



Pension Benefit Guaranty Corporation

***Office of Inspector General***

Audit Report

**Audit of the Pension Benefit Guaranty Corporation's  
Fiscal Year 2011 and 2010 Financial Statements**

***November 14, 2011***

***AUD-2012-1/FA-11-82-1***



# 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 Clifton Gunderson 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, 2011 and 2010. 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, Clifton Gunderson 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, 2011. Serious internal control weaknesses in PBGC's programs and operations resulted in three material weaknesses: (1) entity-wide security program planning and management, (2) access controls and configuration management, and (3) Benefits Administration and Payment Department operations. A significant deficiency was also identified in integrated financial management systems.
- PBGC did not determine the fair market value of plan assets at the date of plan termination in accordance with the regulation established at Title 29 of the Code of Federal Regulation Part 4044.41(b) in certain instances.

Clifton Gunderson is responsible for the accompanying auditor's report dated November 14, 2011 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-2012-1 / FA-11-82-1) is also available on our website at <http://oig.pbgc.gov>.

Sincerely,

Rebecca Anne Batts  
Inspector General  
November 14, 2011

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## Acronyms

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A&A	Assessment and Authorization
BAPD	Benefits and Payment Department
CFR	Code of Federal Regulations
CFS	Consolidated Financial System
ETA	Enterprise Target Architecture
FIPS PUB	Federal Information Processing Standards Publication
FMFIA	Federal Managers' Financial Integrity Act of 1982
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act
IT	Information Technology
IPVFB	Integrated Present Value of Future Benefits
NIST SP	National Institute of Standards and Technology Special Publication
OFFM	OMB Office of Federal Financial Management
OIG	Office of Inspector General
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation
TAS	Trust Accounting System
U.S.C.	United States Code

Audit of the Pension Benefit Guaranty Corporation's  
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**Section I**

**Independent Auditor's Report**

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) 2011 and 2010, 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.
- 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, 2011.
- Reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions, (2) our conclusions on other accompanying information, (3) our audit objectives, scope, and methodology, and (4) management comments and our evaluation.

### **Opinion on Financial Statements**

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2011 and 2010, 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, 2011, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of \$23.27 billion and \$2.77 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 \$227 billion and \$23 billion, respectively. Management based the Single-Employer Program estimate on data for FYs ending in calendar year 2010 that was obtained from filings and submissions to the government and from corporate annual reports. A subsequent adjustment for economic conditions through September 30, 2011, has not been made and as a result the exposure to loss for the Single-Employer Program as of September 30, 2011 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, 2011.

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 significant deficiencies. These material weaknesses adversely affected PBGC's ability to meet the internal control objectives listed in the objectives, scope, and methodology section of this report, or meet Office of Management and Budget (OMB) criteria for reporting matters under FMFIA.

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

1. Entity-wide Security Program Planning and Management
2. Access Controls and Configuration Management
3. Benefits Administration and Payment Department Operations

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 more than 44 million workers and retirees in more than 27 thousand private defined benefit pension plans. Under Title IV of the Employee Retirement Income Security Act of 1974, PBGC insures, subject to statutory limits, pension benefits of participants in covered private defined benefit pension plans in the United States. To accomplish its mission and prepare its financial statements, PBGC relies extensively on information technology (IT) and the effective operation of the Benefits Administration and Payment Department (BAPD). Internal controls over these operations are essential to ensure

the confidentiality, integrity, and availability of critical data while reducing the risk of errors, fraud, and other illegal acts.

The slow progress of mitigating PBGC's systemic security control weaknesses and the serious internal control weaknesses in BAPD posed an increasing and substantial risk to PBGC's ability to carry out its mission during FY 2011. The extended time required and the lack of meaningful progress in PBGC's multiyear approach to correct previously reported deficiencies at the root cause level, introduced additional risks. These include technological obsolescence, inability to execute corrective actions, breakdown in communications and poor monitoring. BAPD's weak internal controls create an environment that could lead to fraud, waste, and abuse.

PBGC's historical decentralized approach to system development and configuration management exacerbated control weaknesses and encouraged inconsistency in implementing strong technical controls and best practices. The influx of 620 plans for over 800,000 participants from 2002-2005 contributed to PBGC's disjointed IT development and implementation strategy. The mandate to meet PBGC's mission objectives by implementing technologies to receive the influx of plans superseded proper enterprise planning and IT security controls. The result was a series of stovepipe solutions built upon unplanned and poorly integrated heterogeneous technologies with varying levels of obsolescence.

The Corporation continued its implementation of an enterprise multi-year corrective action plan (CAP) to address IT security issues at the root cause level. PBGC management realizes these weaknesses will continue to pose a threat to its environment for several years while corrective actions are being implemented. PBGC needs to implement interim corrective actions to ensure fundamental security weaknesses do not worsen as the CAP is being implemented.

PBGC performed a more rigorous and thorough assessment and authorization (A&A) process, formerly referred to as a certification and accreditation process. This process identified significant fundamental security control weaknesses for its general support systems, many of which were reported in prior year's audits. These weaknesses remain unresolved. PBGC reports that the Corporation is in the process of performing A&As on its major applications.

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 A&As.

An effective entity-wide security management program requires a coherent strategy for the architecture of the IT infrastructure, and the deployment of systems. The implementation of a coherent strategy provides the basis and foundation for the consistent application of policy, controls, and best practices. PBGC first needs to develop and implement a framework to improve its security posture. This framework will require time for effective control processes to mature.

Additionally, serious internal control weaknesses in the BAPD's operations were identified by the Office of the Inspector General (OIG) and others during FY 2011. These significant control weaknesses introduced additional risks to PBGC. Specific deficiencies included errors in valuation of plan assets, lack of documentation supporting benefit payments, errors in benefit calculations, and poor oversight of the Pension and Lump Sum System (PLUS). In response to weaknesses identified by OIG, BAPD is currently undergoing a strategic review that may address organizational structure and operational issues. BAPD stated it will develop a plan in

FY 2012 that will address the deficiencies noted in the financial statement audit, Improper Payments Elimination and Recovery Act (IPERA) mandated review, and other internal reviews. This plan is intended to focus on fundamental issues such as internal controls, processes, contractor oversight, and training and staff competencies.

Based on our findings, we are reporting that the deficiencies in the following areas constitute three material weaknesses for FY 2011:

1. Entity-wide Security Program Planning and Management
2. Access Controls and Configuration Management
3. Benefits Administration and Payment Department Operations

We are also reporting the deficiencies in the following area to be a significant deficiency for FY 2011:

4. Integrated Financial Management Systems

Detailed findings and recommendations follow.

## **1. Entity-wide Security Program Planning and Management**

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 continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Through the Federal Information Security Management Act of 2002, Congress requires 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.

PBGC continued the implementation of its CAP to address fundamental weaknesses in its entity-wide security program planning and management. During FY 2011 PBGC began the implementation of a more rigorous and thorough A&A process. Through this process PBGC identified significant fundamental security control weaknesses for its general support systems, many of which were reported on in prior years' audits. While this is an important step in the planning process, these security control weaknesses remain unresolved and PBGC's efforts lack sufficient meaningful incremental progress. PBGC reports that they are in the process of performing A&As on its major applications. The slow rate of progress has introduced additional risks including technological obsolescence, inability to execute corrective actions, breakdown in communications and poor monitoring.

In prior years, PBGC's entity-wide security program lacked focus and a coordinated effort to adequately resolve control deficiencies. These deficiencies, which continue to persist,



prevent 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.

***Recommendations:***

PBGC management should continue to 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.

