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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Investigation To Reform Teamsters' Central States Pension Fund Found Inadequate

The Federal Government's 6-year investigation of the Teamsters' Central States, Southeast and Southwest Areas Pension Fund has cost about $8 million. It disclosed that former Fund trustees and officials allegedly mismanaged Fund assets and failed to carry out their fiduciary responsibilities.

Despite apparent benefits, the Department of Labor's investigation and subsequent Labor and the Internal Revenue Service (IRS) dealings with the Fund trustees had significant shortcomings and left numerous unresolved problems. Consequently, the agencies had to initiate a second investigation of the Fund.

Labor and IRS have taken or are taking actions on what needs to be done in general consonance with GAO's views and recommendations to (1) assure that past mistakes are not repeated in the current investigation, (2) remove the trustees' control and influence over the Fund's assets and moneys, and (3) have the Fund continue using an independent investigation manager to handle its assets after the current managers' contracts expire. The Fund's financial soundness has improved by recent investment performance, but it is still thinly funded and has an unfunded liability of $6.05 billion.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-199238

The Honorable William V. Roth, Jr., Chairman
The Honorable Sam Nunn, Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate

In response to your June 13, 1978, request and later discussions with your offices, we have reviewed the Government's investigation of the Teamsters' Central States, Southeast and Southwest Areas Pension Fund.

In August and September 1980 and October 1981, we testified before the Permanent Subcommittee on our findings and conclusions. This report summarizes the results of our review and contains recommendations to the Secretary of Labor, the Commissioner of Internal Revenue, and the Attorney General on (1) improvements needed in the current investigation at the Fund, (2) actions needed to remove the trustees' control and influence over the Fund's assets and moneys, and (3) actions needed to assure lasting reforms to the Fund's operations and financial soundness. The report also describes the actions taken or to be taken by the Departments of Labor and Justice and the Internal Revenue Service in consonance with our views and recommendations.

As arranged with your offices, unless you publicly announce its contents earlier, we will make no further distribution of this report for 30 days. At that time, we will send copies to the Secretary of Labor; the Commissioner of Internal Revenue; the Attorney General; the Executive Director, Teamsters' Central States, Southeast and Southwest Areas Pension Fund; and other interested parties and make copies available to others upon request.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

INVESTIGATION TO REFORM TEAMSTERS' CENTRAL STATES PENSION FUND FOUND INADEQUATE

D I G E S T

Despite some apparent benefits of the Federal Government's investigation of the Teamsters' Central States, Southeast and Southwest Areas Pension Fund, GAO believes that the investigation and subsequent dealings by the Department of Labor and the Internal Revenue Service (IRS) with the Fund's trustees had shortcomings and deficiencies and left numerous problems unresolved. Consequently, the agencies had to initiate a second investigation of the Fund.

The Fund is one of the largest private pension funds in the Nation and, as of December 31, 1980, it had about $3.1 billion in assets and about 505,400 participants. For many years, the Fund's trustees have been a subject of controversy and allegations of misusing and abusing the Fund's assets and making questionable loans to people linked to organized crime.

Therefore, in mid-1975 Labor initiated an investigation of the Fund under the Employee Retirement Income Security Act (ERISA). The Senate Permanent Subcommittee deferred its own investigation in 1975 to avoid duplicating Labor's work. However, the Subcommittee was not satisfied with Labor's progress. GAO's report responds to the Subcommittee's request for a comprehensive review of the adequacy and effectiveness of Labor's investigation and its coordination with IRS and the Department of Justice. (See pp. 1 to 9.)

LABOR'S INVESTIGATION WAS INCOMPLETE AND HAMPERED BY POOR MANAGEMENT, INEFFECTIVE COORDINATION, AND STAFFING PROBLEMS

Labor's objective of having a Government-wide coordinated investigation did not succeed because IRS declined to participate in a joint investigation. IRS' "go-it-alone" attitude and unwillingness to join the investigation did not adversely affect Labor's investigation until IRS decided in June 1976, without prior notice to the Fund or Labor, to revoke the Fund's tax-exempt status. IRS' action disrupted Labor's investigation and, according to Labor officials, created a "chaotic situation." (See pp. 15 to 16.)

Labor's investigation disclosed many alleged significant problems in the former trustees' management of the Fund's operations. However, Labor narrowly focused on the Fund's

real estate mortgage and collateral loans because of the significant dollar amounts involved and Labor's primary goal of protecting the Fund's assets. Labor ignored other areas of alleged abuse and mismanagement of the Fund's operations by the former trustees and left unresolved questions of potential civil and criminal violations and alleged mismanagement raised by its own investigators. The investigation was also incomplete in that the records had not been obtained or planned third-party investigations completed on all of the 82 loans targeted for investigation even though apparent significant fiduciary violations and imprudent practices were found. (See pp. 22 to 30.)

GAO's review as well as an internal Labor management report of May 1979--the so-called Kotch-Crino report--disclosed that the Special Investigations Staff (SIS), which was responsible for the investigation, had significant staffing, management, and coordination problems which adversely affected SIS' ability to conduct an effective investigation. The Kotch-Crino report concluded that "future SIS effectiveness is doubtful." As a result, SIS was abolished in May 1980. (See pp. 31 to 41.)

GAO also found that, despite interagency agreements, problems in coordination arose periodically between Labor and Justice--which restricted the flow of investigative information from Labor to Justice at times. Also, an impetus for the investigation was allegations linking the trustees to organized crime. Labor believed the new enforcement tools under ERISA gave it the opportunity to detect and seek removal of anyone who might be improperly influencing the Fund and its trustees. Labor's strategy was to have dual objectives to detect civil and criminal violations. Despite Labor's high hopes and goals, the investigation's objective to detect information for criminal investigation and prosecution was not entirely successful, and the results fell short of Labor's and Justice's expectations. In 5 years of investigative activity, Labor made only 11 formal referrals of loan information to Justice which had potential for criminal investigation. Also, Labor's and Justice's efforts resulted in only one criminal conviction. (See pp. 42 to 55.)

LABOR AND IRS DID NOT REQUIRE A WRITTEN AGREEMENT IN RESTORING THE FUND'S TAX-EXEMPT STATUS AND DID NOT INSURE THE FUND'S NEW TRUSTEES MET STATED QUALIFICATIONS

IRS, after coordinating with Labor, restored the Fund's tax-exempt status in April 1977. However, rather than have the trustees enter into a written agreement with Labor, such as a court-enforced consent decree, IRS--with Labor's

approval--based the requalification on the trustees' agreement to operate the Fund in accordance with ERISA and to comply with eight specific conditions prescribed by Labor and IRS. GAO believes that without a court enforceable consent decree Labor and IRS did not have an effective means to require the trustees to adhere to the conditions that they might otherwise have had.

Furthermore, as a condition for requalification the Fund agreed to Labor's and IRS' demand that the four holdover trustees resign. Labor and IRS also developed qualifications the new trustees should meet. However, Labor and IRS did not play an active role in insuring that the new trustees had met the qualifications they had developed even though Labor knew some of the former trustees--who allegedly mismanaged the Fund--were members of the Teamsters' union organizations that selected some of the new trustees. (See pp. 56 to 67.)

TRUSTEES TRY TO REASSERT CONTROL OVER FUND'S ASSETS AND INVESTMENTS

As another condition for requalification, in June 1977, the trustees appointed independent investment managers--the Equitable Life Assurance Society of the United States and Victor Palmieri and Company, Incorporated--to handle most of the Fund's assets. Both Equitable and Palmieri appear to be successfully managing the assets and investments.

Despite Equitable's and Palmieri's performances, the trustees have repeatedly sought to undermine the independence of Equitable and Palmieri and reassert control over the Fund's assets. For example, the trustees have (1) impeded Palmieri's attempts to sell certain Fund real estate in Las Vegas, (2) attempted to terminate Palmieri as an investment manager, and (3) had the Fund hire its own internal staff of real estate analysts--which, according to Labor, duplicated much of the investment managers' work. (See pp. 68 to 74.)

BENEFITS AND ADMINISTRATION ACCOUNT NOT ADEQUATELY MONITORED

Although the Fund transferred substantial funds to Equitable for investments, the Fund's trustees retained a significant amount of the Fund's income in the Benefits and Administration account (B&A account). For example, the account had $142 million at December 31, 1979. The trustees were supposed to use the B&A account to record the employers' contributions, pay the employees' benefits and the Fund's administrative expenses, and maintain an appropriate reserve for the

Fund. The remaining moneys were to be given to the independent managers for investments. Labor and IRS were responsible for monitoring the B&A account to assure the funds were prudently managed. Despite Labor officials' assurances to a congressional subcommittee, GAO found that Labor, as well as IRS, has not adequately monitored the trustees' control over the B&A account. As a result, in one case, the trustees apparently imprudently attempted to use the moneys to make a $91 million questionable loan to settle a court suit. (See pp. 75 to 88.)

LABOR AND IRS DID NOT INVESTIGATE UNRESOLVED PROBLEM AREAS OF ALLEGED MISMANAGEMENT

During its original onsite work at Fund headquarters, Labor's investigators identified patterns of apparent abuse of the Fund by former trustees which went uninvestigated. Also, IRS was not able to adequately investigate the Fund's compliance with the eight conditions of the April 1977 requalification letter. As a result, in April 1980 Labor renewed its investigation at the Fund, and IRS, after securing a court order, renewed its investigation in July 1980. GAO noted, however, that the investigations will not cover all of the potential areas of alleged abuse and mismanagement by the former trustees. (See pp. 89 to 106.)

PENSION PLAN IS STILL THINLY FUNDED

The Fund's last actuary's valuation report (issued in April 1981) stated that the current funding should satisfy ERISA's minimum funding standards. GAO's review of the report showed that the Fund's financial soundness improved, but it still has an unfunded liability, for current and future pension benefits, of $6.05 billion at January 1, 1980. GAO also believes that the plan is thinly funded and that continued annual improvements--based on gains in investment income--cannot be expected to the extent indicated by the valuation. Because the plan is apparently already liberal and the potential effect of things beyond the trustees' control, such as the deregulation of the trucking industry, the actuary recommends a conservative posture regarding any liberalizing of benefits. (See pp. 107 to 123.)

RECOMMENDATIONS

This report contains recommendations to the Secretary of Labor, the Commissioner of Internal Revenue, and the Attorney General. Principal recommendations of the report follow.

GAO is recommending that the Secretary and the Commissioner direct their respective investigation staffs to more closely

cooperate to prevent coordination problems and duplication between the investigations. GAO is also recommending certain actions that the Secretary and the Attorney General should take to help maintain effective coordination between Labor's and Justice's investigation groups. (See pp. 51, 55, 103, and 105.)

To assure that the Fund is managed prudently, GAO is also recommending that Labor, in consultation with IRS, among other things, (1) obtain an enforceable commitment (e.g., consent decree) from the trustees to consider a reorganization of the way the Fund handles and controls the employers' contributions and other income to remove the trustees' control over any of these funds and (2) retain veto power over selection of future trustees to assure they meet the Government's selection criteria and qualifications. (See pp. 67, 83, and 84.)

AGENCY AND FUND COMMENTS AND GAO'S EVALUATION

Labor and IRS generally agreed with the thrust of GAO's report and recommendations and described actions taken and being taken since early in calendar year 1981 which are in general consonance with GAO's views and recommendations on what needs to be done. Justice and Labor also generally agreed with GAO's recommendation on improving coordination between the two agencies. (See pp. 51, 67, 84, and 103.)

Labor pointed out, however, that the investigation and matters covered in the report essentially deal principally with events of the mid-1970s and were essentially concluded by mid-1980. Labor also pointed out therefore--and GAO agrees--that the report does not purport to fully describe or evaluate the recent or current undertakings by the current administration. However, because of Labor's and IRS' ongoing investigations GAO is precluded from determining whether the current administration efforts are fully effective.

Also, GAO obtained comments from the Fund, and the Fund stated that it is attempting to carry out GAO's recommendation on continuing the use of an independent investment manager. It said that the Fund's trustees have stated an unequivocal intent to enter into a consent decree which would require an independent investment manager for at least a 10-year period. GAO has considered the Fund's comments in the final report, but has not included a copy of the comments (see app. XVII).

Contents

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act
GAO	General Accounting Office
IBT	International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America union
IRS	Internal Revenue Service
LMSA	Labor-Management Services Administration
SIS	Special Investigations Staff

CHAPTER 1

INTRODUCTION

The Teamsters' 1/ Central States, Southeast and Southwest Areas Pension Fund (hereafter referred to as the Fund) is one of the largest private pension funds in the Nation. As of December 31, 1980, the Fund had about 505,400 participants and had about $3.1 billion in assets. In 1980, employer contributions to the Fund totaled about $652 million, and pension payments totaled about $362 million. The most recent actuarial report shows that the Fund had an accrued unfunded liability (for current and future plan benefits) of $6.05 billion as of January 1, 1980.

Since the Fund's inception in 1955, its trustees have been the subject of much adverse notoriety, controversy, and allegations of misuse and abuse of its assets. In 1965, for example, Mr. James Hoffa, a former president of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America (IBT) union and a Fund trustee, was convicted and served a prison sentence for fraudulent abuse of the Fund's assets. Allegations have also been made that individuals linked to organized crime had connections with, or actually controlled, the Fund's trustees and that questionable loans had been made by the trustees to people linked to organized crime. 2/

Over the past 14 years, various Federal agencies have investigated the Fund and the alleged misconduct by the trustees. The most recent--and probably one of the most significant and controversial--of the Government's investigations is the Department of Labor's investigation initiated in 1975. This was the first major Federal Government investigation under the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. 1001). ERISA was the first comprehensive legislation regulating private pension plans.

In addition to establishing standards of conduct for private pension plans and plan administrators, ERISA provides the Federal

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1/In its December 2, 1981, comments, the Fund pointed out that the official name of the Fund is "Central States, Southeast and Southwest Areas Pension Fund." We recognize that is the official name; but we added "Teamsters'" since this is the name commonly used to identify the Fund.

2/The allegations of corruption and influence, or actual control, of the Fund by organized crime are described in the "Oversight of Labor Department's Investigation of Teamsters Central States Pension Fund" hearings, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, 96th Cong., 2nd sess. (Aug. 25 and 26, and Sept. 29 and 30, 1980).

Government--particularly Labor--with the tools to regulate, investigate, and review plan operations and management. ERISA provided Labor both civil and criminal enforcement authority and authority to initiate litigation in a Federal district court to seek broad-ranging civil remedies to protect the private pension plans and their participants. Thus, with ERISA, the Federal Government--particularly Labor--had an opportunity to detect and seek removal of anyone who might be improperly controlling and influencing the Fund's operations and its trustees.

At the same time Labor initiated its investigation, the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, was considering its own investigation of the Fund, but deferred it because of Labor's investigation. Subsequently, the Subcommittee became concerned about the progress of Labor's investigation. The Subcommittee, therefore, requested us to comprehensively review the adequacy and effectiveness of Labor's investigation and the adequacy of its coordination with the Internal Revenue Service (IRS) and the Department of Justice.

