC had identified 46 key entity-wide

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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 is implementing the controls required by National Institute of Standards and Technology Special Publication No. 800-53 Revision No. 3 (NIST 800-53), Recommended Security Controls for Federal Information Systems and Organizations. During FY 2012, PBGC performed testing of 59 controls related to the General Support Systems. In addition, PBGC also performed remediation testing regarding prior-year deficiencies associated the General Support Systems.

#### *Assessment of Improper Payment Risk*

Based on the requirements of the Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Reporting Act (IPERA) of 2010, and OMB's implementing guidance (as implemented by OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments), PBGC assessed its outgoing payment streams and performed statistical sampling of a) benefit payments to participants in "final pay" status for plans trusted by PBGC under Title IV of ERISA; and b) multiemployer plan financial assistance payments to eligible multiemployer plans that are unable to pay benefits when due under the requirements of Title IV of ERISA. 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, the 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

In accordance with the Federal Managers' Financial Integrity Act and OMB Circular A-123, the PBGC's FMFIA Assurance Statement for FY 2012 is presented below:

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, 2012, 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 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, 2012, 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. In March 2010, the PBGC's Office of Information Technology finalized an enterprise-wide corrective action plan (CAP) effort. The plan is based on the security controls outlined in NIST 800-53 rev. 3 as a framework and provides a timeline to address the identified weakness over the next several years. During FY 2012, management continued to implement corrective actions, including the following: issued new directives and procedures relating to IT security, implemented an automated network access approval tool, improved the system registration process, made progress in system security and authorization, improved vulnerability scanning, and provided role-based security training. As this is key corporate priority, management continues to perform supplemental IT control testing, and progress towards corrective action plans is closely monitored.

### *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 2012, Benefits Administration and Payment Department (BAPD) took a number of steps to address the deficiencies noted in the audits. To date, BAPD has focused on fundamental issues such as training and staff competencies. In addition, BAPD is currently undergoing a Strategic Review that will address some of the organizational structure and operations to meet its mission challenges. The agency has hired a new Director for BAPD and has hired a valuation expert as part of the new Asset Evaluation Division in BAPD. New procedures have been developed in the area of asset evaluation and are currently being tested. The overall implementation of any recommendations from the Strategic Review remains a multi-year process. Recommendations from the strategic review remain a top priority for PBGC senior leadership.



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## MANAGEMENT REPRESENTATION

PBGC's management is responsible for the accompanying Statements of Financial Condition of the Single-Employer and Multiemployer Funds as of September 30, 2012 and 2011, 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, 2012, and September 30, 2011, 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.

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 2012 and 2011 financial statements, and CliftonLarsonAllen LLP issued an unqualified opinion on those financial statements.

  
Josh Gotbaum  
Director

  
Patricia Kelly  
Chief Financial Officer

November 14, 2012

**PENSION BENEFIT GUARANTY CORPORATION**  
**STATEMENTS OF FINANCIAL CONDITION**

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
<i>(Dollars in Millions)</i>	2012	2011	2012	2011	2012	2011
<b>ASSETS</b>						
Cash and cash equivalents	\$ 3,767	\$ 5,021	\$ 25	\$ 5	\$ 3,792	\$ 5,026
Securities lending collateral (Notes 3 and 5)	3,425	4,587	0	0	3,425	4,587
Investments, at market (Notes 3 and 5):						
Fixed maturity securities	48,176	46,257	1,767	1,720	49,943	47,977
Equity securities	22,619	17,997	0	0	22,619	17,997
Private equity	1,339	1,459	0	0	1,339	1,459
Real estate and real estate investment trusts	511	536	0	0	511	536
Other	77	22	0	0	77	22
Total investments	72,722	66,271	1,767	1,720	74,489	67,991
Receivables, net:						
Sponsors of terminated plans	41	31	0	0	41	31
Premiums (Note 11)	1,086	561	1	1	1,087	562
Sale of securities	1,353	1,807	0	0	1,353	1,807
Derivative contracts (Note 4)	83	178	0	0	83	178
Investment income	452	469	12	12	464	481
Other	4	3	0	0	4	3
Total receivables	3,019	3,049	13	13	3,032	3,062
Capitalized assets, net	40	32	2	1	42	33
Total assets	\$ 82,973	\$78,960	\$ 1,807	\$1,739	\$ 84,780	\$80,699

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

PENSION BENEFIT GUARANTY CORPORATION  
STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in Millions)	2012	2011	2012	2011	2012	2011
<b>LIABILITIES</b>						
Present value of future benefits, net (Note 6):						
Trusteed plans	\$103,126	\$ 91,718	\$1	\$ 1	\$103,127	\$ 91,719
Plans pending termination and trusteeship	418	346	0	0	418	346
Settlements and judgments	56	56	0	0	56	56
Claims for probable terminations	2,035	833	0	0	2,035	833
Total present value of future benefits, net	105,635	92,953	1	1	105,636	92,954
Present value of nonrecoverable future financial assistance (Note 7)						
Insolvent plans	0	0	1,388	1,232	1,388	1,232
Probable insolvent plans	0	0	5,622	3,243	5,622	3,243
Total present value of nonrecoverable future financial assistance	0	0	7,010	4,475	7,010	4,475
Payables, net:						
Derivative contracts (Note 4)	94	173	0	0	94	173
Due for purchases of securities	2,557	4,079	0	0	2,557	4,079
Payable upon return of securities loaned	3,425	4,587	0	0	3,425	4,587
Unearned premiums	328	366	30	31	358	397
Accounts payable and accrued expenses (Note 8)	76	68	3	2	79	70
Total payables	6,480	9,273	33	33	6,513	9,306
Total liabilities	112,115	102,226	7,044	4,509	119,159	106,735
<b>Net position</b>	<b>(29,142)</b>	<b>(23,266)</b>	<b>(5,237)</b>	<b>(2,770)</b>	<b>(34,379)</b>	<b>(26,036)</b>
Total liabilities and net position	\$82,973	\$ 78,960	\$1,807	\$1,739	\$84,780	\$ 80,699

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)	2012	2011	2012	2011	2012	2011
<b>UNDERWRITING</b>						
Income:						
Premium, net (Note 11)	\$ 2,642	\$ 2,072	\$ 92	\$ 92	\$ 2,734	\$ 2,164
Other	13	17	-	0	13	17
Total	2,655	2,089	92	92	2,747	2,181
Expenses:						
Administrative	360	353	20	14	380	367
Other	-	21	-	0	-	21
Total	360	374	20	14	380	388
Other underwriting activity:						
Losses from completed and probable terminations (Note 12)	2,006	201	-	0	2,006	201
Losses from insolvent and probable plans- financial assistance (Note 7)			2,466	1,461	2,466	1,461
Actuarial adjustments (credits) (Note 6)	229	1,672	(6)	37	223	1,709
Total	2,235	1,873	2,460	1,498	4,695	3,371
Underwriting gain (loss)	60	(158)	(2,388)	(1,420)	(2,328)	(1,578)
<b>FINANCIAL:</b>						
Investment income (loss) (Note 13):						
Fixed	4,699	3,502	91	148	4,790	3,650
Equity	4,073	(276)	-	0	4,073	(276)
Private equity	42	144	-	0	42	144
Other	(22)	76	-	0	(22)	76
Total	8,792	3,446	91	148	8,883	3,594
Expenses:						
Investment	83	71	-	0	83	71
Actuarial charges (Note 6):						
Due to expected interest	3,927	3,880	54	52	3,981	3,932
Due to change in interest rates	10,718	1,009	116	10	10,834	1,019
Total	14,728	4,960	170	62	14,898	5,022
Financial income (loss)	(5,936)	(1,514)	(79)	86	(6,015)	(1,428)
Net loss	(5,876)	(1,672)	(2,467)	(1,334)	(8,343)	(3,006)
Net position, beginning of year	(23,266)	(21,594)	(2,770)	(1,436)	(26,036)	(23,030)
Net position, end of year	\$ (29,142)	\$ (23,266)	\$ (5,237)	\$ (2,770)	\$ (34,379)	\$ (26,036)

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

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

(Dollars in millions)	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,	
	2012	2011	2012	2011	2012	2011
<b>OPERATING ACTIVITIES:</b>						
Premium receipts	\$ 2,079	\$ 2,268	\$ 92	\$ 91	\$ 2,171	\$ 2,359
Interest and dividends received	2,122	2,155	58	74	2,180	2,229
Cash received from plans upon trusteeship	126	36	0	0	126	36
Receipts from sponsors/non-sponsors	114	70	0	0	114	70
Receipts from the missing participant program	7	6	0	0	7	6
Other receipts	1	1	0	0	1	1
Benefit payments – trustee plans	(5,333)	(5,382)	0	0	(5,333)	(5,382)
Financial assistance payments			(95)	(115)	(95)	(115)
Settlements and judgments	0	0	0	0	0	0
Payments for administrative and other expenses	(413)	(428)	(20)	(13)	(433)	(441)
Accrued interest paid on securities purchased	(234)	(310)	(3)	(6)	(237)	(316)
Net cash provided (used) by operating activities (Note 15)	(1,531)	(1,584)	32	31	(1,499)	(1,553)
<b>INVESTING ACTIVITIES:</b>						
Proceeds from sales of investments	77,382	85,242	667	1,216	78,049	86,458
Payments for purchases of investments	(77,105)	(83,079)	(679)	(1,248)	(77,784)	(84,327)
Net change in investment of securities lending collateral	(1,162)	(841)	0	0	(1,162)	(841)
Net change in securities lending payable	1,162	841	0	0	1,162	841
Net cash provided (used) by investing activities	277	2,163	(12)	(32)	265	2,131
Net increase (decrease) in cash and cash equivalents	(1,254)	579	20	(1)	(1,234)	578
Cash and cash equivalents, beginning of year	5,021	4,442	5	6	5,026	4,448
Cash and cash equivalents, end of year	\$ 3,767	\$ 5,021	\$ 25	\$ 5	\$ 3,792	\$ 5,026

The accompanying notes are an integral part of these financial statements

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# NOTES TO FINANCIAL STATEMENTS

September 30, 2012 and 2011

## 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, 2012, the single-employer and multiemployer programs reported net positions of \$(29.1) billion and \$(5.2) billion, respectively. The single-employer program had assets of approximately \$83.0 billion offset by total liabilities of \$112.1 billion, which include a total present value of future benefits (PVFB) of approximately \$105.6 billion. As of September 30, 2012, the multiemployer program had assets of \$1.8 billion offset by approximately \$7.0 billion in present value of nonrecoverable future financial assistance. Notwithstanding these deficits, the Corporation has sufficient liquidity to meet its obligations 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 \$78.7 billion of total investments (including cash and investment income) represents the largest component of PBGC’s Statements of Financial Condition combined assets of \$84.8 billion at September 30, 2012. This amount of \$78.7 billion (as compared to investments under management of \$76.1 billion, as reported on page 35) reflects the fact that PBGC experiences a recurring inflow of trustee 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 (\$54.2 billion) represents 69 percent of the total investments, while equity securities (\$22.6 billion) represents 29 percent of total investments. Private market assets (\$1.3 billion), comprised largely of private equity, private debt, and real estate, represent 2 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 sponsored by companies with credit ratings below investment grade, and which were classified by PBGC as reasonably possible of termination as of September 30, 2012, was \$295 billion. The comparable estimates of the single-employer program's reasonably possible exposure for FY 2011 and FY 2010 were \$227 billion and \$170 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 9). For FY 2012, 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, 2012, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of \$27 billion. The comparable estimates of the multiemployer program's reasonable possible exposure for FY 2011 and FY 2010 were \$23 billion and \$20 billion, respectively. The increase in FY 2012 is primarily due to two large plans in the reasonably possible inventory. The sponsor of one plan, now with net liability of \$20 billion, is in the "transportation, communication, and utilities" industry category; the other, now with net liability of \$6 billion, 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 Book* 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 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 addresses the rescission of financial reporting disclosure requirements effective in fiscal year 2011 to eliminate the collateral maintenance implementation guidance. See Note 3 for disclosures of Repurchase Agreements.