PBGC should accelerate the rate of meaningful progress in mitigating the Corporation's systemic security control weaknesses, and address the additional risks of technological obsolescence, inability to execute corrective actions, breakdown in communications and poor monitoring.

PBGC management should effectively communicate to key decision makers the state of its IT infrastructure and environment to facilitate the prioritization of resources to address fundamental weaknesses.

## **2. 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 historical 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. Furthermore, PBGC's information systems are overlapping and duplicative, employing obsolete and antiquated technologies that are costly to maintain. The state of PBGC's IT environment led to increased IT staffing needs, manual workarounds, reconciliations, extensive manipulation, and excessive manual processing that have been ineffective in providing adequate compensating controls to mitigate system control weaknesses.

Access controls should be in place to consistently limit and detect inappropriate access to computer resources (data, equipment, and facilities), or 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, National Institute of Standards and Technology (NIST) special publication (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:***

PBGC management should 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.

**3. Benefit Administration and Payment Department Operations**

BAPD had serious internal control weaknesses identified by OIG and others during FY 2011 that introduced additional risks to PBGC. Specific deficiencies included errors in valuation of plan assets, lack of documentation supporting benefit payments, errors in benefit calculations, and poor oversight of PLUS. In response to weaknesses identified by OIG, BAPD is currently undergoing a strategic review that may address organizational structure and operational issues. BAPD stated it will develop a plan in FY 2012 that will address the deficiencies noted in the financial statement audit, IPERA mandated review, and other internal reviews. This plan is intended to focus on fundamental issues such as internal controls, processes, contractor oversight, and training and staff competencies.

Internal control weaknesses were pervasive throughout BAPD; however, many of the weaknesses identified as part of our financial statement audit stemmed from poor management of contractors. Effective oversight requires good communications with contractors on their responsibilities for contract compliance and providing timely information to PBGC that may affect the controls and/or PBGC's environment. Contracted services are an extension of PBGC's internal controls. PBGC's management does not always consider the exposure and risk that contractors introduce into its environment and how to manage that risk. PBGC does not properly review, assess, and monitor contractor's internal controls related to contracted services.

During FY 2011 we noted deficiencies in BAPD's oversight of contracted reviews of asset values at the date of plan termination (DoPT). These deficiencies were caused by a failure to establish and apply a quality review process to verify and validate the satisfactory completion of contracted DoPT plan asset valuation audits, and a failure to establish a detailed process to ensure the consistent application of a methodology to determine the fair market value of plan assets at DoPT as required by regulation.

We noted deficiencies in BAPD's oversight of the benefit payment determination and disbursement processes. These deficiencies included failures to maintain sufficient documentation necessary to verify the accuracy of benefit payments, and to document appropriate review and approval of benefit payment calculations; and improper benefit determinations resulting in errors in benefits paid.

We also noted deficiencies in BAPD's oversight of the service provider for the PLUS application. These deficiencies included a lack of an executed document between PBGC and the service provider regarding the service provider's responsibilities and security requirements for PLUS; a lack of review by BAPD over the service provider personnel's access to the PLUS system to ensure the personnel were appropriately recertified; a lack of review by BAPD of the PLUS System Contingency Plan to assess the plan's compliance with NIST SP 800-34 requirements; and an inadequate assessment of security risks associated with operations performed in a foreign country.

***Recommendations:***

PBGC should develop and implement procedures to ensure that future contracts for plan asset valuations clearly outline expectations and deliverables in the statement of work, that plan asset valuations meet the regulatory standard of determining fair market value based on the method that most accurately reflects fair market value, that the results of valuation reviews are credible and reliable, and that errors in benefit determinations caused by deficiencies in plan asset valuations are identified and corrected.

PBGC should develop and adopt explicit requirements to obtain and archive source documents, as well as a process to monitor and enforce these requirements to ensure documentation is maintained to support benefit payments.

PBGC should strengthen controls over the determination of benefits to ensure the accuracy of the amounts paid and recorded in the financial statements.

**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 (OFFM), *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.
- 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.

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 the Premium Accounting System, 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. Steps PBGC has taken 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), which is currently in the design phase. TAS will replace existing financial applications Portfolio Accounting and Management (PAM), FY File, TIS, and TIS Transfer. Additionally, TAS will have automated interfaces with the CMS, CFS, and Integrated Present Value of Future Benefits (IPVFB). TAS implementation is currently planned for August 2012. Additionally, PBGC has identified future capabilities in its financial management to-be architecture including a procurement system and an online budgeting system.

***Recommendation:***

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

**Compliance with Laws and Regulations**

Except as discussed below, our tests of PBGC's compliance with selected provisions of laws and regulations for FY 2011 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 three, BAPD Operations, 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 United States Congress, and the President and is not intended to be and should not be used by anyone other than these specified parties.

## Objectives, Scope, and Methodology

PBGC's management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States of America; (2) establishing, maintaining, and evaluating the effectiveness of internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; its assertion of the internal control over financial reporting included in PBGC's FY 2011 Annual Report; and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America; and (2) management maintained effective internal control as of September 30, 2011 based on management's assertion included in PBGC's FY 2011 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 United States of America, 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 audit guidance requires testing and performing limited procedures with respect to certain other information appearing in PBGC's FY 2011 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 accounting principles used and significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of the entity and its operations, including its internal control related to financial reporting (including safeguarding assets) and compliance with laws and regulations; (5) tested relevant internal control over financial reporting (including safeguarding assets) and compliance, and evaluated the design and operating effectiveness of internal control for the FY ended September 30, 2011; (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA; and (7) tested compliance for FY 2011 with selected provisions of laws and regulations that have a direct and material effect on the financial statements.

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.

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 audit guidance that we deemed applicable to the financial statements for the FY ended September 30, 2011. 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 conducted our audits and examinations 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. We believe that our audits and examinations provide a reasonable basis for our opinions.

We considered the material weaknesses identified above in determining the nature, timing, and extent of our audit procedures on the 2011 financial statements.

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

In commenting on the draft of this report (see Section III of this report), PBGC's management concurred with the facts and conclusions in our report. We did not perform audit procedures on PBGC's written response and, accordingly, we express no opinion on it.

A handwritten signature in cursive script that reads "Clifton Henderson LLP".

Calverton, Maryland  
November 14, 2011

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**Section II**

**Pension Benefit Guaranty Corporation's  
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PENSION BENEFIT GUARANTY CORPORATION  
**STATEMENTS OF FINANCIAL CONDITION**

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30, 2011	2010	September 30, 2011	2010	September 30, 2011	2010
<i>(Dollars in millions)</i>						
<b>ASSETS</b>						
Cash and cash equivalents	\$ 5,021	\$ 4,442	\$ 5	\$ 6	\$ 5,026	\$ 4,448
Securities lending collateral (Notes 3 and 5)	4,587	5,427	0	0	4,587	5,427
Investments, at market (Notes 3 and 5):						
Fixed maturity securities	46,257	39,789	1,720	1,607	47,977	41,396
Equity securities	17,997	22,393	0	0	17,997	22,393
Private equity	1,459	2,050	0	0	1,459	2,050
Real estate and real estate investment trusts	536	459	0	0	536	459
Other	22	17	0	0	22	17
Total investments	66,271	64,708	1,720	1,607	67,991	66,315
Receivables, net:						
Sponsors of terminated plans	31	11	0	0	31	11
Premiums (Note 11)	561	754	1	2	562	756
Sale of securities	1,807	1,589	0	0	1,807	1,589
Derivative contracts (Note 4)	178	78	0	0	178	78
Investment income	469	418	12	12	481	430
Other	3	5	0	0	3	5
Total receivables	3,049	2,855	13	14	3,062	2,869
Capitalized assets, net	32	31	1	1	33	32
Total assets	\$78,960	\$77,463	\$1,739	\$1,628	\$80,699	\$79,091