This report details the results of our review. It points out that despite apparent benefits from the Government's investigation efforts, 1/ the investigation and subsequent dealings by Labor and IRS with the Fund's trustees had significant shortcomings and deficiencies, left numerous problems unresolved, and failed to gain lasting reforms and improvement in the Fund's operation. As a consequence, both Labor and IRS had to initiate a second onsite investigation at the Fund.

The report also discusses actions taken or to be taken by Labor, IRS, and Justice in consonance with our recommendations.

THE EMPLOYEE RETIREMENT INCOME SECURITY ACT

To protect employees' interests, ERISA established a comprehensive framework of minimum standards, including standards of conduct, responsibilities, and obligations for administrators, trustees, and fiduciaries of private pension plans. Labor and IRS share the responsibilities for enforcing ERISA. Labor is primarily responsible for enforcing the reporting, disclosure, and fiduciary provisions. IRS enforces the act's participation, vesting, and funding provisions.

One of the most important and significant features of ERISA, designed to prevent abuse and misuse of private pension funds,

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1/See appendix I for a chronology of key events in the Government's investigation and appendix II for a list of principal officials involved in the investigation.

is the stringent requirements placed on persons acting as fiduciaries--persons who exercise control or authority over plan management and assets. ERISA requires a fiduciary to discharge his or her duties solely in the interest of the participants and beneficiaries for exclusively providing them with benefits and defraying the reasonable expenses of administering the plan. Fiduciaries are subject to the "prudent man rule." That is, they must exercise the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use in conducting a similar enterprise.

ERISA provides that fiduciaries who breach their responsibilities, obligations, or duties shall be (1) personally liable to make good any losses resulting from their actions, (2) subject to removal, and (3) subject to civil and criminal prosecution.

Another significant feature of ERISA is that pension plan sponsors and participants can qualify for favorable tax treatment if their plans meet ERISA and related Internal Revenue Code requirements. Qualifying for favorable tax treatment means that business contributions to pension plans are generally tax deductible, earnings on the business contributions held by a pension plan are not taxed, and employees do not pay taxes on their benefits until they receive them.

ERISA and the Internal Revenue Code establish certain criteria and rules a pension plan must meet to qualify for favorable tax treatment. IRS examines a pension plan and makes a determination whether the plan meets the criteria, and if so, IRS issues a letter of qualification. IRS can revoke a plan's qualification--or tax-exempt status--if a later examination reveals that the plan does not fully comply with ERISA and the Code.

ERISA enforcement

Within Labor, the Pension and Welfare Benefit Programs office, in the Labor-Management Services Administration (LMSA), enforces ERISA. LMSA is under the Assistant Secretary of Labor-Management Relations, and it enforces ERISA through a staff at the headquarters and in 6 regional and 24 area offices nationwide. LMSA is assisted by the Division of Plan Benefits Security in Labor's Office of the Solicitor.

LMSA also had a Special Investigations Staff (SIS), which handled the investigation of the Fund from January 1976 until Labor abolished SIS in May 1980. At that time, Labor transferred

most SIS personnel to a Special Litigation Staff 1/ in the Office of the Solicitor.

Within IRS headquarters, the Employees Plans Division under the Assistant Commissioner, Employee Plans and Exempt Organizations, is responsible for enforcing ERISA. The Division enforces ERISA through staff at IRS headquarters and at 7 regional and 19 key district offices 2/ nationwide. In the regions, the Assistant Regional Commissioner (Examination), under the jurisdiction of the Regional Commissioner, enforces ERISA.

THE FUND

The Fund was organized in February 1955, as a multiemployer plan under the Labor Management Relations Act of 1947, as amended (29 U.S.C. 186(c)(5)--the Taft-Hartley Act). This act provides that such trust funds be (1) based on payments or contributions from employers, (2) managed for the sole benefit of eligible employees and their beneficiaries, (3) governed by a written agreement specifying the employer payments/contributions and employee benefits, and (4) administered by an equal number of representatives from the employees' and employers' organizations.

The Fund, from its inception, has been governed by a Board of Trustees established under a trust agreement entered into in March 1955 between the IBT union and seven trucking associations. Since October 1976, the number of trustees has varied from 16 to 10 and finally to the current 8. Since October 1976, half of the Fund's trustees have been selected by IBT's Central and Southern Conferences and the other half by various trucking associations contributing to the Fund. 3/

Under the trust agreement, the Board of Trustees is responsible for managing and protecting the Fund. Also, under ERISA, the Board acts as "fiduciary" of the Fund's assets and is subject to the fiduciary requirements of the act. Before June 30, 1977, the Board established all policies for the Fund's operations including benefit payment levels and made all management and investment

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1/On October 1, 1981, the Special Litigation Staff's name was changed to the Special Litigation Task Force.

2/Although IRS has 58 district offices, employees' plans activities are primarily carried out by 19 offices which are referred to as "key" district offices.

3/See appendixes III, IV, and V for lists of trustees from October 26, 1976, to December 1, 1981, and appendixes VI, VII, and VIII for the union and employer organizations that selected the trustees.

decisions relating to the Fund's assets. In July 1977, under an agreement with Labor and IRS, the Board entered into a series of contracts under which the Equitable Life Assurance Society of the United States was appointed as overall or managing "fiduciary" of the Fund and investment manager for the Fund's real estate east of the Mississippi. Also, the Victor Palmieri and Company Incorporated was appointed investment manager for Fund real estate assets west of the Mississippi. Under their contracts, Equitable and Palmieri assumed control of most of the Fund's assets on October 3, 1977, and the contracts expire on October 2, 1982.

As of December 31, 1980, the Fund had about 391,280 active participants who belong to about 300 local unions of the IBT union. The locals are located throughout the Central, Southeastern, and Southwestern areas of the United States. The Fund also had 89,888 retirees receiving pension benefits under a defined benefit pension plan 1/ as of December 31, 1980.

With about $3.1 billion in assets, the Fund ranks 41st among private pension funds in the country and is the second largest Taft-Hartley trust. The schedule below lists the Fund's total assets as shown on its annual reports (Form 5500) 2/ for calendar years 1976-80.

Calendar year	Total assets (millions)
1976	$1,508
1977	1,706
1978	2,022
1979	2,492
1980	3/3,097

1/A defined benefit pension plan provides (1) definitely determinable benefits based on such factors as years of employment and compensation received and (2) the employers' contributions to fund the benefits be determined actuarially.

2/ERISA requires most pension plans to file annual reports containing basic plan financial and operational information. The Fund files "Form 5500, Annual Return/Report of Employee Benefit Plan (with 100 or more participants)."

3/In December 1981, Fund officials told us that the Fund's assets had increased to $3.4 billion at October 31, 1981.

An Equitable report at the end of calendar year 1980 showed that Equitable and Palmieri had under their control $2.9 billion of the Fund's assets. 1/

The Fund is financed by employer contributions made under collective-bargaining agreements entered into by various local unions and employers and by returns on the Fund's investments. In 1977, about 16,300 employers, belonging to seven employer associations, made contributions, depending upon a scale of such variables as job description, collective-bargaining agreements, and grade of workers.

Over the past several years, the employers' contributions as well as the number of retirees receiving pension benefit payments have increased. This is illustrated in the following schedule, based on the Fund's annual reports for calendar years 1976-80.

Calendar year	Employers' contributions	Benefit payments	Number of retirees or separated participants receiving benefits (note a)
	(millions)		
1976	$321.8	$224.5	69,295
1977	418.7	275.5	73,066
1978	497.1	303.1	79,290
1979	606.6	349.5	83,477
1980	651.9	361.5	89,888

a/ These exclude (1) retired or separated participants entitled to future benefits and (2) deceased participants whose beneficiaries are receiving or are entitled to receive benefits. The Fund's annual report for 1980, for example, showed 19,787 participants under category (1) and 4,434 participants under category (2).

BACKGROUND ON LABOR'S INVESTIGATION OF THE FUND

The impetus for Labor's investigation was the numerous charges and allegations, over the years, concerning the trustees' mismanagement and those linking the Fund to organized crime. It was also speculated that the mysterious disappearance of James Hoffa, the former president of the IBT union, during the summer of 1975 was related to his knowledge about the Fund's operations.

1/ See appendixes IX and X for tables showing Fund assets controlled by Equitable, Palmieri, and other investment managers hired by Equitable.

Consequently, in mid-1975 Labor initiated its investigation under the broad new enforcement, investigative, and litigative powers in ERISA. Under section 504 of ERISA, Labor, for the first time, had the authority to make a comprehensive review and investigation of the Fund by including the authority to inspect books and records at the Fund; subpoena the Fund's records and books; and take testimony under oath or by affadavit from trustees, plan employees, or interested parties.

In addition, Labor has authority to initiate litigation in Federal district court to seek (1) broad-ranging civil remedies against the Fund's fiduciaries to require them to make good any loss suffered by the plan because of breach of fiduciary duty or to restore any profits gained through violation of fiduciary obligations or (2) removal of a trustee or other fiduciary.

ERISA also provides criminal enforcement authority for willful violations of reporting and disclosure provisions; interfering with the rights of a participant or a beneficiary of an employee benefit plan through the use of fraud, violence, or coercion; and prohibiting persons who have been convicted of violating certain criminal laws from holding office in the plan. ERISA requires that, if during an investigation Labor detects potential criminal violations, such as embezzlement or kickbacks, this information is to be referred to Justice for consideration for investigation or prosecution under title 18 of the United States Code.

Labor maintained that prior efforts of the Government to deal with the Fund by using Federal tax, as well as criminal, laws were inadequate and did not produce any discernible change in the trustees' policies or practices. Labor believed that ERISA now provided a basis for a new approach and gave the Government an opportunity and the tools to make a comprehensive investigation and review of the the Fund's operations and management. Labor's overall objectives for the investigation were to determine whether the trustees were administering the Fund in a manner consistent with the fiduciary standards of ERISA and for the exclusive interests of the participants and beneficiaries.

Labor also established SIS at LMSA's headquarters to specifically conduct the investigation.

Senate Subcommittee decides not to duplicate Labor's investigation

The Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, was also concerned by the many allegations of mismanagement of the Fund and, in 1975, was seriously considering making its own investigation of the Fund's management and

operations. According to the the Subcommittee's Chairman: 1/

> "There have been charges of conflicts of interest on the part of individual fund trustees involving borrowers seeking financial backing from the fund. It is alleged that millions of dollars have been invested in enterprises controlled by organized crime, and that large loans have been freely given to associates of known organized crime figures.
>
> "Rightly or wrongly, one can come away from all of the charges and allegations that have been made wondering whether the Central States Fund has been playing a banker's role for organized crime interests over the years."

However, before the Subcommittee undertook its investigation, the former administrator of Labor's Pension and Welfare Benefit Programs Office presented a detailed briefing to the Subcommittee's members and staff on the scope, concept, and basis of its investigation. The Subcommittee Chairman, in describing Labor's briefing and the Subcommittee's understanding of the parameters and scope of Labor's investigation, commented: 1/

> "In short, as it was described to the subcommittee, the Central States Fund task force envisaged a broad-based, carefully planned, and well-coordinated executive branch inquiry into the affairs of the Central States Fund, using the combined resources and expertise of the Labor and Justice Departments and the IRS."

The Chairman also stated that, during the briefing, a good deal of attention was devoted to the question of whether the Subcommittee should also investigate the Fund. He said it was recognized, however, that a simultaneous congressional investigation of the Fund might impede the work of the task force, result in a competition for witnesses and documents, and be counterproductive. Therefore, the Subcommittee Chairman concluded:

> "To obviate such a situation, and in view of the executive branch's major commitment to the task,

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1/See hearings on the "Teamsters' Central States Pension Fund" before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, 95th Congress, 1st sess., pages 1 to 4 (July 18 and 19, 1977).

the subcommittee decided to defer any investigation of the fund to avoid duplicating and possibly complicating the work of the task force."

Labor officials continued with their investigation, but agreed to keep the Subcommittee apprised of the investigation. Also, the Subcommittee continued to exercise oversight jurisdiction over Labor's investigation during congressional hearings. 1/ However, as the investigation proceeded the Subcommittee was not satisfied with the information Labor provided or the progress of the investigation.

OBJECTIVES, SCOPE, AND METHODOLOGY

On June 13, 1978, the Chairman and Ranking Minority Member of the Senate Permanent Subcommittee on Investigations requested us to undertake a comprehensive review of the adequacy and effectiveness of Labor's investigation. As agreed with the Subcommittee, our review focused on determining whether Labor

- --effectively planned, managed, and carried out the investigation;
- --committed adequate staff and resources to the investigation; and
- --adequately coordinated and cooperated with Justice and IRS.

We also reviewed the adequacy and effectiveness of Labor's and IRS'

- --negotiations with the trustees to reform the Fund's operations and requalify the Fund as tax exempt after IRS revoked its tax-exempt status on June 25, 1976, and
- --monitoring of the trustees' compliance with the Government's conditions of April 26, 1977, which requalified the Fund's tax-exempt status.

We made the review at (1) Labor headquarters in Washington, D.C., and its field site in Chicago, Illinois, located near the Fund's offices and (2) Justice headquarters in Washington, D.C., and U.S. attorneys' offices in Chicago, Illinois, and Philadelphia, Pennsylvania. Our review was performed in accordance with our "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

1/Since 1976, the Subcommittee and several other Senate and House Subcommittees have held hearings on the Government's investigation of the Fund (see app. XII).

Review at Labor

At Labor's headquarters, we reviewed the pertinent provisions of the Labor Management Relations Act of 1947 (the Taft-Hartley Act) and ERISA and its amendments of 1980, 1/ particularly those relating to Labor's enforcement authorities and responsibilities. In addition, we identified and evaluated Labor regulations, policies, procedures, and strategies for enforcing ERISA and for making investigations of pension plans, such as the Fund.

To determine the adequacy of Labor's staffing and resources provided for the investigation, we reviewed and evaluated the organization, staffing budgets, and other pertinent personnel records for offices involved in the investigation. These were SIS in LMSA and the Division of Plan Benefits Security and the Special Litigation Staff 2/ in the Office of the Solicitor. We also reviewed the personnel and other records of 16 selected SIS members to determine and evaluate their education, background, work experience, and training.

We also interviewed key Labor officials 3/ involved in the investigation. In addition, at the request of the Subcommittee, we interviewed former key Labor officials who were involved in the investigation including the former administrator of the Pension and Welfare Benefit Programs Office, the former director of SIS, the former deputy director (counsel) of SIS, a former Associate Solicitor, and the former consultant to the Secretary of Labor appointed to oversee the investigation from February to June 1977.

