



Testimony for the  
Committee on Health, Education, Labor and Pensions  
U.S. Senate

---

For Release at 10:00 AM EST  
Wednesday December 1, 2010

# **PBGC: Is Stronger Management and Oversight Needed?**

Testimony of

**Rebecca Anne Batts**

Inspector General  
Pension Benefit Guaranty Corporation

December 1, 2010

Chairman Harkin, Ranking Member Enzi, and Members of the Committee:

Thank you for inviting me here today to discuss the Pension Benefit Guaranty Corporation's (PBGC) oversight and management of its Single and Multi-employer Pension Insurance programs. PBGC protects the pensions of approximately 44 million workers and retirees in more than 27,500 private defined benefit pension plans. Under Title IV of the Employee Retirement Income Security Act of 1974, PBGC insures, subject to statutory limits, pension benefits of participants in covered private defined benefit pension plans. To accomplish its mission, PBGC relies extensively on the use of contractors and on information technology. 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.

## **IN SUMMARY**

My testimony today is essentially "good news" testimony. In some areas, focused attention by PBGC leadership has already resulted in effective corrective action; for example, during the past year, PBGC implemented OIG's specific recommendations to enhance privacy processes and also made additional improvements with the stated goal of making PBGC a model for handling of sensitive information. In other areas, much remains to be done and full implementation of corrective action may take years. Sustained management attention and oversight will be needed if PBGC is to fully implement its current plans to improve the effectiveness and integrity of its contracting practices. While PBGC has developed corrective action plans to address serious weaknesses in information technology security, execution of the plans is scheduled to take between three and five years and many critical details of the plans have yet to be developed. During the interim, careful review by those with oversight responsibility for PBGC will be needed to ensure that corrective action plans stay on track to completion.

## **BACKGROUND**

PBGC receives no funds from general tax revenues; instead PBGC is financed by insurance premiums paid by companies that sponsor defined benefit pension plans, investment income and assets from terminated plans. PBGC has been in a deficit position (where current and future commitments to participants exceed resources) for a number of years. Inadequate minimum contributions, inadequate insurance premiums, employer shift from defined benefit pension plans to defined contribution pension plans and insufficient funding of terminated plans are factors contributing to the deficit. Between the end of fiscal years 2008 and 2009, the deficit in PBGC's single-employer insurance program doubled in size from \$10.7 billion to \$21.1 billion. In FY 2010, the single-employer program's net position declined by \$.52 billion, increasing the program's deficit to \$21.59 billion.

PBGC currently pays monthly retirement benefits to over 800,000 retirees in 4,150 plans. Including those who have not yet retired and participants in multiemployer plans receiving financial assistance, PBGC is responsible for the current and future pensions of more than 1.4 million people.

## **THE PBGC OFFICE OF INSPECTOR GENERAL**

The PBGC Office of Inspector General provides an independent and objective voice that helps the Congress, the Board of Directors, and PBGC protect the pension benefits of American workers. Like all federal Offices of Inspector General, the PBGC Office of Inspector General is charged with providing leadership and recommending policies and activities designed to prevent and detect fraud, waste, abuse, and mismanagement; conducting and supervising independent audits and investigations; and recommending policies to promote sound economy, efficiency, and effectiveness. As Inspector General, I report directly to the PBGC Board of Directors, through the PBGC Board Chair; this reporting relationship has supported OIG's ability to audit and investigate the aspects of PBGC operations that pose the highest risks for fraud, waste, abuse, and mismanagement.

During the past two years, my office has conducted numerous independent audits and investigations pertaining to agency programs and operations, resulting in significant improvements and changes that ultimately serve to protect America's pensions. Many of the reports have been quite critical of PBGC, in some instances placing significant stress on the relationship between the Office of Inspector General and the Corporation. Nevertheless, the PBGC Board of Directors and PBGC have responded appropriately and professionally to implement many of the improvements recommended by the Office of Inspector General.