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,	
<i>(Dollars in Millions)</i>	2011	2010	2011	2010	2011	2010
<b>LIABILITIES</b>						
Present value of future benefits, net (Note 6):						
Trusted plans	\$91,718	\$ 88,021	\$1	\$ 1	\$91,719	\$ 88,022
Plans pending termination and trusteeship	346	501	0	0	346	501
Settlements and judgments	56	55	0	0	56	55
Claims for probable terminations	833	1,445	0	0	833	1,445
Total present value of future benefits, net	92,953	90,022	1	1	92,954	90,023
Present value of nonrecoverable future financial assistance (Note 7)						
Insolvent plans	0	0	1,232	1,179	1,232	1,179
Probable insolvent plans	0	0	3,243	1,851	3,243	1,851
Total present value of nonrecoverable future financial assistance	0	0	4,475	3,030	4,475	3,030
Payables, net:						
Derivative contracts (Note 4)	173	67	0	0	173	67
Due for purchases of securities	4,079	3,076	0	0	4,079	3,076
Payable upon return of securities loaned	4,587	5,427	0	0	4,587	5,427
Unearned premiums	366	364	31	31	397	395
Accounts payable and accrued expenses (Note 8)	68	101	2	2	70	103
Total payables	9,273	9,035	33	33	9,306	9,068
Total liabilities	102,226	99,057	4,509	3,064	106,735	102,121
<b>Net position</b>	<b>(23,266)</b>	<b>(21,594)</b>	<b>(2,770)</b>	<b>(1,436)</b>	<b>(26,036)</b>	<b>(23,030)</b>
Total liabilities and net position	\$78,960	\$ 77,463	\$1,739	\$1,628	\$80,699	\$ 79,091

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,	
	2011	2010	2011	2010	2011	2010
<i>(Dollars in Millions)</i>						
<b>UNDERWRITING</b>						
Income:						
Premium, net (Note 11)	\$ 2,072	\$ 2,231	\$ 92	\$ 93	\$ 2,164	\$ 2,324
Other	17	30	0	0	17	30
Total	<u>2,089</u>	<u>2,261</u>	<u>92</u>	<u>93</u>	<u>2,181</u>	<u>2,354</u>
Expenses:						
Administrative	353	368	14	12	367	380
Other	21	(7)	0	0	21	(7)
Total	<u>374</u>	<u>361</u>	<u>14</u>	<u>12</u>	<u>388</u>	<u>373</u>
Other underwriting activity:						
Losses from completed and probable terminations (Note 12)	201	509	0	0	201	509
Losses from financial assistance (Note 7)			1,560	831	1,560	831
Actuarial adjustments (credits) (Note 6)	1,672	(1,190)	0	0	1,672	(1,190)
Total	<u>1,873</u>	<u>(681)</u>	<u>1,560</u>	<u>831</u>	<u>3,433</u>	<u>150</u>
Underwriting gain (loss)	<u>(158)</u>	<u>2,581</u>	<u>(1,482)</u>	<u>(750)</u>	<u>(1,640)</u>	<u>1,831</u>
<b>FINANCIAL:</b>						
Investment income (loss) (Note 13):						
Fixed	3,502	5,233	148	183	3,650	5,416
Equity	(276)	2,116	0	0	(276)	2,116
Private equity	144	404	0	0	144	404
Other	76	(159)	0	0	76	(159)
Total	<u>3,446</u>	<u>7,594</u>	<u>148</u>	<u>183</u>	<u>3,594</u>	<u>7,777</u>
Expenses:						
Investment	71	81	0	0	71	81
Actuarial charges (Note 6):						
Due to passage of time	3,880	4,215	0	0	3,880	4,215
Due to change in interest rates	1,009	6,396	0	0	1,009	6,396
Total	<u>4,960</u>	<u>10,692</u>	<u>0</u>	<u>0</u>	<u>4,960</u>	<u>10,692</u>
Financial income (loss)	<u>(1,514)</u>	<u>(3,098)</u>	<u>148</u>	<u>183</u>	<u>(1,366)</u>	<u>(2,915)</u>
Net loss	<u>(1,672)</u>	<u>(517)</u>	<u>(1,334)</u>	<u>(567)</u>	<u>(3,006)</u>	<u>(1,084)</u>
Net position, beginning of year	<u>(21,594)</u>	<u>(21,077)</u>	<u>(1,436)</u>	<u>(869)</u>	<u>(23,030)</u>	<u>(21,946)</u>
Net position, end of year	\$ <u>(23,266)</u>	\$ <u>(21,594)</u>	\$ <u>(2,770)</u>	\$ <u>(1,436)</u>	\$ <u>(26,036)</u>	\$ <u>(23,030)</u>

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

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

<i>(Dollars in millions)</i>	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,	
	<b>2011</b>	2010	<b>2011</b>	2010	<b>2011</b>	2010
<b>OPERATING ACTIVITIES:</b>						
Premium receipts	\$ 2,268	\$ 2,086	\$ 91	\$ 93	\$ 2,359	\$ 2,179
Interest and dividends received	2,155	1,989	74	73	2,229	2,062
Cash received from plans upon trusteeship	36	81	0	0	36	81
Receipts from sponsors/non-sponsors	70	241	0	0	70	241
Receipts from the missing participant program	6	3	0	0	6	3
Other receipts	1	5	0	0	1	5
Benefit payments – trusteeed plans	(5,382)	(5,284)	0	0	(5,382)	(5,284)
Financial assistance payments			(115)	(97)	(115)	(97)
Settlements and judgments	0	0	0	0	0	0
Payments for administrative and other expenses	(428)		(13)	(11)	(441)	(420)
		(409)				
Accrued interest paid on securities purchased	(310)		(6)	(7)	(316)	(320)
		(313)				
Net cash provided (used) by operating activities (Note 15)	<b>(1,584)</b>	(1,601)	<b>31</b>	51	<b>(1,553)</b>	(1,550)
<b>INVESTING ACTIVITIES:</b>						
Proceeds from sales of investments	85,242	71,459	1,216	1,039	86,458	72,498
Payments for purchases of investments	(83,079)	(69,163)	(1,248)	(1,089)	(84,327)	(70,252)
Net change in investment of securities lending collateral	(841)	2,923	0	0	(841)	2,923
Net change in securities lending payable	841	(2,923)	0	0	841	(2,923)
Net cash provided (used) by investing activities	<b>2,163</b>	2,296	<b>(32)</b>	(50)	<b>2,131</b>	2,246
Net increase (decrease) in cash and cash equivalents	579	695	(1)	1	578	696
Cash and cash equivalents, beginning of year	4,442	3,747	6	5	4,448	3,752
Cash and cash equivalents, end of year	<b>\$ 5,021</b>	\$ 4,442	<b>\$ 5</b>	\$ 6	<b>\$ 5,026</b>	\$ 4,448

The accompanying notes are an integral part of these financial statements

## NOTES TO FINANCIAL STATEMENTS

September 30, 2011 and 2010

### 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 in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980, the Single-Employer Pension Plan Amendments Act of 1986, the Pension Protection Act of 1987, the Retirement Protection Act of 1994, the Consolidated Appropriations Act, 2001, the Deficit Reduction Act of 2005, and the Pension Protection Act of 2006. 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 passage of time) are included in this area.