To determine the effectiveness of Labor's coordination efforts with other Government agencies, we reviewed and evaluated the (1) various agreements Labor and Justice entered into during 1975 and 1978 and (2) memorandum of understanding Labor and IRS signed in 1978. These memorandums and agreements set out the formal procedures, coordination, and enforcement responsibilities for Labor, IRS, and Justice. Our evaluation included determining whether the three agencies followed the procedures and carried out their responsibilities and effectively coordinated their investigation efforts.

Our review to determine the adequacy and effectiveness of Labor's investigation of the Fund and its dealings with the Fund's trustees was based, for the most part, on a review of various internal Labor reports on the investigation and an extensive review

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1/See footnote 1, page 13.

2/See footnote 1, page 4.

3/See appendix II for a list of the key Labor and other agency officials.

and evaluation of the voluminous records and documents compiled by SIS since beginning its investigation in 1975. SIS essentially maintained two filing systems, one system entitled "The Executive Files" contained records and documents on Labor's management of the investigation. We reviewed and evaluated all of the documents in this system.

The other system entitled "SIS Formal File System" contained records and documents from, and relating to the Fund, reports, memorandums, and records prepared by SIS during the investigation. We reviewed and evaluated the files containing the significant records, reports, and documents on SIS' investigations at the Fund and its dealings with Fund officials.

SIS also had several hundred case and bulk files containing records and documents which SIS developed during its review of particular Fund loans, loan groupings, or transactions. These files involved a good deal of the "evidentiary" material supporting Labor's civil suit filed against the former Fund trustees and officials in February 1978. 1/ Since our office's policy is not to review issues in litigation, we did not make a detailed review of the material in the case and bulk files. We did, however, review and evaluate documents and records in the case and bulk files pertinent and relevant to Labor's management of the investigation, its coordination efforts, and its dealing with Fund officials.

In addition to SIS' records, the Division of Plan Benefits Security in the Office of the Solicitor maintained a chronological file on the investigation. We made a detailed review and evaluation of the records and documents in these files from 1976 through mid-1980.

During the course of our review, high-level Labor officials had the following three internal reports prepared on the investigation.

1. A May 11, 1979, report entitled "Special Investigations Staff Review"--the so-called Kotch-Crino Report--prepared for the Deputy Assistant Secretary of LMSA by two LMSA field office staff.

2. A November 19, 1979, report entitled "Central States Southeast and Southwest Areas Pension and Health and Welfare Funds" prepared for the Deputy Assistant Secretary of LMSA by an LMSA Atlanta Deputy Assistant Regional Administrator.

1/Donovan v. Fitzsimmons, et al., C.A. 78C-342 USDC, N-D-Ill.

3. A February 1, 1980, report summarizing the performance of the current Fund trustees, and it was prepared by the Solicitor and submitted to the Secretary of Labor.

The findings in the above reports disclosed many of the problems and shortcomings we found in Labor's investigation of the Fund. Therefore, we have included pertinent references in our report.

We also made a brief visit to Labor's Chicago field office and test checked some of the duplicate investigative files for completeness against those at Labor headquarters. Also, we interviewed three LMSA Chicago officials who had participated in the investigation.

Review at Justice

At Justice headquarters and the U.S. attorneys' offices in Chicago and Philadelphia, we interviewed officials of the Criminal Division, its Organized Crime and Racketeering Section, and the Civil Division. Our interviews were designed to obtain information on the officials' evaluation of the cooperation and coordination with Labor during the investigation and in handling its civil suit against former Fund officials filed in February 1978.

We also reviewed and evaluated Justice's documents and records pertinent to the investigation and the coordination between Labor and Justice, particularly on the referral of potential criminal violations from Labor to Justice. We had complete access to Justice's records except those relating to its open investigations. However, this restriction did not affect our ability to evaluate the coordination.

Review at IRS

Our review of the effectiveness of Labor's coordination with IRS was based on a review of Labor's records, transcripts of hearings held by the various congressional subcommittees on the investigation, interviews with current and former Labor and Justice officials, and material supplied by the Senate Permanent Subcommittee on Investigations. We did not review IRS records or interview IRS officials involved in the investigation in light of the restrictions imposed by section 6103 of the Internal Revenue Code, on the disclosure of any information concerning its investigation of a single taxpayer. An IRS headquarters' official told us that IRS considers the Fund an individual taxpayer. Therefore, IRS considered that it was prohibited from giving us any information on its investigation of the Fund--"if such an investigation by IRS was made."

Other limitations

We did not:

--Review the records of the Fund, the trustees, the Fund officials, or its investment managers because ERISA, at the time of our review, did not give GAO access to the records of private pension trusts. 1/

--Interview officials of the Fund and its investment managers or the trustees. 2/

--Review Labor's and IRS' renewed investigation of the Fund.

--Review Labor's and IRS' investigation of the Teamsters' Central States, Southeast and Southwest Areas Health and Welfare Fund.

We did, however, review the Fund's and investment managers' records and the Fund's actuarial reports Labor had or the Subcommittee or the Fund provided us.

Also, consistent with our office policy of not addressing issues in litigation, we did not review the merits of Labor's civil lawsuit filed on February 1, 1978, against the former Fund trustees and officials.

We also had a restriction placed on us by Labor as to our access to the May 11, 1979, Kotch-Crino report. We were not aware of this report until the day of our testimony before the Senate Permanent Subcommittee on Investigations on August 25, 1980. In fact, a Labor official had told us that the report did not exist. Therefore, we made no reference to it in our prepared testimony on August 25. By not having the Kotch-Crino report, we were not aware

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1/On September 26, 1980, ERISA was amended by the Multiemployer Pension Plan Amendments Act of 1980 (Public Law 96-364). This act requires GAO to conduct a study of the effects of the amendments, and to do this, GAO shall have access to any books, documents, papers, records, or other information within the possession or control of the administrator or sponsor of a multiemployer plan.

2/On October 22, 1981, we furnished the Fund a copy of our draft report. At the Fund's request, on December 2, 1981, we met with the Fund's Executive Director and an attorney representing the Fund and were presented the Fund's comments on the draft report. We have considered the Fund's comments in our final report, but we have not included a copy of the comments (see app. XVII).

of its findings and therefore duplicated some of the areas covered by it. Normally, we would have done less work in areas of already identified management problems. Also, we could have used it to confirm and amplify our testimony. We have included references to the Kotch-Crino report's findings in this report.

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There were certain limitations and restrictions to our review work. Nevertheless, we were able to make a detailed review of an extensive amount of records and documents on the Government's investigation of the Fund and its negotiations with the Fund's trustees. We also obtained a significant amount of information and insights into the Government's actions during the investigation from our detailed interviews with numerous former and current Government officials responsible for the investigation.

Moreover, we reviewed additional data and documents given to us by the Subcommittee and the hearings records, which contained detailed periodic summaries of the status of the Government's investigation. In addition, we used the expertise of (1) our principal actuaries to help in our review and analysis work on the Fund's financial soundness and (2) a senior attorney to help in reviewing the legal matters pertaining to the investigation.

We believe that, in the aggregate, our review work was sufficient for us to (1) achieve our objectives, i.e., to determine the adequacy and effectiveness of the Government's investigation and negotiations with the trustees to reform the Fund and (2) draw valid conclusions and make relevant recommendations on the improvements needed in the new investigation and additional reforms needed to assure the Fund is prudently and soundly managed.

CHAPTER 2

UNSUCCESSFUL ATTEMPT TO HAVE A GOVERNMENT-WIDE COORDINATED INVESTIGATION

The objective of having a Government-wide investigation did not succeed because IRS declined to participate in a joint investigation. IRS' "go-it-alone" attitude and unwillingness to join the investigation did not adversely affect Labor's investigation until IRS decided on June 25, 1976, without prior notice to the Fund or Labor, to revoke the Fund's tax-exempt status.

IRS' action disrupted Labor's investigation and, according to Labor officials, created a "chaotic situation." IRS' action also adversely affected the Fund's cooperation with Government investigators. Labor officials said they had to spend more time trying to resolve their coordination and cooperation problems with IRS and the Fund, than on the investigation.

IRS DECLINES TO JOIN LABOR AND JUSTICE IN A JOINT INVESTIGATION

Labor's investigation started in the summer of 1975. It was headed by the former Administrator of LMSA's Pension and Welfare Benefit Programs Office. To be successful, the former administrator considered that the investigation would require unique levels of coordination among Labor, IRS, and Justice. In addition, ERISA requires that Labor coordinate its investigative efforts with Justice and IRS. Labor, therefore, attempted to develop a coordinated Government-wide approach by inviting Justice and IRS to join in the investigation. Justice agreed to join the investigation, and on December 1, 1975, Labor and Justice entered into a memorandum of understanding.

Labor and Justice agreed that the primary thrust of the investigation would be to develop civil remedies available to Labor that would enable the Government to reform the Fund. Also, it was agreed that Labor would lead the investigation, and its investigation would focus primarily on asset management and determining whether the Fund was complying with ERISA's fiduciary provisions. However, Labor was to pass potential criminal violations on to Justice.

Justice was to center its efforts on possible criminal violations of Federal laws including ERISA, but it was to give Labor the benefit of its knowledge gained through past criminal investigations and prosecutions.

At the time Labor began its investigation, IRS also had an investigation in process at the Fund's headquarters in Chicago. IRS had been investigating the Fund since about 1968. On August 22, 1975, the former administrator wrote to the Commissioner of Internal Revenue advising him of Labor's investigation and inviting IRS to participate in a joint investigation. He said that a jointly planned and executed investigation should reduce duplication of effort by the agencies.

IRS, however, declined to participate and advised Labor that it wished to continue its separate investigation of the Fund. IRS declined to join Labor's investigation although IRS was reviewing basically the same areas as Labor, such as prudence of loans and whether fiduciary standards of ERISA were followed. IRS did agree to Labor's request in the fall of 1975 to provide Labor tax information on the Fund's transactions under investigation for the years 1969 and after.

Fund officials expressed concern about the overlapping and duplicate investigations by Labor and IRS. Before Labor's onsite investigation began at the Fund's headquarters, the Fund officials initiated a meeting in November 1975 with IRS and Labor in an attempt to get the Federal agencies to coordinate the investigation. At the meeting, Fund officials stated that the then Administrator, Pension and Welfare Benefit Programs Office, said the Government had an obligation to "get its act together" to avoid duplication of reproduction and staff costs. IRS officials at the meeting, however, were opposed to Labor's entrance into the general area of their investigation, and they told Fund officials that Labor would not be a part of IRS' audit.

Labor's joint task force concept was designed to ensure that the broad civil remedies made available for the first time to the Government by ERISA were effectively used. The former administrator, who handled Labor's early discussions with IRS, told us that his intention at the earlier meetings with IRS and Justice was to attempt to establish a one-government-team approach on the investigation. Thus, the investigation would be viewed as an overall Government effort and not the individual efforts of the various agencies. In the former administrator's opinion, this combined Government approach never got started because of IRS' refusal to participate in the investigation.

IRS' REVOCATION OF THE FUND'S TAX-EXEMPT STATUS ADVERSELY AFFECTED LABOR'S INVESTIGATION

IRS' "go-it-alone" attitude and unwillingness to join the investigation did not burden or adversely affect Labor's investigation until June 25, 1976, when IRS decided (without prior notice to the Fund or Labor) to revoke the Fund's tax-exempt status.

In a letter to the trustees, IRS' Chicago district director stated that the qualification was revoked because the Fund was not operating for the exclusive benefit of plan beneficiaries in that:

> "Payment of benefits were not made in accordance with the terms of the plan.
>
> "Accrued benefits of participants were forfeited after retirement.
>
> "Records of participants service were not sufficient to determine participant benefits under the plan.
>
> "Contributions owing to the Fund by participating employers were forgiven to the detriment of plan participants.
>
> "The trust failed to establish [sic] policies and procedures in Fund operations that would provide for timely and proper payment of benefits to qualifying participants.
>
> "The trust computed participant benefits inconsistent with plan provisions."

The district director's letter also stated that the Fund's investment policies and practices were imprudent as exemplified by the following:

> "Terms of the loans designed to protect the interest of the beneficiaries in the Fund were not enforced.
>
> "Trust funds were disbursed without adequate security.
>
> "Trust funds were invested for a return not commensurate with the prevailing rates.
>
> "Trust funds were invested without requiring reasonable repayment terms.
>
> "Trust funds were invested against the advice of professional advisors retained by the trust.
>
> "Trust funds disbursed to individuals known to be unworthy of trust."

The revocation was effective immediately and retroactive to February 1965.

IRS' revocation surprised not only Labor and Justice, but also Fund officials. According to the Fund's former executive director, IRS' action had an immediate and devastating effect on the Fund's financial operations because some of the 16,000 employers withheld their contributions, others threatened to place the money in escrow accounts, and those who were constantly delinquent in the their payments merely had another excuse.

He also said that the six banks which were then handling several hundred millions of dollars of the Fund's assets raised serious questions about their own rights to engage in legal investment activities. This, he said, resulted in a drop in return on the Fund's investments.

IRS recognized that its revocation had the potential for a substantial adverse effect on the Fund's estimated 500,000 participants and beneficiaries. IRS testified at congressional hearings in August 1980 1/ that, if the provisions of the revocation had been fully implemented, each of the employees and/or beneficiaries would have been taxed retroactively, on their individual tax returns, for some of the benefits received.

Neither Labor nor Justice had advance knowledge or warning of IRS' intention to revoke the Fund's tax qualification. In fact, in January 1976 IRS told Labor "there is no way the Fund will be disqualified." And, again on June 20, 1976, 5 days before IRS' letter revoking the Fund's tax-exempt status, the Chicago district director told the former SIS director that a decision on revocation of the Fund's tax status would not be made until the autumn of 1976.

According to Labor officials, IRS' action created a "chaotic situation." For example, the officials stated that onsite work at the Fund's headquarters stopped because Fund officials believed that "the Federal Government's act was not in order," and the Fund was not dealing with the Government as a whole, but as an assortment of departments. As a result, Fund officials became less cooperative. Labor officials said that they had to spend more time trying to resolve their coordination and cooperation problems with IRS and the Fund, than on the investigation.

Recognizing the severe consequences of its revocation, IRS, beginning on July 2, 1976, granted the Fund a series of reliefs from the retroactive effect of the revocation. IRS, however, continued to meet with Fund officials and tentatively agreed to a series of actions the trustees had taken, or planned to take, in managing the Fund's assets and benefit payments.

1/See footnote 2, page 1.

Labor officials strongly objected to IRS' approach because they believed that IRS' acceptance of preliminary or partial reforms could bind the entire Government and jeopardize the joint Labor/Justice investigation and Labor's negotiations with Fund officials. The former administrator, Pension and Welfare Benefit Programs Office, in an August 17, 1976, letter to IRS, said that IRS' proposed action to accept the Fund's commitment to take certain actions may seriously impede the ultimate success of the joint Labor/Justice investigation. He also stated that IRS' action could compromise Labor's ability to obtain more pervasive equitable relief against the Fund and its fiduciaries available to Labor under ERISA. In August 1976, IRS officials agreed to coordinate their efforts with Labor.

