Pension Benefit Guaranty Corporation

Office of Inspector General

Evaluation Report

PBGC Lawfully Terminated the National Steel Plans, but Accepted Poor Quality Work from Contractors

October 23, 2013

EVAL 2014-01/PA-09-66-2

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

October 23, 2013

MEMORANDUM

TO: Joshua Gotbaum
Director

FROM: Rashmi Bartlett *Rashmi Bartlett*
Assistant Inspector General for Audit

SUBJECT: OIG Evaluation Report No. 2014-01/PA-09-66-2, "PBGC Lawfully Terminated the National Steel Plans, but Accepted Poor Quality Work from Contractors"

This report presents the results of our second evaluation of PBGC's actions when terminating certain steel plans located in Minnesota. We initiated this evaluation in response to a request from U. S. Senators Amy Klobuchar and Al Franken, and former U.S. Congressman James Oberstar. Our overall objective was to evaluate PBGC's actions in terminating and establishing benefits for the Minnesota Steelworker pension plans.

We found that PBGC complied with its statute when making termination and benefit decisions; however, its processes for validating participant information was seriously flawed. PBGC acted within its authority to select the termination dates. Also, PBGC did not violate the law when it made certain decisions that reduced pension benefits.

In contrast, PBGC's efforts to identify valid and accurate participant information necessary for individual benefit calculations were unreliable for the seven terminated National Steel pension plans. In 2004 and 2005, PBGC's contractor performed and PBGC accepted seven source document audits and seven participant data audits for National Steel plans and relied on them to produce valuations of the terminated pension plans and individual participant benefit calculations. However, these fourteen audits for the National Steel plans failed to meet applicable professional standards and PBGC protocols.

As a result of OIG's previous reviews in 2011 of National Steel and United Airlines pension plans, the Corporation has begun to address serious weaknesses in its benefit operations. Therefore, we are not making any new recommendations to PBGC as a result of our report on the processing of National Steel Plans' terminations. PBGC's response to the report is included, in its entirety, as Appendix C to this report.

We appreciate the courtesies and cooperation extended to us by members of your staff during this evaluation.

Executive Summary

This report presents the results of our second evaluation addressing concerns from the Minnesota Congressional delegation about PBGC's actions when terminating certain steel plans located in Minnesota. The National Steel Corporation (National Steel) was one of the largest integrated steel producers in the United States. National Steel maintained eight defined benefit plans; seven of those plans were terminated on December 6, 2002 and trusteed by PBGC on May 31, 2003.

Our overall objective was to evaluate PBGC's actions in terminating and establishing benefits for the Minnesota Steelworker pension plans. This included whether PBGC adhered to laws and its own policy when it terminated the National Steel plans; whether the source document and participant data audits were properly performed; and the effectiveness of PBGC's oversight and quality control processes for these data audits.

In brief, our review found that PBGC complied with its statute when making termination and benefit decisions; however, its processes for validating participant information were seriously flawed. PBGC acted within its authority to select the termination dates. Also, PBGC did not violate the law when it made certain decisions that reduced pension benefits – in particular, in establishing a termination date that resulted in shutdown benefits not accruing to National Steel participants (Rule of 65 benefits).

In contrast, PBGC's efforts to identify valid and accurate participant information necessary for individual benefit calculations were unreliable for the seven terminated National Steel pension plans. From 2003- 2005, PBGC's contractor performed and PBGC accepted seven source document audits and seven participant data audits for National Steel plans and relied on them to establish the participant database used to value the individual participant benefits and the liability. However, these fourteen audits for the National Steel plans failed to meet applicable professional standards and PBGC protocols. This occurred because PBGC and its contractor did not exercise due professional care in the conduct of these audits. Further, PBGC did not provide effective oversight for the contractor; and accepted and paid for sub-standard audit work.

As a result of OIG's review of PBGC's processing of terminated National Steel and United Airlines pension plans,[1] the Corporation has begun to address serious weaknesses in its benefit operations. Since 2011, PBGC has made significant changes to entire benefits operations to address those weaknesses. Therefore, we are not making any new recommendations to PBGC as a result of our report on the processing of National Steel Plans' terminations. We will continue to monitor PBGC's progress in improving operations, establishing and strengthening internal controls, and conducting its oversight activities.

We provided a draft of this report to PBGC for review and comment. PBGC's full response to the official draft is in Appendix C of this report.

[1] See *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed*, No.2011-10/PA-09-66-1, issued March 30, 2011 (http://oig.pbgc.gov/pdfs/PA-09-66-1.pdf), and *PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient*, No.:2012-05/PA-10-72, issued November 30, 2011 (http://oig.pbgc.gov/pdfs/PA-10-72-1.pdf).

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Abbreviations

AICPA	American Institute of Certified Public Accountants
ABO	Accumulated Benefit Obligation
APP	Asset Protection Plan
BAPD	Benefits Administration and Payment Department
COTR	Contracting Officer's Technical Representative
CPA	Certified Public Accountant
DOPT	Date of Plan Termination
ERISA	Employee Retirement Income Security Act of 1974
EVTAC	Eveleth Taconite Company
GAO	Government Accountability Office
IG	Inspector General
IMRG	Integrated Management Resources Group, Inc.
LTV	LTV Corporation
PBGC	Pension Benefit Guaranty Corporation
PDA	Participant Data Audit
PPA	Pension Protection Act of 2006
PRISM	Participant Records Information System Management
TPD	Trusteeship Processing Division
TWG	Trusteeship Working Group
USWA	United Steelworkers of America

Background and Objectives

Background

The Pension Benefit Guaranty Corporation (PBGC) protects the retirement incomes of nearly 43 million American workers in more than 26,000 private-sector defined benefit pension plans. PBGC was created by the Employee Retirement Income Security Act (ERISA) of 1974 to encourage the continuation and maintenance of private-sector defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum. Defined benefit pension plans promise to pay a specified monthly benefit at retirement, commonly based on salary and years on the job.

If a defined benefit pension plan terminates without sufficient assets to pay all promised benefits, PBGC steps in and becomes trustee. At the time of termination, activities under a pension plan such as benefit accruals and vesting cease. In addition to the terminated plan's assets, PBGC uses its own assets to pay benefits to insure that participants do not lose all their benefits.

Basic pension benefits a participant has earned are guaranteed by PBGC– such as pension benefits at normal retirement age, and disability benefits - up to a monthly limit that is set by law. Generally, the limit is permanently established for each pension plan based on the plan's termination date. For some participants, however, the benefits the employer has promised are greater than the legal limits PBGC can pay.

Congressional Request

The Office of Inspector General (OIG) received a request from U. S. Senators Amy Klobuchar and Al Franken, and former U.S. Congressman James Oberstar to review and examine the work of the PBGC regarding Minnesota steelworker pension plans. Beginning in 2002, when PBGC terminated and trusteed several Minnesota steelworker pension plans, the pension benefits of thousands of plan participants were reduced. While there were unique circumstances regarding each plan termination, the Minnesota congressional members were concerned about the perceived disparities between pension plan benefits for these steelworkers. Specifically, the delegation requested clarity regarding the following:[2]

- "Did the PBGC consistently apply the Employee Retirement Income Security Act (ERISA), as well as its own regulations and policies, when terminating and calculating the benefits of these plans [National Steel] as compared to similar plans?"

- "While PBGC granted 'Rule of 65' shutdown benefits to LTV Steel Mining participants, PBGC did not grant similar benefits to National Steel Pellet Company participants. Please report on the appropriateness, legality, and rationale for the disparate treatment."

[2]Letter from U. S. Senators Amy Klobuchar and Al Franken, and former U.S. Congressman James Oberstar to PBGC Inspector General Rebecca Anne Batts, dated August 2009.

- “ERISA prohibits employers from cutting back accrued employee retirement benefits (anti-cutback law). Plan participants contend that PBGC’s actions to reduce pension benefits represent a violation of the federal anti-cutback law.”

- “Please explain PBGC’s process for affixing the date of pension plan termination. Pension plan participants contend that PBGC improperly affixes the date of plan termination on the announcement of PBGC’s intention to assume a pension, rather than the date on when the PBGC officially becomes the trustee of the terminated pension plan.”

- “National Steel Pellet Company Hourly Wage participants contend their pension was fully funded and that their pension funds were improperly merged with other National Steel Corporation pension funds.”

This report is the second and final report to address the concerns of the Minnesota congressional delegation and their constituents. In an effort to address these areas of concern, the OIG reviewed selected aspects of PBGC’s benefit termination process. This report focuses on PBGC’s process to collect and validate participant information essential to the determination of participant benefits and PBGC’s handling of specific issues raised by the Minnesota congressional delegations arising from the termination of the National Steel Corporation’s family of seven pension plans.[3]

National Steel Corporation

The National Steel Corporation (National Steel) was one of the largest integrated steel producers in the United States that engaged in the manufacture and sale of a wide variety of flat rolled carbon steel products sold primarily to the automotive, construction, and container markets. National Steel was formed in 1929 through the merger of Great Lakes Steel Corporation, Weirton Steel Corporation, and Hanna Iron Ore Company. It purchased Granite Steel Corporation in 1971; it is headquartered in Mishawaka, Indiana. On March 6, 2002, National Steel and 41 of its subsidiaries filed for relief under Chapter 11 of the United States bankruptcy code. On May 20, 2003, National Steel sold substantially all of its assets for steel making and finishing and its iron ore pellet operations to United Steel Corporation.