As of September 30, 2011, the single-employer and multiemployer programs reported net positions of \$(23.3) billion and \$(2.8) billion, respectively. The single-employer program had assets of approximately \$79.0 billion offset by total liabilities of \$102.2 billion, which include a total present value of future benefits (PVFB) of approximately \$93.0 billion. As of September 30, 2011, the multiemployer program had assets over \$1.7 billion offset by approximately \$4.5 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 \$73.5 billion of total investments (including cash and investment income) represents the largest component of PBGC’s Statements of Financial Condition combined assets of \$80.7 billion at September 30, 2011. This amount of \$73.5 billion (as compared to investments under management of \$69.8 billion, as reported on page 32 [of the PBGC FY 2011 Annual Report]) 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 (\$53.5 billion) represents 73 percent of the total investments, while equity securities (\$18.0 billion) represents 25 percent of total investments. Private market assets (\$1.5 billion), comprised largely of private equity, private debt, and real estate, represent 2 percent of the total investments.

### ***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, 2011, was \$227 billion. The comparable estimates of the single-employer program's reasonably possible exposure for 2010 and 2009 were \$170 billion and \$168 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 9). For 2011, 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, 2011, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of \$23 billion. The comparable estimates of the multiemployer program's reasonable possible exposure for FY 2010 and FY 2009 were \$20 billion and \$326 million, respectively. The significant increase from prior years is primarily due to the addition of two large plans to the reasonably possible inventory. The sponsor of one plan, now with net liability of \$16.4 billion, is in the "transportation, communication, and utilities" industry category; the other, now with net liability of \$5.4 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.

## **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 (GAAP). The preparation of the financial statements in conformity with 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 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.

During FY 2010, PBGC implemented FASB Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements* (ASU 2010-06) and FASB Accounting Standards Update No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820) – Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, as amended (ASU 2009-12). ASU 2010-06 added disclosures for significant transfers between Levels 1 and 2; separate presentation for transfers into and transfers out of Level 3; class of assets and liabilities; and valuation techniques for Levels 2 and 3. ASU 2009-12 permits, as a practical expedient, a reporting entity to measure the fair value of an investment on the basis of net asset value (NAV) per share. ASU 2009-12 requires disclosures by class of NAV investment including the attributes of the investments, such as: the nature of any restrictions on the investor’s ability to redeem its investments at the measurement date; any unfunded commitments; and the investment strategies of the investees.

### ***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 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 GAAP; additionally, the issuance for applying fair value was dispersed among many accounting pronouncements that require fair value measurement.

### ***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 trusteeed and to provide funds for financial assistance. The Pension Protection Act of 1987 created a single-employer revolving (7th) fund 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 trusteeed, 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) trusteeed 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, and (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, and (3) probable terminations – plans that PBGC determines are likely to terminate and be trusteeed 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.



### ***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 56 [of the PBGC FY2011 Annual Report]. 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."

## ***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 termination premiums that are reserved at 100 percent, interest, and penalties (see Note 11).

## ***Capitalized Assets***

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

## ***Present Value of Future Benefits (PVFB)***

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

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

(1) **Trusteed Plans**—represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trustee by PBGC prior to fiscal year-end. Assets are shown separately from liabilities for trustee plans.

(2) **Pending Termination and Trusteeship**—represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans for which termination action has been initiated and/or completed prior to fiscal year-end. Unlike trustee plans, the liability for plans pending termination and trusteeship is shown net of plan assets.

(3) **Settlements and Judgments**—represents estimated liabilities related to settled litigation.

(4) **Net Claims for Probable Terminations**—In accordance with the FASB Accounting Standards Codification Section 450, *Contingencies*, PBGC recognizes net claims for probable terminations with \$50 million or more of underfunding, 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. 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 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, 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. Determining 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 temporarily 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.

### ***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. In FY 2010, PBGC revised its administrative expense allocation methodology to ensure each insurance program continued to receive its fair share of administrative expenses. (This resulted in some prior single-employer indirect costs being moved to the multiemployer program). Beginning in FY 2010, resource activity levels in the multiemployer program rose significantly in the areas of financial assistance processing, field audits of newly insolvent plans, additional actuarial analysis of ongoing and terminated multiemployer plans, and responding to a growing number of technical and legal requests from plan administrators and practitioners. The revised expense allocation methodology fully captures these and all other 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 passage of time is classified as financial activity. These adjustments and charges (credits) represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 6).

### ***Depreciation and Amortization***

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

### ***Reclassification***

Certain security lending collateral amounts in the FY 2010 financial statements have been reclassified to be consistent with the FY 2011 presentation. All such changes had no impact on FY 2010 or FY 2011 net positions.

### **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 (to be announced) 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” 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 trusteeed 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

PBGC obtained a recovery in the form of an ownership interest in a new entity, emerging from a chapter 11 bankruptcy proceeding. This interest was valued as private equity and was sold on March 31, 2011 for the amount of \$591.6 million.

As the following table illustrates, the market value of investments of the single-employer program increased significantly from September 30, 2010, to September 30, 2011.

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

<i>(Dollars in millions)</i>	September 30, 2011		September 30, 2010	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$20,935	\$23,775	\$19,652	\$21,288
Commercial paper/securities purchased under resale agreements	6	6	199	199
Asset backed securities	5,088	5,150	2,681	2,733
Pooled funds				
Domestic	374	393	476	481
International	0	0	0	0
Global/other	0	0	0	0
Corporate bonds and other	11,021	11,765	9,250	10,168
International securities	5,088	5,168	4,492	4,920
Subtotal	42,512	46,257	36,750	39,789
Equity securities:				
Domestic	1,678	1,681	1,760	1,824
International	1,067	1,015	940	1,083
Pooled funds				
Domestic	6,377	7,990	7,256	10,778
International	5,373	7,308	5,765	8,691
Global/other	3	3	15	17
Subtotal	14,498	17,997	15,736	22,393
Private equity	1,452	1,459	2,169	2,050
Real estate and real estate investment trusts	447	536	441	459
Insurance contracts and other investments	23	22	22	17
Total*	\$58,932	\$66,271 **	\$55,118	\$64,708

\*Total includes securities on loan at September 30, 2011, and September 30, 2010, with a market value of \$6.125 billion and \$5.674 billion, respectively.

\*\*This total of \$66,271 million of investments at market value represents the single-employer assets only. It differs from the total investments of \$73.50 billion shown on page 32 of this report [FY 2011 PBGC Annual 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**

<i>(Dollars in millions)</i>	September 30, 2011		September 30, 2010	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$1,533	\$1,720	\$1,478	\$1,607
Equity securities	0	0	0	0
Total	\$1,533	\$1,720	\$1,478	\$1,607

## INVESTMENT PROFILE

	September 30,	
	2011	2010
Fixed Income Assets		
Average Quality	AA	AA
Average Maturity (years)	14.9	15.5
Duration (years)	9.6	9.9
Yield to Maturity (%)	3.3	3.8
Equity Assets		
Average Price/Earnings Ratio	12.9	18.4
Dividend Yield (%)	2.9	2.3
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 with 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 2010 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, government bond futures, interest rate, credit default and total return swaps and swaption contracts, stock warrants and rights, debt option contracts, and foreign currency forward and option contracts. Some of these derivatives are traded on organized exchanges and thus bear minimal counterparty risk. The counterparties to PBGC's non-exchange-traded derivative contracts are major financial institutions subject to ISDA (International Swaps and Derivatives Association, Inc.) master agreements. PBGC monitors 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). 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 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, 2011 and 2010, 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, 2011, and September 30, 2010.