In an August 1980 congressional hearing, 1/ the Assistant Commission for Employee Plans and Exempt Organizations, IRS, testified that Labor and IRS, in IRS' opinion, cooperated on their investigations beginning at an early date (September 1975) and that both agencies regularly consulted about the progress of their respective examinations. IRS' former Chicago district director admitted in testimony, however, that a joint audit was discussed, but he said it was mutually agreed that each agency would make independent audits because IRS' thrust was toward plan benefits and administration and Labor's was toward fiduciary standards compliance. He also said that IRS' examination concentrated on pre-ERISA years (i.e., 1966 through 1975), while Labor's examination emphasized post-ERISA years (i.e., beginning with 1975).

Although IRS officials believed Labor and IRS coordinated their investigations, the former Chicago district director testified that he did not believe that revoking the Fund's tax-exempt status would have had any effect on Labor's investigation and dealings with the Fund. In fact, he said until GAO's testimony in August 1980, he was not aware that his action had caused chaotic conditions in Labor's investigation.

The former Chicago district director was also asked by Subcommittee members why he did not tell Labor about the June 25, 1976, revocation. He said that in early 1976 IRS suggested that Labor amend its 1975 request for tax information so that IRS could give Labor information on the Fund's activities for plan years before 1969. Labor agreed, however, it did not request amendment of the disclosure agreement until after June 1976.

The former Chicago district director stated that the revocation covered primarily pre-ERISA years (from 1965 through Jan. 31, 1976) and Labor's right to IRS' data on the Fund only covered 1969

1/See footnote 2, page 1.

and subsequent years. Therefore, it was his judgment that he was precluded from telling Labor of the revocation because of the restrictions imposed by section 6103 of the Internal Revenue Code which prohibits IRS from disclosing any information concerning its investigation of a single taxpayer.

CONCLUSIONS

We believe that IRS' decision not to join the Labor/Justice investigation destroyed Labor's attempt to have a Government-wide investigation and set back Labor's investigation. IRS' explanation that it was pursuing a different course than Labor is not borne out by the facts. For example, the former Chicago district director's letter disqualifying the Fund was based, in part, on alleged imprudent practices by the trustees or fiduciary violations, the very same area Labor was investigating.

In our view, the former Chicago district director's decision, although on legally supportable grounds, was taken from a technical standpoint. The former district director admitted during the testimony--and as documented by our review--that IRS had discussed the revocation with Labor and had provided Labor with information IRS had developed on the Fund's activities before 1969. IRS also stated that Labor had agreed to submit a request for access to information before 1969. Yet, because of a technicality (the lack of a formal request) the former district director did not tell Labor about his intent to revoke the Fund's tax-exempt status.

AGENCY COMMENTS

By letter dated November 24, 1981, IRS commented on our draft report. (See app. XV.)

IRS stated that, as its officials indicated in testimony before the Senate Permanent Subcommittee on Investigations on November 2, 1981, 1/ IRS' examination of the Fund was the first major examination of a multiemployer plan after the enactment of ERISA. IRS said that ERISA is a law of great complexity, and at the time of the revocation of the exempt status of the Fund, the dual jurisdiction provisions of titles I and II of the act presented substantial coordination problems. Further, IRS said there was limited experience under ERISA when functional responsibility for the examination of the Fund was taken over by the Employees Plans and Exempt Organizations Division of the Chicago district office in 1975.

1/Hearings on the "Government's Ability to Combat Labor Racketeering," Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, 97th Cong., 1st sess., Oct. 28, 29, and Nov. 2, 1981.

IRS stated, however, that these problems have been addressed by Reorganization Plan No. 4 of 1978 and administrative actions taken by IRS and Labor. Accordingly, IRS concluded that some actions taken by them at that time, such as disqualifying the Fund without prior notice to Labor, would not be repeated now or in the future.

We agree with IRS' comments that its coordination problems with Labor would probably not be repeated provided Reorganization Plan No. 4 is properly implemented by both agencies. As discussed in chapter 8, IRS' and Labor's coordination efforts in the second investigation of the Fund have apparently improved.

CHAPTER 3

LABOR'S INVESTIGATION NARROWLY FOCUSED ON REAL ESTATE LOANS AND IGNORED OTHER AREAS OF ALLEGED ABUSES

Labor's investigation disclosed many alleged significant problems in the former trustees' management of the Fund's operations. However, Labor narrowly focused on the Fund's real estate mortgages and collateral loans because of the significant dollar amounts involved and Labor's primary goal of protecting and preserving the Fund's assets. Labor's approach ignored other areas of alleged abuse and mismanagement of the Fund's operations by the former trustees and left unresolved questions of potential civil and criminal violations and alleged mismanagement raised by its investigators.

Labor's limited investigation was also incomplete. Labor targeted 82 of the Fund's 500 mortgage and collateral loans for investigation. Labor's investigators found apparent significant fiduciary violations and imprudent practices by the former trustees on many of the 82 loans. Labor terminated its investigation of the asset management procedures at the Fund even though its investigators had not obtained the records or completed investigations on all of the 82 targeted loans. This may have precluded Labor from obtaining valuable information for its investigation on potential civil or criminal violations.

LABOR USED VOLUNTARY APPROACH RATHER THAN SUBPOENA POWERS

In January 1976, Labor began its investigation at the Fund's headquarters in Chicago. Rather than using the administrative subpoena powers under ERISA, Labor officials accepted the trustees' offer to voluntarily cooperate by making the Fund's records and books available for review and its personnel available for interviews. Labor agreed to this approach, because, according to the former administrator, the Pension and Welfare Benefit Programs Office, the investigation could be conducted more efficiently and expeditiously and it gave Labor immediate access to the Fund's records.

Under this approach, however, the Fund's records were not authenticated or obtained under oath, and as indicated below, despite the offer of voluntary cooperation, the Fund did not give Labor all of the records it requested. Labor later had to issue a subpoena to authenticate and update the information.

LABOR'S INVESTIGATION DISCLOSED MANY PROBLEM AREAS

Labor's initial analysis of the Fund's books and records disclosed many problem areas and patterns of apparent abuse by the trustees. These included numerous indications of apparent loan and investment practices that constituted fiduciary breaches under ERISA, such as loans made to companies on the verge of bankruptcy, additional loans made to borrowers who had histories of delinquency, loans to borrowers to pay interest on outstanding loans that the Fund recorded as interest income, and lack of controls over rental income.

Labor's initial analysis also disclosed other problem areas or patterns of apparent abuse, including (1) failure to properly manage real estate and non-real-estate-related investments, (2) questions on the Fund's liquidity position, (3) questions on the reasonableness of administrative expenses, (4) failure to properly manage fees the Fund charged borrowers for loans, (5) questions on the propriety of payments made to the former trustees for allowances and expense claims--some of which could involve potential criminal violations, (6) questions on the reasonableness of payments to firms providing services to the Fund, and (7) allegations of improprieties regarding payments of pension benefits and determinations of eligibility.

In a September 1976 report, SIS' chief auditor indicated that, based on the patterns of alleged abuse disclosed by the preliminary analysis, full-scale audits were justified in most of the above-mentioned areas. Labor officials, however, focused their investigative efforts on the Fund's asset management, specifically on the portfolio of real estate mortgages and collateral loans. Labor made no significant analysis, nor did it complete its review of, or pursue, other potential areas of abuse.

LABOR FOUND MANY APPARENT IMPRUDENT PRACTICES

At the beginning of Labor's onsite investigation in 1976, the Fund's assets totaled about $1.4 billion. Of this amount, about $902 million was in real estate mortgages and collateral loans, as shown in the schedule on the next page.

	(millions)	
Current assets:		
Cash	$144	
Other current assets	118	
Total (current assets)		$ 262
Investments:		
Stocks and bonds	145	
Real estate mortgages and collateral loans	902	
Real estate investments	165	
Other investments	13	
Total (investments)	1,225	
Less: provision for re-evaluation of invested assets	118	
Net investments		1,107
Fixed assets		2
Total assets		$1,371

SOURCE: Department of Labor records.

Labor's analysis showed that the $902 million in real estate mortgages and collateral loans consisted of 500 loans made to 300 borrowers. Labor targeted 82 of the loans valued at $518 million for review. Its analysis showed that, of these 82 loans, amounts totaling $425 million were made to seven entities or persons as follows:

Individual or entity	Amount of loans (millions)
Mr. Allen Glick	$146
Mr. Alvin I. and Mrs. Deborah Malnik	33
Mr. Morris Shenker	26
Aladdin Hotel Corporation	38
Penasquitos, Inc.	89
La Costa Land Company	43
Hyatt Group	50
	$425

SOURCE: Department of Labor records.

Labor's review identified many apparent imprudent practices in the former trustees' management in many of the 82 targeted loans, including the loans to the above-mentioned entities or persons as well as apparent violations of ERISA's fiduciary requirements. Labor found that, on a number of the loans, the former trustees had failed to follow virtually any of the basic procedures that would be followed by a prudent lender.

According to Labor, the former trustees failed to obtain adequate financial or other pertinent information when granting loans or restructuring or modifying them and failed to obtain adequate collateral. Once loans were granted, the former trustees failed to monitor them and take appropriate action to assert or exercise rights--legal, contractual, or equitable--available to the Fund under the terms of the loans.

One case, for example, involved a $2.2 million loan made in January 1975 to Alvin and Deborah Malnik which was secured by real property in Philadelphia, Pennsylvania. According to Labor, at the time the loan was made, the Fund trustees had failed to obtain (1) an independent and reliable appraisal of the value of the security and (2) sufficient reliable information regarding the financial condition of the borrowers, and prospective guarantors of the loan, to enable them to reach a prudent decision regarding the making of the loan. After disbursing the loan, the trustees failed to enforce the Fund's right to an assignment of rents from the property, and they agreed to modify the borrowers' loan obligation by deferring payment of delinquent interest.

LABOR DID NOT COMPLETE INVESTIGATION OF TARGETED LOANS

Labor did not complete its investigation on the 82 targeted loans. As a result, it lost an opportunity to obtain valuable information for its investigation on potential civil or criminal violations.

In late 1976--after Labor had been onsite at the Fund for almost a year and obtained records showing many apparent imprudent practices and apparent fiduciary violations on many of the 82 loans--the former SIS director formulated a plan for extensive investigation of third parties connected with the targeted loans (i.e., parties who were not principals to loan transactions). The former director planned to make investigations of about 75 to 100 third parties in early 1977. Third parties to be investigated included the borrowers' affiliates and/or associates and lenders that previously had refused to make loans to these borrowers.

The former director's plan involved issuing investigative subpoenas to obtain documents from borrowers and related third parties and taking investigative depositions of Fund trustees, Fund employees, and key third parties related to the targeted loans. The former director said the objective of the third-party investigations was to "close the circle" of the overall investigation of loan transactions. That is, to find out as much as possible about a loan transaction before any litigative action and to determine whether the former trustees tried to find out if borrowers used loans for the purpose intended.

In addition, the Secretary of Labor and other officials emphasized the planned third-party investigations in July 1977 hearings before the Senate Permanent Subcommittee on Investigations. 1/ The Secretary and other officials stated that Labor's investigation was shifting from a review of Fund records to a search for evidence in the possession of third parties, including obtaining depositions from third parties.

However, some of the third-party investigations planned by the former SIS director for early 1977 were not made because, at that time, Labor shifted to a civil litigative strategy--i.e., analyzing documents and assembling evidence available to determine the potential for a civil suit.

We gathered the following information on subpoenas issued as of mid-1979 from the records and files of SIS and the Office of the Solicitor.

--The former SIS director prepared a list of about 80 third parties to be deposed and subpoenaed to produce records on 19 of the targeted loans.

--SIS' and the Office of the Solicitor's records showed that only 14 of these third parties were actually deposed and subpoenaed (many in September and October 1977). In addition, a few third parties on the former director's list had voluntarily agreed to be interviewed in 1979, after Labor filed its civil suit.

The records also showed that Labor issued a total of 80 subpoenas--including the 14 above--for testimony or records. Most subpoenas were issued in the last half of 1977 and most related to only two loans (a $3.15 million loan to the Alsa Land Development Corporation and a $18 million loan to the Morefield Enterprises Limited Partnership).

1/See footnote 1, page 8.

Some of the 19 loans on which the former SIS director intended to make third-party investigations eventually became part of Labor's civil suit in February 1978. The former SIS acting director told us that Labor had not requested any subpoenas on these loans since the suit was filed. Labor's records also show that about 119 third parties had voluntarily agreed to interviews by Labor officials and that most of these third-party interviews related to five loans on the former director's April 1977 list.

Former SIS officials, including the former director and deputy director, testified in August and September 1980 congressional hearings 1/ that third-party investigations were the core of SIS' investigation and that Labor's failure to pursue the investigations gutted SIS' efforts. They stated that this had the effect of insulating borrowers from an examination of both civil and criminal implications of their conduct. It removed, they testified, SIS' ability to detect and eliminate organized crime influence on the operations of the Fund and its assets.

One former SIS official also stated that, most importantly, the effect of SIS' not making the third-party investigations was that it lost the broad scope of an administrative investigation of the Fund's loan transactions. He said that an administrative investigation has the broad scope similar to a grand jury probe, whereas discovery in a lawsuit is limited to the allegations of the complaint. According to the former SIS director, the third-party investigations were postponed by officials in the Office of the Solicitor and the Pension and Welfare Benefit Programs Office.

Labor's Solicitor, in the same congressional hearings, acknowledged that the third-party investigations requested by the former SIS director were not made and that these investigations were pursued through the civil discovery process rather than the investigative or administrative route. The Solicitor explained that the third-party situation was a fundamental policy disagreement between SIS and the Office of the Solicitor. SIS did not want Labor to proceed with immediate plans for litigation, but wanted to be given 2 or 3 years to complete a broad-scale investigation and to complete the third-party investigations. It was the Solicitor's--and Secretary of Labor's--decision that Labor did not have that much time available for the investigation.

LABOR DID NOT OBTAIN ALL FUND RECORDS NEEDED

After Labor shifted to a litigative strategy in early 1977, it terminated that portion of its onsite investigation focusing

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1/ See footnote 2, page 1.

on the Fund's management of real estate assets and reviews of the Fund's records and documents. This termination was publicly announced by the Secretary of Labor in March 1977. Labor's investigators left the Fund's headquarters in May 1977. At that time, however, Labor had not obtained from the Fund all of the documents on 17 of the 82 targeted loans. Also, the trustees refused to provide documents on 6 of the 17 loans.

After Labor's investigators left the site, Labor officials requested various documents on the Fund's loan transactions and other activities. For example, in the autumn of 1977, Labor requested records on 39 different loans. However, the trustees refused to provide Labor with any more documents or records. They cited as their reasons public statements by the Secretary of Labor and other Labor officials that the investigation of records had been terminated and that Labor supposedly was shifting to a search for evidence from third parties. In March 1978, the trustees formally notified Labor that they were terminating their voluntary cooperation. As a result, Labor had to gain access to documents on some of the 82 targeted loans during the discovery phase of its civil suit, 1/ which it filed on February 1, 1978, against former trustees and Fund officials.