National Steel maintained eight defined benefit plans; seven of those plans were terminated as of December 6, 2002 and trusteed by PBGC on May 31, 2003. The pension plan for the hourly employees of the American Steel Corporation (the eighth plan) was not trusteed by PBGC; instead, it was terminated as a standard termination since the plan was funded well enough to pay all benefits owed to participants and beneficiaries. The seven National Steel plans trusteed by PBGC are depicted in the table below.

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[3] To adequately address the delegations concerns, we focused our evaluation on the terminated steel plans that impacted Minnesota steelworkers and miners, namely those of the National Steel Corporation and the LTV Corporation. Also, for comparative analysis, we also reviewed selected aspects of the Bethlehem Steel Corporation’s plan termination. However, since aspects of the termination of the Thunderbird Mining Company’s pension plan were in litigation during our review, we did not include this plan within our scope (Thunderbird Mining is a subsidiary of the EVTAC Mining Company).

Pension Plan	Number of Participants/ Beneficiaries
Granite City Pension Plan for Chemical Workers	1,360
Weirton Retirement Plan	11,962
National Steel Corporation Retirement Plan	5,728
National Steel Corporation Pension Plan Hourly Employees	10,404
Granite City United Steelworkers of America Pension Plan	3,830
Pension Plan for Salaried Employees of National Steel Pellet	225
National Steel Pellet Company Pension Plan for Wage Employees	1,643

Table 1: National Steel Corporation pension plans trusteed by PBGC. We did not audit this data, derived from PBGC's Case Management System, a computerized system for tracking events and inquiries affecting pension plans.

Plan Terminations

In 2002, the PBGC recorded more than $9 billion in losses from actual or probable plan terminations. Of that amount, $7.9 billion related to five steel plans: a $3.9 billion loss from the termination of bankrupt Bethlehem Steel Corporation's massively underfunded pension plan; a $1.9 billion loss from the takeover of several pension plans sponsored by failed steelmaker LTV Corporation; a $1.3 billion loss from the termination of pension plans offered by the bankrupt National Steel Corporation; and the much smaller losses of $0.5 billion for Kaiser Aluminum and $0.3 billion for Republic Technologies from the terminations of their pension plans.

Fixing the Date of Plan Termination. PBGC can seek to terminate a pension plan if it makes one of several determinations, including that PBGC's "possible long-run loss may reasonably be expected to increase unreasonably if the plan is not terminated."[4] PBGC has exercised this authority in a number of cases to terminate plans whose liabilities were expected to increase substantially due to anticipated plant or company-wide shutdowns. This statutory scheme, however, sometimes resulted in a race between the company to shut down a facility and the PBGC to ask a court to terminate the plan (without advance notice to the company). Furthermore, the law provides that, when PBGC terminates a pension plan, the date of plan termination is "the date established by the [PBGC] and agreed to by the plan administrator."[5] If an agreement on the date cannot be reached, pension law provides that the termination date is established by the court.[6]

Shutdown Benefits. Some pension plans offer benefits that are contingent on a certain event occurring. A "shutdown benefit" is such a contingent-event benefit that is triggered by a plant shutdown or permanent layoff. These benefits permit participants who meet certain age and service requirements to begin receiving retirement benefits after a plant shutdown rather than having to wait until normal retirement date. Shut-down benefits are generally not pre-funded by

[4] ERISA section 4042(a)(4), 29 U.S.C. 1342(a)(4).

[5]ERISA section 4048(a)(3), 29 I.S.C.1348(a)(3).

[6]ERISA section 4048(a)(4), 29 U.S.C. 1348(a)(4).

the plan sponsor; that is, no money is put into the pension plan to cover the liability to the plan if the participants become eligible for the benefits because the event occurred.

Provisions for shutdown benefits, a type of early retirement benefit, are found primarily in the pension plans of large unionized companies in the auto, steel, and tire and rubber industries. PBGC reports that fewer than five percent of workers in PBGC-insured plans have shutdown benefit provisions in their plans. In pension plans of integrated[7] steel companies, shutdown benefits provide an unreduced early retirement benefit as early as age 42 (i.e., a worker would receive at age 42 the same monthly benefit he would have normally receive at age 62) plus a $400 monthly supplement until age 62.[8] Once triggered, this early retirement benefit continues to be paid, even if the worker finds new employment in the steel industry or any other industry. Because the increased benefits are usually available to an entire group of participants (e.g., all the eligible employees at the plant that shut down), the shutdown event can greatly increase a plan's liabilities in one stroke. Shutdown benefits may double or even triple the cost of a worker's benefit. Yet, this liability would not be funded through normal employer contributions to the plan.

Under a PBGC regulation that has existed since 1975, shutdown benefits are guaranteed by PBGC only if triggered prior to plan termination – that is, if the contingent event occurs before the plan terminates. The regulation says, essentially, if the plan is terminated prior to a plant shutting down, there are no shutdown benefits guaranteed by the agency. If, instead, the company shuts down a facility or the entire company, shutdown benefits are guaranteed if the plan terminates afterwards. It's a timing issue. Thus, PBGC's loss increases dramatically if termination is delayed until after shutdown triggers payment of those benefits. Not only has the company not paid money to the plan to fund these shutdown benefits, it also has not paid any premiums to the PBGC to reflect the risk (and potential cost) of these benefits.

When a company is in bankruptcy and its assets are sold to a third party or liquidated, usually the pension plan is terminated. This was the case with four large steel companies in 2001-2002 time period: LTV Steel, National Steel, Republic Technologies, and Bethlehem Steel. All of these steel companies' pension plans provided for early retirement benefits for certain qualified employees if all or part of the company were shut down, each company filed for bankruptcy protection, and had pension plans that terminated. The table below reflects PBGC's potential shutdown benefit liability in 2002 for these four companies' terminated pension plans.

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[7] An integrated steel mill operates the complete cycle of production processes, taking in iron ore, coal and other raw materials, and delivering finished steel products. In contrast, the non-integrated steel mills purchase scrap iron and re-melt it in electric furnaces to make steel. The integrated producers are typically larger and use unionized labor, while the smaller non-integrated steel producers typically use non-union workers. National Steel, LTV Steel, and Bethlehem Steel all operated integrated steel mills.

[8] This is the so-called "Social Security bridge" provision. It is a supplement that plans may offer in connection with early retirement provisions, including shut-down benefit provisions, but can be used in any plan in which one may retire before reaching social security age (62), i.e., it is not limited to shutdown benefits.

PENSION PLAN	PLAN TERMINATION DATE	PARTICIPANTS IN PENSION PLAN	PBGC'S POTENTIAL SHUTDOWN BENEFIT LIABILITY
LTV Steel	**March 31, 2002**	**82,291**	**$202 Million**
Republic Technologies	**June 14, 2002**	**6,237**	**$96 Million**
National Steel	**December 6, 2002**	**35,404**	**$348 Million**
Bethlehem Steel	**December 18, 2002**	**97,015**	**$566 Million**

Table 2: PBGC's potential shutdown benefit liability in 2002 for LTV Steel, Republic Technologies, National Steel and Bethlehem Steel

The Pension Protection Act of 2006. Since the 2002 termination of the National Steel significant changes have occurred in ERISA with the passage of the Pension Protection Act of 2006 (PPA). In particular, the PPA fixed the issue concerning when to set the plan termination date for companies that have filed for bankruptcy protection. According to the PPA, the bankruptcy petition date is deemed to be the plan termination date and any benefit accruing after that date is not guaranteed. Therefore, if a shutdown triggering event occurred after the bankruptcy date, shutdown benefits would not be guaranteed by PBGC.

Minnesota Steelworkers' and Miners' Concerns Regarding PBGC's handling of the National Steel Pension Plan Terminations

After receiving the request from members of the Minnesota congressional delegation to review and examine the work of PBGC regarding Minnesota steelworker pension plans, we established dedicated email and postal mail accounts to allow the steelworkers to send directly to our office any concerns or comments they had regarding PBGC's handling of their terminated pension plans. From this effort, we received correspondence from 127 plan participants. After careful review of each correspondence and a review of participant appeals, we determined the following to be the participant's major areas of concern:

- PBGC's decision process for fixing the date of pension plan termination;
- Why National Steel participants were not granted shutdown benefits, such as the "Rule-of-65," while such benefits were granted to LTV Steel participants;
- The difference in the plan funding levels reported by the plan sponsor versus those reported by PBGC; and
- Whether PBGC's actions to reduce pension benefits represented a violation of the federal anti-cutback law.