#### FAIR VALUES OF DERIVATIVE INSTRUMENTS

		<b>Asset Derivative</b>					
		<b>September 30, 2011</b>			<b>September 30, 2010</b>		
<i>(Dollars in millions)</i>	Statements of Financial Condition Location	<b>Notional</b>	<b>FMV</b>	Statements of Financial		<b>Notional</b>	<b>FMV</b>
				Condition Location	Condition Location		
Futures	Derivative Contracts	<b>\$3,586</b>	<b>\$90</b>	Derivative Contracts		\$2,211	\$2
Swap agreements							
Interest rate swaps	Investments-Fixed	<b>1,330</b>	<b>(15)</b>	Investments-Fixed		1,086	(7)
Credit default swaps	Investments-Fixed	<b>2,150</b>	<b>6</b>	Investments-Fixed		2,023	10
Option contracts	Investments-Fixed	<b>121</b>	<b>1</b>	Investments-Fixed		38	4
Forwards - foreign exchange	Investments-Fixed	<b>3,021</b>	<b>26</b>	Investments-Fixed		3,530	(32)
	Investments-Equity	<b>45</b>	<b>1</b>	Investments-Equity		0	0
		<b>Liability Derivative</b>					
		<b>September 30, 2011</b>			<b>September 30, 2010</b>		
<i>(Dollars in millions)</i>	Statements of Financial Condition Location	<b>Notional</b>	<b>FMV</b>	Statements of Financial		<b>Notional</b>	<b>FMV</b>
				Condition Location	Condition Location		
Futures	Derivative Contracts	<b>\$2,148</b>	<b>\$ (2)</b>	Derivative Contracts		\$1,024	\$ (1)
Option contracts	Derivative Contracts	<b>1,202</b>	<b>(4)</b>	Derivative Contracts		2,591	(11)

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**

<i>(Dollars in millions)</i>	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
		Sept. 30, 2011	Sept. 30, 2010
<b>Futures</b>			
Contracts in a receivable position	Investment Income-Fixed	<b>(\$38)</b>	\$73
Contracts in a receivable position	Investment Income-Equity	<b>0</b>	0
Contracts in a payable position	Investment Income-Fixed	<b>177</b>	25
Contracts in a payable position	Investment Income-Equity	<b>0</b>	0
<b>Swap agreements</b>			
Interest rate swaps	Investment Income-Fixed	<b>0</b>	58
Credit default swaps	Investment Income-Fixed	<b>12</b>	19
<b>Option contracts</b>			
Options purchased (long)	Investment Income-Fixed	<b>3</b>	17
Options purchased (long)	Investment Income-Equity	<b>0</b>	0
Options written (sold short)	Investment Income-Fixed	<b>2</b>	(4)
Options written (sold short)	Investment Income-Equity	<b>0</b>	0
<b>Forward contracts</b>			
Forwards - foreign exchange*	Investment Income-Fixed	<b>(42)</b>	(37)
	Investment Income-Equity	<b>1</b>	0

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

\* For FY 2010, the value for Forwards - foreign exchange was reclassified from \$(23) million to \$(37) million, which had no impact on the FY 2010 Net loss.

***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 US government securities and sovereign debt issued by non-US 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, 2011, and September 30, 2010, was \$6.125 billion and \$5.674 billion, respectively. The increase in loan balances was mainly attributable to increased allocation and utilization of PBGC's U.S. corporate bonds and U.S. equities. U.S. Government securities continue to represent PBGC's largest amount of assets on loan. The 2011 year-end lendable balance for U.S. Government securities was approximately \$8.2 billion or 33 percent of PBGC's overall lendable securities balance; while the September 30, 2010 balance for U.S. Government securities was approximately \$6.1 billion or 29 percent of PBGC's overall lendable security balance. Utilization levels of U.S. Government securities on September 30, 2011 was lower than a year earlier, but was 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 \$4.587 billion at September 30, 2011, and \$5.427 billion at September 30, 2010. 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 most conservative cash collateral pools available. PBGC had earned income from securities lending of \$14.5 million as of September 30, 2011. 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, 2011, PBGC loaned out \$6.125 billion in securities of approximately \$24.379 billion of securities available for securities lending. Of the \$6.125 billion market value of securities on loan at September 30, 2011, approximately 72 percent are lent U.S. government securities.

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. In that regard, non-cash collateral previously included with securities lending cash collateral was reclassified in the amount of \$364 million within the FY 2010 Statements of Financial Condition to be consistent with the FY 2011 reporting. Likewise corresponding cash flow changes have been incorporated in the FY 2010 Statements of Cash Flows. All such changes have no impact on FY 2010 or FY 2011 net positions.

#### **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. 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" 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.

Amounts in the table below represent the derivative contracts in a receivable position at financial statement date. Collateral deposits of \$81 million, which represent cash paid as collateral on certain derivative contracts, are shown.

## DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2011	September 30, 2010
Open receivable trades on derivatives:		
Collateral deposits	\$81	\$76
Futures contracts	90	2
Interest rate swaps	0	0
Credit default swaps	7	0
Total	<u>\$178</u>	<u>\$78</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 \$167 million, which represent cash received as collateral on certain derivative contracts, are included.

## DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2011	September 30, 2010
Open payable trades on derivatives:		
Collateral deposits	\$167	\$55
Futures contracts	2	1
Interest rate swaps	0	0
Credit default swaps	0	0
Options-fixed income	4	11
Total	<u>\$173</u>	<u>\$67</u>

### 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 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, some of which is internally developed. 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 in 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, 2011**

<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	\$ 427	\$ 4,599		\$ 5,026
Securities lending collateral		4,587		4,587
Investments:				
Fixed maturity securities				
U.S. Government securities		25,495		
Commercial paper/securities purchased under resale agreements		6		
Asset backed/Mortgage backed securities		5,150		
Pooled funds				
Domestic		50	343	
International				
Global/other				
Corporate bonds and other	1	11,764	0 ***	
International securities	<u>37</u>	<u>5,131</u>	<u>0</u>	
Total fixed maturity securities	38	47,596	343	47,977
Equity securities:				
Domestic	1,607	66	8	
International	1,014	0 ***	1	
Pooled funds				
Domestic	0 ***	7,990		
International		7,308		
Global/other	<u>2</u>	<u>1</u>	<u>0</u>	
Total equity securities	2,623	15,365	9	17,997
Private equity			1,459	1,459
Real estate and real estate investment trusts	12	1	523	536
Insurance contracts and other Investments		22		22
Receivables:				
Derivative contracts*	90	88		178
<b>Liabilities</b>				
Payables:				
Derivative contracts**	6	167		173

\* 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, 2011, 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, 2011**

<i>(Dollars in millions)</i>	Fair Value at September 30, 2010	Total Realized and Unrealized Gains (Losses) included in Income	Purchases, Issuances and Settlements, Net	Transfers Into Level 3	Transfers Out of Level 3	Fair Value at September 30, 2011	Change in Unrealized Gains (Losses) Related to Financial Instruments held at September 30, 2011 **
<b>Assets:</b>							
Pooled funds (fixed Corporate bonds and other *	\$ 331	\$12				\$ 343	\$ 12
Domestic/Int'l equity *	1	(1)				0***	(1)
Private equity	5	0***	4	0***	0***	9	(1)
	2,050	13	(604)		0***	1,459	166
Real estate & real estate investment trusts	450	73				523	73
Other *	0					0	

\*assets which are not actively traded in the market place

\*\* amounts included in the Total Realized and Unrealized Gains (Losses) column. Please do not use the data in this column; it solely represents unrealized gains and losses and cannot be derived from other columns from 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; Fair Value Measurement and Disclosures*, 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, 2011**

	Fair Value (in millions)	Unfunded Commitments <sup>1</sup>	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Real estate (a)	\$ 536	\$158	n/a	n/a
Private equity (b)	1,459	391	n/a	n/a
Pooled funds (c)	<u>15,694</u>	<u>0</u>	<u>n/a</u>	<u>n/a</u>
Total	<u>\$ 17,689</u>	<u>\$549</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 151 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 526 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.