Labor's civil suit

During its investigation, Labor determined that 12 of the 82 targeted loans or groups of loans would support immediate litigation. On February 1, 1978, Labor filed the civil suit in the U.S. district court for the Northern District of Illinois, Eastern Division, against 17 former Fund trustees and 2 officials 2/ to recover losses resulting from their alleged mismanagement and breaches of their fiduciary duties. The suit involves 12 real estate and collateral loans and 3 other financial transactions to individuals. Labor said there were numerous delays during the first 2 years of the litigation due to (1) discovery disputes among Labor, the defendants, and the Fund, and (2) the fact that the case was assigned and reassigned to four different judges.

1/See footnote 1, page 11.

2/The suit listed 17 former trustees: Frank E. Fitzsimmons, Roy L. Williams, Robert Holmes, Donald Peters, Joseph W. Morgan, Frank H. Ranney, Walter W. Teague, Jackie Presser, Albert D. Matheson, Thomas J. Duffey, John F. Spickerman, Sr., Herman A. Lueking, Jack A. Sheetz, William J. Kennedy, Bernard S. Goldfarb, Andrew G. Massa, and William Presser. The two former officials are Alvin Baron and Daniel Shannon; however, Mr. Shannon was later dropped from the complaint. Also, Mr. Frank Fitzsimmons died in May 1981, and Mr. William Presser died in July 1981. Labor is considering substituting their estates in the lawsuit.

Labor said the case has now been assigned permanently to a U.S. district judge, and on April 21, 1981, Labor filed a motion to (1) amend the complaint to add 9 additional transactions to the previous 15 examples of alleged imprudence by the defendants and (2) allow Labor access to the Fund's records on the 9 additional transactions through discovery. The 24 transactions consisted of 19 real estate mortgage and collateral loans, 1 loan commitment, and 4 other financial transactions with individuals. 1/ Labor's amended suit cited loans made by the former trustees to the seven persons or entities listed on page 24 as alleged imprudent transactions.

In addition to requesting to add nine more alleged imprudent loan transactions to the original complaint, Labor's April 1981 motion would have (1) added the Fund as a defendant to the suit and (2) clarified that the case seeks injunctive relief in the form of modified investment procedures for the Fund, in addition to monetary recovery from the defendants.

On October 7, 1981, the court issued an order granting and denying, in part, the provisions of Labor's April 1981 motion. The court (1) permitted Labor to specify the nine additional loan transactions in the complaint and (2) authorized Labor's request to specify the injunctive and equitable relief it sought. The court, however, rejected Labor's proposal to include the Fund as a defendant to the suit.

In addition, the court severed the nine additional transactions from the complaint and ordered a separate trial for these transactions. It also stayed discovery on the nine transactions pending completion of the trial on the 15 transactions in the original complaint. Also, while approving Labor's access to the Fund's microfilmed documents on the nine additional transactions and certain other transactions, the court indicated Labor could not introduce into evidence or otherwise rely upon these additional documenting materials during the trial on the original complaint.

Labor, because it believes certain aspects of the court's order are based upon misimpressions of fact, submitted a motion on October 22, 1981, requesting the court to reconsider, clarify, and amend its October 7 order. As of December 1, 1981, the court had not ruled on Labor's motion.

CONCLUSIONS

Labor said it focused on the Fund's real estate loans because of the significant dollar value of these assets and because its

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1/See appendix XI for a detailed description of the alleged imprudent transactions cited in Labor's civil suit of February 1978.

primary objective was to protect and preserve the Fund's assets. In Labor's opinion, this single purpose may have been justified; however, in our view, this approach ignored other alleged areas of abuse and mismanagement of the Fund's operations by the trustees. As a result, Labor left unresolved questions of potential civil and criminal violations and alleged mismanagement raised by its SIS investigators.

Also, in our view, the Office of the Solicitor's refusal to allow SIS to complete the third-party investigations as planned by the former SIS director resulted in an inadequate and incomplete investigation. The Solicitor claimed that, first, Labor had to prepare for litigation to safeguard the Fund's assets, if negotiations stalemated, and secondly, the trustees, who had so flagrantly violated their fiduciary responsibilities, had to be held accountable in a court of law. She acknowledged, however, that SIS had to give up third-party investigations to prepare for the litigation, and that in September 1977, when they resumed third-party investigations, the decision was made to file suit which closed off the administrative subpoena process.

We believe, therefore, that Labor lost an opportunity during its investigation when it failed to complete the third-party investigations. This may have precluded Labor from obtaining valuable information for its investigation on potential civil or criminal violations.

In our opinion, the fact that Labor had to resume an onsite investigation at the Fund's headquarters is persuasive evidence of the inadequacies and shortcomings in Labor's original investigation. Moreover, Labor appears again not to be investigating all alleged abuses by the former trustees. (See ch. 8.)

CHAPTER 4

LABOR'S INVESTIGATION HAMPERED BY POOR MANAGEMENT, INEFFECTIVE INTERNAL COORDINATION, AND STAFFING PROBLEMS

SIS was responsible for performing Labor's investigation of the Fund since its beginning in January 1976 until May 1980. Labor told the Office of Management and Budget and the Congress that for SIS to conduct the investigation of the Fund's pension and health and welfare funds in an adequate and timely manner, a staff of 45 professional and investigative support positions were required. In August 1976, SIS was authorized the 45 positions requested. Labor, however, reduced the SIS allocation for 1979 from 45 to 36 positions and then to 34 for 1980.

Moreover, SIS had problems in hiring professional staff, and many positions were unfilled throughout the investigation. In fact, SIS never filled all 45 authorized positions; its maximum staff was 28.

SIS' professional staff, for the most part, appeared experienced, but Labor provided the staff little formal training on areas pertinent to the investigation. Also, SIS had significant problems in the management of the investigation, particularly in its coordination with the Office of the Solicitor. These problems were also highlighted in the Kotch-Crino report and, as a result, Labor abolished SIS in May 1980.

THE CONGRESS APPROVED ALL STAFF POSITIONS REQUESTED FOR SIS--BUT SIS NEVER FILLED ALL POSITIONS

Labor established SIS in January 1976, to plan, develop, and conduct highly complex and sensitive investigations of the operations of selected pension plans suspected of violating ERISA. Its professional staff included auditors and investigators augmented by attorneys assigned to the Office of the Solicitor. Labor's original concept was to have the lawyers work directly with SIS during the investigation and form an integrated team which could conduct the investigation while at the same time plan and be responsible for handling any potential litigation.

The table on the next page shows, for fiscal years 1976-80, the permanent staff requested by SIS, along with the levels approved by the Congress and allocated to SIS by Labor, and the unfilled positions at the end of each fiscal year and on May 5, 1980, when SIS was abolished.

Fiscal year	Requested by SIS	Approved by Labor	Approved by the Congress	Allocated by Labor	SIS staff onboard at yearend	Number of unfilled positions at yearend
1976	20	20	20	20	13	7
July to Sept. 1976 (note a)	20	20	20	20	20	
1977	45	45	45	45	25	20
1978	45	45	45	45	22	23
1979	45	45	45	36	24	12
1980	35	35	35	34	20	b/14

SOURCE: Department of Labor.

a/Fiscal year transition quarter.

b/Positions on May 5, 1980, when SIS was abolished.

As the table shows, Labor in 1977 requested that SIS be increased to 45 positions. In February 1977, at the House hearings on Labor's fiscal year 1977 supplemental appropriation request, 1/ Labor officials testified that SIS had been investigating the Fund for over a year and that the 25 added staff positions were needed to analyze the tremendous amount of data gathered during the investigation. Labor officials stated that, if the Congress gave SIS the 25 positions, Labor could complete the investigation in 2 years; otherwise, it would take SIS twice as long (or 4 years) to complete its investigation.

The Congress gave SIS the 25 additional staff positions. However, 3 years later when SIS was abolished, Labor had neither finished the investigation nor filled all of the positions.

For fiscal years 1978-79, the Congress approved the 45 positions Labor requested for SIS. Labor testified in February 1978, at the House hearings for the fiscal year 1979 appropriations, 2/

1/Hearing on Supplemental Appropriations for fiscal year 1977 before the Subcommittee on the Departments of Labor and Health, Education, and Welfare, House Committee on Appropriations, 95th Cong., 1st sess., page 640 (Feb. 18, 1977).

2/Hearings on Departments of Labor and Health, Education, and Welfare Appropriations for 1979 before the Subcommittee on the Departments of Labor and Health, Education, and Welfare, House Committee on Appropriations, 95th Cong., 2nd sess., page 477 (Feb. 9, 1978).

that SIS would remain at 45 positions. In fact, during the year, Labor reduced SIS to 36 positions and reassigned the 9 positions to another office.

At the fiscal year 1980 House appropriation hearings in February 1979, 1/ a Labor official testified that:

> "In numbers of positions that are assigned, there are 36. We do not contemplate either decreasing it or increasing it for the 1980 year."

However, in fiscal year 1980, Labor reduced SIS from 36 to 34 positions.

SIS also had problems in hiring professional staff, and many positions were unfilled throughout the investigation. As the table on page 32 shows, SIS, in fact, never filled all 45 authorized positions. Its maximum permanent staff was 28 during the quarters ending March and June 1977.

SIS officials, who were the selecting officials, said that the positions were unfilled because (1) qualified people were difficult to find, (2) SIS set too high a standard, and (3) problems inherent in the Civil Service Commission hiring system prevented SIS from hiring people outside the system who wanted to join the team. Also, they said that the former SIS director was too busy to interview applicants. However, LMSA personnel and placement officials said that the delays in recruiting and filling the vacancies occurred because the SIS selection officials procrastinated and were unable to make decisions in selecting candidates.

PROBLEMS IN TRAINING SIS PROFESSIONAL STAFF

The SIS staff whose personnel records we reviewed appeared experienced. Most were college graduates with degrees in such fields as accounting and business administration. Many were previously employed at other offices within Labor, other Federal agencies, or in private industry, and their work experience appeared appropriate for their investigative responsibilities.

However, Labor provided little formal training to the SIS personnel during the onsite investigation in 1976 and 1977. For example, upon examining the personnel records of 16 selected SIS

1/Hearings on Departments of Labor and Health, Education, and Welfare Appropriations for 1980 before the Subcommittee on the Departments of Labor and Health, Education, and Welfare, House Committee on Appropriations, 96th Cong., 1st sess., page 569 (Feb. 21, 1979).

staff members, we found that none of the SIS personnel had been given formal classroom training pertinent to the enforcement of ERISA's provisions. More importantly, none of them had been given training to obtain knowledge of, or how to detect and identify, fiduciary violations of ERISA even though this was the main thrust of Labor's investigation.

We had reported on a similar situation whereby Labor provided little formal classroom training to its enforcement staffs in a prior report on Labor's enforcement of ERISA. 1/ In response to our report, the Secretary of Labor stated that during 1978, Labor had implemented a comprehensive training program for staff and since the greatest program emphasis was to obtain compliance with ERISA's fiduciary provisions, the first set of courses concerned basic fiduciary training which was provided to all professional staff; this was followed by advanced fiduciary training to field staff; and finally, a course for the field staff on investigation skills which covers auditing, investigation planning, and other investigative functions.

The Acting Director of SIS told us that the SIS personnel on board in 1978 attended a 1-week course of basic fiduciary training. He acknowledged, however, that SIS staff members had received little training while on the staff. He said since the investigation was so important he believed that, by hiring experienced persons, training could be delayed for awhile.

SOME SIS STAFF MEMBERS DISSATISFIED WITH MANAGEMENT OF THE INVESTIGATION

In an effort to obtain a cross section of the SIS staff members' views on how well Labor managed the investigation, we interviewed nine professional staff members in SIS. The nine represented about one-third of the staff at the time of our review and included six permanent staff (three investigators, two auditors, and one lawyer) and three other Labor employees detailed to work on the initial phase of the investigation in early 1975 and 1976. The permanent staff had been working on the investigation since 1976, and all those interviewed had performed work at the Fund's headquarters in Chicago.

Some of the staff interviewed expressed dissatisfaction with and criticism of SIS' and the Office of the Solicitor's handling of the investigation. Some of the specific comments by the staff interviewed on the areas of dissatisfaction follow.

1/See "Laws Protecting Union Members and Their Pension and Welfare Benefits Should Be Better Enforced" (HRD-78-154, Sept. 28, 1978).

--Most staff members said that they had received no guidelines or audit programs, or only received a little guidance, on how to conduct the investigation.

--Most staff members said that no training was provided or the training provided was too little or insufficient.

--Four staff members stated that the supervision provided by SIS officials was deficient.

--Some staff members had negative opinions on the communication between SIS and the Office of the Solicitor. Comments included "there was a lack of communication and overall knowledge within SIS"; "the Solicitor's Office left SIS in the dark"; and "coordination between SIS and the Solicitor's Office was not smooth."

--Two staff members said their SIS supervisors had placed restrictions on their performance during the investigation. For example, they could not talk to Fund employees, and if they needed to, they had to obtain advance approval from the SIS supervisors.

--Only three staff members said that they had contact with IRS or Justice, and two of the three said coordination was satisfactory.

--Three of the staff members had no contacts with the Fund. However, of the four that did, only one stated he had no problems. The three others said they encountered some hostility from Fund employees. One believed that the Fund had purged the files Labor was examining.

The overall picture drawn from the interviews indicated that morale problems and dissension existed within SIS. For instance, SIS members complained that auditors supervised investigators, and an auditor was made chief investigator. They also stated that the skills of auditors and investigators were different and their efforts were not adequately coordinated, which resulted in duplication of effort.

In addition, the interviews indicated problems between SIS and the Office of the Solicitor. Two SIS members complained that the investigation of the Fund was actually managed by attorneys in the Office of the Solicitor who did not know how to manage an investigation. Another complained that the attorneys would not approve an investigation into many of the Fund's questionable transactions which SIS brought to the Office of the Solicitor's attention.

LABOR'S KOTCH-CRINO REPORT CONFIRMS MANAGEMENT PROBLEMS

Similar coordination and management problems in Labor's investigation were noted in Labor's Kotch-Crino report of May 11, 1979.

This report entitled "Special Investigations Staff Review" was prepared for the Deputy Assistant Secretary for LMSA by two LMSA field office staff members. The Deputy Assistant Secretary had been requested 1/ by the Under Secretary of Labor--who the Secretary of Labor had designated to monitor Labor's investigation--to have a management review made of SIS' handling of the investigation. The review was made from February to April 1979 and covered the following areas: (1) the status and future plans for the investigation; (2) SIS' cooperation with the Office of the Solicitor, particularly SIS' responsiveness and work product quality; (3) SIS' coordination with Justice; and (4) the status of SIS, in terms of supervision, administration, morale, and overall effectiveness.