Our ongoing audit work addresses some of the most critical issues facing PBGC. We are in the process of applying for law enforcement authority and have begun the process of enhancing the nature and sophistication of the investigations we conduct. Recent cases accepted by United States Attorney's Offices include significant issues such as complex multi-employer pension plan fraud. We are performing some of our investigations in concert with other agencies, including the Department of Labor OIG Office of Labor Racketeering and Fraud, and other federal, state, and local law enforcement agencies.

Over the last 5 years, we have issued 52 reports addressing PBGC's oversight of its programs and made 359 recommendations for improvement or recovery of questioned costs. Although PBGC has responded positively to many of our recommendations, 176 recommendations, contained in 40 different reports, remain open as of today.

## **THE STATUS OF PBGC ACTIONS TO IMPLEMENT OIG RECOMMENDATIONS**

The following are examples of some of PBGC's recent accomplishments in responding to OIG recommendations, as well as areas where additional oversight and management attention are needed.

### **PBGC took action to protect sensitive and personally identifiable information.**

Last spring my office reported concerns with PBGC's privacy program. By law, PBGC has an affirmative responsibility to protect the confidentiality, integrity, and availability of personally identifiable information. PBGC's mission requires the collection, storage and transmittal of a great deal of personally identifiable information, such as the names, social security numbers, and earning histories of workers in trusteed plans. In March 2010, we reported that PBGC's

Privacy Office did not properly monitor its privacy processes for quality and compliance. Further, PBGC's process for reporting personally identifiable information events was inaccurate and unverifiable. Technical controls (e.g., encryption of laptop computers) required strengthening.

To their credit, the Corporation took immediate measures to begin addressing reported concerns. Some actions directly addressed OIG's recommendations; for example, specific guidance and procedures were developed for privacy staff to follow in reporting to the United States Computer Emergency Readiness Team (US-CERT) security incidents involving the disclosure of personally identifiable information. PBGC's actions went well beyond the specific recommendations included in OIG's report. PBGC reexamined its privacy program with the stated intention of making PBGC a model for handling sensitive information and surveyed other federal agencies to identify best practices. The Privacy Office then developed and implemented key guidance, including detailed record keeping instructions and a requirement that all incidents involving personally identifiable information be reported to US-CERT within one hour of discovery. The guidance was widely disseminated via email to all PBGC employees and contractors with PBGC email accounts, as well as to the contract service providers that handle or access personally identifiable information at contractor facilities. PBGC followed up by giving in-person training on privacy protection standards and reporting requirements to those PBGC employees and contractors (e.g., staff at Field Benefit Administration sites) who frequently handle sensitive information.

Earlier this fall, we reviewed PBGC's corrective actions related to PBGC's privacy program. Our testing showed that our recommendations in this important area had been effectively implemented. The Corporation's positive reaction to OIG's findings increased the likelihood that PBGC will be able to properly protect the personally identifiable information and other sensitive data with which it has been entrusted.

### **PBGC initiated actions to protect its securities on loan to other investors.**

Securities lending is a small but important component of PBGC's overall investment program and is intended to obtain incremental investment return. As of September 30, 2010, PBGC had about \$21 billion in securities available for lending; of this amount, about \$5.7 billion in securities was actually on loan. OIG's review of PBGC's Securities Lending Program disclosed the general absence of written guidance at all levels and little documentation of the procedures used to implement, monitor, and oversee the program. Further, we reported that PBGC was unable to independently validate that the gross and net revenues earned through the program were correctly calculated by the bank with custody of PBGC's loaned assets. Upon issuance of our report, representatives of the PBGC Board of Directors and PBGC leadership responded promptly and corrective actions were initiated.

PBGC is making progress in the implementation of the sixteen recommendations included in OIG's report. For example, PBGC has developed and is testing a method to validate the amount of revenue earned through securities lending. That is, PBGC will soon be capable of "checking" the calculations of its custodian to ensure the Corporation receives the full amount of earnings to which it is entitled. Reducing PBGC's dependence on the custodial bank is an important step. Further, PBGC is in the process of implementing a number of internal controls intended to

provide effective oversight and monitoring of the securities lending program. OIG continues to work diligently to support PBGC in its ongoing efforts develop needed controls over this complex investment practice.