Objectives

Our overall objective was to evaluate PBGC's actions in terminating and establishing benefits for the Minnesota Steelworker pension plans.[9] For this report, our specific objectives were to determine for the National Steel pension plans: (1) whether PBGC adhered to applicable laws, and its own policy, when performing selected aspects of the pre-termination and trusteeship processes; (2) whether the source document and participant data audits met applicable professional standards; (3) whether the audits were conducted in accordance with contractual terms and PBGC's established protocols; and (4) the effectiveness of PBGC's oversight and quality control processes for these data audits.

Fieldwork for this evaluation was performed from December 2010 through May 2012. The evaluation was conducted in accordance with the *Quality Standards for Inspections* established by the Council of the Inspectors General on Integrity and Efficiency, as well as applicable OIG policies and procedures. These standards require that we plan and perform the evaluation to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our evaluation objectives.

Findings

I. PBGC Did Not Violate ERISA in Termination and Benefit Decisions in the National Steel Plans

A. PBGC's Termination Decision for National Steel Complies with ERISA and Is Well-Documented

PBGC did not violate ERISA or its own policy in termination and benefit decisions with respect to the National Steel pension plans. The termination record for National Steel provides adequate justification as to why PBGC moved to terminate the National Steel plans prior to the shutdown of operations, which resulted in participants' ineligibility for shut-down benefits.

PBGC's Termination Decisions are made on a Case-by-Case Basis

While one of PBGC's missions is to encourage the continuation of private pension plans,[10] it also must protect the long-run health of the PBGC's pension insurance program. In ERISA section 4042, PBGC was given the authority to involuntarily terminate a defined benefit pension plan

[9] To adequately address the Minnesota delegations concerns, we decided to focus our review work on the terminated steel plans that impacted Minnesota steelworkers and miners, namely the National Steel Corporation and the LTV Steel Company, Inc. Because certain aspects of the termination of the Thunderbird Mining Company's pension plan was in litigation during our review, we did not review this plan (Thunderbird Mining is a subsidiary of the EVTAC Mining Company).

[10] ERISA 4002(a)(1), 29 U.S.C. 1302(a)(1).

when any of four statutory criteria was met:

1. The plan has not met its minimum funding standard;
2. The plan will be unable to pay benefits when due;
3. The reportable event relating to certain payments to a substantial owner; or
4. The possible long-run loss to PBGC with respect to the plan "may reasonably be expected to increase unreasonably if the plan is not terminated."

PBGC monitors the financial health of the plans it insures; National Steel was one of those plans. While National Steel was attempting to reorganize under Chapter 11's bankruptcy proceedings (petition filed on March 6, 2002), PBGC was analyzing the company's ability to continue funding and maintaining the plans. In a memorandum to the Trusteeship Working Group (TWG),[11] PBGC financial analysts recommended that PBGC seek involuntary termination of seven of the eight National Steel plans based on the following application of ERISA 4042(a) termination criteria:

- "National has not made any minimum funding contributions to the four largest of the Plans for a full year, the missed contributions now total about $150 million. The Plans are collectively underfunded by about $1.5 billion, of which $1.2 billion is attributable to the four largest plans. In addition, all of the Plans have shutdown benefit provisions which, if triggered, would boost the aggregate underfunding to approximately $2.2 billion. For the four largest plans, these missed contributions satisfy the criterion of ERISA § 4024(a)(1)."
- "In addition, because each of the seven Plans has a funded ratio of only about 50%, and because National has no realistic prospect of adequately funding them, they meet the criterion of ERISA 4042 § (a)(2)."
- "Finally, because National has stopped funding the Plans while continuing to pay out plan benefits (including nonguaranteed benefits), and because a purchase of National's assets could under certain circumstances trigger some $350 million in guaranteed shutdown benefits, there is a significant risk that PBGC's long-run loss will increase unreasonably if the Plans are not terminated, satisfying the criterion of ERISA § 4042(a)(4)."

This TWG recommendation memorandum was supported by much documentation, including an analysis performed by a contracted financial analysis firm who specialized in the metals industry.

[11] The Trusteeship Working Group is an interdepartmental group made up of voting members which include the TWG Chairperson. The TWG is comprised of least two voting members from the following disciplines: actuaries, financial analysts, auditors and attorneys. The TWG is to objectively review a recommendation to terminate a pension plan to ensure that: (1) the administrative record supporting the termination decision is complete; (2) the various actuarial, financial, factual and legal issues in the case are appropriately developed; and that (3) the termination criteria have been met based on the relevant statutory criteria.

The Trusteeship Working Group concurred in this recommendation on December 4 and sent the recommendation to the Director. Under PBGC's processes, the PBGC Director was established as the approving official for termination determinations at this dollar level. On December 5, 2002, the Director signed Notices of Determination (NOD) to terminate the seven National Steel pension plans which stated, in part: "PBGC intends to proceed pursuant to ERISA § 4042, 29 U.S.C. §1342, to have the Plans terminated and PBGC appointed as statutory trustee, and pursuant to ERISA §- 4048, 29 U.S.C. § 1348, to have December 6, 2002, established as the Plans' termination date."

PBGC served notice of its termination decision in multiple ways. The NODs were sent to the plan sponsor. PBGC immediately issued a press release announcing its intention to terminate the National Steel plans. From this press release, national newspapers (e.g., Wall Street Journal) and local newspapers in geographic areas where the National Steel companies were located reported that PBGC was terminating the plans. PBGC also prepared a Notice to all National Steel Corporation participants, retirees and beneficiaries dated December 6, which is reproduced in Appendix B, that stated, in part:

> The Pension Benefit Guaranty Corp. ("PBGC"), a United States government agency, has determined under provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") that the above pension plans must end and that the PBGC must become statutory trustee of the pension plans. PBGC has determined that the company's sponsorship of the pension plans will end on December 6, 2002. As of that date, participants cannot earn any additional benefits under the plans.

Moreover, National Steel issued a memorandum to all employees on December 6 notifying them of PBGC's "intention to seek to assume responsibility for seven of eight National Steel Corporation pension plans." As of December 6, 2002, the participants had official notice that their pension plans were going to be terminated and they should not have expected to accrue any additional benefits as of that date.

Setting the National Steel Plans' Termination Date

On May 31, 2003, PBGC entered into a Trusteeship Agreement with National Steel and set the plans' termination date as December 6, 2002. Though the Trusteeship Agreement followed the NOD by almost six months and may appear to be a "retroactive" termination date, the termination date remained the same date – December 6, 2002 – that PBGC established in the NOD and published in the public Notices.

Many courts of appeals have affirmed PBGC's authority to establish the termination date. In an analogous pension plan involving steelworkers that was terminated in 2002 with similar circumstances as National Steel, PBGC took action to terminate the plans before shutdown benefits would accrue, and the Sixth Circuit Court of Appeals upheld PBGC's termination date.

In *PBGC v. Republic Technologies International, LLC and United Steelworkers of America*, 386 F.3d 659, 662-664 (Oct. 1, 2004), the Sixth Circuit recited the following facts:

- Republic Technologies International (RTI) was a leading producer of special bar quality steel products; it had two defined benefit pension plans that provided shutdown benefits; RTI filed for bankruptcy in 2001.
- RTI and the Steelworkers union negotiated a "shutdown agreement" in April 2002 that specified that sale to the potential purchaser would constitute a shutdown under the pension plan provisions. The bankruptcy court scheduled a hearing for July 9 to approve the agreement. The sale to the purchaser closed on August 16, 2002.
- PBGC's Trusteeship Working Group met on June 11, 2002, to consider the recommendation that the plans be terminated; the plans were severely underfunded; the TWG memo stated: "shutdown benefits potentially increased the amount of unfunded liabilities for the plans by almost $96 million." The TWG concurred in the terminations.
- On June 12, 2002, the PBGC Director issued a Notice of Determination establishing June 14, 2002 as the plans' termination date.

In considering whether the plans' termination date should be June 14 (as set by PBGC) or August 17 (the day after the asset sale), the Sixth Circuit analyzed and adopted a two-part approach that had been applied by several other circuit courts: (1) determine the earliest date when the participants had actual or constructive notice of the plan's termination, “i.e., sufficient notice to extinguish their reliance interests;” and (2) once that date is determined, "then select whatever later date serves the interest of PBGC." Applying this test, the court then concluded:

> After the employees received notice that PBGC intended to terminate the pension plans on June 14, the participants "no longer had a justifiable expectation in the accrual of vested pension rights."... In this case, PBGC, a self-financing public insurance corporation, is seeking an earlier termination date in order to protect its insurance fund from continued accruals of liabilities of unsound plans. ... Every court to consider the issue has concluded that expectation interests in the accrual of benefits are extinguished on the date the participants receive reasonable notice from PBGC that the plan is going to be terminated. (386 F.3d at 666-667).

These facts are very similar to those in National Steel. The pension plans provided for shutdown benefits. While National Steel was in bankruptcy and negotiating an asset sale with United Steel Corporation, PBGC took considered action based on ERISA 4042 to involuntarily terminate the pension plans - including considering the $350 million liability for shutdown benefits that could accrue. The Director signed Notices of Determination on December 5, 2002 and it was published the following day. The asset sale to United Steel culminated in May 2003. However, once PBGC issued the Notice on December 6 that specifically stated: “[a]s of that date, participants cannot earn any additional benefits under the plans,” the participants "expectation interest in the accrual of benefits are extinguished." For the National Steel pension plans, that date was December 6, 2002.