During FY 2011, PBGC implemented FASB Accounting Standards Update No. 2009-16, *Transfers and Servicing (Topic 860) – Accounting for Transfers of Financial Assets* and FASB Accounting Standards Update No. 2011-02, *Receivables (Topic 310) – A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring*. Accounting Standards Update 2009-16 improves the relevance, representations, and comparability of the information that PBGC provides in its financial reports regarding transfers of financial assets. See Note 3 for disclosures regarding Securities Lending and Repurchase Agreements. Accounting Standards Update 2011-02 requires disclosures for loan modifications that constitute troubled debt restructurings. See Note 7 for disclosures on multiemployer financial assistance notes receivable.

### ***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 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. Prior to Section 820, there were different definitions of fair value with limited guidance for applying those definitions in U.S. GAAP; additionally, the issuance for applying fair value was dispersed among many accounting pronouncements that require fair value measurement.

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## ***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.

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 Condition, 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 Condition 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 Condition 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 present value of future benefits and present value of nonrecoverable future financial assistance. 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.

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### ***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.

### ***Securities Lending Collateral***

PBGC participates in a securities lending program administered by its custodian bank. The custodian bank requires collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank. 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 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 61. Resale agreements that mature in one day are included in "Cash and cash equivalents" which are reported on the Statements of Financial Condition.

### ***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."

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## ***Premiums***

Premiums receivable represent the estimated earned but unpaid portion of the premiums for plans that have a plan year commencing before the end of PBGC's fiscal year and past due premiums deemed collectible, including penalties and interest. The liability for unearned premiums represents an estimate of payments received during the fiscal year that cover the portion of a plan's year after PBGC's fiscal year-end. "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).

In accordance with the FASB Accounting Standards Codification Section 605-10-S99, *Revenue Recognition*, PBGC has strengthened the revenue recognition policy for termination premiums in bankruptcy and non-bankruptcy liquidations. The effect of this did not result in material change for our financial statements. We did not adjust any prior-period information. The effect of the change on income from operations and other items are immaterial, and there is no material effect on any other components of equity or net assets.

## ***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.



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(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. 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 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,



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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 insolvencies for plans that are likely to become insolvent and require financial assistance in the future. 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. For example, a multiemployer plan that no longer has contributing employers files a notice of termination with PBGC. 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.

Note that PBGC has initiated a comprehensive review of accounting policies and processes addressing the classification and measurement of potential claims for financial assistance by multiemployer plans that may become insolvent in the future. This review will include (1) benchmarking the current accounting policy against other, similar contingent liability accounting policies, (2) identifying and analyzing alternative contingent liability processes, and (3) developing recommendations on possible modification to the current policies and processes. PBGC anticipates that any such modifications will be adopted and implemented by the end of fiscal year 2013. These steps are consistent with PBGC’s ongoing efforts to review the efficacy of its accounting policies each year.

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

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### ***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 Condition, 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.

### ***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.

### ***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 data (e.g., deaths, revised participant data). Actuarial charges (credits) 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).

To ensure consistency and comparability of the information presented in PBGC’s FY 2011 and FY 2012 financial statements and consistent with the presentation for the single-employer program, beginning FY 2012, losses from financial assistance in the multiemployer program have been reclassified to actuarial charges, credits, and adjustments. These categories provide improved transparency for those plans receiving and/or about to begin receiving financial assistance from the multiemployer program. In our FY 2011 Statements of Operations and Changes in Net Position, losses from financial assistance decreased \$99 million and actuarial adjustments increased \$37 million, resulting in a reclassification to the underwriting gain of \$62

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million. Furthermore, in the financial portion of the Statements of Operations and Changes in Net Position, due to expected interest increased by \$52 million and due to change in interest rates increased by \$10 million, resulting in a reclassification to the financial loss of \$62 million. All such changes were reclassified within the FY 2011 Statements of Operations and Changes in Net Position, and have no impact on FY 2011 net position. Likewise, such FY 2012 Statements of Operations and Changes in Net Position reclassifications have no impact on FY 2012 net position.

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

## **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.

In prior years, foreign exchange forward contracts and swap contracts were recorded gross of receivables and payables. Beginning in FY 2010, foreign exchange forwards are included in "Fixed maturity securities"

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rather than “Receivables, net – Derivative contracts” or “Derivative contracts” (liabilities). Swaps are netted rather than recorded at gross levels for the individual contracts as “Receivables, net – Derivative contracts” and “Derivative contracts” (liabilities). Certain amounts shown as futures for receivables and payables were offset to reflect a net margin variation for one recently trustee plan. Bond forwards and TBAs have been reclassified to “Receivables, net – Sale of securities” and “Due for purchases of securities” from derivative contracts receivables and payables.

As the following table illustrates, the market value of investments of the single-employer program increased significantly from September 30, 2011, to September 30, 2012.

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

(Dollars in millions)	September 30, 2012		September 30, 2011	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$21,122	\$23,629	\$20,935	\$23,775
Commercial paper/securities purchased under resale agreements	442	442	6	6
Asset backed securities	3,350	3,509	5,088	5,150
Pooled funds				
Domestic	450	408	374	393
International	0	0	0	0
Global/other	0	0	0	0
Corporate bonds and other	9,798	11,073	11,021	11,765
International securities	8,443	9,115	5,088	5,168
Subtotal	43,605	48,176	42,512	46,257
Equity securities:				
Domestic	2,047	2,417	1,678	1,681
International	575	670	1,067	1,015
Pooled funds				
Domestic	8,128	10,798	6,377	7,990
International	5,805	8,733	5,373	7,308
Global/other	1	1	3	3
Subtotal	16,556	22,619	14,498	17,997
Private equity	1,398	1,339	1,452	1,459
Real estate and real estate investment trusts	445	511	447	536
Insurance contracts and other investments	84	77	23	22
Total*	\$62,088	\$72,722 **	\$58,932	\$66,271

\*Total includes securities on loan at September 30, 2012, and September 30, 2011, with a market value of \$4.298 billion and \$6.125 billion, respectively.

\*\*This total of \$72.72 billion of investments at market value represents the single-employer assets only. It differs from the total investments of \$78.74 billion shown on page 35 of this report which includes investments of the multiemployer program, cash and cash equivalents and accrued investment income.

## INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

(Dollars in millions)	September 30, 2012		September 30, 2011	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$1,568	\$1,767	\$1,533	\$1,720
Equity securities	0	0	0	0
Total	\$1,568	\$1,767	\$1,533	\$1,720

## INVESTMENT PROFILE

	September 30,	
	2012	2011
Fixed Income Assets		
Average Quality	AA	AA
Average Maturity (years)	14.0	14.9
Duration (years)	9.3	9.6
Yield to Maturity (%)	2.7	3.3
Equity Assets		
Average Price/Earnings Ratio	15.6	12.9
Dividend Yield (%)	2.6	2.9
Beta	1.03	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 established by PBGC. 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. Furthermore, 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 at any time. 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. That is, 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 (1) to mitigate risk (e.g., adjust duration or currency exposures), (2) to enhance investment returns, and/or (3) 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 Condition.

During fiscal years 2012 and 2011, PBGC, through its investment managers, invested in investment products that used various U.S. and non-U.S. derivative instruments including but not limited to: S&P 500 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 currency



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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 its counterparty risk and exchanges collateral under most contracts to further support performance by its counterparties.

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, 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. 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, 2012 and 2011, 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.

Effective January 1, 2009, PBGC adopted 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 Condition, as well as the notional amounts, while 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, 2012, and September 30, 2011.

#### FAIR VALUES OF DERIVATIVE INSTRUMENTS

(Dollars in millions)	Asset Derivative					
	September 30, 2012			September 30, 2011		
	Statements of Financial Condition Location	Notional	FMV	Statements of Financial Condition Location	Notional	FMV
Futures	Derivative Contracts	\$ 1,323	\$4	Derivative Contracts	\$ 3,586	\$90
Swap agreements						
Interest rate swaps	Investments-Fixed	1,904	12	Investments-Fixed	1,330	(15)
Credit default swaps	Investments-Fixed	2,180	14	Investments-Fixed	2,150	6
Option contracts	Investments-Fixed	146	2	Investments-Fixed	121	1
Forwards - foreign exchange	Investments-Fixed	4,650	(27)	Investments-Fixed	3,021	26
	Investments-Equity	0	0	Investments-Equity	45	1
(Dollars in millions)	Liability Derivative					
	September 30, 2012			September 30, 2011		
	Statements of Financial Condition Location	Notional	FMV	Statements of Financial Condition Location	Notional	FMV
Futures	Derivative Contracts	\$ 2,283	\$ (9)	Derivative Contracts	\$ 2,148	\$ (2)
Option contracts	Derivative Contracts	1,042	(11)	Derivative Contracts	1,202	(4)

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

(Dollars in millions)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
		Sept. 30, 2012	Sept. 30, 2011
Futures			
Contracts in a receivable position	Investment Income-Fixed	\$9	(\$38)
Contracts in a receivable position	Investment Income-Equity	0	0
Contracts in a payable position	Investment Income-Fixed	69	177
Contracts in a payable position	Investment Income-Equity	0	0
Swap agreements			
Interest rate swaps	Investment Income-Fixed	14	0
Credit default swaps	Investment Income-Fixed	38	12
Option contracts			
Options purchased (long)	Investment Income-Fixed	(14)	3
Options purchased (long)	Investment Income-Equity	0	0
Options written (sold short)	Investment Income-Fixed	4	2
Options written (sold short)	Investment Income-Equity	0	0
Forward contracts			
Forwards - foreign exchange	Investment Income-Fixed	14	(42)
	Investment Income-Equity	0	1
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 whereby the custodian bank lends PBGC's securities to third parties. The custodian bank requires initial collateral from the borrower that equals 102 percent to 105 percent of the securities lent. Collateral consisting of cash and non-cash instruments is held by the custodian bank. The custodian bank either requires additional collateral or returns collateral to cover daily market value changes. The margin call for additional collateral occurs when levels fall below the initial collateral requirement, except for U.S. Government securities and sovereign debt issued by non-U.S. Governments where the margin call may not occur until collateral held falls below certain levels depending upon the composition of collateral but never lower than 100 percent of the securities lent. Any cash collateral received is invested.