At the time of our review, written policies regarding the securities lending program were virtually non-existent. PBGC has begun the arduous process of drafting written policy guidance regarding the establishment, investment objectives, risk tolerance, and measurement standards and operations of the securities lending program. We have worked closely with PBGC, reviewing several iterations of PBGC's draft documents and offering suggestions and edits. Because the PBGC Board has the authority and responsibility for establishing and overseeing the investment policy and its implementation, the securities lending guidelines proposed in our report should be submitted to the Board and Board Representatives for review. Our recommendations for guidance will not be considered complete until this has been done.

### **PBGC is working toward protection of the Corporation's ability to carry out its mission through the use of information technology**

OIG has focused much of its recent audit work on the serious weaknesses in PBGC's information technology practices that pose increasing and substantial risks to PBGC's ability to carry out its mission. For the past two years, PBGC's annual financial statement audit included an adverse opinion on internal control, based in part on systemic information technology security control weaknesses. A report on PBGC compliance with the Federal Information Security Management Act described PBGC's information systems as "a series of stovepipe solutions built upon unplanned and poorly integrated heterogeneous technologies with varying levels of obsolescence."

The operations of PBGC are heavily dependent on information technology. During the summer of 2008, shortly after I became Inspector General at PBGC, I learned that PBGC frequently dismissed OIG's concerns about information security. The auditors and investigators in my office worked hard to demonstrate the need to enhance attention to this crucial area. In the fall of 2009, we gave PBGC senior leadership a restricted disclosure presentation on the results of penetration testing conducted to discover weaknesses and to exploit discovered vulnerabilities. After our presentation, new leadership was assigned to enhance PBGC's security posture and to develop a long-term corrective action plan to address long-standing issues. Importantly, PBGC committed to build and manage security controls to an appropriate National Institute of Standards and Technology (NIST) standard. Further, PBGC made the decision to enter into an interagency agreement with the Bureau of Public Debt to leverage its expertise in security control. PBGC is beginning to actively address serious information technology issues and the substantial risks they pose for PBGC's ability to carry out its mission.

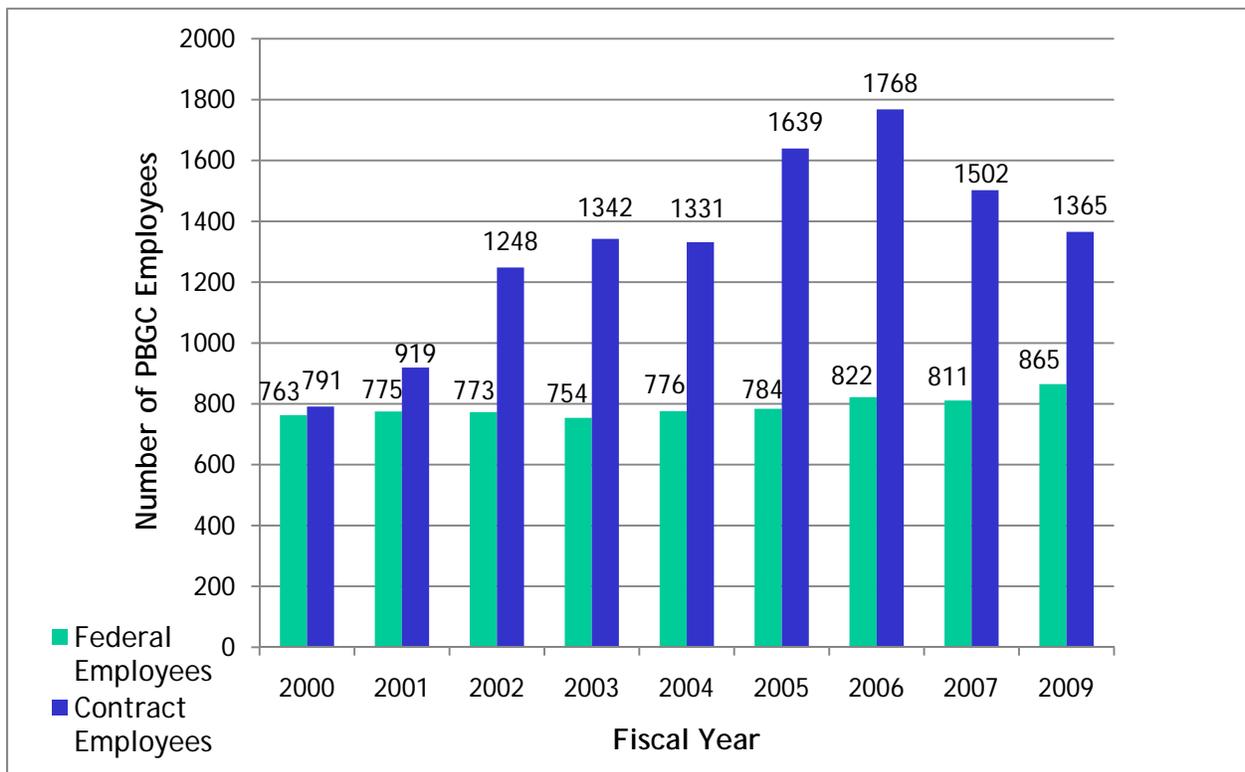
The Corporation has embarked on a coherent approach to resolving and correcting fundamental information technology weaknesses. PBGC has developed and is implementing multi-year corrective action plans to address security issues at the root cause level. The corrective action plans are an important first step that reflects the priority that PBGC leadership places on this critical issue. However, PBGC's realistic assessment is that a timeframe of between three and