Differences Between LTV and National Steel Terminations

The Minnesota Congressional delegation and the National Steel participants point to the near-by LTV Steel companies, who also had defined benefit pension plans that provided shutdown benefits. Shortly before the National Steel terminations, PBGC did not move to terminate three pension plans sponsored by LTV Steel, resulting in the accrual of over $200 million in shutdown benefits to those participants. This is the crux of the Minnesota Steelworkers complaint that they were treated differently – and unfairly. As outlined above, each pension plan is treated differently, as ERISA section 4042 requires PBGC to examine the particular facts and circumstances of an individual plan against the statutory criteria to make a decision whether that plan must be terminated.

The LTV pension plans in which participants received shutdown benefits are LTV Steel Mining, LTV Hourly and LTV Salaried. A few facts about the timelines of these plans follow:

- **LTV Steel Mining Pension Plan**. On December 6, 2000, LTV Steel announced that iron mining and pellet production at the LTV Steel Mining Company, located in Minnesota, would cease permanently on February 24, 2001. On December 29, 2000, LTV Steel Corporation filed for Chapter 11 bankruptcy protection and shortly thereafter, on January 5, 2001, LTV Mining Company shut down its operations. PBGC did not terminate LTV Steel's mining pension plan until March 31, 2002, which was after shutdown benefits had accrued to the miners.
- **LTV Steel Hourly and Salaried Pension Plans**. Throughout LTV's bankruptcy the company had been losing cash at a rate of over $1 million a day and was projected to run out of liquidity by the end of December 2001. LTV had applied for a $250 million government-guaranteed loan under the Emergency Steel Loan Guarantee Act ("ESLGA"), which was believed to be essential for LTV to survive. On November 20, 2001, after having been in bankruptcy for 11 months, LTV petitioned the bankruptcy court for approval to implement an "asset protection plan" (APP)[12] to close operations at various steel manufacturing sites and to sell-off LTV steel assets. Since LTV plans (including the miners) shutdown before PBGC terminated them, millions in shutdown benefits accrued to the LTV participants.

  PBGC's Trusteeship Working Group (TWG) convened an informational meeting on November 29, 2001 to discuss the turn of events related to LTV. At this meeting, details were presented that, if the LTV plans were not terminated prior to the December 4th court hearing, PBGC would likely incur a $200 million increase in unfunded liabilities as the result of the accrual of shutdown benefits if the bankruptcy court approved the APP motion. This informational meeting memorandum, however, did not become an official recommendation to the TWG to terminate. PBGC did not terminate the LTV plans prior to the December 4th court hearing, thereby allowing $200 million in unfunded shutdown benefits to accrue. Just a

[12] The asset protection plan provided for the cessation of operations and the maintenance of selected assets for sale. Steel facilities were to be hot-idled for nine weeks while the facilities were taken through an accelerated auction.

few days following this TWG meeting, the court approved LTV's motion and shortly thereafter, as predicted, the company shut down its major operations and declared shutdown benefits for both its hourly and salaried employees – a bill, which the bankrupt company would not be paying, but rather PBGC. In April 2002, LTV's integrated steel business was sold and the purchaser did not assume any of its pension plans. PBGC terminated and trusteed LTV's pension plans in March 2002.

Just a few months after incurring this $200 million unfunded shut down liability for LTV participants, PBGC moved swiftly to take termination action prior to National Steel, RTI, and Bethlehem Steel's plant shutdowns, thereby avoiding the accrual of shutdown benefits for participants of these plans. When PBGC learned that these bankrupt steel companies were planning to sell their assets and thereby possibly trigger company shutdowns, with accompanying shutdown benefits, PBGC moved to terminate these plans prior to their asset sales. PBGC's prompt actions in these three steel cases precluded the agency from incurring huge unfunded early retirement benefits for participants - close to $350 million in unfunded shutdown liabilities for National Steel, $95 million for RTI, and in excess of $500 million were averted for Bethlehem Steel.[13]

The PBGC record does not contain documentation why PBGC did not act to terminate the LTV plans prior to plant shutdowns (and assumption of a $200 million unfunded shutdown benefit liability) when it had information that this scenario was likely. As part of OIG's inquiry as to why the Corporation chose to treat seemingly similarly situated bankrupt companies differently when determining when to termination, the OIG interviewed the then-current director of PBGC, Steven Kandarian. Mr. Kandarian became PBGC's Director on December 3, 2001 - the same month LTV filed its APP motion. He stated the decisions to terminate the various steel plans were his.

- At the time he arrived he thought LTV could be saved, but did not think National Steel and Bethlehem Steel had any chance of survival.
- He thought LTV still had a chance of obtaining a government loan and did not want the actions of PBGC to inadvertently interfere with such.
- After the LTV shutdown on December 19, 2001, PBGC's immediate assumption of unfunded benefit liabilities (including $200 million in shutdown benefits), resulted in about a 20 percent reduction in PBGC's assets.
- He studied the ERISA system carefully and determined that PBGC must "get out front" on these cases and he decided they would err on the side of taking plans sooner before shutdown benefits could accrue.

[13] Like in the RTI plans' terminations, in the Bethlehem Steel case, PBGC gave 2 days' notice of the PBGC-initiated termination. Largely, because PBGC had been criticized for involuntarily terminating pension plans without prior notice, however, the day in between the notice and the day PBGC took legal action to terminate the plan, Bethlehem's corporate executives shut down one facility, resulting in 188 workers at Bethlehem Steel's Steelton, Pennsylvania facility receiving approximately $14.5 million in shutdown benefits.

- He felt this would be the "greater good to PBGC," weighing the health of the pension insurance system as a whole for all covered participants against the interests of the participants in a particular plan to receive unfunded benefits.

Mr. Kandarian's statements to the OIG are supported by contemporaneous statements he made to a newspaper. In a 2002 article in the Cleveland Plain Dealer, the former director was quoted as stating, "…the agency did not step in earlier at LTV because efforts were being made to get a government loan and emerge from bankruptcy. …it would have sent a terrible message if an agency picked up the pension burden of a company that was seeking a loan from another arm of government. They tried to keep LTV alive."

Further, Mr. Kandarian's current explanation is documented in his 2003 responses to two Congressional letters when U.S. senators inquired about the timing of these large steel terminations and why LTV participants received shutdown benefits and those in the Bethlehem and National Steel plans, whose companies failed about the same time, did not. In response to a letter from an Indiana senator, then-PBGC Director Kandarian reported the following: because National Steel and Bethlehem Steel were in bankruptcy and had no intention of continuing their pension plans in the long term, PBGC moved to terminate the plans before major shutdowns occurred. If the plans terminations were postponed until shutdowns had occurred, the increased liability due to these unfunded shutdown benefits would ultimately be borne by the remaining participants in the defined benefit system.[14] Likewise, in response to a letter from a senator from Maryland, former PBGC Director Kandarian stated: "In the case of LTV, it was not clear until late in the bankruptcy that the company would liquidate and that PBGC would become responsible for LTV's pension plans…. With Bethlehem Steel, it was clear early on that the pension plan would have to be terminated. In fact, PBGC officials began discussions with Bethlehem Steel regarding possible pension plan termination shortly after the bankruptcy filing." The director went on to state that, "PBGC has clearly indicated to steel companies and to the USWA[15] that it does not favor payment of shutdown benefits in the context of a company sale or liquidation where the pension plans will not be continued."[16]

From the records, PBGC acted within its authority in ERISA 4042 in making termination decisions and establishing plan termination dates for both the National Steel and LTV Steel pension plans. Though PBGC's records do not explain the rationale for PBGC waiting to terminate LTV, subsequent contemporaneous documents do. In a matter like LTV, where PBGC's exposure is large, appears imminent, there are recommendations to take action and PBGC decides not to do so, it would be a best practice to record the factors PBGC considered to support its decision that it was in the best interests of the government not to take action at that particular time.

[14] February 2003 letter from Mr. Kandarian to Senator Bayh's January 2003 letter.

[15] United Steelworkers of America.

[16] February 2003 letter from Mr. Kandarian to Senator Mikulski's January 2003 letter.

B. *Calculation of Plan Funding Level at Termination is Different from On-going Funding under ERISA*

Many of the participants of the terminated National Steel Pellet Hourly Pension Plan expressed concern about the vast difference between their plan's funded status, as reported by the plan sponsor, and the funded status reported by PBGC once the agency took over the plan. The difference between these two reported funding levels led to the Pellet Hourly Wage participants' contention that their pension plan was fully funded and should not have been taken over by PBGC. Specifically, an undated document entitled "Notice to Participants of National Steel Pellet Company Pension Plan for Hourly Wage Employees,"[17]represented that the Pellet Hourly Plan was 88.3 percent funded as of January 1, 2000. As of the plan's December 6, 2002 termination date, however, PBGC calculated the plan was only 40 percent funded, with total underfunding of $72 million. There are many reasons for this difference.