The Kotch-Crino report, supplemented by summaries of interviews the two LMSA staffers had with SIS' and the Office of the Solicitor personnel and other documents, was highly critical of Labor's investigation of the Fund. As described by the Subcommittee's chief counsel in congressional testimony in September 1980, 2/ among the significant points and findings developed in the report are the following.

--SIS was directed to conduct an investigation of the Fund and handle the litigation resulting from the investigation. This objective was never totally achieved. SIS' mandate was narrowed early in its history; it did not litigate any cases, nor did it ever even approach the litigation stage.

--As for investigations, Labor's Office of the Solicitor preempted SIS' jurisdiction, taking away its independence and making it a support operation of the Office of the Solicitor.

--From the investigation's beginning, Labor's hierarchy eroded and took away SIS' authority and responsibility.

--The Office of the Solicitor wanted SIS under its control, and this objective was achieved early in the investigation.

1/At the time of the request, the Deputy Assistant Secretary for LMSA was then Labor's Acting Inspector General.

2/See footnote 2, page 1.

However, once control was obtained, the Office of the Solicitor took little or no interest in SIS.

--The Office of the Solicitor gave SIS no constructive guidance or management. SIS was viewed as the Solicitor's investigative support arm. Beyond that, SIS had very little to do.

--What SIS did was very demeaning to SIS professional staff, which complained, for example, of having to do substantial clerical work, such as filing and photocopying.

--As a result, SIS' personnel morale declined, and disagreements, suspicion, and hostility between SIS and the Office of the Solicitor increased.

--Labor failed to devote needed resources to SIS' efforts. Senior Labor officials were occupied with other matters and failed to give sufficient attention to SIS and the investigation of the Fund.

--Early in the investigation, the scope of SIS' inquiry was severely limited and many areas of abuse detected in 1976 were not pursued; no new areas, outside of Labor's litigation, were planned, initiated, or permitted. The Office of the Solicitor dictated this investigative policy.

--Labor failed to pursue culpable third parties in the investigation and because of the civil lawsuit it was decided to forgo third-party investigations.

--Because persons associated with the Fund were not properly investigated timely, the opportunities to investigate potential civil and possibly criminal violations were apparently lost.

--The Office of the Solicitor viewed itself as a lawyer in a lawyer-client relationship with SIS. It did not wish to get involved in a hard-fought investigation, litigation, nor was it willing to have a cooperative relationship with its investigator and client, i.e., SIS.

--The Office of the Solicitor did not devote enough time and resources to Labor's investigation of the Fund.

The report concluded that:

"SIS is seriously hampered by a lack of leadership and supervision, by mismanagement, and by poor administration. Serious morale problems and personality conflicts exist. Although personnel are

generally competent, notable staff weaknesses and training deficiencies exist. There is no evidence of a cohesive management team in terms of cooperation, respect or operational ability. Future SIS effectiveness is doubtful."

According to the report, SIS and the Office of the Solicitor generally agreed that SIS' acting director from 1977 until the time of the report was not doing a capable job, and virtually every SIS employee interviewed by Kotch and Crino believed the acting director was an ineffective, incompetent manager and administrator. Yet, the report points out, Labor never replaced him or appointed a permanent SIS director.

The report recommended, among other actions, that SIS be abolished and a new Special Litigation Staff be formed in the Office of the Solicitor to support Labor's litigation against the former Fund trustees.

LABOR'S ACTION ON THE KOTCH-CRINO REPORT 1/

According to the Subcommittee General Counsel's testmony in congressional hearings in September 1980, 2/ the Deputy Assistant Secretary of LMSA, shortly after the report was completed, took the original copy and attachments to the Under Secretary and discussed it with the Under Secretary, Labor's Solicitor, and another LMSA official. Later, the Under Secretary discussed the report with the Secretary of Labor.

Apparently the Deputy Assistant Secretary kept the original copy and attachments until the autumn of 1979, then he gave them to the Assistant Secretary for LMSA. In March 1980, the Assistant Secretary returned the original and attachments to the Deputy Assistant Secretary, and the Deputy Assistant Secretary destroyed the original report and attachments because he believed the documents had served their usefulness.

About the same time in 1980, we asked the Deputy Assistant Secretary about the Kotch-Crino report and were told that the report did not exist. Later in 1980, the Senate Permanent Subcommittee on Investigations' staff also requested a copy of the report from Labor. The Deputy Assistant Secretary and other

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1/As indicated previously (see p. 13), we were not aware of the Kotch-Crino report until the day, August 25, 1980, we testified before the Senate Permanent Subcommittee on Investigations. Therefore, comments on Labor's action are, for the most part, from the Subcommittee's hearings and records.

2/See footnote 2, page 1.

Labor officials in SIS and the Office of the Solicitor also stated to the Subcommittee that the report had been destroyed.

Finally, after the Subcommittee served a subpoena on an attorney in the Office of the Solicitor, Labor produced a copy of the report and attachments. Apparently, one of the LMSA area officials who prepared the report had kept a copy for his personal files. The Subcommittee's investigation also indicated that the Deputy Assistant Secretary had destroyed or disposed of the report apparently per instructions of top-level Labor officials.

The Secretary of Labor and other officials, in September 1980 congressional hearings, 1/ disputed the Subcommittee's contention that the report had been destroyed deliberately or that instructions were given to Labor employees to have it destroyed. According to the Secretary, the two LMSA field staff members were assigned to conduct a confidential management review of SIS and interview SIS and other employees to identify management problems and recommend solutions. They did their job well and prepared a thorough report, according to the Secretary, and the report confirmed many of the suspected problems at SIS. The Secretary said he was briefed on the review and decided that the substance of the recommendations on SIS should be adopted.

The Secretary said that the review included information divulged by employees in confidence, including both frank comments and petty and malicious allegations made by some employees about others. He said Labor officials believed that the allegations were largely incredible or irrelevant, except as a reflection of the personnel problems within SIS. The Secretary said that to minimize the dissemination of this information within Labor, only a limited number of copies of the report were made and after its purpose had been served and recommendations had been carried out, the official coordinating the review discarded his copies. However, according to the Secretary, there was no highly dramatic or willful destruction of documents.

During the September 1980 hearings, 1/ the Subcommittee members, however, disagreed with the Secretary's statements and believed the reports were in fact destroyed by Labor officials without proper authority. The Subcommittee cited an opinion dated September 12, 1980, by the Acting Archivist of the United States, who stated that LMSA had no authority to destroy a report, such as the Kotch-Crino report, nor had they or Labor submitted a request for such authority.

The Subcommittee members also disagreed with Labor's characterization of the report and believe the report and attachments contain serious allegations of potential violations of law and

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1/See footnote 2, page 1.

employee misconduct. They include allegations of employees' sexual misconduct and obstruction of justice and that some employees involved in SIS' investigations associated with organized crime figures. According to the Subcommittee, this information was never referred to the appropriate agencies for further investigation. The Subcommittee, therefore, referred the allegations to Justice to determine whether they merit further investigation of any civil or criminal misconduct. A Justice official told us that the allegations merit further investigations and, as of December 1981, its investigation was still in process.

SIS abolished

According to the Secretary of Labor, Labor adopted the substance of the Kotch-Crino report by disbanding SIS on May 5, 1980, and transferring most of the personnel to the Special Litigation Staff 1/ in the Office of the Solicitor. This staff was established to litigate Labor's civil suits against the former trustees and Fund officials. These former SIS personnel, except for two individuals, will not be performing any new investigative work at the Fund. The remainder were transferred to other LMSA offices. In April 1980, Labor established a special unit, at its Chicago office, to perform future investigative work at the Fund. (See ch. 8.)

SIS' data indicated its estimated costs, for the investigation from 1976 to May 1980, at about $4.4 million. In addition, the Special Litigation Staff, the LMSA Chicago office staff, and the Office of the Solicitor have incurred estimated costs of about $3.4 million for total costs of about $8 million for the investigation as of December 31, 1981. 2/

CONCLUSIONS

The Congress approved all of the staff positions that Labor stated SIS needed to perform the investigations of the Fund in an adequate and timely manner. However, SIS failed to fill all of the positions, and Labor later reduced SIS staff. Labor officials told us that SIS could not investigate the patterns of alleged abuse and mismanagement its investigators found--other than real estate mortgage and collateral loans--because of staffing shortgages. If SIS had filled the 45 authorized permanent positions, we believe that it would have been able to review some of the unresolved areas and complete more third-party investigations.

1/On October 1, 1981, the Special Litigation Staff's name was changed to the Special Litigation Task Force.

2/These costs do not include IRS' and Justice's investigation costs, which we could not obtain.

Labor also failed to (1) adequately train SIS personnel in areas related to the investigation, (2) maintain an effective work environment which adversely affected the morale of SIS personnel, and (3) ensure effective coordination between SIS and the Office of the Solicitor. Consequently, we believe--and the Kotch-Crino report confirmed--that these shortcomings significantly weakened and adversely affected SIS' investigation efforts. In our opinion, they also contributed significantly to the (1) problems SIS experienced in managing the investigation and (2) ineffective coordination and often extremely caustic relationship with the Office of the Solicitor. As we point out in chapter 8, we believe Labor needs to act to assure these mistakes are not repeated in its second investigation of the Fund.

CHAPTER 5

LABOR FAILED TO ADEQUATELY COORDINATE WITH JUSTICE

In December 1975, Labor and Justice agreed to coordinate their joint investigations of the Fund. We found, however, that problems in coordination and cooperation arose periodically between Labor and Justice despite the interagency agreements. As a result, the flow of investigative information from Labor to Justice was restricted at times.

Also, an impetus for Labor's investigation was the charges and allegations concerning the trustees' alleged mismanagement and those linking the Fund to organized crime figures. With its broad new enforcement authority and tools under ERISA--including the right to make an onsite inspection and review of Fund records and books--Labor believed it had the opportunity to detect and seek removal of anyone who might be improperly controlling and influencing the Fund's operations and its trustees. Labor's strategy, therefore, was to have a Government-wide coordinated investigation with dual objectives of detecting both civil and criminal violations.

Despite Labor's high hopes and its advantage of having access to the Fund's records and books, one of the primary objectives of the investigation--to develop information for criminal investigations and prosecution--was not entirely successful and the results fell short of Labor's and Justice's expectations.

We found that Labor's and Justice's efforts failed to produce a significant number of formal information referrals that Justice could pursue through its criminal investigations. In fact, as of June 23, 1981, Justice officials said that since Labor's investigation started in 1975, only one case resulted in a criminal conviction, although several cases were still under investigation. The other cases were closed primarily because of the Government's inability to substantiate a criminal violation.

RESPONSIBILITIES OF LABOR AND JUSTICE

As the chief law enforcement agency, Justice is responsible for investigating possible violations of title 18 of the United States Code and possible criminal violations under ERISA. Labor is also responsible for detecting and investigating civil and criminal violations of ERISA (29 U.S.C. 1134). However, when its investigation discloses evidence of a possible criminal law violation, including the embezzlement by a fiduciary of a plan, Labor must refer the case to Justice for consideration for investigation and prosecution (29 U.S.C. 1136).

In accordance with these provisions and its intent of having a joint investigation, Labor and Justice entered into the December 1, 1975, memorandum of understanding to establish a coordinated effort in their investigation of the Fund. Under the agreement, the two agencies established an interdepartmental policy committee of high ranking Labor and Justice officials to oversee the investigation.

COORDINATION BETWEEN LABOR AND JUSTICE DETERIORATES

During the first year of the investigation (1976), the coordination arrangements were informal and apparently worked well. In 1977, Labor's management of the investigation changed from an investigative to a litigative posture. This resulted in changes in Labor's philosophies in handling the investigation, which were not always fully attuned to Justice's needs.

For example, Labor postponed most of its planned investigative work involving third parties until after the civil suit was filed. According to an official from Justice's Criminal Division, who was the liaison with Labor, this may have "dried up a source" of information on potential criminal activity.

The deteriorating coordination was expressed in a January 31, 1978, memorandum from the Deputy Assistant Attorney General, Criminal Division, to the Assistant Attorney General, Criminal Division. The memorandum stated that several distinct problems had arisen which presented grave difficulties and also appeared not to be resolvable at the operational level. These problems included:

--The inability of Justice's liaison to obtain information indicating potential crimes or criminal misconduct under ERISA from Labor.

--A total shutdown of communications between Justice and Labor's representatives on the investigation of the Fund.

The memorandum also stated that Labor had not kept Justice apprised of its investigative efforts and that, in fact, Labor's investigative staff had been instructed not to discuss the investigation with Justice.

As a result, significant problems surfaced. One problem dealt with the contention by Justice's Criminal Division that Labor, in late 1977 and early 1978, did not provide sufficient advance notice to the Division, and the appropriate U.S. attorney's office, of Labor's intent to file the civil suit against the former Fund trustees and officials. Justice officials said that the lack of advance notice caused problems because their

main witness in a criminal case against a former Fund official was named as a defendant in Labor's civil suit. The witness then became less cooperative and did not agree to testify until about an hour before the trial began.

Another problem dealt with the flow of information from Labor to Justice. Labor denied Justice officials copies of summaries prepared by Labor's attorneys because Labor considered these documents internal drafts. In fact, this problem became so bad in August 1978 that a Justice attorney threatened to subpoena Labor's investigators so that Justice could interview them about records on certain loans that Labor would not provide Justice.

This problem was particularly significant because Labor was the focal point for the joint investigative effort and its onsite access to Fund records. Justice relied on Labor's investigative efforts to help detect potential criminal violations. Officials in Justice's Criminal Division said that Labor's actions ran counter to the "spirit of full cooperation" originally envisioned in the agreement with Labor.

POLICY AND WORKING GROUP COMMITTEES NOT EFFECTIVE

Under the December 1975 agreement, Labor and Justice established an interdepartmental policy committee to assure that the investigation would be effective and resolve disputes. This committee, however, seldom met once the investigation began. The committee was nonexistent when the above problems surfaced.

It was replaced in mid-1977 by an informal interagency working group composed of intermediate-level officials who were to coordinate each department's ERISA responsibilities and the investigation of the Fund. Finally, in December 1978, Labor and Justice entered into another interagency agreement which formally set up the working group to meet biweekly. The agreement also provided for the referral to appropriate higher officials--who were not defined--of any litigative problems not resolved by the working group.

Despite the working group and interagency agreement, coordination problems still arose. For example, at working group meetings, the Justice's Criminal Division liaison official with Labor attempted to obtain Labor's plans about filing a lawsuit at least 3 months before the suit was filed. He was not told of Labor's plans until the day before the civil suit was actually filed and then he was told by officials from Justice's Civil Division.

Some of these coordination problems may have been avoided if the interdepartmental policy committee had played a more active role and carried out its oversight function.