five years is needed to achieve the objectives of the PBGC's plans. According to PBGC's schedule, corrective action for many of OIG's recommendations will not be complete until 2015.

Current PBGC leadership has been straightforward in acknowledging the challenges it faces in revitalizing PBGC's information technology processes. Implementing the corrective action plans will be difficult and time-consuming. Some of PBGC's challenges, like the continuous stream of new and ever-changing federal requirements, are shared by all federal entities. Others are unique to PBGC. For example, PBGC still has an acting Chief Information Officer, PBGC system security expertise is still maturing, and trust-building is still a work-in-process for the office that manages PBGC's information technology. Strong leadership and effective, persistent oversight, from within the organization as well as from the outside, will be needed if PBGC is to ensure the security of the information technology systems that support the PBGC mission.

**PBGC must ensure the integrity of the contracting process.**

PBGC relies heavily on the services of contractors to carry out its operations, a factor that makes procurement and contracting a significant PBGC activity. PBGC reports spending about two-thirds of its annual operating budget through contracts. Historically, nearly two of every three people who do the work of PBGC are contract employees, as shown by the following table. Thus, ensuring that contractors provide the goods and services for which they are paid is critical to PBGC's ability to meet its mission.



OIG continues to devote a significant portion of its resources to audits, investigations, and reviews of PBGC's procurement and contracting activities. Forty-three open audit recommendations relate to PBGC's contracting practices; some have remained open for more than five years without effective resolution. Many of the most critical issues we are currently

addressing have been caused or exacerbated by poor contract management. Our ongoing monitoring also shows a continued need for close management attention in this area.

While PBGC places tremendous reliance on its contractors, the Corporation has experienced serious and costly problems with the quality and utility of some of the contract deliverables for which it paid. Many of these issues could have been avoided through effective contract management, including careful contract monitoring, acceptance of deliverables and evaluation of contractor performance. PBGC senior leadership also needs to reinforce the idea that allowing a contractor to provide a deliverable of a lesser quality than called for in a contract constitutes a form of waste or abuse, if not outright fraud.