Congress drafted ERISA to govern pension plans: in Title I of ERISA, Congress provided rules governing the operation of pension plans by the companies that sponsor the plans; in Title IV, Congress created a pension insurance program administered by PBGC for defined benefit pension plans and provided the sole means to terminate these plans. In Title I, Congress set out specific and detailed provisions regarding how plan sponsors are to value the assets and benefit liabilities of the pension plan in compliance with rules established by the Secretary of Treasury, and in accordance with the Internal Revenue Code.[18] In Title IV, Congress established different, and less detailed, provisions for PBGC's valuation of assets and benefit liabilities;[19] Congress also gave PBGC express authority to issue regulations to implement the statute.[20]

Prior to the enactment of the Pension Protection Act of 2006 (PPA), ERISA section 4011 required that certain underfunded plans provide to their participants and beneficiaries a notice of the plan's funding status.[21] The determination of "plan funding" is complex, using many different assumptions. To understand the divergence between the funding calculations that are used before and after a plan terminates, consider the different methods set out in ERISA (prior to enactment of PPA) –that actuaries used to estimate the liability for the present value of the future benefits – i.e., the eventual pension payments that retirees will receive. Prior to PPA, the

[17] Because this "Notice" is not on National Steel's letterhead and contains information about PBGC, it may appear that it was issued by PBGC. However, PBGC does not issue such notices to plan participants. Rather, the notice followed the model document PBGC provided for plans to use to meet the notice to participant requirements in then-ERISA 4011 for certain underfunded plans (see *http://www.pbgc.gov/res/other-guidance/tu/tu00-2.html.*).

[18] ERISA section 302 "Minimum Funding Standards" (29 U.S.C. 1082) in effect at the time the National Steel plans were operating and terminated was repealed by the Pension Protection Act of 2006 (Pub. L. 109-280). References in this report are to the statute in effect at the time.

[19] ERISA section 4044, 29 U.S.C. 1344, and implementing regulations at 29 C.F.R. 4044.

[20] ERISA 4002(b)(3); 29 U.S.C. 1302(b)(3).

[21] ERISA section 4011 was repealed by the Pension Protection Act of 2006; new section ERISA section 101(f) now requires annual notices to participants regardless of funding status.

funding status reported to participants was determined using the "current liability"[22] method, while PBGC used (and still uses) the "termination liability" method. Current and termination liabilities differ because the assumptions used to calculate them differ.

- The current liability method measured the value of accrued benefits using detailed assumptions specified in ERISA and other applicable laws and regulations. Current liability represented an estimate of the benefits earned to date, assuming that the sponsor would remain in business and the plan and its liabilities continues.

- The termination liability method begins from a different point – the plan is not continuing and the liabilities are now fixed. The termination liability reflects the cost to settle pension obligations in the private market – that is, the cost to purchase annuities to satisfy all benefit obligations of the plan as of the date of plan termination.

- Another important factor in the difference between the two funding percentages is how the plan's assets are valued. Prior to PPA, plan sponsors could value the plan assets "on the basis of any reasonable actuarial method of valuation which takes into account fair market value,"[23] while PBGC was (and still is) required to value the assets at fair market value "based on the method of valuation that most accurately reflects such fair market value.[24]

- Interest rates and retirement assumptions are key factors used in both these methods, and Federal law gives plan sponsors some choice in selecting the assumptions used to calculate the current plan liability. The degree to which the factors the plan used differ from those used by PBGC to calculate termination liability will impact the degree of difference between the two. For instance, for the purpose of reporting to participants the plan's current liability, Federal law required the plan sponsor to select the highest interest rate from within a permissible range of rates.[25] On the other hand, to calculate termination liability, PBGC uses an interest rate that is derived from annuity price surveys of insurance companies facilitated by the American Council of Life Insurers.

- Assumptions about when participants will retire also differ between the two calculations. For ongoing plans, Federal law required actuaries to use "reasonable"

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[22] ERISA section 302(d)(7), 29 U.S.C. 1082(d)(7) defined "current liability" in the then-current Minimum Funding Standards provision. ERISA does not refer to a "current liability method;" the OIG is using that as a reader-friendly way to differentiate between the method used by plan sponsors and that used by PBGC. We also note this section was repealed by PPA in 2006 and replaced with a new section 302.

[23] Then-current ERISA section 302(c); 29 U.S.C. 1082(c) (since repealed and replaced under PPA).

[24] 29 C.F.R. 4044.41(b).

[25] Then-current 29 C.F.R. § 4011.10(c) stated: "The Notice Funding Percentage that must be included in the Participant Notice for a plan year is the 'funded current liability percentage' (as that term is defined in section 302(d)(9)(C) of ERISA) for that plan year or the prior plan year." (http://www.pbgc.gov/res/laws-and-regulations/code-of-federal-regulations/part-4011---disclosure-to-participants.html). At that time, ERISA section 302(d)(9)(C) specified that plans were required to use the highest permitted interest rate.

> assumptions based on their "best estimate" of when people will retire, taking into account the specific experience of the plan and reasonable expectations.[26] On the other hand, for termination liability calculations, PBGC issued regulations defining "expected retirement age" based on its experience that when a plan terminates, it's more likely that people will lose their jobs and will elect to retire at the earliest date.[27]

Hence, the relationship between "current liability" and "termination liability" is variable and complex. Further, as noted by the Government Accountability Office (GAO), "because of leeway in the actuarial methodology and assumptions that sponsors may use to measure plan assets and liabilities, underfunding may actually have been more severe and widespread than reported on the [pension plan's] Form 5500", *Annual Return/Report of Employee Benefit Plan*."[28]

Adding to this complexity is the fact that plan sponsors – then and now – are not required to provide data that would help participants understand the different methods for calculating the funding status of plans and the consequences of pension underfunding and plan terminations. Specifically, the notices to participants are not required to disclose that the plan sponsor values the plan's funding status on an on-going basis, whereas PBGC values the plan's liability on a termination basis. This causes workers, such as the Pellet Hourly participants, to be shocked and dismayed when PBGC reports that their plan was funded at a ratio that was less than half of what they expected.

PBGC's use of the termination liability method to value the National Steel plans' liability, rather than the current liability method established under ERISA Title I for on-going plans, recognized Congress' different treatment of terminated and on-going pension plans.[29]

In addition to the different valuation methods, economic conditions impact the actual value of plan assets. In a report that examined weaknesses in ERISA's funding rules, GAO noted "Factors that increased the severity of plans' unfunded liability in 2002 [the year National Steel plans terminated] were the recent sharp decline in the stock market and a general decline in

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[26] Internal Revenue Code section 412(c)(3) that was in effect when National Steel plans were terminated provided that, for single-employer plans, "all costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods . . . each of which is reasonable (taking into account the experience of the plan and reasonable expectations)…"; this statute was repealed by PPA.

[27] 29 C.F.R. § 4001.2 definition of "Expected retirement age," (XRA) and XRA regulations at 29 C.F.R. §§ 4044.55-.57; see Preamble to regulations for PBGC explanation, 46 Fed. Reg. 9492, 9495-97 (Jan. 28, 1981) (interim rule), *adopted as final rule without change*, 47 Fed. Reg. 15780 (April 13, 1982).

[28] *Recent Experiences of Large Defined Benefit Plans Illustrate Weaknesses in Funding Rules*, GAO-05-294 (May 2005), pages 3 and 4.

[29] The OIG makes no representation about the accuracy of PBGC's determination that the National Steel plans were 47 percent funded. As we have previously determined, the plan asset valuation was seriously flawed; in this report, we find that the benefit liability determination is also seriously flawed. PBGC compares the value of plan assets to benefit liabilities to determine the plan's funded status.

interest rates."[30] Using the Bethlehem Steel plan as an example, GAO observed the following facts:

- The Forms 5500 submitted by the Bethlehem Steel Corporation for plan years 1992-1999 showed the plan's funding increased from 86 percent to 97 percent [i.e., the current liability].
- By the time the plan terminated in December 2002 "plan funding fell to 45 percent as assets decreased and liabilities increased, and sponsor contributions were not sufficient to offset the changes."[31] [i.e., termination liability].
- Seventy-three percent of Bethlehem Steel's $6.1 billion plan assets were in domestic and foreign stocks as of September 30, 2000.
- In 2001, those assets had decreased by $1.5 billion (about 25 percent) and by plan termination in December 2002, its assets had been reduced another 23 percent to about $3.5 billion.[32]
- Thus, within two years, the plan's assets, in actual value, had decreased by 43 percent.

GAO also noted in this report that a 2002 survey of pension plan investments "indicated that defined-benefit plans in general had about 62.8 percent of their assets invested in U.S. and international stocks in 1999."[33]

These Bethlehem Steel plan facts are similar to National Steel Pellet Hourly plan: National Steel reported to participants that their plan funding status in 2000 was 88.3 percent, but when the plan terminated in December 2002, PBGC determined the plan was only 40 percent funded to cover the benefit liabilities. Indeed, documents prepared by National Steel in 2001 and 2002 and submitted to the Federal government showed the same decline in asset value as GAO noted for Bethlehem Steel.