The total value of securities on loan at September 30, 2012, and September 30, 2011, was \$4.298 billion and \$6.125 billion, respectively. The decrease in loan balances was mainly attributable to decreased utilization of PBGC's U.S. Government Securities due to lower demand. In addition, low yields made lending U.S. Government securities less attractive.

U.S. Government securities continue to represent PBGC's largest amount of assets on loan. The FY 2012 year-end lendable balance for U.S. Government securities was approximately \$7.0 billion or 54 percent of PBGC's overall lendable securities balance; while the September 30, 2011 balance for U.S. Government securities was approximately \$8.2 billion or 33 percent of PBGC's overall lendable security balance. Of the \$4.298 billion market value of securities on loan at September 30, 2012, approximately 54 percent are lent U.S. Government securities. Utilization levels of U.S. Government securities, U.S. corporate bonds and U.S. equities on September 30, 2012 were lower than a year earlier, but was partially offset by the increased loan balances of U.S. corporate bonds and U.S. equities.

The amount of cash collateral received for these loaned securities was \$3.425 billion at September 30, 2012, and \$4.587 billion at September 30, 2011. 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 \$19.1 million from its securities lending programs as of September 30, 2012. 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. As of September 30, 2012, PBGC loaned out \$4.298 billion in securities of approximately \$26.959 billion of securities available for securities lending.

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 Condition. Non-cash collateral, which consists primarily of U.S. Treasuries, has recently increased to material levels.

### ***Repurchase Agreements***

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

As of September 30, 2012, PBGC had \$36 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, 2012.

## Note 4: Derivative Contracts

PBGC’s derivative financial instruments are recorded at fair value and are included on the Statements of Financial Condition 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.

Amounts in the table below represent the derivative contracts in a receivable position at financial statement date. Collateral deposits of \$79 million, which represent cash paid as collateral on certain derivative contracts, are shown.

### DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2012	September 30, 2011
Open receivable trades on derivatives:		
Collateral deposits	\$79	\$81
Futures contracts	4	90
Interest rate swaps	0	0
Credit default swaps	0	7
Total	<u>\$83</u>	<u>\$178</u>

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 \$72 million, which represent cash received as collateral on certain derivative contracts, are included.

### DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2012	September 30, 2011
Open payable trades on derivatives:		
Collateral deposits	\$72	\$167
Futures contracts	9	2
Interest rate swaps	0	0
Credit default swaps	2	0
Options-fixed income	11	4
Total	<u>\$94</u>	<u>\$173</u>

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## Note 5: Fair Value Measurements

Effective January 1, 2009, PBGC adopted the provisions of the FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures*. The standard does not require the measurement of financial assets and liabilities at fair value, but provides a consistent definition of fair value and establishes a framework for measuring fair value in accordance with U.S. GAAP. The standard is intended to increase consistency and comparability in, and disclosures about, fair value measurements, by providing users with better information about the extent to which fair value is used to measure financial assets and liabilities, the inputs 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 PBGC would transact, and PBGC 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. The fair value hierarchy is based on the observability of inputs to the valuation of a financial asset or liability as of the measurement date. The standard 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 it carries at fair value in the Statements of Financial Condition 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); 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, 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.

The three levels are described below:

*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, and 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 the following:

- a. Quoted prices for similar assets or liabilities in active markets – included are 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 – included are corporate stock, pooled funds fixed income, pooled funds equity, and foreign investments equity;
  - c. Pricing models whose inputs are observable for substantially the full term of the asset or liability – included are insurance contracts and bank loans; and
  - d. Pricing models whose inputs are derived principally from or 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 management'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. We include 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 in this level, and are comprised of securities that are no longer traded on the active market and/or not managed by any asset manager. Private equity, real estate funds, and separate accounts that invest primarily in U.S. commercial real estate, are valued based on each underlying investment within the fund/account incorporating 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 price that would be received to sell the asset or paid to transfer the liability (an exit price).

**FAIR VALUE MEASUREMENTS ON A RECURRING BASIS AS OF SEPTEMBER 30, 2012**

<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 Condition
<b>Assets</b>				
Cash and cash equivalents	\$ 425	\$ 3,367		\$ 3,792
Securities lending collateral		3,425		3,425
Investments:				
Fixed maturity securities				
U.S. Government securities		25,396		
Commercial paper/securities purchased under resale agreements		442		
Asset backed/Mortgage backed securities		3,509		
Pooled funds				
Domestic		131	277	
International				
Global/other				
Corporate bonds and other	2	11,071		
International securities	(12)	9,127		
Total fixed maturity securities	(10)	49,676	277	49,943
Equity securities:				
Domestic	2,240	170	7	
International	668	2		
Pooled funds				
Domestic	7	10,791		
International	2	8,731		
Global/other	1	-	0 ***	
Total equity securities	2,918	19,694	7	22,619
Private equity			1,339	1,339
Real estate and real estate investment trusts	2	1	508	511
Insurance contracts and other Investments		75	2	77
Receivables:				
Derivative contracts*	4	79		83
<b>Liabilities</b>				
Payables:				
Derivative contracts**	20	74		94

\* 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, 2012, 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, 2012**

<i>(Dollars in millions)</i>	Fair Value at September 30, 2011	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, 2012	Change in Unrealized Gains (Losses) Related to Financial Instruments held at September 30, 2012 **
<b>Assets:</b>								
Pooled funds (fixed)	\$ 343	\$(66)					\$ 277	\$ (66)
Corporate bonds and other *	0***	0***	0***	0***			0***	0***
Domestic/Int'l equity *	9	0***	1	(3)			7	0***
Private equity	1,459	(66)	12	(66)			1,339	(66)
Real estate & real estate investment trusts	523	(24)	9	0***			508	(24)
Other *	0				2		2	

\*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, 2012**

	<b>Fair Value (in millions)</b>	<b>Unfunded Commitments <sup>1</sup></b>	<b>Redemption Frequency (If Currently Eligible)</b>	<b>Redemption Notice Period</b>
Real estate (a)	\$ 511	\$118	n/a	n/a
Private equity (b)	1,339	304	n/a	n/a
Pooled funds (c)	<u>11,206</u>	<u>0</u>	n/a	n/a
Total	<u>\$ 13,056</u>	<u>\$422</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 157 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 617 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). 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.

**Hypothetical and Actual Interest Rate Sensitivity Calculations of PVFB  
Single-Employer Trusteed Plans and the Multiemployer Program\***

<b>September 30, 2012</b> <i>(Dollars in millions)</i>	<b>Hypothetical Rates</b> <b>2.28% for 25 years,</b> <b>1.97% thereafter</b>	<b>Actual Rates**</b> <b>3.28% for 25 years,</b> <b>2.97% thereafter</b>	<b>Hypothetical Rates</b> <b>4.28% for 25 years,</b> <b>3.97% thereafter</b>
Single-Employer Program	\$115,759	<b>\$103,126</b>	\$92,712
Multiemployer Program	8,063	<b>7,010</b>	6,126
Total	\$123,822	<b>\$110,136</b>	\$98,838

\*Level 3 Fair Value Measurements

\*\*Actual rates and PVFB amounts calculated for September 30, 2012 quarterly financial statements.

## Note 6: Present Value of Future Benefits

The following table 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, 2012 and for the fiscal year ended September 30, 2011.

For 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. In FY 2011, PBGC used a 20-year select interest factor of 4.31% followed by an ultimate factor of 4.26% 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 the opinion of management, 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, including Federal Reserve policy, changing expectations about longevity risk, and competitive market conditions may affect these rates.

For FY 2012, PBGC used the Retirement Plan-2000 Combined Healthy (RP-2000 CH) Male and Female Tables, each set back one year and projected 22 years to 2022 using Scale AA. For September 30, 2011, PBGC used the same table, set back one year and projected 21 years to 2021 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 (12 years in FY 2012, 11 years in FY 2011) plus PBGC's calculated duration of its liabilities (10 years in FY 2012 and FY 2011).

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PBGC continues to utilize the results of its 2011 mortality study. The study showed that the mortality assumptions used in FY 2010 reflected higher mortality than was realized in PBGC's seriatim population. Therefore, PBGC adopted a base mortality table (i.e. RP-2000 CH set back one year instead of GAM94 set forward one year) that better reflects past mortality experience. The study also recommended changes in the mortality assumptions for disabled lives that PBGC implemented in the June 30, 2011 and subsequent valuations. 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.

The present values of future benefits for trustee multiemployer plans for FY 2012 and FY 2011 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.



## RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	September 30,	
(Dollars in millions)	2012	2011
Present value of future benefits, at beginning		
of year -- Single-Employer, net	\$ 92,953	\$90,022
Estimated recoveries, prior year	205	107
Assets of terminated plans pending trusteeship, net, prior year	280	542
Present value of future benefits at beginning of year, gross	93,438	90,671
Settlements and judgments, prior year	(56)	(55)
Net claims for probable terminations, prior year	(833)	(1,445)
Actuarial adjustments -- underwriting:		
Changes in method and assumptions	\$ 76	\$1,881
Effect of experience	153	(209)
Total actuarial adjustments -- underwriting	229	1,672
Actuarial charges -- financial:		
Expected interest	3,927	3,880
Change in interest rates	10,718	1,009
Total actuarial charges -- financial	14,645	4,889
Total actuarial charges, current year	14,874	6,561
Terminations:		
Current year	2,035	2,363
Changes in prior year	(16)	(206)
Total terminations	2,019	2,157
Benefit payments, current year*	(5,384)	(5,340)
Estimated recoveries, current year**	(243)	(205)
Assets of terminated plans pending trusteeship, net, current year	(271)	(280)
Settlements and judgments, current year	56	56
Net claims for probable terminations:		
Future benefits***	7,686	1,379
Estimated plan assets and recoveries from sponsors	(5,651)	(546)
Total net claims, current year	2,035	833
Present value of future benefits, at end of year -- Single-Employer, net	105,635	92,953
Present value of future benefits, at end of year -- Multiemployer	1	1
Total present value of future benefits, at end of year, net	\$105,636	\$92,954

\* The benefit payments of \$5,384 million and \$5,340 million include \$51 million in FY 2012 and \$(42) million in FY 2011 for benefits paid from plan assets by plans prior to trusteeship.