**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, 2011 and 2010.

For 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. In FY 2010, PBGC used a 25-year select interest factor of 4.41% followed by an ultimate factor of 4.51% 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.

Beginning in FY 2006, and ending with FY 2008, a Barclays Capital Aggregate Bond Index (formerly Lehman Long Corporate A and Higher Bond index) as of the last trading day of the month was used and was applied to both the select and ultimate factors instead of the select factor only as had been prior practice. Interest factors beginning in FY 2006 are now rounded to two decimal places instead of one so as to be able to state to the level of a single basis point.

In late 2008, significant volatility in the bond markets led PBGC to research the relationship between quarterly bond yields and annuity prices. As a result of this research, PBGC ended the use of a bond index in the determination of interest factors. The quarterly interest factors now incorporate the most recent quarterly annuity price survey data. Previously, the price survey data was used only once a year with the bond index then applied to determine subsequent interest factors during the year.

Based on a 2011 study of PBGC's participant mortality, new healthy lives mortality tables have been adopted for the June 30, 2011 and subsequent valuations. For June 30, 2011, PBGC used the Retirement Plan-2000 Combined Healthy (RP-2000 CH) Male and Female Tables, each 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 (11 years in FY 2011) plus PBGC's calculated duration of its liabilities (10 years in FY 2011). The study also recommended changes in the mortality assumptions for disabled lives which will also be implemented in the June 30, 2011 and subsequent valuations. For September 30, 2010, PBGC used 1994 Group Annuity Mortality (GAM) 94 Static Table set forward one year, projected 26 years to 2020 using scale AA.

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 annuity prices, when combined with the stronger mortality table (i.e., longer life expectancy), result in a higher interest factor than what we would have used with the previous mortality table.

The reserve for administrative expenses in the FY 2006 valuations was assumed to be 1.18 percent of benefit liabilities plus additional reserves for cases in which plan asset determinations, participant database audits and actuarial valuations were not yet complete. As the result of an updated study, the expense reserve factor beginning with FY 2007 has changed to 1.37 percent and carried forward to FY 2008, FY 2009, FY 2010, and FY 2011. The factors to determine the additional reserves were also re-estimated and continue to be based on plan milestone completion as well as case size, number of participants and time since trusteeship.

The present values of future benefits for trustee multiemployer plans for FY2011 and 2010 reflect the payment of assistance and the changes in interest and mortality assumptions, the passage of time 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, 2011 AND 2010**

	September 30,	
<i>(Dollars in millions)</i>	2011	2010
Present value of future benefits, at beginning		
of year -- Single-Employer, net	<b>\$90,022</b>	\$83,035
Estimated recoveries, prior year	<b>107</b>	175
Assets of terminated plans pending trusteeship, net, prior year	<b>542</b>	820
Present value of future benefits at beginning of year, gross	<b>90,671</b>	84,030
Settlements and judgments, prior year	<b>(55)</b>	(58)
Net claims for probable terminations, prior year	<b>(1,445)</b>	(1,870)
Actuarial adjustments -- underwriting:		
Changes in method and assumptions	<b>\$ 1,881</b>	\$ (1,286)
Effect of experience	<b>(209)</b>	96
Total actuarial adjustments -- underwriting	<b>1,672</b>	(1,190)
Actuarial charges -- financial:		
Passage of time	<b>3,880</b>	4,215
Change in interest rates	<b>1,009</b>	6,396
Total actuarial charges -- financial	<b>4,889</b>	10,611
Total actuarial charges, current year	<b>6,561</b>	9,421
Terminations:		
Current year	<b>2,363</b>	3,130
Changes in prior year	<b>(206)</b>	(15)
Total terminations	<b>2,157</b>	3,115
Benefit payments, current year*	<b>(5,340)</b>	(5,467)
Estimated recoveries, current year***	<b>(205)</b>	(107)
Assets of terminated plans pending trusteeship, net, current year	<b>(280)</b>	(542)
Settlements and judgments, current year	<b>56</b>	55
Net claims for probable terminations:		
Future benefits**	<b>1,379</b>	3,073
Estimated plan assets and recoveries from sponsors	<b>(546)</b>	(1,628)
Total net claims, current year	<b>833</b>	1,445
Present value of future benefits, at end of year -- Single-Employer, net	<b>92,953</b>	90,022
Present value of future benefits, at end of year -- Multiemployer	<b>1</b>	1
Total present value of future benefits, at end of year, net	<b>\$92,954</b>	\$90,023

\* The benefit payments of \$5,340 million and \$5,467 million include \$(42) million in 2011 and \$182 million in 2010 for benefits paid from plan assets by plans prior to trusteeship.

\*\* The future benefits for probable terminations of \$1,379 million and \$3,073 million for fiscal years 2011 and 2010, respectively, include \$288 million and \$253 million, respectively, for probable terminations not specifically identified and \$1,091 million and \$2,820 million, respectively, for specifically identified probables.

\*\*\*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 June 30, 2011 the first triggering event under the indenture occurred, and UAL is obligated to issue one tranche of \$62.5 million of the 8% Notes no later than February 15, 2012.

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

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

	September 30, 2011		September 30, 2010	
	Basis	Market Value	Basis	Market Value
<i>(Dollars in millions)</i>				
U.S. Government securities	\$ 0	\$ 0	\$ -	\$ -
Corporate and other bonds	148	148	353	353
Equity securities	137	139	270	270
Private equity	0	0	0	0
Insurance contracts	7	7	0	0
Other	(19)	(14)	(81)	(81)
Total, net	<b>\$273</b>	<b>\$280</b>	<b>\$542</b>	<b>\$542</b>

**Net Claims for Probable Terminations**

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

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

**RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS**

<i>(Dollars in millions)</i>	September 30,	
	2011	2010
Net claims for probable terminations, at beginning of year	\$ 1,445	\$ 1,870
New claims	\$ 545	\$ 337
Actual terminations	(474)	(596)
Deleted probables	(718)	(376)
Change in benefit liabilities	35	186
Change in plan assets	0	24
Loss (credit) on probables	(612)	(425)
Net claims for probable terminations, at end of year	<b>\$ 833</b>	<b>\$ 1,445</b>

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

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

<i>(Dollars in millions)</i>	FY 2011	FY 2010
Wholesale and Retail Services	\$ 602	\$ -
Health Care	231	193
Manufacturing	-	911
Services	-	341
Total	<b>\$ 833</b>	<b>\$ 1,445</b>

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

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

### ACTUAL PROBABLES EXPERIENCE

As Initially Recorded Beginning in 1987

<i>(Dollars in millions)</i>	Status of Probables from 1987-2010 at September 30, 2011			
	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Beginning in 1987, number of plans reported as Probable:				
Probables terminated	362	79%	\$28,471	73%
Probables not yet terminated or deleted	0	0	0	0
Probables deleted	94	21	10,335	27
Total	456	100%	\$38,806	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

<i>(Dollars in millions)</i>	September 30, 2011	September 30, 2010
Gross balance at beginning of year	\$484	\$387
Financial assistance payments - current year	115	97
Write-offs related to settlement agreements	0	0
Subtotal	599	484
Allowance for uncollectible amounts	(599)	(484)
Net balance at end of year	\$ 0	\$ 0

The losses from financial assistance reflected in the Statements of Operations and Changes in Net Position include period changes in the estimated present value of nonrecoverable future financial assistance.