PBGC has recently committed to taking a number of important actions to improve the effectiveness of its contracting activities. For example:

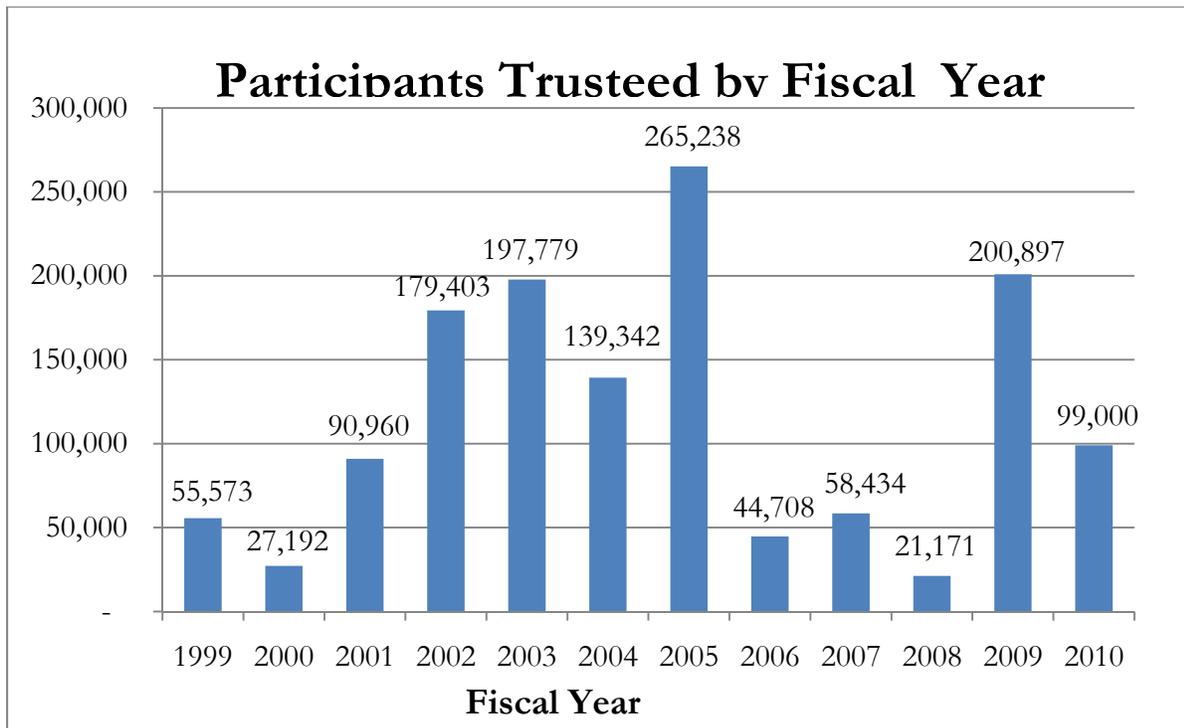
- Our on-going reviews of two of the largest Single Employer program claims in PBGC's history show that a PBGC contractor did not exercise due professional care in performing audits of plan assets and of plan participant information. PBGC's oversight of the contractor was ineffective in identifying obvious and material errors and omissions in the work. To its credit, PBGC leadership is taking action to address the issues, including (1) contracting for a Certified Public Accounting (CPA) firm to re-perform the work related to these two plan sponsors' pension plans; (2) developing a plan for how contractor work will be monitored, evaluated, and accepted; and (3) reviewing plan asset evaluations completed over the last two years, with the objective of using identified deficiencies to train reviewers and staff and to update procedures.
- In response to our audit recommendations, PBGC developed a set of Standard Operating Procedures (SOP) to guide procurement activities and establish basic internal controls over the contracting process. Based on our review of the document, the SOPs form a useful "first step" toward improving procurement effectiveness. However, PBGC leadership needs to develop a method to determine the degree to which those with responsibility for contracting are complying with the new procedures and to make any necessary corrections or adjustments as needed.
- During the course of a recent evaluation, we became aware of a reduction in the minimum qualifications for contract staff at some of PBGC's remote sites. There was no indication that PBGC sought reduced rates when staff with lesser qualifications were provided or that PBGC confirmed the contractors' assertions that fully qualified staff could not be retained. Based on our discussions with PBGC management, the Corporation solicited a contractor to provide a thorough and objective assessment of PBGC practices associated with the acquisition, planning and contract administration for the remote site contracts. The resulting report, issued on October 29, 2010, confirmed our initial observations and made fourteen recommendations for improvement in PBGC's contract modification process. PBGC leadership has committed to implementing the report's recommendations.