\*\*United Continental Holdings, Inc. (UAL) is obligated under an indenture to issue to PBGC up to \$500 million aggregate principal amount of 8% Contingent Senior Notes (8% Notes) in up to eight equal tranches of \$62.5 million if certain UAL earnings related triggering events occur. As of September 30, 2012, UAL issued two tranches of \$62.5 million of the 8% Notes.

\*\*\* The future benefits for probable terminations of \$7,686 million and \$1,379 million for fiscal years 2012 and 2011, respectively, include \$299 million and \$288 million, respectively, for probable terminations not specifically identified and \$7,387 million and \$1,091 million, respectively, for specifically identified probabilities.

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

(Dollars in millions)	September 30, 2012		September 30, 2011	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	\$ 0	\$ 0	\$ 0	\$ 0
Corporate and other bonds	108	109	148	148
Equity securities	164	170	137	139
Private equity	0	0	0	0
Insurance contracts	0 *	0 *	7	7
Other	(8)	(8)	(19)	(14)
Total, net	\$264	\$271	\$ 273	\$ 280

\* 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

(Dollars in millions)	September 30,	
	2012	2011
Net claims for probable terminations, at beginning of year	\$ 833	\$1,445
New claims	\$ 1,736	\$ 545
Actual terminations	(150)	(474)
Deleted probables	(394)	(718)
Change in benefit liabilities	10	35
Change in plan assets	0	0
Loss (credit) on probables	1,202	(612)
Net claims for probable terminations, at end of year	\$ 2,035	\$ 833

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

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

(Dollars in millions)	FY 2012	FY 2011
Manufacturing	\$ 1,900	\$ -
Health Care	135	231
Wholesale and Retail Services	-	602
Services	-	-
Total	\$ 2,035	\$833

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

(Dollars in millions)	Status of Probables from 1987-2011 at September 30, 2012			
	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Beginning in 1987, number of plans reported as Probable:				
Probables terminated	364	79%	\$28,622	73%
Probables not yet terminated or deleted	0	0	0	0
Probables deleted	98	21	10,729	27
Total	462	100%	\$39,351	100%

## 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

(Dollars in millions)	September 30, 2012	September 30, 2011
Gross balance at beginning of year	\$599	\$484
Financial assistance payments - current year	95	115
Write-offs related to settlement agreements	0	0
Subtotal	694	599
Allowance for uncollectible amounts	(694)	(599)
Net balance at end of year	\$ 0	\$ 0

The losses from financial assistance and probable financial assistance are reflected in the Statements of Operations and Changes in Net Position include period changes in the estimated present value of nonrecoverable future financial assistance. The 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, 2012, the corporation expects 148 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 148 plans is \$7.010 billion. The 148 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, 2012		September 30, 2011	
	Number of Plans	Net Liability	Number of Plans	Net Liability
Plans currently receiving financial assistance	41	\$1,388	41	\$1,232
Plans that have terminated but have not yet started receiving financial assistance	61	1,725	60	1,487
Ongoing plans (not terminated) that the corporation expects will require financial assistance in the future	46	3,897	34	1,756
Total	148	\$7,010	135	\$4,475

Of the 148 plans:

- 1) 41 have exhausted plan assets and are currently receiving financial assistance payments from PBGC. The present value of future financial assistance payments for these insolvent 41 plans is \$1.388 billion.
- 2) 61 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 61 terminated plans is \$1.725 billion.
- 3) 46 plans are ongoing (i.e., have not terminated), but PBGC expects these plans 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 46 ongoing plans is \$3.897 billion.

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

<i>(Dollars in millions)</i>	September 30, 2012	September 30, 2011
Balance at beginning of year	\$4,475	\$3,030
Changes in allowance:		
Losses from insolvent and probable plans - financial assistance	2,466	1,461
Actuarial adjustments	(6)	37
Actuarial charges (credits):		
Due to expected interest	54	52
Due to change in interest rates	116	10
Financial assistance granted (previously accrued)	(95)	(115)
Balance at end of period	<u>\$7,010</u>	<u>\$4,475</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 rates. 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 Condition:

### ACCOUNTS PAYABLE AND ACCRUED EXPENSES

<i>(Dollars in millions)</i>	September 30, 2012	September 30, 2011
Annual leave	\$ 9	\$ 8
Other payables and accrued expenses	<u>70</u>	<u>62</u>
Accounts payable and accrued expenses	<u>\$ 79</u>	<u>\$ 70</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 the Corporation'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.

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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 as 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, 2012. The following standard criteria for a single-employer plan sponsor to be classified as Reasonably Possible are as follows:

- a. 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.
- b. An application for a funding waiver is pending or outstanding with the IRS.
- c. A minimum funding contribution has been missed.
- d. 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.
- e. The sponsor(s) has no bond rating, but analysis indicates that its unsecured debt would be below investment grade.
- f. The sponsor(s) meet at least one of the PBGC "high risk" criteria.
- g. 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, 2011. The reasonably possible exposure to loss in these plans was \$295 billion for FY 2012. This is an increase of \$68 billion from the reasonably possible exposure of \$227 billion in FY 2011. This reasonably possible exposure increased primarily due to the decrease in the interest rate used for valuing liabilities and low asset returns for calendar year 2011.

Except in 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 the Corporation for plan years ended on or after December 31, 2010. The Corporation adjusted the value reported for liabilities to December 31, 2011, using a select rate of 3.08% for the first 20 years and 3.37% 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 2021 using Scale AA to approximate annuity prices as of December 31, 2011. The underfunding associated with these plans could be substantially different at September 30, 2012, because of the economic conditions that changed between December 31, 2011 and September 30, 2012. The Corporation did not adjust the estimate for events that occurred between December 31, 2011, and September 30, 2012.



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 2012	FY 2011
Manufacturing *	\$155,857	\$120,690
Transportation, Communication and Utilities **	67,355	50,133
Services	29,795	25,879
Wholesale and Retail Trade	17,199	12,218
Health Care	12,089	8,818
Finance, Insurance, and Real Estate	8,463	5,953
Agriculture, Mining, and Construction	4,205	3,426
Total	<b>\$294,963</b>	<b>\$227,117</b>

\* 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, 2012, that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of \$27 billion.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 7), or reasonably possible as the present value of guaranteed future benefit and expense payments net of any future contributions or withdrawal liability payments as of the later of September 30, 2012, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2012. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts required consideration of many complex factors, such as an estimate of 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 the Corporation'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 2017. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2012, are as follows:

### COMMITMENTS: FUTURE LEASE PAYMENTS

(Dollars in millions)	
Years Ending September 30,	Operating Leases
2013	\$ 18.9
2014	18.5
2015	18.3
2016	18.0
2017	17.9
Thereafter	39.8
Minimum lease payments	<u>\$131.4</u>

Lease expenses were \$17.6 million in FY 2012 and \$18.3 million in FY 2011.

## 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 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 \$2.734 billion that consisted primarily of \$1.215 billion in flat-rate premiums, \$1.495 billion in variable-rate premiums, and \$0.033 billion in termination premiums, offset by a bad debt expense of \$0.014 billion. Bad debt expenses include a reserve for uncollectible premium receivables (including flat, variable, and termination premiums), interest, and penalties. Net premium income for FY 2011 was \$2.164 billion and consisted primarily of approximately \$1.235 billion in flat-rate premiums, \$0.929 billion in variable-rate premiums, and \$0.202 billion in termination premiums, offset by a bad debt expense of \$0.207 billion. 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, 2012	September 30, 2011
Flat Rate Premium:		
Single-Employer	\$1,123	\$1,143
Multiemployer	<u>92</u>	<u>92</u>
Total Flat Rate Premium	1,215	1,235
Variable Rate Premium	1,495	929
Interest and Penalty Income	5	5
Termination Premium	33	202
Less Changes in the Allowance Reserve for Bad Debts for Interest, Penalties, and Premiums	<u>(14)</u>	<u>(207)</u>
<b>Total</b>	<u><b>\$2,734</b></u>	<u><b>\$2,164</b></u>
Single-Employer	\$2,623	\$2,077
Termination Premium	33	202
Less Changes in the Allowance Reserve for Bad Debts for Interest, Penalties, and Premiums	<u>(14)</u>	<u>(207)</u>
Total Single-Employer	<u>2,642</u>	<u>2,072</u>
Multiemployer	92	92
Less Changes in the Allowance Reserve for Bad Debts for Interest and Penalties	<u>0*</u>	<u>0*</u>
Total Multiemployer	<u>92</u>	<u>92</u>
<b>Total</b>	<u><b>\$2,734</b></u>	<u><b>\$2,164</b></u>

\* 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	2012 Changes in Prior Year Terminations	Total	New Terminations	2011 Changes in Prior Year Terminations	Total
Present value of future benefits	\$2,035	\$ (16)	\$2,019	\$ 2,363	\$ (206)	\$2,157
Less plan assets	1,027	228	1,255	1,173	175	1,348
Plan asset insufficiency	1,008	(244)	764	1,190	(381)	809
Less estimated recoveries	0	(39)	(39)	0	(3)	(3)
Subtotal	1,008 <sup>1</sup>	(205)	803	1,190 <sup>1</sup>	(378)	812
Settlements and judgments		1	1		1	1
Loss (credit) on probables	(150) <sup>2</sup>	1,352 <sup>3</sup>	1,202 <sup>4</sup>	(474) <sup>2</sup>	(138) <sup>3</sup>	(612) <sup>4</sup>
Total	\$ 858	\$1,148	\$2,006	\$ 716	\$(515)	\$ 201

<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 \$150 million at September 30, 2012, and \$474 million at September 30, 2011, 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

<i>(Dollars in millions)</i>	Single-Employer Program Sept. 30, 2012	Multiemployer Program Sept. 30, 2012	Memorandum Total Sept. 30, 2012	Single-Employer Program Sept. 30, 2011	Multiemployer Program Sept. 30, 2011	Memorandum Total Sept. 30, 2011
Fixed maturity securities:						
Interest earned	\$1,800	\$44	\$1,844	\$1,796	\$57	\$1,853
Realized gain	2,005	36	2,041	973	31	1,004
Unrealized gain	894	11	905	733	60	793
Total fixed maturity securities	4,699	91	4,790	3,502	148	3,650
Equity securities:						
Dividends earned	66	0	66	67	0	67
Realized gain	1,385	0	1,385	2,857	0	2,857
Unrealized gain (loss)	2,622	0	2,622	(3,200)	0	(3,200)
Total equity securities	4,073	0	4,073	(276)	0	(276)
Private equity:						
Distributions earned	27	0	27	27	0	27
Realized gain (loss)	81	0	81	(9)	0	(9)
Unrealized gain	(66)	0	(66)	126	0	126
Total private equity	42	0	42	144	0	144
Other income (loss)	(22)	0	(22)	76	0	76
Total investment income	\$8,792	\$91	\$8,883	\$3,446	\$148	\$3,594

## Note 14: Employee Benefit Plans

All permanent full-time and part-time PBGC 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.