LABOR MADE FEW FORMAL REFERRALS OF POTENTIAL CRIMINAL VIOLATIONS TO JUSTICE

Over the years, allegations have been made that individuals linked to organized crime had connections with, or actually controlled, the Fund's trustees and that questionable loans had been made by the trustees to people linked to organized crime. 1/ In fact, the Senate Permanent Subcommittee on Investigations cited allegations characterizing the Fund as playing a banker's role for organized crime interests over the years. 2/ The Subcommittee also cited evidence charging that a former trustee--who is now president of the IBT--is controlled by a reputed organized crime leader in Kansas City and exercises great influence with the Fund for this organized crime figure. (See pp. 79 to 82.)

Thus, the impetus for Labor's investigation was such charges and allegations concerning the trustees' alleged mismanagement and those linking the Fund to organized crime. Labor's strategy was to have a Government-wide coordinated investigation with dual objectives of detecting both civil and criminal violations.

Labor was to lead the investigation and focus on asset management and to determine whether the Fund was complying with ERISA's fiduciary provisions. However, Labor was to pass potential criminal violations on to Justice which was to center its efforts on investigating and prosecuting the potential criminal violations.

Morever, Labor, for the first time, had the authority, under ERISA, to make a comprehensive review and investigation of the Fund including the authority to inspect books and records onsite at the Fund, subpoena the Fund's records and books, and take testimony under oath or by affidavit from trustees, plan employees, or third parties. Labor maintained that prior efforts of the Government to deal with the Fund were inadequate and did not produce any discernible change in the trustees' policies or practices. With the broad new tools and authority under ERISA, Labor believed that the Federal Government had an opportunity to detect and seek removal of anyone--including those allegedly tied to organized crime--who might be improperly controlling and influencing the Fund's operations and its trustees.

Despite Labor's high hopes and its advantage of having access to the Fund's records and books, one of the primary objectives of the investigation--to develop information for criminal investigations and prosecution--was not entirely successful, and the results fell short of Labor's and Justice's expectations.

1/See footnote 2, page 1.

2/See footnote 1, page 8.

We found that Labor, in the first 5 years of investigative activity, provided Justice's Criminal Division 11 formal loan information referrals in writing that had potential for criminal investigation. Labor made five referrals in 1977, five in 1978, and one in 1979. On August 18, 1980, Justice's Assistant Attorney General, Criminal Division, told us in a memorandum that none of the 11 referrals had resulted in any criminal indictments and that 4 of them had been closed because the investigation failed to substantiate criminal violations. He said seven referrals were still under investigation. However, on June 23, 1981, the Assistant Attorney General, Criminal Division, said that only one of the remaining seven referrals was still open, and the others were closed because preliminary investigation failed to substantiate any criminal violations or because of the statute of limitations.

The Assistant Attorney General said Justice investigated other matters which, directly or indirectly, involve 15 other Fund loans. Of these 15 cases, he said that only 1 resulted in a conviction. For three others, criminal indictments were secured, but two resulted in an acquittal or dismissal, and the other went to trial in June 1981. Five of the remaining 11 were still under investigation as of June 23, 1981. The Assistant Attorney General said that two others were still open, but these were expected to be closed soon. The remaining four investigations were closed without any indictments because of the Government's inability to substantiate a criminal violation.

Justice officials told us that, overall, most of the information received from Labor had not been useful for their criminal investigative efforts, including organized crime strike force program activities.

Labor referral data inaccurate

Labor officials said that, in addition to formal referrals, Labor officials at work groups or other meetings had informally discussed or provided Justice's staff with other information. Our review disclosed, however, that Labor has failed to keep accurate records on formal and informal referrals and that it provided inconsistent, inaccurate, and incomplete information to congressional subcommittees on such referrals.

For example, in testimony in March 1980, before the House Subcommittee on Oversight, the Secretary of Labor 1/ was asked

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1/Hearings on "Review of Progress on Teamsters' Central States Pension Fund Reform" before the Subcommittee on Oversight, House Committee on Ways and Means, 96th Cong., 2nd sess., page 97 (Mar. 24, 1980).

whether Justice had received any information from Labor. The Secretary testified that:

> "* * * In the last 3 years we have run into 25 situations that we thought warranted investigation by the Justice Department."
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> * * * * *
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> "We have referred information on 25 cases to them in the last 3 years. We assume they are looking into things we have referred to them. * * *"

However, on June 5, 1980, in response to the House Subcommittee on Oversight's question for further details on how many referrals Labor made to Justice for possible criminal investigation for each year since 1977, the Secretary said:

> "* * * In 1977, the Department referred 12 possible [criminal] leads to DOJ. Since that time, due to the nature of the effective and harmonious relationship between the two departments, we have not needed to keep such records. * * *"

Labor gave 11 formal loan information referrals that had potential for criminal investigation to Justice's Criminal Division. Also, on August 18, 1980, Justice's Assistant Attorney General, Criminal Division, confirmed that Justice had received the 11 formal referrals from Labor.

The apparent confusion over the accuracy on the number of items which Labor said it turned over to Justice with potential for criminal investigation was also brought out in September 1980 congressional hearings. 1/ In his opening statement at the hearings, the Secretary of Labor stated that, within the past 4 years, Labor had provided Justice with information relating to more than 80 Fund transactions in addition to voluminous information relating to other aspects of the Fund's operation. An attorney in Labor's Office of the Solicitor also testified that the 26 cases cited by Justice in its August 18, 1980, memorandum to GAO is not entirely accurate. He said he personally knew of about 80 transactions that Labor discussed with Justice or provided information on to Justice.

To clear up the confusion, the Chairman of the Subcommittee requested that Labor supply an accurate figure on referrals. Labor did supply the requested information, but rather than helping

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1/See footnote 2, page 1.

resolve the situation, the information appears to have confused the situation.

A detailed list provided by Labor shows a total of 112 referrals made as follows: 0 in 1975, 2 in 1976, 12 in 1977, 59 in 1978, 1 in 1979, and 38 in 1980. Labor stated that the list contained referrals and included specific matters brought to Justice's attention orally or in writing.

However, Labor did not specify referrals made in writing from those made orally. Moreover, 45 of the transactions listed by Labor were supplied at the request of Justice rather than specifically referred by Labor. In addition, Labor admitted that the list contains duplicate referrals, i.e., several of the transactions listed for 1978 and 1980 had been included in previous referrals.

KOTCH-CRINO REPORT CONFIRMS COORDINATION PROBLEMS WITH JUSTICE

Further evidence on the lack of effective coordination between Justice and Labor was noted in the May 1979 Kotch-Crino report.

The report cited coordination problems similar to those we found, such as Labor restricting the flow of information to Justice and Labor denying Justice officials summaries prepared by Labor's attorneys. The report characterized the latter point as a significant problem area and a "major" irritant to Justice.

The Kotch-Crino report also acknowledged that a few formal criminal referrals were made in writing to Justice, but most were done informally without record at meetings or by telephone. It also stated that any information of a criminal nature that was sent to Justice was referred in a haphazard way, with little or no regard for proper procedure. According to the report, an LMSA official stated that a formalized referral system was not necessary because Justice had complete access to SIS files and because the SIS investigation has revealed no hard evidence of embezzlement or kickbacks.

In addition, the Kotch-Crino report also noted other problems affecting Labor's and Justice's coordination and development of potential criminal violations. The report stated that:

--SIS was instructed in no uncertain terms that Labor's policy was to develop civil cases, but not criminal cases and to gather information indicating criminal behavior was deemphasized.

--The acting director of SIS said that SIS has never conducted any aspect of a criminal investigation and in his view "had better not."

--The acting director of SIS acknowledged that the names of organized crime personalities turned up in the Fund's loan records, but specific referral to Justice was sometimes not made since no ERISA violation was apparent.

--It is SIS' policy that its investigators will not pursue any aspect of criminal investigations. The policy is based on SIS' restrictions, civil jurisdiction, and a lack of personnel.

The report mentioned that several of the more criminally oriented SIS investigators expressed dissatisfaction with SIS' general deemphasis of criminal matters. Although acknowledging and accepting that SIS has a civil role, they thought that coordination could be more effective. For example, SIS apparently never reviewed available LMSA files or consulted LMSA in-house expertise. Also, Justice never provided a target list of organized crime names and activities during SIS' investigation of the Fund.

The report recommended that Labor honor the memorandum of understanding by (1) establishing a formal written system of referring potential criminal violations to Justice, (2) suggesting a single Justice coordinator for all Fund activities, (3) establishing procedures wherein Justice periodically orients and briefs the officials of the Office of the Solicitor, (4) suggesting one designated receiver in Justice for all Fund records, and (5) establishing a system wherein the Office of the Solicitor automatically forwards to Justice pertinent additional records regarding any matter previously referred.

According to the Secretary of Labor, Labor agreed with the Kotch-Crino report and shortly thereafter acted to implement the recommendation by disbanding SIS. However, Labor, in our view, has not acted on the report's recommendations regarding Labor's coordination problems with Justice. For example, Labor had not established an adequate formal referral system.

The Deputy Assistant Attorney General, Criminal Division, testified at the March 1980 1/ hearings that there may have been some friction between the two departments in the past; however, they are now cooperating smoothly, and the work group meetings have successfully minimized and averted potential conflicts. At the same hearings, the Secretary of Labor also testified that the

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1/See footnote 1, page 46.

work group was being used satisfactorily and he hoped that the initial coordination problems were resolved. In the September 1980 congressional hearings, 1/ the Secretary also stated that in relationships between any two organizations the size of Labor and Justice, particularly where each has highly motivated people who believe that their particular jobs are most important, it is inevitable that there will be problems of communications, assignment of priorities, and occasional misunderstandings.

CONCLUSIONS

In our opinion, despite Labor's extensive investigation efforts at the Fund and its review of massive volumes of records, one of the investigation's objectives--to detect information for potential criminal investigation--has not been entirely successful. As of June 23, 1981, only one criminal indictment had resulted from Labor's referrals. Justice officials have stated that--overall--Labor's information has not been useful in their criminal investigation efforts, including the organized crime strike force program.

Also, as indicated by our review--and the Kotch-Crino report--Labor and Justice still experienced coordination and cooperation problems despite several agreements and working group committees. The latest coordination agreement provides for referring any litigation strategy problems that the members of the working group cannot resolve to appropriate higher officials. However, the appropriate higher officials are not defined. In our view, Labor and Justice officials should consider a forum, such as the interdepartmental policy committee--but tailored to current needs--originally established by the December 1975 coordination agreement. The object of that committee, among other things, was to handle questions on which litigative strategy (civil or criminal) was appropriate for obtaining information.

To ease another coordination problem and ensure free flow of information to Justice, Labor needs to remind its Office of the Solicitor attorneys that Justice should have access to all records including their summaries on individual loan cases. Justice should caution its attorneys that these analyses are internal, draft documents and are to be treated as such.

Over the years, much controversy has arisen on the number of formal and informal referrals of potential criminal violations by Labor to Justice. We believe that Labor should establish, as suggested in the Kotch-Crino report, a more effective system of referring potential criminal violations to Justice. Labor should,

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1/See footnote 2, page 1.

we believe, also consider adopting the other recommendations in the Kotch-Crino report.

RECOMMENDATIONS TO THE SECRETARY OF LABOR AND THE ATTORNEY GENERAL

To help maintain effective coordination between Labor and Justice, we recommend that the Secretary and the Attorney General take action to have their December 1978 coordination agreement revised to define the "higher officials" who should or would resolve the litigation strategy problems the working group members cannot resolve or consider reestablishing an Interdepartmental Policy Committee similar to the one established in 1975.

In view of the continuing controversy on the actual referrals Labor made to Justice, we recommend that the Secretary direct the Office of the Solicitor to establish a more effective system to process referrals of potential criminal violations to Justice.

Finally, we recommend that the Secretary also direct the Office of the Solicitor to carry out the recommendations in the Kotch-Crino report to honor the memorandum of understanding (agreements) with Justice, by (1) establishing a more effective written system of referring potential criminal violations to Justice, (2) suggesting a single Justice coordinator for all Fund activities, (3) establishing procedures wherein Justice periodically orients and briefs officials of the Office of the Solicitor, (4) suggesting one designated receiver in Justice for all Fund records, and (5) establishing a system wherein the Office of the Solicitor automatically forwards to Justice pertinent additional records regarding any matter previously referred.

AGENCY COMMENTS AND OUR EVALUATION

We received comments on our draft report from Labor in an October 26, 1981, letter, and from Justice in a November 17, 1981, letter. (See app. XIII on p. 147 and app. XIV on p. 166.)

The agencies generally concurred with our recommendations and indicated actions already taken or to be taken in agreement with them.

Labor said, for example, it concurs with the goal of our recommendation that Labor and Justice define the higher officials "who should or would resolve the litigation strategy problems the working group members cannot resolve." Labor said that the establishment of the high-level Task Force on March 4, 1981, responds to this concern about lack of coordination.

According to Labor, on March 4 the Secretary of Labor met with the Attorney General and the Secretary of the Treasury to discuss coordination efforts and each recognized that coordination has been a problem in the past. As a result of the meeting, Labor said a high-level Task Force--made up of the Secretaries of Labor and the Treasury and the Attorney General and representatives from all three departments--was created. The Task Force working group is chaired by the Solicitor of Labor, and it includes representatives of IRS, the civil and criminal divisions of Justice (including the Organized Crime Strike Force), and the relevant program agencies within Labor (including LMSA).

Labor said since March, the Task Force has met on more than 20 occasions, and through these meetings, they have been able to maintain communication, assure interdepartmental cooperation, and coordinate activities. Recently, Labor said the three departmental heads met again and renewed their pledge of coordination.

Justice noted that the letter, which embodied the December 1978 coordination agreement, was signed by the former Assistant Attorney General, Criminal Division, and the former Assistant Secretary of Labor, Labor-Management Relations, and it assumed that these officials would become involved in the resolution of any major litigation strategy problems which the mid-level working group members could not resolve.

Justice stated that, in fact, during the past year the Assistant Attorney General, Criminal Division, or his representatives, which often included the Chief of the Organized Crime and Racketeering Section, met personally on several occasions with Labor's Solicitor in order that the Solicitor could advise them directly concerning the present status of civil litigation being currently pursued by Labor against the Fund and former trustees of the Fund. Justice stated that the former Acting Assistant Attorney General, Civil Division, and his representatives have also attended these meetings, and that the Attorney General and Associate Attorney General have been briefed personally by the Secretary of Labor and the Solicitor concerning these matters.

Justice said (as the former Deputy Assistant Attorney General testified in March 1980), 1/ although there may have been friction in the past between Justice and Labor concerning the coordination of parallel criminal and civil investigations of the Fund, the parallel investigations appeared to be proceeding smoothly. Justice believes that coordination has been facilitated by disseminating to field personnel written guidelines concerning cross-notification between the two agencies before the initiation of

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1/See footnote 1, page 46, and discussion on page 49.

court action; use of subpoenas, depositions, etc. Justice concluded that the higher level Justice officials, mentioned above, have been and will continue to be available to resolve coordination problems which cannot be satisfactorily resolved at lower levels.