As of September 30, 2011, the corporation expects 135 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 135 plans is \$4.475 billion. The 135 plans fall into three categories – plans currently receiving financial assistance; plans that have terminated but have not yet started receiving financial assistance from PBGC; and ongoing plans (not terminated) that the corporation expects will require financial assistance in the future.

## MULTIEMPLOYER FINANCIAL ASSISTANCE

<i>(Dollars in millions)</i>	September 30, 2011		September 30, 2010	
	Number of Plans	Net Liability	Number of Plans	Net Liability
Plans currently receiving financial assistance	41	\$1,232	41	\$1,179
Plans that have terminated but have not yet started receiving financial assistance	60	1,487	51	1,067
Ongoing plans (not terminated) that the corporation expects will require financial assistance in the future	34	1,756	29	784
Total	135	\$4,475	121	\$3,030

Of the 135 plans:

- 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 \$1.232 billion.
- 60 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 60 terminated plans is \$1.487 billion.
- 34 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 34 ongoing plans is \$1.756 billion.

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

<i>(Dollars in millions)</i>	September 30, 2011	September 30, 2010
Balance at beginning of year	\$3,030	\$2,296
Changes in allowance:		
Losses (credits) from financial assistance	1,560	831
Financial assistance granted (previously accrued)	(115)	(97)
Balance at end of year	\$4,475	\$3,030

**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, 2011	September 30, 2010
Annual leave	\$ 8	\$ 8
Other payables and accrued expenses	<u>62</u>	<u>95</u>
Accounts payable and accrued expenses	<u>\$ 70</u>	<u>\$103</u>



## Note 9: Reasonably Possible Contingencies

Single-employer plans sponsored by companies whose credit quality is below investment grade pose a greater risk of being terminated. In addition, there are some multiemployer plans that may require future financial assistance. The estimated unfunded vested benefits exposure amounts disclosed below represent the Corporation's estimates of the reasonably possible exposure to loss in these plans given the inherent uncertainties about these plans.

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, 2011.

The estimate of unfunded vested benefits exposure to loss for the single-employer plans of these companies was measured as of December 31, 2010. The reasonably possible exposure to loss in these plans was \$227 billion for FY 2011. This is an increase of \$57 billion from the reasonably possible exposure of \$170 billion in FY 2010. This reasonably possible exposure increased primarily due to the growth in the number of companies meeting the reasonable possible criteria (see Note 2), and the decrease in the interest rate used for valuing liabilities. Although high asset returns for calendar year 2010 partially offset the increase in liabilities, the net result was an increase in unfunded liabilities.

The estimate of unfunded vested benefits exposure to loss is not 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, 2009. The Corporation adjusted the value reported for liabilities to December 31, 2010, using a select rate of 3.93% for the first 20 years and 4.33% 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 2020 using Scale AA to approximate annuity prices as of December 31, 2010. The underfunding associated with these plans could be substantially different at September 30, 2011, because of the economic conditions that existed between December 31, 2010 and September 30, 2011. The Corporation did not adjust the estimate for events that occurred between December 31, 2010, and September 30, 2011.

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 2011	FY 2010
Manufacturing *	\$120,690	\$101,888
Transportation, Communication and Utilities **	50,133	30,178
Services	25,879	15,356
Wholesale and Retail Trade	12,218	12,844
Health Care	8,818	3,985
Finance, Insurance, and Real Estate	5,953	2,840
Agriculture, Mining, and Construction	3,426	2,653
Total	\$227,117	\$169,744

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

\*\* Primarily airline

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 currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of \$23 billion, due primarily to two large plans. PBGC obtained an independent actuarial analysis of the solvency of these two large plans in both FY 2010 and FY 2011.

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, 2011, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2011. 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.

### **Note 10: Commitments**

PBGC leases its office facility under a commitment that began on January 1, 2005, and expires December 10, 2019. 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 2014. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2011, are as follows:

#### **COMMITMENTS: FUTURE LEASE PAYMENTS**

<i>(Dollars in millions)</i>	
Years Ending September 30,	Operating Leases
2012	\$ 18.8
2013	18.0
2014	17.7
2015	17.6
2016	17.0
Thereafter	39.0
Minimum lease payments	<u>\$128.1</u>

Lease expenses were \$18.3 million in 2011 and \$18.4 million in 2010.

### **Note 11: Premiums**

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and penalties on the unpaid portion of or underpayment of premiums. Interest continues to accrue until the premium and the interest due are paid. For plan year 2010 the flat-rate premiums for single-employer pension plans was \$35 per participant and for multiemployer plans, \$9 per participant. For plan year 2011, per participant rates were \$35 for single-employer plans and \$9 for multiemployer plans. PBGC recorded net premium income of \$2.164 billion that consisted primarily of \$1.235 billion in flat-rate premiums, \$929 million in variable-rate premiums, and \$202 million in termination premiums offset by a bad debt expense of \$207 million. Bad debt expenses include a reserve for uncollectible premium receivables consisting of termination premiums that are reserved conservatively at 100 percent, as well as some write-off of interest and penalties. Net premium income for fiscal year 2010 was \$2.324 billion and consisted primarily of approximately \$1.288 billion in flat-rate premiums, \$1.030 billion in variable-rate premiums, and \$237 million in termination premiums offset by a bad debt expense of \$244 million. The termination premium applies to certain plan terminations occurring after 2005. If a pension plan terminates in a distress termination pursuant to ERISA section 4041(c)(2)(B)(ii) or (iii), or in a PBGC-initiated termination under ERISA section 4042, the plan sponsor and its controlled group are liable to PBGC for a termination premium at the rate of \$1,250 per plan participant per year for three years.

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

## PREMIUMS

<i>(Dollars in millions)</i>	September 30, 2011	September 30, 2010
Flat Rate Premium:		
Single-Employer	<b>\$1,143</b>	\$1,194
Multiemployer	<u>92</u>	<u>94</u>
Total Flat Rate Premium	<b>1,235</b>	1,288
Variable Rate Premium	<b>929</b>	1,030
Interest and Penalty Income	<b>5</b>	13
Termination Premium	<b>202</b>	237
Less Write-offs of Interest, Penalties, and Termination Premiums	<u>(207)</u>	<u>(244)</u>
<b>Total</b>	<b><u>\$2,164</u></b>	<b><u>\$2,324</u></b>
Single-Employer	<b>\$2,077</b>	\$2,237
Termination Premium *	<b>202</b>	237
Less Write-offs of Interest, Penalties, and Termination Premiums	<u>(207)</u>	<u>(243)</u>
Total Single-Employer	<u><b>2,072</b></u>	<u>2,231</u>
Multiemployer	<b>92</b>	94
Less Write-offs of Interest and Penalties	<u><b>0**</b></u>	<u>(1)</u>
Total Multiemployer	<u><b>92</b></u>	<u>93</u>
<b>Total</b>	<b><u>\$2,164</u></b>	<b><u>\$2,324</u></b>

\* The termination premium is reserved at 100% since no significant collection has yet been achieved.