The Corporation's contribution to the CSRS plan for both FY 2012 and FY 2011 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 11.7 percent of base pay for FY 2012, increased from 11.2 percent for FY 2011. 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 \$20 million in FY 2012 and \$19 million in FY 2011.

These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to PBGC 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,	
	2012	2011
Proceeds from sales of investments:		
Fixed maturity securities	\$70,055	\$73,641
Equity securities	6,120	9,113
Other/uncategorized	1,874	3,704
Memorandum total	\$78,049	\$86,458
Payments for purchases of investments:		
Fixed maturity securities	\$(69,841)	\$(77,935)
Equity securities	(6,681)	(4,144)
Other/uncategorized	(1,262)	(2,248)
Memorandum total	\$(77,784)	\$(84,327)



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

(Dollars in millions)	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30, 2012	2011	September 30, 2012	2011	September 30, 2012	2011
Net income (loss)	<b>\$(5,876)</b>	\$ (1,672)	<b>\$(2,467)</b>	\$(1,334)	<b>\$(8,343)</b>	\$(3,006)
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	<b>(6,958)</b>	(1,634)	<b>(46)</b>	(91)	<b>(7,004)</b>	(1,725)
Net gain (loss) of plans pending termination and trusteeship	<b>(27)</b>	23	<b>0</b>	0	<b>(27)</b>	23
Losses (credits) on completed and probable terminations	<b>2,006</b>	201	<b>0</b>	0	<b>2,006</b>	201
Actuarial charges (credits)	<b>14,874</b>	6,561	<b>0</b>	0	<b>14,874</b>	6,561
Benefit payments - trustee plans	<b>(5,333)</b>	(5,382)	<b>0</b>	0	<b>(5,333)</b>	(5,382)
Settlements and judgments	<b>0</b>	0	<b>0</b>	0	<b>0</b>	0
Cash received from plans upon trusteeship	<b>126</b>	36	<b>0</b>	0	<b>126</b>	36
Receipts from sponsors/non-sponsors	<b>114</b>	70	<b>0</b>	0	<b>114</b>	70
Amortization of discounts/premiums	<b>99</b>	100	<b>10</b>	10	<b>109</b>	110
Changes in assets and liabilities, net of effects of trustee and pending plans:						
(Increase) decrease in receivables	<b>(510)</b>	144	<b>0</b>	1	<b>(510)</b>	145
Increase in present value of nonrecoverable future financial assistance			<b>2,535</b>	1,445	<b>2,535</b>	1,445
Increase in unearned premiums	<b>(38)</b>	2	<b>(1)</b>	0	<b>(39)</b>	2
Increase (decrease) in accounts payable	<b>(8)</b>	(33)	<b>1</b>	0	<b>(7)</b>	(33)
Net cash provided (used) by operating activities	<b>\$(1,531)</b>	\$(1,584)	<b>\$ 32</b>	\$ 31	<b>\$(1,499)</b>	\$(1,553)

### Note 16: Litigation

Legal challenges to PBGC's policies and positions continued in FY 2012. At the end of the fiscal year, PBGC had 47 active cases in state and federal courts and 473 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. In addition to such recorded costs, PBGC estimates with a degree of certainty that possible losses of up to \$68 million could be incurred in the event that PBGC does not prevail in these matters.

### Note 17: Subsequent Events

Management evaluated subsequent events through publication on November 14, 2012, 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, 2012 and before the financial statements were available to be issued, that provided additional evidence about conditions that existed at September 30, 2012 have been recognized in the financial statements.

For the single-employer program, there was one nonrecognized subsequent event. Subsequent to September 30, 2012, business and financial conditions significantly declined for one controlled group that

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sponsors two single-employer plans (unfunded guaranteed liabilities of \$0.063 billion). Had these events occurred on or prior to September 30, 2012, PBGC's financial statements would have reflected an additional loss of \$0.063 billion resulting in an FY 2012 single-employer net loss of \$5.939 billion and an FY 2012 single-employer net position of \$(29.205) billion.

For the multiemployer program, there was one nonrecognized subsequent event. On November 5, 2012, PBGC received a formal notice of a mass withdrawal termination from a multiemployer plan, resulting in the present value of financial assistance of approximately \$0.127 billion as of September 30, 2012. Had this event occurred on or prior to September 30, 2012, PBGC's financial statements would have reflected an additional loss of \$0.127 billion, resulting in a FY 2012 multiemployer program net loss of \$2.59 billion and a FY 2012 multiemployer program net position of \$(5.36) billion.

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## Appendix A - Improper Payment Risk Assessment

### Introduction

The Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Office of Management and Budget's (OMB) implementing guidance (as implemented by OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments), requires Federal agencies to conduct a risk assessment of their programs and activities to identify programs that are susceptible to significant improper payments. OMB guidance provides that both qualitative and quantitative factors, including optional statistical sampling, can be used in making determination that a program is susceptible to significant improper payments. If a program is determined to be susceptible to significant improper payments, then a number of measures must be taken each year, including required statistical sampling to determine baseline error rates, development of improper payment target reduction rates, and development of formal corrective action plans. In compliance with Executive Order 13520, the PBGC Director serves as the agency accountable official for improper payment reporting purposes.

As a follow-up to the pilot risk assessment that PBGC conducted in FY 2011, PBGC formally assessed its programs, or payment streams, for improper payment risk for FY 2012. The purpose of the risk assessment was to determine whether any of PBGC's payment streams warranted classification as being susceptible to significant improper payment risk under the Step 1 risk assessment guidance detailed in OMB's Memorandum No. M-11-16, dated April 14, 2011 (this guidance excepted payroll and travel payments to employees and intragovernmental payments from assessment).

### Scope and Methodology

PBGC assessed its outgoing payment streams with the support of an international public accounting and consulting firm. The largest payment streams assessed included the following:

- 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, the risk assessment for each payment stream 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 the

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FY 2011 IPERA pilot risk assessment. From a quantitative perspective, we also considered whether PBGC's gross annual improper payments (i.e., the total amount of overpayments plus underpayments) within a payment stream would 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).

### *Supplemental Statistical Sampling*

As part of its Step 1 risk assessment, PBGC evaluated whether or not it would be appropriate to supplement its analysis with optional statistical sampling procedures as permitted by OMB guidance.

Regarding benefit payments and multiemployer plan financial assistance payments, PBGC determined that it was appropriate to apply statistical sampling procedures based on complexity of these two programs and consideration of other applicable risk factors.

Other payment streams, including payments to contractors, were not subjected to the optional statistical sampling procedures based on a consideration of the applicable risk factors, including the results of the FY 2011 pilot risk assessment.

### *Statistical Sampling Design*

Using information gained from the FY 2011 pilot risk assessment, PBGC updated the payment definitions and testing approaches to better focus on key payment processing elements. While not required under the Step 1 risk assessment procedures, PBGC sought and obtained OMB approval of its plan, including defining the FY 2012 reporting period for IPERA reporting purposes as those payments that were made during the last six months of FY 2011 and the first six months of FY 2012.

For the 12 months ended March 31, 2012, PBGC issued 7.9 million benefit payments totaling \$4.3 billion to participants in "final pay" status (this refers to those participants that had received a final benefit determination letter). During the same time period, PBGC issued 197 payments totaling \$104 million to eligible multiemployer pension plans.

In designing the sampling plans, PBGC followed OMB statistical sampling guidance regarding minimum sample sizes and took steps to ensure that the resulting samples would be representative of the payment populations being tested, including the use of sample stratification techniques. PBGC also briefed the OIG on its testing approaches and sampling plans for the two payment streams subjected to statistical sampling.

For benefit payments, a sample of 407 payments was tested representing a total of \$5.4 million, and for multiemployer plan financial assistance payments, a sample of 28 payments was tested representing a total of \$28 million.

### *Statistical Sampling Results*

As detailed further below, for both benefit payments and multiemployer plan financial assistance payments, the sampling projections of estimated improper payment rates were well under 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.

Details regarding both estimated gross (over payments and under payments added together) and net (under payments subtracted from over payments) improper payments (IP) from both a dollar value and a percentage perspective based on the statistical projections for each payment stream are presented below:

- a) The following charts present the statistical sampling results for benefit payments:

FY 2012 Estimated Net Improper Payments for Benefit Payments		
Payment Outlays	Net IP %	Net IP \$
\$ 4,320,646,788	0.83%	\$ 35,758,594

FY 2012 Estimated Gross Improper Payments for Benefit Payments <sup>1</sup>						
Payment Outlays	Gross IP %	Gross IP \$	Over-payments %	Over-payments IP \$	Under-payments %	Under-payments IP \$
\$ 4,320,646,788	0.95%	\$ 41,030,011	0.89%	\$ 38,394,303	0.06%	\$ 2,635,709

FY 2012 Estimated Gross Improper Payments for Benefit Payments by OMB Error Type				
OMB Error Type	Payment Outlays	Actual Gross Improper Payment \$ Noted	Estimated Gross Improper Payment %	Estimated Gross Improper Payment \$
Incorrect Amount	\$4,320,646,788	\$ 70,995.94	0.38%	\$ 16,225,767
Ineligible Recipient		\$ 892.10	0.30%	\$ 12,973,507
Lack of Documentation		\$ 1,505.48	0.57%	\$ 24,804,245
<b>All Issues Noted<sup>2</sup></b>		<b>\$ 72,501.42</b>	<b>0.95%</b>	<b>\$ 41,030,011</b>

<sup>1</sup> The “Gross IP %” figure represents the ‘gross improper payment rate’ and is calculated by dividing Gross IP \$ by the “Payment 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. Note: The ‘net improper payment rate’ or Net IP % is similarly calculated, except that numerator is the difference between gross overpayments and underpayments.

<sup>2</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.