- **OIG has repeatedly expressed the need for PBGC to be more vigilant about the integrity and effectiveness of its contracting processes.** A special team led by the Chief Financial Officer and the General Counsel was established to assist the Procurement Department in responding to open audit recommendations and in enhancing PBGC’s ability to contract effectively and in compliance with relevant guidance. As a result, many long-standing recommendations have been closed and others are nearing completion. Additionally, plans have been made to review the actions of the contracting officer’s technical representatives and the technical monitors who provide day-to-day monitoring and supervision of PBGC’s contractors. PBGC leadership should ensure that these reviews are carried out carefully and that necessary corrective actions are taken if the reviews show a lack of compliance with established contracting practices.

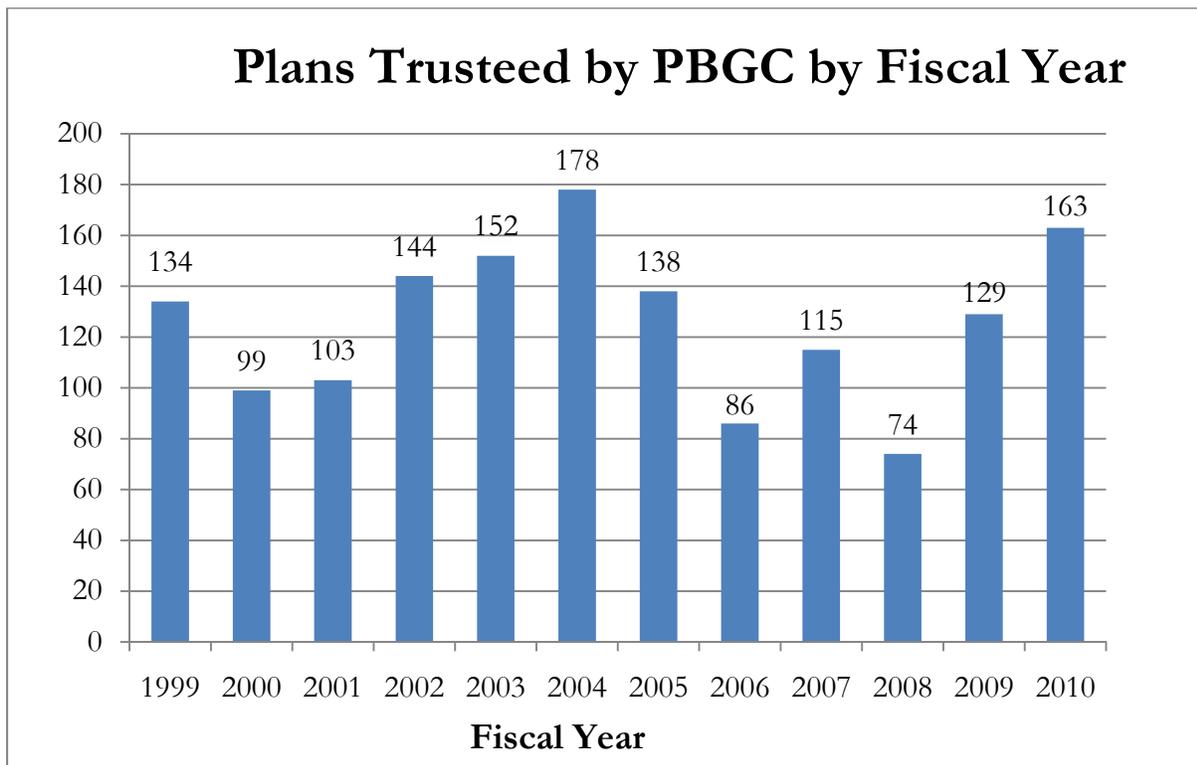
**PBGC should prepare strategically for the possibility of a workload surge.**

In response to a request from the Chairman of the Senate Special Committee on Aging, OIG reviewed PBGC’s planning efforts to strategically prepare for the potential influx of pension plans. In our report, issued last month, we explained our conclusion that PBGC needs to develop specific strategies and tactics to be used in the event of a serious workload surge.