We note that in the Form 10-Q filed with the Securities and Exchange Commission for the third quarter of 2002, National Steel Corporation reported:

> Due to the sharp decline in the value of equity holdings in the Company's pension trusts, the September 30, 2002 market value of the assets in the National Steel employee pension plans is significantly lower than previously anticipated and will continue to be lower than the accumulated benefit obligation (ABO). In addition,

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[30] Testimony of Barbara D. Bovbjerg, GAO Director, Education, Workforce & Income Security Issues, *Changing Funding Rules and Enhancing Incentives Can Improve Plan Funding*, GAO-04-176T, October 29, 2003, page 7, based on report GAO-04-176.

[31] Id.

[32] Id.

[33] Id. at 7-8.

> since our Chapter 11 filing, while we have continued to accrue pension expense, we have not made funding payments to the pension trust."

Thus, in addition to ERISA's different treatment of current and termination liability calculations, changed economic conditions added to the vast difference between National Steel Pellet Hourly Plan's reported funding value in 2000 of 88.3 percent and PBGC's termination value in December 2002 of 40 percent.

C. Anti-Cutback Law Is Not Applicable to PBGC

Participants in the terminated National Steel Pellet Hourly Pension Plan asserted that PBGC had violated the anti-cutback law when it calculated their benefits. The participants expected to receive a certain benefit amount based on their years of work, however, when PBGC terminated and trusteed their pension plan many participants learned that they would receive a reduced benefit. Based on our review, PBGC did not violate the anti-cutback law when it reduced the participants' benefits but rather implemented ERISA required reductions in participants' pension benefits.

During our review, eight National Steel participants sent correspondence to our office stating that PBGC had violated the anti-cutback law. In addition, in numerous telephone conversations and in our meeting in Minnesota,[34] many of the steelworkers stated their belief that PBGC violated the "anti-cutback" rule when PBGC's calculation resulted in a reduced benefit. In one letter, a National Steel pension participant cited that PBGC "guarantees pensions up to $3,000, and I see no reason why my pension was cut" to $992.92. Another participant's letter sums up the steelworkers' position:

> "Anti-cutback rule states that benefits already earned cannot be taken away from you. So the benefits you had accrued before the plan changed cannot be reduced."

Specifically, the anti-cutback rule in ERISA § 204[35] states:

> The accrued benefit of a participant under a plan may not be decreased by an amendment of the plan, other than an amendment described in section 302(d)(2) or 4281.

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[34] At the Request of Senators Franken and Klobuchar, on April 15, 2011, the IG provided a briefing to National Steel participants in Minnesota to share the results of our first report regarding PBGC's processing of terminated Minnesota steelworker pension plans.

[35] 29 U.S.C. § 1054(g)(1); there is a companion rule in the Internal Revenue Code at 26 U.S.C. §411(g)(1).

On its face, this statute does not apply to PBGC. Section 204 plainly states that an accrued benefit "may not be decreased <u>by an amendment to the plan</u> [emphasis supplied]."[36] Section 204 prohibits a defined benefit pension plan from being amended to reduce accrued benefits – that is, the benefits of current plan participants that relate to their past service cannot be reduced through a plan amendment. A plan can only be amended while it is operational; once a plan is terminated, it cannot be amended. Thus, the anti-cutback rule applies to on-going pension plans not to PBGC.

ERISA contains different regulations for active and terminated plans. In fact, ERISA requires PBGC to make certain reductions in a participant's benefit, beginning with the precept that the benefit amount "guaranteed" by PBGC is the monthly benefit to which the participant would be entitled at age sixty-five.[37] The "phase-in" of benefits that have been in effect for less than 60 months prior to plan termination is another statutory reduction that PBGC must implement.[38] When a pension plan terminates and PBGC becomes trustee of the plan, it applies ERISA's benefit provisions and reduces – or "cuts back" – the participants' benefits to the level that are permitted under ERISA Title IV.[39]

Therefore, PBGC did not violate ERISA's anti-cutback provision but instead applied ERISA Title IV required benefit reduction provisions when it reduced participants' benefits.[40]

II. PBGC's Participant Data and Source Document Audits Provided Unreliable Results

A. Contractor's Work Was Seriously Flawed

Serious sampling errors plagued PBGC's efforts to determine the accuracy and validity of the information contained in the participant databases for the National Steel plans. Specifically, PBGC's contractor incorrectly calculated sampling error rates, ignored high error rates and began testing the participant databases prior to the inclusion into the databases hundreds of eligible participants.

Additionally, when performing the source document audits, PBGC's contractor did not document the testing of the source documents obtained from the plan sponsor; nor did the

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[36] In *Battoni v. IBEW Local Union No 102 Employee Pension Plan*, the Third Circuit Court of Appeals addressed the interpretation of § 204 and stated: "To state a claim for violation of ERISA's Anti-Cutback rule one must show (1) that a plan was amended and (2) that the amendment decreased an accrued benefit." 594 F.3d 230 (3rd Cir. 2010).

[37] ERISA § 4022(b)(3), 29 U.S.C. 1322(b)(3).

[38] ERISA § 4022(b)(1), 29 U.S.C. 1322 (b)(1).

[39] ERISA § 4042(d)(1)(b)(i) , 29 U.S.C. 1342 (d)(1)(b)(i).

[40] During this review, we did not consider PBGC's application of ERISA's benefit reduction provisions and, therefore, makes no representation as to whether PBGC applied them appropriately.

contractor assess the plan sponsor's internal control system to help determine the validity and accuracy of the participant data supplied by the sponsor and used by PBGC to build its participant databases. Finally, the audit work supporting both the source document and participant data audits failed to meet Government Auditing Standards and did not provide reasonable assurance as to the validity, reliability, and accuracy of the participant information.

PBGC accepted the contractor's work even though error rates were significantly high according to PBGC's own protocol. Sampling error rates far exceeded BAPD's expected error rate of 5 percent, in one or more sub-populations for each of the seven National Steel participant data audits. Yet, the contract auditors failed to follow the BAPD sampling procedures and, consequently, failed to correct and re-test this data for accuracy. For example, using the sample size and number of errors reported, we calculated the actual error rates for the following sub-populations:

Plan Name	Category Sampled	Universe	Sample Size	Number of Errors	OIG Calculated Error Rate
Granite City Pension Plan for Chemical Workers	Terminated Vested	62	8	2	25%
Granite City United Steelworkers of America Pension Plan	Beneficiaries	538	22	5	23%
National Steel Corporation Pension Plan Hourly Employees	Retirees	4036	62	9	15%
National Steel Pellet Company Pension Plan for Wage Employees	Retirees	755	52	8	15%
NS Corporation Retirement Program	Retirees	2306	65	8	12%
National Steel Weirton Retirement Plan	Terminated Vested	685	9	1	11%
Pension Plan for Salaried Employees of National Steel Pellet	Retirees	101	52	3	6%

Table 3: Examples of a high error rate in each National Steel participant data audit

The objective of sampling (or testing of the participant database) is to gain an acceptable level of assurance concerning the accuracy of the entire database (i.e., that the participant data contained in the source documents[41] were accurately entered into the database). To accomplish this, the auditor traces each sampled database record to the applicable source document. A sampling error occurs whenever any sampled data element in the participant database does not match the information in the applicable source document. An error can be either significant or insignificant.[42] Although there were one or more sub-populations within each of the seven audits that "failed" the database testing (i.e., the actual error rate exceeded the 5 percent expected

[41] The source for the participant data would typically be obtained from either paper source documents or electronic databases maintained by the plan sponsor.

[42] Significant errors are discrepancies that affect PBGC's ability to determine a participant's entitlement to a benefit or change the amount of a guaranteed benefit by more than $5 per month and affect the present value of future benefits or mean that PBGC cannot locate the participant. Only significant errors can cause a sub-population to be designated "Fail".

error rate for errors identified as significant), the auditors did not identify these sub-populations as failures in their report, nor was there any evidence the auditors corrected and re-tested the data to ensure actuaries were provided a reliable database to use in calculating participants' benefits. To further illustrate this point, all of the sub-populations, identified in the table above had an unacceptable number of significant errors and should have been designated as a "fail," thereby properly identifying the sections of the database that required corrections and re-testing. Although these "failed" sub-populations had error rates up to five times higher than the acceptable error rate of 5 percent, both PBGC and the contract auditor's management personnel did not follow procedures and approved all seven of these reports without ensuring the proper corrections were made to the participant databases.

Furthermore, our work also disclosed that the contract auditors incorrectly calculated many of the sampling error rates. Instead of calculating the actual error rate for the entire sub-population, as required by BAPD's Operations Manual, the auditors instead calculated the error rates for each incorrect data element *within* a sub-population, resulting in the reporting of much lower error rates than the true error rate would have been for the entire sub-population. For example, for the beneficiaries' sub-population of the Granite United Steelworkers Plan, the auditors calculated and reported errors for each of the seven data elements of this sub-population, depicting error rates of 4.5 percent for each of these data elements[43]; when in fact the actual error rate for the entire beneficiaries' sub-population was 23 percent; an error rate that was more than four times greater than BAPD's expected error rate of 5 percent. Once again, both PBGC and the contract auditor's management personnel did not follow procedures and approved these reports with faulty calculations of error rates.