- b) The following charts present the statistical sampling results for multiemployer plan financial assistance payments:

FY 2012 Estimated Net Improper Payments for Multiemployer Plan Financial Assistance		
Payment Outlays	Net IP %	Net IP \$
\$ 104,194,070.00	0.10%	\$ 104,382

FY 2012 Estimated Gross Improper Payments for Multiemployer Financial Assistance <sup>1</sup>						
Payment Outlays	Gross IP %	Gross IP \$	Over-payments IP %	Over-payments IP \$	Under-payments IP %	Under-payments IP \$
\$ 104,194,070	0.10%	\$ 104,382	0.10%	\$ 104,382	0.00%	\$ -

FY 2012 Estimated Gross Improper Payments for Multiemployer Plan Financial Assistance Payments by OMB Error Type				
OMB Error Type	Payment Outlays	Actual Gross Improper Payment \$ Noted	Estimated Gross Improper Payment %	Estimated Gross Improper Payment \$
Incorrect Amount	\$104,194,070	\$ 22,207.88	0.095%	\$ 99,061.12
Lack of Documentation		\$ 1,406.52	0.005%	\$ 5,320.35
All Issues Noted		\$ 23,614.40	0.100%	\$ 104,382.03

### Improper Payment Risk Assessment Conclusion

Based on the results of the Step 1 risk assessment of PBGC's payment streams for FY 2012, including the supplemental statistical sampling of benefit payments and multiemployer plan financial assistance payments, PBGC's payment streams are not susceptible to significant improper payment risk. PBGC informed OMB and OIG of the statistical sampling results prior to finalizing its improper payment reporting.

PBGC plans to re-assess its largest payment streams on a rotational basis, and will complete formal risk assessments of all payment streams no later than FY 2015. Further, PBGC will continue to monitor improper payment risks, on an ongoing basis, as part of regular operations, work to continue to improve payment documentation practices, and implement the Administration's Do-Not-Pay database initiative to conduct pre- and post-payment checks based on the plan PBGC submitted to OMB on August 28, 2012.



## 2012 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 2011.

### PRESENT VALUE OF FUTURE BENEFITS AND NONRECOVERABLE FINANCIAL ASSISTANCE - 2012

	Number of Plans	Estimated Number of Participants <i>(in thousands)</i>	Liability <i>(in millions)</i>
<b>I. SINGLE-EMPLOYER PROGRAM</b>			
A. Terminated plans			
1. Seriatim at fiscal year-end (FYE)	4,009	983	\$66,814
2. Seriatim at DOPT, adjusted to FYE	14	77	6,742
3. Nonseriatim <sup>1</sup>	424	330	30,500
4. Missing Participants Program (seriatim) <sup>2</sup>		22	59
Subtotal	4,447	1,412	\$104,115
B. Probable terminations (nonseriatim) <sup>3</sup>	6	82	7,686
Total <sup>4</sup>	4,453	1,494	\$111,801
<b>II. MULTIEMPLOYER PROGRAM</b>			
A. Pre-MPPAA terminations (seriatim)	10	*	\$ 1
B. Post-MPPAA liability (net of plan assets)			
1. Currently Receiving Assistance	41	76	1,388
2. Probable for Assistance	107	149	5,622
Total	158	225	\$7,011

\* 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 \$2,035 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 \$5,651 million. Thus, the net claims for probable terminations as reported in the financial statements are \$7,686 million less \$5,651 million, or \$2,035 million.
4. The PVFB in the financial statements (\$105,636 million) is net of estimated plan assets and recoveries on probable terminations (\$5,651 million), estimated recoveries on terminated plans (\$243 million), and estimated assets for plans pending trusteeship (\$271 million), or, \$111,801 million less \$5,651 million less \$243 million less \$271 million = \$105,636 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 4,009 plans, representing about 90 percent of the total number of single-employer terminated plans (70 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-the seriatim method. This was an increase of 69 plans over the 3,940 plans valued seriatim last year. For 14 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 2012.

For 424 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 liabilities from the plan's most recent actuarial valuation forward to the end of fiscal year 2012 using certain assumptions and adjustment factors.

For the actuarial valuation, PBGC used a select and ultimate interest rate assumption of 3.28% for the first 25 years after the valuation date and 2.97% thereafter. The mortality tables 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. 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 2011, the mortality table used for valuing healthy lives were the RP-2000 Combined Healthy Male and Female Tables, each projected 21 years to 2021 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.

## 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 148 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.

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## 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, 2012.

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; and (3) the resulting total liability represents my best estimate of anticipated experience under these programs.

I, Joan M. Weiss, 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.



Joan M. Weiss, FSA, EA

*Chief Valuation Actuary, PBGC*

*Member, American Academy of Actuaries*

*A complete actuarial valuation report, including additional actuarial data tables, is available at [www.pbgc.gov](http://www.pbgc.gov).*



## 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 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, 2012 and 2011. 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 audit guidance.

In their audit of PBGC's Single-Employer and Multiemployer Program Funds, 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 (including safeguarding assets) and compliance with laws and regulations and its operations as of September 30, 2012. 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.
- PBGC did not determine the fair market value of plan assets at the date of plan termination in accordance with the regulation established in Title 29 of the Code of Federal Regulation Part 4044.41(b) in certain instances.

The PBGC Annual Report includes other information such as management's discussion and analysis, improper payment assessment, actuarial valuation, and organizational wide data, in addition to the financial statements. CliftonLarsonAllen applied limited procedures to this data and is not providing an opinion or any assurance on the information.

CliftonLarsonAllen is responsible for the accompanying auditor's report dated November 14, 2012 and the conclusions expressed in the report. We do 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-2013-1 / FA-12-88-1) is also available on our website at <http://oig.pbgc.gov>.

Sincerely,

Rebecca Anne Batts  
Inspector General

November 14, 2012



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

## Independent Auditor's Report

In our audits of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC or the Corporation) for fiscal years (FY) 2012 and 2011, we found:

- The financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America (U.S.).
- PBGC did not have effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operations as of September 30, 2012.
- One instance of reportable noncompliance with selected provisions of laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our conclusions on other accompanying information; (3) management's responsibility for the financial statements; (4) our responsibility for the audit; and (5) management's comments and our evaluation.

## Opinion on the Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with accounting principles generally accepted in the U.S., the financial condition of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2012 and 2011, and the results of their operations and cash flows for the FYs then ended.

By law, PBGC's Single-Employer and Multiemployer Program Funds must be self-sustaining. As of September 30, 2012, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of \$29.14 billion and \$5.24 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 \$295 billion and \$27 billion, respectively. Management based the Single-Employer Program estimate on data for FYs ending in calendar year 2011 that was obtained from filings and submissions to the government and from corporate annual reports. A subsequent adjustment for economic conditions through September 30, 2012 has not been made,

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and as a result the exposure to loss for the Single-Employer Program as of September 30, 2012 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.

### **Opinion on Internal Control**

Because of the effect of the material weaknesses described below on the achievement of the objectives of the control criteria contained in the Federal Managers' Financial Integrity Act of 1982 (FMFIA) at 31 U.S.C. 3512(c) and (d), PBGC did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operations as of September 30, 2012.

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 deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

We identified certain deficiencies in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operation that we consider material weaknesses, and other deficiencies that we consider to be a significant deficiency. These material weaknesses adversely affected PBGC's ability to meet the internal control objectives listed in management's responsibility for the financial statements section of this report, or to meet Office of Management and Budget (OMB) criteria for reporting matters under FMFIA.

We consider the deficiencies in the following areas 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 a 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 deficiencies in the following area a significant deficiency:

4. Integrated Financial Management Systems

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PBGC protects the pensions of approximately 43 million workers and retirees in more than 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



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participants in covered private defined benefit pension plans in the U.S. 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.

BAPD manages the termination process for defined benefit plans, provides participant services (including calculation and payment of benefits) for PBGC-trusteed 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) and the Actuarial Services Division (ASD). 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 include underlying documentation used to support the calculation of benefit amounts for the participant and the pension liabilities recorded on PBGC financial statements. 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 TPDs, as well as mortality tables and interest rate factors, as key inputs to calculate pension plan liabilities recorded on PBGC's financial statements.

BAPD continues to have serious control weaknesses throughout the department. 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 increase significant risks to PBGC's operations, including accurate calculation of plan participants' benefits, accurate financial reporting and compliance with prescribed laws and regulations. In FYs 2012 and 2011, PBGC hired a contractor to perform a review of its programs and activities for improper payments in accordance with the Improper Payment Elimination and Recovery Act. In addition to identifying that actual improper payments occurred, the contractor found that the underlying documentation used to support the benefit payments was not always available. Similar documentation is used to support the actuarial calculations of PBGC pension plan liabilities and related expenses. During FY 2012, we continued to identify numerous deficiencies in BAPD controls that included inadequate documentation to support the calculation of participants' benefits and liabilities, errors in their liability calculations, and errors in valuing plan assets.

The establishment and implementation of the appropriate internal controls is 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 regulation 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 BAPD's senior leadership in the monitoring and response to such risks is warranted on a continuous basis.

In response to weaknesses previously identified above, BAPD continues to undergo a strategic review with the intention of addressing the organizational structure and operational issues. In FY 2012, BAPD hired a new Director and continued efforts to develop a plan to address the deficiencies noted in prior OIG financial statements and performance audit reports. PBGC intends the plan to focus on fundamental issues such as internal controls, processes, contractor oversight, training, and staff competencies.

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IT continues to be a challenge for management. The safeguarding of PBGC's systems and data is essential to protect PBGC's operations and mission. The OIG and others have consistently identified serious internal control vulnerabilities and systemic security control weaknesses in the IT environment over the last several years. PBGC's delayed progress in mitigating these deficiencies at the root-cause level continued to pose increasing and substantial risks to PBGC's ability to carry out its mission during FY 2012. Due to the persistent nature and extended time required to mitigate such vulnerabilities, additional risks threaten PBGC's ability to safeguard its systems. These risks include technological obsolescence, inability to execute corrective actions, breakdown in communications, and poor monitoring.

PBGC has made some progress in addressing IT security weaknesses at the root-cause level by continuing the implementation of its FY 2010 Enterprise Corrective Action Plan (CAP), and introducing additional reporting controls to track progress. Additional tracking controls include the Enterprise Plan of Action and Milestones (POA&M) and the Progress Status Reports on corrective actions. However, the current PBGC corrective action process was disjointed, with stove-piped responsibilities that did not provide a holistic view to inform key decision makers on progress made and resources needed to complete critical tasks. PBGC is in the process of improving its corrective action process to be more cohesive where the CAP will inform the POA&M which will, in turn, provide the Contracts and Control Review Department (CCRD) with the official status of corrective actions to be included in the Listing of Open OIG Recommendations.