The recent global economic downturn caused financial hardships for many businesses in a number of different sectors, which directly impact PBGC’s operations and forecasting. The risk of numerous pension plans simultaneously terminating could cause a domino effect requiring PBGC to assume a large number of participants in a short period of time. Conversely, if the economy is strong, PBGC may only assume twenty or forty thousand participants in a given year (see the chart below).



The number of plans that PBGC assumes on a year-to-year basis fluctuates based on numerous factors, mainly the economic strength of the country. PBGC experienced an influx of pension plans from FY 2002-2005, when PBGC became responsible for paying more than 700,000 participants from plans that were terminated and trustee, primarily from the airline and steel industries (see the chart below). PBGC is experiencing one of the busiest periods in its history. In FY 2009, PBGC terminated and trustee 129 plans with more than 200,000 participants. During FY 2010, PBGC assumed responsibility for 99,000 additional workers and retirees in 163 failed plans.



The Government Accountability Office lists PBGC on its High Risk list, in part, because PBGC continues to be “exposed to the threat of terminations of large underfunded pension plans sponsored by financially weak firms.” PBGC acknowledged in its FY 2010 Annual Report issued last month that no reasonable estimate could be made of 2011 terminations.

The future is difficult to predict. The uncertainty about 2011 termination, when considered together with the exposure noted by GAO, provides sufficient reason for PBGC to expand and enhance its planning for possible workload surges.

To date, the Corporation has generally kept its planning activities simplistic and linear. PBGC executive leadership explained their belief that a “playbook” approach, explicitly detailing the steps to be taken, was impractical. To their view, because a workload surge could take many varied and unpredictable forms, the only practical option was reliance on the Corporation’s

ability to develop and implement an “ad hoc” approach, in the event that a workload surge materialized. Based on our review, we identified a number of specific activities the Corporation could take to enhance its readiness in the event of a workload surge. These activities could be best implemented as part of an overall strategic plan, an approach that we consider to be a best practice. However, even in the absence of a comprehensive Workload Surge Strategy Plan, implementing the recommendations in our report would help position the Corporation to deal with a significant workload surge.

The Chief Operating Officer responded to our report, noting PBGC’s conclusion that the risk of a large influx of plans is much lower now than anticipated in fiscal year 2009. Further, his response stated management’s belief that the resources needed to address the report’s recommendations would be better used in other higher priority areas. Accordingly, instead of implementing OIG’s recommendations as written, PBGC proposed the creation of a Large Influx Working Group (LIWG) Planning Document as a basis for alternative actions to address the recommendations. We will need to review the planning document PBGC proposes to draft before we can determine whether PBGC’s proposed approach adequately addressed the report’s findings.

## **CONCLUSION**

We recognize PBGC’s progress in addressing numerous high priority areas and support its efforts to address our related recommendations. Considering the organization-wide impact of the information technology security issues and the weaknesses in contracting practices, PBGC leadership and those with oversight responsibility should target their oversight efforts on the effective execution of the corrective action plans that have been developed. Additionally, for critical weaknesses that cannot be addressed in the near future, interim measures should be developed and adopted to minimize the associated risks. OIG will continue our monitoring activities until PBGC demonstrates that it has been fully responsive to our recommendations. In addition, we plan future audit work in the areas of highest risk to validate the effectiveness of PBGC corrective actions.

Mr. Chairman, that concludes my remarks. I would be happy to answer any questions that you or other member of the committee may have.



Testimony for the  
Committee on Health, Education, Labor and Pensions  
U.S. Senate

---

For Release at 10:00 AM EST  
Wednesday December 1, 2010

# **PBGC: Is Stronger Management and Oversight Needed?**

Testimony of

**Rebecca Anne Batts**

Inspector General  
Pension Benefit Guaranty Corporation

December 1, 2010