		DATA ELEMENTS[44]		
Plan Name	**Sub-Population**	**PBGC's Calculated Error Rate for the Date of Termination**	**PBGC's Calculated Error Rate for the Date of Retirement**	**OIG's Calculated Error Rate for the Sub-Population**
NS Corporation Retirement Program	Retirees	4.6%	3.1%	12%
Granite City United Steelworkers of America Pension Plan	Beneficiaries	4.5%	4.5%	23%
National Steel Pellet Company Pension Plan for Wage Employees	Retirees	3.4%	2.6%	15%

Table 4: Selected sub-population sampling errors in National Steel plans.

[43] Each data element had one error, with a sub-population sample size of 22, therefore deriving a 4.5 percent error rate.

[44] Each of the sub-populations in table 4 depicted error rates for more than the two data elements identified; however, for illustrative purposes, we chose to show examples of error rates for only two of the data elements for each sub-population.

PBGC accepted audits with premature database sampling. The final testing (sampling) of the PDA databases for two National Steel plans was performed before all applicable participants had been included in the databases. Specifically,

- For the National Steel Weirton plan, the auditors performed the final testing of the participant database prior to determining whether to include an additional 295 participants who were later determined to have vested as of DOPT and therefore should have been included in the database. Therefore, the total participant population sampled was 11,745, but should have been 12,040. Additionally, the report did not mention any additional testing performed to validate the data supplied for these newly added 295 participants.

- For the National Steel Hourly plan, the auditors performed the final testing of the participant database prior to performing work to account for transfers between plans, therefore in this instance the total participant population sampled was 10,388, but should have been 10,417. No additional testing was performed to determine the validity of the data in the database for these additional 29 participants.

PBGC accepted audits with questionable validity. When performing the source document audits, PBGC's contractor did not document the testing of the source documents obtained from the plan sponsor. For instance, neither the work papers nor the reports detailed the sampling methodology, such as, information concerning the size of the population or how sample sizes were determined. The reports only show the participant category sampled and the number of files reviewed. The reports also did not disclose the criteria for determining whether the source documents were valid. Furthermore, the reports conclude that the source documents "are accurate and complete," yet make no mention as to how these conclusions were derived.

Additionally, according to PBGC's policy, the auditors were to assess the plan sponsor's internal control system to help determine the validity and accuracy of the participant data supplied by the sponsor and used by PBGC to build its participant databases. For example, there was no evidence the contractors determined whether the plan sponsor had instituted controls to provide reasonable assurance that participant data was recorded and processed accurately, completely and on a timely basis, and that modifications to participant data were valid and authorized.

B. PBGC's Oversight of the Contractor Was Inadequate

PBGC's oversight of the contract auditors was ineffective in identifying obvious and material errors and omissions in the work IMRG performed on the National Steel participant data and source document audits. According to the contract, PBGC was to conduct audits of the IMRG's services under the contract, "to obtain reasonable assurance that PBGC policies are being followed and internal controls are in place and are functioning." PBGC personnel responsible for monitoring IMRG's performance included the Contracting Officer's Technical

Representative (COTR) and personnel within the assigned Trusteeship Processing Division (TPD).[45]

No Evidence of COTR Monitoring. PBGC provided no COTR records demonstrating any monitoring or oversight of IMRG's work during the performance period of the National Steel source document and participant data audits. That is, PBGC provided no progress reports, no documentation to support any feedback from PBGC personnel who worked directly with the contractor, and no documents regarding the inspection and acceptance of the contractor's deliverables.

No Evidence of TPD Monitoring. PBGC officials advised that they were unable to locate any evidence of TPD monitoring. We found no evidence of such monitoring. There were no written products to show whether IMRG's work complied with contract performance standards related to technical quality, timeliness, demonstration of specific expertise, and overall performance. Furthermore, in reviewing the audit work papers, we noted that TPD personnel did not initial and date any of the work papers, as evidence of PBGC's review of these documents, nor did the work papers contain any review comments or notes authored by PBGC personnel.

Although there was no corroborating evidence that PBGC personnel reviewed any of IMRG's work, both the PBGC manager and the PBGC auditors assigned to manage and provide oversight for these fourteen National Steel audits signed IMRG's audit reports concurring with the results, supporting work papers, and attachments. Neither the PBGC manager nor the PBGC auditors commented on the inadequacies of the contract auditors' work or on the extensive noncompliance with Government Auditing Standards.

PBGC's Participant Data and Source Document Audits Did Not Comply with Contract Requirements. PBGC's contract with IMRG required that "work products are consistent with Government Auditing Standards" and that they comply with BAPD's operating manual. Government Auditing Standards, established by the Comptroller General of the United States, are the professional standards for government auditing that provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence. As we found in our prior National Steel audit of IMRG's plan asset audit work,[46] IMRG did not follow either the Government Audit Standards or the BAPD procedures in conducting post-trusteeship audits. If PBGC had monitored the contractor while it was performing the work and reviewed its deliverables, PBGC should have noted that IMRG was not complying with contract requirements, whether the more stringent Government Auditing Standards or the BAPD manual. Following are examples of inadequate audit work in the 14 products IMRG submitted:

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[45] TPDs are divisions within BAPD with primary responsibility for activities related toterminated pension plans that PBGC trustees.

[46] *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed*, No. 2011-10/PA-09-66-1, issued March 30, 2011 (http://oig.pbgc.gov/pdfs/PA-09-66-1.pdf)

- Incomplete audit work papers. Neither PBGC nor its contract auditor maintained a complete record of the auditors' work, whether in the form of work papers or in any other written form. For example:

    - ➢ Sampled personnel and payroll files that were to be obtained from the plan sponsor for analysis during the source document audit were not maintained in the work paper files;

    - ➢ The databases from which the samples were selected for the auditing of the participant databases were not maintained in the work paper files. According to the participant data audit reports, these databases were archived on PBGC's "I" drive. However, PBGC can no longer locate these databases;

    - ➢ The source documents traced to verify accuracy of participant data were not always maintained; and

    - ➢ The examination, evaluation, and resolution of "failed" sub-populations were not documented.

The maintenance of such documentation is necessary to support the sampling confidence level certified by the auditor and reviewer for the participant data audits.

- Audit work did not support the participant data audit reports' conclusions. Due to the numerous flaws in the sampling methodology and the lack of evidence as to whether identified errors were corrected, the participant data audit sampling results did not support the contractor's and PBGC's conclusions that, "…the valuation database, as constructed, may be relied upon to produce reasonable plan valuation and accurate individual benefit calculations…"

- No evidence that the audit engagement was adequately planned. Many of the errors and omissions noted previously would not have occurred if the audit had been properly planned. Although required by the manual, there was no audit program in the work papers. According to the PBGC auditor in charge of providing direct oversight for these audits, she cannot "recall" whether audit programs were developed for these audits.

- No documentation of significant conclusions and judgments. Because neither PBGC nor its contract auditors ensured documentation of key conclusions, others -- including those who review the work after the fact -- do not have the necessary information to allow reliance on the report's conclusions. For example, the following significant decisions were made concerning the audits, but were not documented in the work papers:

    - ➢ The contract auditors used two different sets of criteria when performing the sampling for the National Steel participant data audits, yet did not disclose this in the work papers. For example, the then-current PBGC[47] criteria stipulated an acceptable error rate of 5 percent

[47] This section of BAPD's Operations Manual, was dated March 28, 2003, and was entitled "12.7 Audit Participant Database." The National Steel participant data audits were completed in 2004 and early 2005.

and sample size of 60 for large populations; while a draft PBGC[48] criteria allowed an acceptable error rate of only 2 percent and required sample sizes of 160 for large populations. Based on OIG's review of the seven National Steel participant data audits, the auditors chose to follow certain aspects of both criteria, without properly documenting these decisions in the work papers, making it difficult to determine whether the sampling was accurately performed to achieve the desired confidence level concerning the accuracy and reliability of the entire population.

- ➢ The auditors did not document the factors used to decide which source documents to use to build the participant database; documentation, validity, and completeness are prime considerations when completing the source document audits.

- ➢ Management decisions regarding which type of errors would be considered significant during the participant data audits were not documented.

- No evidence of supervisory review of work performed. Although the participant data audit and database construction reports were signed by IMRG officials, there was no evidence of supervisory reviews annotated on any of the work papers.

PBGC Personnel Ultimately Responsible for Questionable Contract Work. Although a contractor completed the National Steel source document and participant data audits, PBGC was ultimately responsible for ensuring the contractor provided quality products in accordance with applicable auditing standards. In our opinion, both PBGC and its contract auditor failed in their responsibility for ensuring that the National Steel source document and participant data audits were conducted in accordance with applicable professional standards.