The Corporation has also made progress in addressing the design of its infrastructure, account management, enterprise security management, and configuration management, but the control processes have not reached a level of maturity to prove their effectiveness. PBGC is implementing a disciplined and integrated approach to Configuration, Change, and Release Management (CCRM) Process & Procedures consistent with National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, Rev 3. The Corporation has also developed and is implementing additional policies and procedures; additional technical and configuration management tools are also being deployed. However, much remains to be done, and the pace of progress remains slow.

PBGC anticipated completing the assessment and authorization (A&A) process, formerly referred to as a certification and accreditation process, on the Corporation's major applications in FY 2012, but was unable to complete the process. The work on the A&As that has been performed through FY 2012 identified significant fundamental security control weaknesses in PBGC's general support systems, many of which were reported in prior year's audits and remain unresolved. We continued to find deficiencies in the areas of security management, access controls, configuration management, and segregation of duties. Control deficiencies were also found in policy administration, and the completion of A&A for all major applications.

PBGC developed an information security policy framework, including the *Information Security Policy* which is supported by standards, processes, procedures, and a guide published in June 2012, *The Office of Information Technology (OIT) Security Authorization Guide*. This *Guide* provides steps and templates for use in preparing and completing the Security Authorization and Assessment process which follows NIST 800-37. Also, the *Guide* provides a checklist to support OIT's review of submitted artifacts as evidence of controls implemented. PBGC is documenting the review process with the checklist. The new information security policy framework has not reached a level of maturity to determine its effectiveness. PBGC is still in the process of establishing an enterprise-wide continuous monitoring program; and deploying additional network management, monitoring and configuration tools in its environment.

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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 security control weaknesses create an environment that could lead to improper application of benefits to plan participations, inaccurate financial reporting, fraud, waste, and abuse.

Based on our findings, we are reporting that the deficiencies in the following areas constitute three material weaknesses for FY 2012:

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 2012:

4. Integrated Financial Management Systems

Detailed findings and recommendations follow.

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

BAPD is the core department within PBGC to maintain plan and participant information and to calculate plan benefits and related liabilities. BAPD's management and oversight function is a key component of the control environment in which its division managers and staff operates. The continuous deficiencies of the aforementioned function increase PBGC's operational and financial reporting risks.

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

During FY 2012, BAPD made errors in calculating the PVFB liability for some participants. ASD is primarily responsible for the calculation of the PVFB liability that is recorded on PBGC's financial statements, based on actuarial assumptions and methods. These calculation errors were primarily due to two reasons: (1) the actuarial liability factors were applied to incorrect or incomplete data inputs and (2) a plan's particular benefit provisions were not sufficiently reviewed to correctly calculate individual participants' PVFB liability. Specifically, BAPD's ASD used actuarial assumptions because the best available data was not updated into the applicable information system. For example, in some instances an actual date of birth was used to calculate a specific benefit but the estimated date of birth was entered into the applicable information system causing the calculation of the liability to be incorrect. In other instances, ASD incorrectly calculated certain liabilities of the participants using a single life annuity benefit plan provision instead of the joint and survivorship benefit. During our June 30 interim testing, we identified an error in the calculation of the participant liability for one large plan related to one of the plan's unique provisions. Management was not aware of this unique plan benefit and that it had been inappropriately excluded from the participants' liability calculations. This error required additional efforts by BAPD management to determine the underlying cause and to calculate an overall plan adjustment to PBGC's liability at September 30. Due to these errors noted during the interim period, we adjusted our year-end audit procedures to address the increased operational and financial reporting risks. Using a statistically based sampling technique, we noted approximately 13% of the samples tested in which the liability calculated

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for a plan participant was either overstated or understated. The projected value of the error to the entire PVFB liability of approximately \$106 billion at September 30, 2012, had an estimated range of approximately \$507 million understatement to \$875 million overstatement and a point estimate of \$185 million overstatement.

We also noted deficiencies in BAPD's maintenance of underlying documentation used to support the calculation of the PVFB. BAPD's TPDs are primarily responsible for maintaining the plan and participant files utilized to determine the benefit and liabilities amounts owed to plan participants. The information system that maintains the participant documentation such as birth certificates, marriage certificates, participant benefit applications, plan provisions, salary data, etc., is the Image Processing System (IPS). 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. We also noted that the documentation was not maintained in a single systematic manner and required herculean efforts by BAPD and other PBGC departments to locate and provide the documentation. The lack of appropriate documentation results in limited physical and financial reporting controls, and could lead to improper benefit payment and participant liability calculations by PBGC. Consequently, 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 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

Although BAPD has undertaken efforts to revalue assets for certain pension plans trusted by PBGC, internal control weaknesses in this area continue to merit focus. The fair market value of a pension plan's assets at the date of plan termination (DoPT) is an essential factor needed to determine the retirement benefit amounts owed to plan participants. The lack of BAPD's effective oversight and monitoring of contracted reviews over asset valuations continued to pose significant risks to the participants' benefit determinations. During FY 2012, BAPD hired contractors to perform revaluations of plan assets for some large plans which resulted in increased benefits owed to certain plan participants. BAPD management stated that a risk analysis is currently underway to determine which additional pension plans may have asset valuation misstatements and pose the greatest risks to the participants' benefit payments. This risk analysis was not complete at September 30, 2012. In addition, management has yet to finalize a quality control review process to verify and validate the satisfactory completion of contracted DoPT plan asset valuation audits, and to establish a detailed process to ensure the consistent application of a methodology to determine the fair market value of plan assets at DoPT at September 30, 2012.

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Additional weaknesses identified as part of the prior year financial statement audit stemmed from inadequate management of contractors, a condition that continues to exist. As previously discussed, these contractors perform critical functions such as the valuing of plan assets. Services provided by contractors should be subject to an effective system of internal controls. Management has not always fully considered the exposure and risk that contractors introduce into its environment. BAPD intended to develop corrective action plans in FY 2012 to focus on fundamental issues such as internal controls, processes, contractor oversight, and training and staff competencies. However, the development of these plans was still in progress at September 30, 2012.

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

Promptly correct the errors in its calculations identified by the auditors.

Develop and implement a comprehensive documentation retrieval system that clearly identifies the location of the participants' census data and benefit calculation elements in a systematic manner.

Update the technical reference guide used by ASD to document the procedures used to calculate the qualified pre-survivor annuity and deferred retirement ages.

Update current procedures to ensure that all plan provisions are considered in the calculation of the individual participant liability. The procedures should be documented in formal procedural manual and/or checklist.

Refine their current procedures for processing plans and uploading participant data in the Genesis database to ensure that the best available data is used to support benefit payments and IPV liabilities.

Modify the BAPD Operations Manual to explicitly incorporate policies and procedures to archive source records. The BAPD Operations Manual details the process of creating the participant database, but does not explicitly require the archival of source records.

Ensure that adequate documentation is maintained, which supports, substantiates, and validates benefit payment calculations by implementing proper monitoring and enforcement measures in compliance with approved policies and procedures.

Improve the training of persons tasked with the calculation and review of benefit determinations to ensure their skills are matched with the complexities of the tasks assigned.

Continue to implement procedures to verify that future contracts for plan asset valuations clearly outline expectations and deliverables in the statement of work.

Continue to develop a quality assurance program aimed to ensure that plan asset valuations meet the regulatory standard of determining fair market value based on the method that most accurately reflects fair market value.

Continue to enhance and formalize efforts to improve staff skills, whether federal or contractor, in planning the valuation reviews, understanding the risks, and developing appropriate scopes and procedures to support credible and reliable results.



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Identify those plans that might potentially have a pervasive misstatement to the financial statements if DoPT asset values were originally misstated. Management should then re-evaluate the DoPT asset values for those identified plans and consider the impact of any known differences on the financial statements.

## 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. Deficiencies persisted in FY 2012, which prevented PBGC from implementing effective security controls to protect its information from unauthorized access, modification, and disclosure. 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. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

An entity-wide information security management program is the foundation of a security control structure and 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.

In the *Federal Information Security Management Act of 2002*, Congress required each federal agency to establish an agency-wide information security program to provide security to the information and information systems that support the operations and assets of the agency, including those managed by a contractor or other agency. OMB Circular No. A-130, Appendix III, *Security of Federal Automated Information Resources*, requires agencies to implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated in general support systems and major applications.

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

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 the Corporation, including those managed by contractors or other federal agencies.

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 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

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disciplined and integrated approach through development of *Configuration, Change, and Release Management (CCRM) Process & Procedures* consistent with NIST 800-53, Rev 3. The Corporation has also developed and is implementing additional policies and procedures, including deploying technical and configuration management tools. Technical tools have been or are being deployed 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 Tiger Team focus on system scanning and vulnerability management, support PBGC's capability to carefully document and validate system vulnerabilities and also provide evidence as to the operating effectiveness of some technical common controls.

Access controls should be in place to consistently limit and detect inappropriate access to computer resources (data, equipment, and facilities); and monitor access to computer programs, data, equipment, and facilities. These controls protect against unauthorized modification, disclosure, loss, or impairment. Such controls include both logical and physical security controls to ensure that federal employees and contractors will be given only the access privileges necessary to perform business functions. Federal Information Processing Standards Publication (FIPS PUB) 200, *Minimum Security Requirements for Federal Information and Information Systems*, specifies minimum access controls for federal systems. FIPS PUB 200 requires PBGC's information system owners to limit information system access to authorized users.

Industry best practices, NIST SP 800-64, *Security Considerations in the System Development Life Cycle*, and other federal guidance recognize the importance of configuration management when developing and maintaining a system or network. Through configuration management, the composition of a system is formally defined and tracked to ensure that an unauthorized change is not introduced. Changes to an information system can have a significant impact on the security of the system. Documenting information system changes and assessing the potential impact on the security of the system, on an ongoing basis, is an essential aspect of maintaining the security posture. An effective entity-wide configuration management and control policy, and associated procedures, are essential to ensuring adequate consideration of the potential security impact of specific changes to an information system. Configuration management and control procedures are critical to establishing an initial baseline of hardware, software, and firmware components for the entity, and subsequently controlling and maintaining an accurate inventory of any changes to the system.

Inappropriate access and configuration management controls do not provide PBGC with sufficient assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction.

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

Develop and implement a coherent strategy for correcting IT infrastructure deficiencies and 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.



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#### 4. Integrated Financial Management Systems

The risk of inaccurate, inconsistent, and redundant data is increased because PBGC lacks a single integrated financial management system. The current system cannot be readily accessed and used by financial and program managers without extensive manipulation, excessive manual processing, and inefficient balancing of reports to reconcile disbursements, collections, and general ledger data.