\*\* 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

<i>(Dollars in millions)</i>	For the Years Ended September 30,					
	2011			2010		
	New Terminations	Changes in Prior Year Terminations	Total	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	\$2,363	\$ (206)	\$2,157	\$ 3,130	\$ (15)	\$3,115
Less plan assets	1,173	175	1,348	1,688	474	2,162
Plan asset insufficiency	1,190	(381)	809	1,442	(489)	953
Less estimated recoveries	0	(3)	(3)	0	16	16
Subtotal	1,190*	(378)	812	1,442*	(505)	937
Settlements and judgments		1	1		(3)	(3)
Loss (credit) on probables	(474)	(138)	(612)**	(596)	171	(425)**
Total	\$ 716	\$(515)	\$ 201	\$ 846	\$(337)	\$ 509

\* gross amounts for plans terminated during the year

\*\* see Note 6 – includes a credit of \$474 million at September 30, 2011, and includes a credit of \$596 million at September 30, 2010, previously recorded relating to plans that terminated during the period

### Note 13: Financial Income

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

#### INVESTMENT INCOME SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS

	Single-Employer Program Sept. 30, 2011	Multiemployer Program Sept. 30, 2011	Memorandum Total Sept. 30, 2011	Single-Employer Program Sept. 30, 2010	Multiemployer Program Sept. 30, 2010	Memorandum Total Sept. 30, 2010
<i>(Dollars in millions)</i>						
Fixed maturity securities:						
Interest earned	\$ 1,796	\$ 57	\$ 1,853	\$ 1,587	\$ 54	\$ 1,641
Realized gain	973	31	1,004	1,527	53	1,580
Unrealized gain	733	60	793	2,119	76	2,195
Total fixed maturity securities	3,502	148	3,650	5,233	183	5,416
Equity securities:						
Dividends earned	67	0	67	52	0	52
Realized gain	2,857	0	2,857	573	0	573
Unrealized gain (loss)	(3,200)	0	(3,200)	1,491	0	1,491
Total equity securities	(276)	0	(276)	2,116	0	2,116
Private equity:						
Distributions earned	27	0	27	19	0	19
Realized gain (loss)	(9)	0	(9)	373	0	373
Unrealized gain	126	0	126	12	0	12
Total private equity	144	0	144	404	0	404
Other income (loss)	76	0	76	(159)	0	(159)
Total investment income	\$ 3,446	\$ 148	\$ 3,594	\$ 7,594	\$ 183	\$ 7,777

#### 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 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 2011 and 2010 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 11.2 percent of base pay for both 2011 and 2010. 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 \$19 million in 2011 and \$18 million in 2010.

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 two tables, one for Sales and one for Purchases, provide further details on cash flows from investment activity. Sales and purchases of investments are driven by the level of newly trusted 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)

<i>(Dollars in millions)</i>	September 30,	
	2011	2010
Proceeds from sales of investments:		
Fixed maturity securities	\$73,641	\$60,295
Equity securities	9,113	5,302
Other/uncategorized	3,704	6,901
Memorandum total	<u>\$86,458</u>	<u>\$72,498</u>
Payments for purchases of investments:		
Fixed maturity securities	\$(77,935)	\$(63,937)
Equity securities	(4,144)	(4,504)
Other/uncategorized	(2,248)	(1,811)
Memorandum total	<u>\$(84,327)</u>	<u>\$(70,252)</u>

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

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

<i>(Dollars in millions)</i>	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30, 2011	2010	September 30, 2011	2010	September 30, 2011	2010
Net income (loss)	<b>\$(1,672)</b>	\$ (517)	<b>\$(1,334)</b>	\$(567)	<b>\$(3,006)</b>	\$(1,084)
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	<b>(1,634)</b>	(6,022)	<b>(91)</b>	(131)	<b>(1,725)</b>	(6,153)
Net gain (loss) of plans pending termination and trusteeship	<b>23</b>	37	<b>0</b>	0	<b>23</b>	37
Losses (credits) on completed and probable terminations	<b>201</b>	509	<b>0</b>	0	<b>201</b>	509
Actuarial charges (credits)	<b>6,561</b>	9,421	<b>0</b>	0	<b>6,561</b>	9,421
Benefit payments - trustee plans	<b>(5,382)</b>	(5,284)	<b>0</b>	0	<b>(5,382)</b>	(5,284)
Settlements and judgments	<b>0</b>	0	<b>0</b>	0	<b>0</b>	0
Cash received from plans upon trusteeship	<b>36</b>	81	<b>0</b>	0	<b>36</b>	81
Receipts from sponsors/non-sponsors	<b>70</b>	241	<b>0</b>	0	<b>70</b>	241
Amortization of discounts/premiums	<b>100</b>	89	<b>10</b>	9	<b>110</b>	98
Changes in assets and liabilities, net of effects of trustee and pending plans:						
(Increase) decrease in receivables	<b>144</b>	(179)	<b>1</b>	4	<b>145</b>	(175)
Increase in present value of nonrecoverable future financial assistance			<b>1,445</b>	734	<b>1,445</b>	734
Increase in unearned premiums	<b>2</b>	9	<b>0</b>	0	<b>2</b>	9
Increase (decrease) in accounts payable	<b>(33)</b>	14	<b>0</b>	2	<b>(33)</b>	16
Net cash provided (used) by operating activities	<b>\$(1,584)</b>	\$(1,601)	<b>\$ 31</b>	\$ 51	<b>\$(1,553)</b>	\$(1,550)

### Note 16: Litigation

Legal challenges to PBGC's policies and positions continued in 2011. At the end of the fiscal year, PBGC had 40 active cases in state and federal courts and 459 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 November 14, 2011, 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, 2011 and before the financial statements were available to be issued, that provided additional evidence about conditions that existed at September 30, 2011 have been recognized in the financial statements.

For the single-employer program, there were two nonrecognized subsequent events. Subsequent to September 30, 2011, business and financial conditions significantly declined for two single-employer plans (unfunded guaranteed liabilities of \$188 million). Had these events occurred on or prior to September 30, 2011, PBGC's financial statements would have reflected an additional loss of \$188 million resulting in a FY 2011 single-employer Net loss of \$1,860 million and a FY 2011 single-employer Net position of \$(23,454) million.

For the multiemployer program, there were no nonrecognized subsequent events or transactions that provided evidence about conditions that did not exist at September 30, 2011, and which arose before the financial statements were available to be issued.



Audit of the Pension Benefit Guaranty Corporation's  
Fiscal Year 2011 and 2010 Financial Statements

Audit Report AUD-2012-1 / FA-11-82-1

**Section III**

**Management Comments**




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

Office of the Director

MEMORANDUM

November 9, 2011

To: Rebecca Anne Batts  
Inspector General

From: Josh Gotbaum   
Director

Subject: Response to the Independent Auditor's Combined Audit Report on the  
FY 2011 Financial Statement Audit

Thank you for the opportunity to comment on the Office of Inspector General's FY 2011 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 2011.

We also recognize and concur with your opinion on internal controls. Management has already set the foundation and continues its work for addressing the two material weaknesses (entity-wide security program planning and management, and access controls and configuration management) and the significant deficiency (integration of financial management systems) that were recognized in previous audits. Regarding the new material weakness in benefits administration and payment department operations, as you know we have begun work on reviewing these findings and will be developing a corrective action plan.

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  
Richard H. Macy  
Alice Maroni  
Ann Orr  
Michael Rae  
Vince Snowbarger  
Judith Starr  
Martin O. Boehm

If you want to report or discuss confidentially any instance of misconduct, fraud, waste, abuse, or mismanagement, please contact the Office of Inspector General.

Telephone:  
The Inspector General's HOTLINE  
1-800-303-9737

The deaf or hard of hearing, dial FRS (800) 877-8339 and give the Hotline number to the relay operator.

Web:  
<http://oig.pbgc.gov/investigation/details.html>

Or Write:  
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