III. PBGC's Corrective Actions Initiated During OIG's Review

As a result of OIG's review of PBGC's processing of terminated National Steel and United Airlines pension plans, the Corporation has continued to address serious weaknesses in its benefit operations. In 2011, PBGC hired independent certified public accounting firms to revalue the National Steel and United Airlines plan assets and then recalculated participants' benefits based on their results. At United, most people were not affected at all, but about 34,500 people's benefits increased slightly - on average, by less than one percent. PBGC plans to re-issue the benefit determination letters to those participants who were affected.

In the National Steel plans, PBGC also revalued the plan assets and calculated new benefits. In this case, it appeared that the asset values were slightly lower than originally reported, which would have resulted in benefit decreases for some participants. However, since many years had passed and less documentation remained, PBGC decided not to change the original benefit determinations.

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[48] This draft section of BAPD's Operations Manual, was released November 30, 2005, and was entitled "12.7 Audit Participant Database."

In addition to re-accomplishing the original work and correcting errors, in 2012, the Deputy Director of Operations directed a strategic review of the structure, processes and procedures of PBGC's benefits operations. PBGC contracted with an external consultant to support the strategic review. In addition, PBGC hired a new Director of the Benefits Administration and Payment Department (BAPD). Under his leadership, BAPD has a new sense of urgency in developing effective corrective actions to address open audit recommendations and greater transparency in communications with the OIG.

As a result of this review and other analyses performed by management, the Corporation has begun making changes throughout the entire benefits operation, including processes, organizational restructuring, and personnel. To date, PBGC has:

- Recruited new leadership and staff, introduced additional training to enhance staff competencies and hired staff with auditing certifications;

- Established a new group of specialists in asset evaluation, including the hiring of three valuation experts, and contracted with an independent certified public accounting firm to provide additional valuation support;

- Improved operational and evaluation policies and procedures;

- Improved contractor oversight, and formed an independent quality management department to sharpen focus on quality and accountability.

IV. Concluding Remarks

We are not making any new recommendations to PBGC as a result of our report on the processing of National Steel Plans' terminations. As noted in the previous section, the Corporation has taken steps since 2011 to make significant changes to the entire benefits operations to address weaknesses. We will continue to monitor PBGC's progress in improving operations, establishing and strengthening internal controls, and conducting its oversight activities.

Appendix A: Scope and Methodology

The Office of Inspector General (OIG) received a request from U. S. Senators Amy Klobuchar and Al Franken, and U.S. Congressman James Oberstar to review and examine the work of the PBGC regarding Minnesota steelworker pension plans. This report is the second[49] and final report we plan to issue to address the concerns of the Minnesota congressional delegation and their constituents. The delegation requested the OIG review:

- Whether PBGC consistently applied ERISA, as well as its own regulations and policies , when terminating and calculating the benefits related to pension plans of Minnesota steelworkers as compared to similar plans; and

- PBGC's handling of selected participant concerns related to: shutdown benefits; PBGC's process for affixing the date of plan termination; determination of a plan's percentage of funding; and the applicability of the anti-cutback law to PBGC.

In an effort to address these areas of concern, the OIG reviewed selected aspects of PBGC's pre-trusteeship and benefit termination processes. This report focuses on PBGC's efforts to identify valid and accurate participant information for benefit calculations for National Steel Corporation's family of seven terminated pension plans; and selected aspects of PBGC's pre-termination process for the National Steel, LTV, and Bethlehem Steel plan terminations.

Fieldwork for this evaluation was performed from December 2010 through May 2012. The evaluation was conducted in accordance with the Quality Standards for Inspections established by the Council of the Inspectors General on Integrity and Efficiency, as well as applicable OIG policies and procedures. These standards require that we plan and perform the evaluation to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our evaluation objectives.

To achieve our evaluation objectives, we performed a detailed review of the seven source document audits and seven participant data audits of National Steel Pension Plans dated June 2003 through April 2004, and accepted by PBGC in June 2003 through January 2005. PBGC's audits - the subject of our review - were conducted by contract auditors, under PBGC oversight, and were intended to identify valid and accurate participant information for benefit calculations for seven terminated National Steel pension plans.

In addition to performing a detailed review of the issued Participant Data and Source Document Audit reports and supporting work papers and attachments, the OIG evaluation team:

1.) Identified and analyzed the laws, regulations, professional standards (including Government Auditing Standards and standards promulgated by the AICPA), and PBGC policy and

[49] On March 30, 2011, we issued the first report entitled, *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed* (PA-09-66-1). This report focused on PBGC's process to value the assets of the National Steel Corporation's family of seven terminated plans.

guidance applicable to the Participant Data and Source Document Audit process and to oversight of contractors.

2.) Obtained and analyzed PBGC's contract with IMRG for audit services to be provided between 2002 and 2008, as well as key documentation, progress reports, and other correspondence and documentation pertaining to the conduct of the National Steel Participant Data and Source Document Audits.

3.) Interviewed various BAPD managers; the TPD auditor who concurred with the Participant Data Audit reports; and various PBGC personnel with responsibility for leading the Participant Data and Source Document Audits of National Steel pension plans.

4.) Reviewed and analyzed the following National Steel Plan audits: Plan Document, Source Document, and Participant Data.

5.) Reviewed and analyzed selected Forms 5500, actuarial case memos, and certain aspects of PBGC's Case Management System to compare the participant counts as of the date of plan termination.

6.) Conducted detailed testing of the contract auditors' limited work papers that were available to support the participant data and source document audits.

7.) Reviewed the termination records for the National Steel, LTV, and Bethlehem Steel terminations.

8.) Reviewed applicable sections of ERISA related to plan terminations, the anti-cutback law, and the measurement of a plan's funded status.

Appendix B: PBGC Notice to National Steel Participants, Retirees and Beneficiaries

ATTENTION ALL NATIONAL STEEL CORP. AND WEIRTON STEEL CORP. PARTICIPANTS, RETIREES AND BENEFICIARIES OF THE FOLLOWING PENSION PLANS --

National Steel Corp. Retirement Program

National Steel Corp. Pension Plan-Hourly Employees

Granite City United Steelworkers of America Pension Plan

Granite City Pension Plan For Chemical Workers, Bricklayers, Hodcarriers, Blacksmiths, and Watchman's Union

National Steel Pellet Co. Pension Plan For Hourly Wage Employees

Pension Plan For Salaried Employees of National Steel Pellet Co.

Weirton Retirement Program

The Pension Benefit Guaranty Corp. ("PBGC"), a United States government agency, has determined under provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") that the above pension plans must end and that the PBGC must become statutory trustee of the pension plans.

PBGC has determined that the company's sponsorship of the pension plans will end on December 6, 2002. As of that date, participants cannot earn any additional benefits under the plans. PBGC will seek to take over the plans' assets and assume responsibility for paying benefits. In the interim, **National Steel Corp.** remains responsible for payment of plan benefits.

PBGC will guarantee benefits, according to plan provisions, up to the maximum amounts allowed by ERISA. Current retirees will experience no interruption in benefit payments. As participants become eligible for retirement under the plans and complete the required forms, PBGC will begin to pay their pension benefits. PBGC currently pays benefits to more than 300,000 individuals in over 3,000 pension plans it has previously taken over. The maximum guarantee for workers in plans that terminate in 2002 is $3,579.55 a month (or $42,954.60 a year) for persons retiring at age 65. Maximum guarantees are adjusted for retirees at other ages or those who elect survivor benefits.

PBGC
U.S. GOVERNMENT AGENCY

PENSION BENEFIT GUARANTY CORPORATION
December 6, 2002

Appendix C: PBGC Response

PENSION BENEFIT GUARANTY CORPORATION'S RESPONSE TO AUDIT REPORT

PBGC
Protecting America's Pensions
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

Office of the Director

MEMORANDUM

October 18, 2013

To: Deborah Stover-Springer
Acting Inspector General

Josh Gotbaum

From: Joshua Gotbaum

Subject: Your Report on PBGC's Processing of National Steel Plans

Thank you for your report. National Steel's bankruptcy meant that thousands covered by National Steel's pension plans were no longer protected by National Steel and found their pension obligations in the hands of PBGC. Since there are limits on PBGC insurance, that meant that, for many, the tragedy of the bankruptcy was compounded by finding out that they would not get their full pension. The fact that, had PBGC not taken over the plan and paid benefits, the cuts would have been worse, is not much comfort.

We hope your report will provide some comfort to the thousands affected that PBGC fulfilled its obligations in accordance with the law, that the pension termination decision and the benefit decisions were well-documented. Having carefully reviewed these issue in response to your earlier report, we feel confident that the National Steel plan participants' benefits have been calculated properly under the terms of their plans and ERISA. We are all well-aware, however, that PBGC benefits cannot fully compensate for the loss of the jobs and pension plans at National Steel.

We, of course, continue to work to preserve the integrity of our processes. Thanks to your earlier report, we knew that some of the asset valuation work was poorly done, so we made changes and reviewed that work. It is helpful that your current report acknowledges the improvements PBGC made in its asset valuation process. Your report also highlights other areas where we can and will continue to make improvements.

Thank you again for your work. We hope that it brings some closure to the many whose lives were so tragically affected by the National Steel bankruptcy.

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:
Pension Benefit Guaranty Corporation
Office of Inspector General
PO Box 34177
Washington, DC 20043-4177