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. The Circular states:

A financial system, hereafter referred to as a core financial system, is an information system that may perform all financial functions including general ledger management, funds management, payment management, receivable management, and cost management. The core financial system is the system of record that maintains all transactions resulting from financial events. It may be integrated through a common database or interfaced electronically to meet defined data and processing requirements. The core financial system is specifically used for collecting, processing, maintaining, transmitting, and reporting data regarding financial events. Other uses include supporting financial planning, budgeting activities, and preparing financial statements. Any data transfers to the core financial system must be: traceable to the transaction source; posted to the core financial system in accordance with applicable guidance from the Federal Accounting Standards Advisory Board; and in the data format of the core financial system.

OMB's Office of Federal Financial Management, *Core Financial System Requirements*, lists the following financial management system performance goals, outlined in the framework document, applicable to all financial management systems. All financial management systems must do the following:

- Demonstrate compliance with accounting standards and requirements.
- Provide timely, reliable, and complete financial management information for decision making at all levels of government.
- Meet downstream information and reporting requirements with transaction processing data linked to transaction engines.
- Accept standard information integration and electronic data to and from other internal, government-wide, or private-sector processing environments.
- Provide for "one-time" data entry and reuse of transaction data to support downstream integration, interfacing, or business and reporting requirements.
- Build security, internal controls, and accountability into processes and provide an audit trail.
- Be modular in design and built with reusability as an objective.
- Meet the needs for greater transparency and ready sharing of information.

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- Scale to meet internal and external operational, reporting, and information requirements for both small and large entities.

Because PBGC has not fully integrated its financial systems, PBGC's ability to accurately and efficiently accumulate and summarize information required for internal and external financial reporting is impacted. Many of the weaknesses include the lack of standard data classifications and common data elements, duplication of transaction entry and obsolete and antiquated technologies.

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 have either been abandoned (such as the suspension of work on the Premium and Practitioner System to replace PAS) or have been ineffective in leading to the integration of its financially significant systems. Unless PBGC develops and implements a well-designed IT architecture and infrastructure to guide and constrain modernization projects, it risks investing time and resources in systems that do not reflect the Corporation's priorities, are not well integrated, are potentially duplicative, and do not optimally support mission operations and performance.

To its credit, PBGC began to develop an overall strategy, but much work remains before the strategy can be completed and implemented. Specific steps PBGC has taken in FY 2012 include the following:

- Continued work on its Enterprise Target Architecture (ETA), which provides the road map for all PBGC system development and integration, including financial management system integration.
- Implemented interface enhancements for CFS, including the payroll interface modernization, procurement interface, travel interface, and invoice automation. These interfaces provide additional automated capabilities for CFS and reduce the amount of manual data inputs for certain transactions.

However, major work remains to be completed to provide PBGC with integrated financial management capabilities. PBGC plans to implement the Trust Accounting and FY File System (TAS) in January 2013 after completing the TAS user acceptance testing. TAS will replace the following existing financial applications: Portfolio Accounting and Management (PAM), FY File, Trust Interface System (TIS), and TIS Transfer. Additionally, TAS will have automated interfaces with the CMS, CFS, and IPVFB. Lastly, PBGC has identified future capabilities in its financial management to-be architecture including a procurement system and an online budgeting system.

PBGC's IT initiatives include further corrective actions through the implementation of TAS and the Premium and Practitioner System (PPS). Also during FY 2012, PBGC began the development of PPS. PPS will be fully integrated with the Oracle eBusiness Suite COTS solution used for PBGC's Consolidated Financial Systems, and will replace the PAS in December 2013.

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**Recommendation:** We recommend that management:

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

### **Report on Compliance and Other Matters**

Except as discussed below, our tests of PBGC's compliance with selected provisions of laws and regulations for FY 2012 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Title 29 of the Code of Federal Regulation (C.F.R.) Part 4044.41 Subpart (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."

As reported above in material weakness number one, we noted instances where PBGC failed to determine the fair market value of plan assets at DoPT as required by this regulation.

This conclusion is intended solely for the information and use of PBGC's OIG, Board of Directors, management of PBGC, Government Accountability Office, OMB, the U.S. Congress, and the President and is not intended to be and should not be used by anyone other than these specified parties.

### **Other Information**

The Chair's message, Director's message, annual performance report, summary of historical financial performance, financial statement highlights, management's discussion and analysis, management representation, improper payment assessment, actuarial valuation, letter of the inspector general, and organization contain a wide range of data, some of which is not directly related to the financial statements. We have applied certain limited procedures to this information in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### **Management's Responsibility for the Financial Statements**

PBGC's management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the U.S.; (2) designing, implementing and maintaining internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; (3) its assertion of the internal control over financial reporting is included in PBGC's FY 2012 Annual Report; and (4) complying with applicable laws and regulations.

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## Auditor's Responsibility

We are responsible for conducting our audit in accordance with standards generally accepted in the U.S.; the standards applicable to the financial audits and examination engagements contained in Government Auditing Standards, issued by the Comptroller of the U.S.; and OMB Bulletin 07-04. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the U.S.; and (2) management maintained effective internal control as of September 30, 2012 based on management's assertion included in PBGC's FY 2012 Annual Report and on the criteria contained in FMFIA, the objectives of which are the following:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with accounting principles generally accepted in the U.S., and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with applicable laws and regulations: Transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and government wide policies identified by OMB audit guidance.

We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and laws for which OMB Bulletin 07-04 requires testing and performing limited procedures with respect to certain other information appearing in PBGC's FY 2012 Annual Report.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessed the appropriateness of the accounting principles used and significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of PBGC and its operations, including its internal control related to financial reporting (including safeguarding of assets) and compliance with laws and regulations; (5) evaluated the effectiveness of the design of internal control; (6) tested the operating effectiveness of relevant internal controls over financial reporting (including safeguarding assets) and compliance, for the FY ended September 30, 2012; (7) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA; and (8) tested compliance for FY 2012 with selected provisions of certain laws and regulations. The procedures selected depend on the auditors' judgment, including our assessment of risks of material misstatement of the financial statements, whether due to fraud or error. We believe we obtained sufficient and appropriate audit evidence on which to base our opinion.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. 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 risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

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We did not test compliance with all laws and regulations applicable to PBGC. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements, and to those required by OMB Bulletin 07-04 that we deemed applicable to PBGC's financial statements for the FY ended September 30, 2012. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We considered the material weaknesses identified above in determining the nature, timing, and extent of our audit procedures on the 2012 financial statements.

### **Management Comments and Our Evaluation**

In commenting on the draft of this report (see page 111) of PBGC's FY 2012 Annual Report), PBGC's management concurred with the facts and conclusions in our report. We did not audit PBGC's written response and, accordingly, we express no opinion on it.



Calverton, Maryland  
November 14, 2012

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

Office of the Director

## MEMORANDUM

November 14, 2012

To: Rebecca Anne Batts  
Inspector General

From: Josh Gotbaum   
Director

Subject: Response to the Independent Auditor's Combined Audit Report on the  
FY 2012 Financial Statement Audit

Thank you for the opportunity to comment on the Office of Inspector General's FY 2012 combined audit report, including the opinions on PBGC's financial statements, internal controls, and compliance with laws and regulations.

Management appreciates the work your office performs in your oversight of this audit. As PBGC's work involves billions of dollars and affects millions of Americans, it is especially noteworthy that the Corporation has once again received an unqualified opinion on our financial statements for FY 2012.

We also recognize and concur with your opinion on internal controls. Management has already set the foundation and continues its work for addressing the three material weaknesses (benefits administration and payment department management and oversight, entity-wide security program planning and management, and access controls and configuration management) and the significant deficiency (integrated financial management systems) that were recognized as a result of prior audit work.

We are committed to addressing the findings in our corrective action plans and will keep you informed of our progress.

cc: Laricke Blanchard  
Patricia Kelly  
Alice Maroni  
Ann Orr  
Michael Rae  
Srividhya Shyamsunder  
Judith Starr  
Martin Boehm  
Theodore Winter

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## ORGANIZATION

### Board of Directors

Hilda L. Solis, *Chair*  
*Secretary of Labor*

Timothy F. Geithner  
*Secretary of the Treasury*

Rebecca M. Blank  
*Acting Secretary of Commerce*

### Executive Management

Josh Gotbaum  
*Director*

Laricke Blanchard  
*Deputy Director Policy*

Ann Orr  
*Chief of Staff*

Vacant  
*Deputy Director Operations*

Patricia Kelly  
*Chief Financial Officer*

Srividhya Shyamsunder  
*Acting Chief Information Officer*

Alice C. Maroni  
*Chief Management Officer*

Sanford Rich  
*Chief of Negotiations and Restructuring*

Judith R. Starr  
*General Counsel*

### Office of Inspector General

Rebecca Anne Batts  
*Inspector General*

Reports directly to the Board through its Chair

### Board Representatives

Phyllis C. Borzi  
*Assistant Secretary of Labor,*  
*Employee Benefits Security Administration*

Mary J. Miller  
*Under Secretary of the Treasury*  
*for Domestic Finance*

Vacant  
*Board Representative*  
*U.S. Department of Commerce*



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## Corporate Management

Jennifer Messina  
*Acting Director*  
Corporate Finance and  
Restructuring Department

Edgar Bennett  
*Director*  
Budget and Organizational  
Performance Department

Arthur S. Block  
*Director*  
Procurement Department

Martin O. Boehm  
*Director*  
Contracts and Controls  
Review Department

Diane Braunstein  
*Director*  
Quality Management  
Department

Cathy Kronopolus  
*Director*  
Facilities and Services  
Department

Arrie Etheridge  
*Director*  
Human Resources Department

Israel Goldowitz  
*Chief Counsel*  
Office of the Chief Counsel

John Greenberg  
*Chief Investment Officer*  
Corporate Investments  
Department

Salil Mehta  
*Director*  
Policy, Research and  
Analysis Department

Philip R. Langham  
*Director*  
Benefits Administration and  
Payment Department

John H. Hanley  
*Director*  
Legislative Department

Deborah Herald  
*Director*  
IT Infrastructure Operations  
Department

J. Jioni Palmer  
*Director*  
Communications and  
Public Affairs Department

Anand Kothari  
*Acting Director*  
IT & Business Modernization

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

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## **The PBGC Advisory Committee**

Appointed by the President of the United States

### ***Representing the Interests of the General Public***

David M. Strauss, *Chairman*  
Bismarck, North Dakota

Dallas L. Salisbury  
Washington, DC

Harry J. Wilson  
Scarsdale, New York

### ***Representing the Interests of Employers***

Cheryl Alston  
Frisco, Texas

Daralyn Peifer  
Minnetonka, Minnesota

### ***Representing the Interests of Employee Organizations***

David Blitzstein  
Washington, DC

Joyce Mader  
Washington, DC