Labor said that it does not concur with our recommendation that the Office of the Solicitor establish a formal system to document referrals of potential criminal violations to Justice because a formal system already exists and an effective informal system is also being used. Labor said when an investigator discovers possible criminal violations, a memorandum is prepared to LMSA's National Office of Enforcement through the Area Administrator. The National Office then contacts the Justice representative, and in a meeting or by telephone, they determine the appropriate approach to follow. When cases involving criminal matters are determined to be appropriate for referral to Justice, a formal referral memorandum is sent. Labor said, in addition, there is an informal system of contacts between Justice and Labor in Washington, D.C., and in the various regions nationwide.

Justice stated that it favors any system which assists in the accurate tracking of criminal case referrals and is willing to assist in the improvement of systems now in effect. It said the Special Investigations Task Force which is currently in charge of Labor's litigation involving the Fund has been careful to furnish all such referrals in writing and it would expect that any such referrals would continue to be directed to the Chief of the Oranized Crime and Racketeering Section, Criminal Division. Justice said it favors the format now used by the Pension and Welfare Benefit Programs Office, namely, a summary report of investigation which lists witnesses, documents and their location, and appropriate field personnel who can be contacted for further details.

We agree with Justice that there appears to be a need for improvements in the current referral system to assist in the accurate tracking of criminal case referrals. We believe, therefore, that Labor should work with Justice to develop a more effective referral system to be compatible with and agreeable to both agencies.

Labor concurred, in part, with our recommendation that the Office of the Solicitor carry out the recommendations in the Kotch-Crino report to honor the memorandums of understanding (agreements) with Justice. Labor stated that that our recommendation contains five parts, and as to part (1), it notes that there is a formal written system for referring criminal violations to Justice, and, in the context of the Central States Teamsters' investigations and litigation, the need for cumbersome formal referrals has been obviated by the close coordination that exists between the departments. Thus, Labor said materials which might be relevant to

ongoing grand jury proceedings or other criminal investigations are forwarded directly to the individuals at Justice who can put the information to best use, and the transfer of information is recorded in an appropriate manner. Labor said it believes that prudent management of its coordinate law enforcement responsibilities is best served by this more direct transfer of information.

As to parts (2), (3), and (4), Labor noted that it is certainly willing to cooperate with any designated Justice officials. Labor also noted that in Chicago, Justice has specified one representative with whom the investigative supervisor in charge of Labor's investigation at the Fund meets on a regular basis and Task Force representatives have been designated by Justice. As to part (5), Labor believes that the current system of cooperation satisfies the concerns of the Kotch-Crino report.

In regard to the Kotch-Crino recommendation that there be a single Justice coordinator "for all Fund activities," Justice noted that the Chief, Organized Crime and Racketeering Section, Criminal Division, is the responsible official who currently acts as the coordinator for all criminal investigations relating to the Fund. Also, Justice said that the Director, Federal Programs Branch for General Litigation, Civil Division, is currently responsible for the oversight of civil litigation involving the Fund pursuant to the December 1, 1975, Memorandum of Understanding between Justice and Labor. Justice said it believes that this arrangement represents an appropriate division of responsibilities.

In regard to the Kotch-Crino recommendation that Justice establish procedures to periodically brief the officials of the Office the Solicitor, Justice stated that as it testified in March 1980 1/ the Criminal Division advised that it was prepared to provide any assistance requested by Labor to familiarize civil investigators with the kind of activities which may constitute a potential criminal violation. Later, Justice said its Criminal Division attorneys met in Washington, D.C., with personnel from Labor's Area Offices to brief them on developments in the Federal criminal law governing employee benefit plans. According to Justice, this presentation was similar to that provided to criminal investigators in Labor's Office of the Inspector General and the Federal Bureau of Investigation. Moreover, Justice said this kind of information has routinely been furnished to representatives of the Office of the Solicitor by the mid-level working group.

In regard to the Kotch-Crino recommendation on a single Justice receiver of all Fund records, Justice said, although it is willing to assist Labor in tracking the transfer of Fund documents

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1/See footnote 1, page 46.

between the two agencies, it objects to the routine physical transfer of all Fund records through a receiver at Justice in Washington, D.C., or any other single location. It believes that such a procedure, if required in all cases, would greatly impair the ability of personnel at operational levels to expeditiously pursue their investigations.

Justice said, however, that members of the mid-level working group have implemented procedures whereby copies of documents are rountinely made and retained at their source so that investigators working parallel criminal and civil investigations do not confront each other over simultaneous access to documents. It said procedures of prior cross-notification are also in effect with respect to Fund investigations concerning the use of subpoenas, depositions, etc.

In summary, Justice said it believes that the major problems concerning the coordination of parallel criminal and civil investigations of the Fund have been resolved and it looks forward to further cooperative efforts.

Labor said it concurs with the proposed recommendation in our draft report that the Office of the Solicitor provide Justice's Criminal Division attorneys analyses on various Fund transactions which indicate potential criminal violations. Labor said it recognizes its obligation to provide Justice with information which may be found to warrant consideration for criminal prosecution and its investigators are aware of ERISA criminal provisions and are instructed to be alert to possible uses of information for criminal investigations. Pursuant to that practice, Labor said it will continue to make all relevant information, including attorney analyses of Fund transactions, available to Justice. In certain instances, where attorney analyses are privileged and sensitive, or where uncontrolled disclosure to, or by Justice, might jeopardize ongoing litigation, Labor said it has, with the agreement of Justice, imposed safeguards on such disclosures.

We agree with Justice's comments as well as Labor's that the agencies have apparently taken significant actions to improve their coordination efforts on their parallel investigations and that, if the actions and procedures are properly implemented, they should help resolve or alleviate the major coordination problems of the past and answer the recommendations in our report and the Kotch-Crino report. However, because of the ongoing investigation, we are precluded from determining whether Labor's and Justice's actions are fully effective and improve their coordination efforts. Therefore, we are retaining the recommendations in our report until we can review the effectiveness of Labor's and Justice's actions.

CHAPTER 6

LABOR AND IRS DID NOT REQUIRE A WRITTEN AGREEMENT IN RESTORING FUND'S TAX-EXEMPT STATUS AND DID NOT INSURE THAT THE FUND'S NEW TRUSTEES MET STATED QUALIFICATIONS

IRS, on June 25, 1976, without prior notice to Labor, revoked the Fund's tax-exempt status. However, IRS after reconsidering the impact of its unilateral action on the Government's investigative efforts finally agreed to fully coordinate with Labor in August 1976. Labor and IRS then had extensive discussions and considered many options--from a court-enforced "consent decree" 1/ to requiring the trustees to resign and appointing a neutral board of trustees--in reforming the Fund and having IRS restore its tax-exempt status.

IRS restored the Fund's tax-exempt status on April 26, 1977. But, rather than have the trustees enter into a written agreement with Labor, such as a court-enforced consent decree, IRS--with Labor's approval--based the requalification on the trustees' agreement to operate the Fund in accordance with ERISA and to comply with eight specific conditions prescribed by Labor and IRS.

We believe that a consent decree would have been a more effective remedy because Labor could have proceeded directly against the trustees in the event the decree's terms were not complied with. A consent decree is enforceable through the issuance of a court order directing compliance with the agreed-to-terms. The failure to comply with the order may lead to the issuance of a contempt-of-court citation.

Furthermore, as a condition for requalification, the Fund agreed to Labor's and IRS' demand that the four holdover trustees resign. However, Labor and IRS did not play an active role in insuring the new trustees met qualifications they had developed even though Labor knew that some of the former trustees--who allegedly mismanaged the Fund--were members of the union organizations that selected some of the new trustees.

1/A consent decree is an order of preliminary or permanent injunction entered by a court of competent jurisdiction on the basis of the Government's complaint, the consent of the defendant to the entry of a decree embodying certain relief (usually without admitting or denying the allegations of the complaint), and an agreed form of judgment.

LABOR CONSIDERED--BUT DROPPED-- COURT-ENFORCED CONSENT DECREE TO REFORM THE FUND

IRS and Labor officials continued to meet in 1976 and coordinate on the conditions for IRS to restore the Fund's tax-exempt status. As a result of these meetings, both IRS and Labor proposed minimum standards to correct past practices and to govern the Fund's future operations. For example, IRS proposed that the trustees be required to transfer all of the Fund's assets and receipts, except those needed for current benefit payments, administrative expenses, existing loan commitments, and operations, to an independent, outside professional investment manager. Labor, however, proposed that a "neutral" board of trustees, composed of a majority of individuals not affiliated with the Fund, be established to govern the Fund.

In addition, Labor officials and Fund representatives (from July to Oct. 1976) had informal negotiations on changing the Fund's operations, limiting the scope of the trustees' management, and removing some trustees. Furthermore, Labor officials during the negotiations said that they discussed the possibility of obtaining a consent decree which would have been judicially enforceable in a Federal district court. The proposed consent decree would have prescribed, during the period of Labor's investigation, the manner in which the trustees would manage the existing assets and make investments.

Labor, however, dropped the consent decree requirement and accepted the Fund's counterproposal to restructure its board of trustees from 16 to 10, and 11 of the 16 trustees agreed to resign (1 had previously resigned) and 6 new trustees would be appointed. According to the former SIS director, Labor dropped the consent degree requirement and accepted the Fund's proposal because top-level Office of the Solicitor and LMSA officials believed some "dramatic action" was needed.

LABOR AND IRS PLAYED NO ACTIVE ROLE IN INSURING SIX NEW TRUSTEES APPOINTED IN OCTOBER 1976 WERE QUALIFIED AND INDEPENDENT

Until October 26, 1976, the Fund was managed by a board of 16 trustees--8 of them were selected by the trucking associations and 8 by the Teamsters' union councils and conferences. As a result of its agreement with Labor, the trustees amended the trust agreement, effective October 26, 1976, with the consent of the employer trucking associations, to reduce the board from 16 to 10

members--5 union members and 5 employers were appointed. 1/ Also, all but 4--2 union and 2 employer--of the 16 trustees resigned. Six new trustees--three union and three employer--were appointed to bring the board to full strength. 2/

The new trustees were selected under article II of the revised trust agreement. This article provides that the employer associations shall designate the employer trustees and the Central and Southern Conferences of the Teamsters' union shall jointly designate the employee trustees. The trust agreement does not provide for a particular person to be responsible for selecting the trustees. Further, the agreement contains nothing on how the employer associations and union conferences are to make the selections. Thus, they are free to adopt any selection method.

Despite Labor having developed qualifications new trustees should meet, Labor and IRS officials did not review the six new trustees' qualifications, experience, or associations with the old trustees. In fact, Labor did not know what methods were used or who selected the union or the employer trustees. A SIS special investigator proposed that Labor investigate the actual mechanics of how names are offered for consideration by the employer and union groups making the selection. He suggested, for example, that Labor adopt a forthright approach to the Fund by requesting a list of union conferences and agenda and a copy of the Fund's October 11, 1976, resolution. This resolution approved the three new union trustees in October 1976. However, Labor never made this investigation.

Also, Labor officials (including those who negotiated with Fund officials from July to Oct. 1976) considered suggesting that the Fund appoint "independent" or professional trustees who were not affiliated with the plan sponsors. They also considered suggesting that the Fund be told as firmly as possible that the new trustees had to be completely acceptable in terms of competence, honesty, and background.

However, the officials concluded that the most Labor could tell the Fund was which of the trustees were not acceptable, but it could not be placed in the position of selecting the new trustees by approving or rejecting nominees. Some Labor officials

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1/On August 15, 1979, the trustees amended the trust agreement to reduce the board from 10 to 8 members (4 union members and and 4 employer members).

2/See appendixes III, IV, and V for lists of the trustees from October 26, 1976, to December 1, 1981, and appendixes VI, VII, and VIII for the union and employer associations that selected the trustees.

had reservations about the public perception of Labor excluding union members from serving as trustees of a collectively bargained plan.

THE FUND AGREES TO GOVERNMENT DEMANDS FOR REFORMS

A new Secretary of Labor was appointed in late January 1977. After reviewing Labor's investigation and assessing the evidence, the Secretary stated that Labor had a strong case that could stand up in court. The Secretary stated, however, that the chance of protracted and bitter litigation was significant. The Secretary decided that the Government's primary goal was to preserve the Fund's assets. He also decided that Labor and IRS should explore, with the Fund's representatives, the possibility of achieving the relief believed necessary without litigation.

Labor and IRS continued to meet to develop a coordinated effort in dealing with the Fund. Labor and IRS had also decided that the four trustees who had served before October 26, 1976, would have to resign with new trustees being selected. Labor and IRS agreed on criteria for selecting the new trustees that included the following:

--The board would be restructured so that a majority of the trustees would be persons--either individuals or entities, such as banks or insurance companies--not affiliated with and independent of the union or any employer contributing to the Fund.

--The neutral trustees would be highly qualified professionals from a variety of disciplines with recognized ability.

--The trustees must be independent and free of ties with the Fund and its plan sponsors (e.g., cited was Mr. Archibald Cox, a former solicitor general of the United States).

--The Government would be involved in the selection and would exercise veto power over any proposed candidate.

Labor had also coordinated with Justice on the use of a majority of neutral trustees--chosen by the union and employers. In fact, on January 18, 1977, the Secretary of Labor requested an opinion from the Attorney General on whether the proposed neutral board of trustees would comply with the Taft-Hartley Act. Justice advised Labor on January 27, 1977, that such a proposed board of trustees would comply with the requirements of the Taft-Hartley Act.

On February 16, 1977, Labor and IRS presented to Fund representatives the Government's demands to restore the Fund's tax-exempt status. Labor's and IRS' demands included the requirements that the (1) four trustees who served before October 26, 1976, resign and (2) board be restructured so that the new board consisted of a majority of neutral professionals and a minority of representatives of the union and contributing employers.

According to the Secretary of Labor's testimony, 1/ Labor and IRS officials also told Fund officials that they were prepared to go to court to (1) remove the four holdover trustees and require new trustees to remove themselves from the day-to-day management of the Fund's assets and (2) make certain changes in the pension plan and procedures, outside the asset management area, to bring the plan into compliance with ERISA's minimum standards and to meet certain IRS qualification requirements.

In a February 23, 1977, meeting, Fund representatives presented a counteroffer under which, among other things, the board would remain, but deal only with noninvestment matters and delegate investment authority over Fund assets to a committee of independent, neutral professionals. The Fund also agreed to amend its plan to comply with ERISA outside the asset management area.

Although Labor and IRS were not completely satisfied with the Fund's progress, on February 26, 1977, IRS extended the relief of the Fund's tax exemption to the end of April 1977. Later, during the final negotiations, Labor and IRS gave the trustees a choice to (1) restructure the board to obtain a majority of neutral trustees or (2) retain the present board structure, with the remaining four original trustees to resign and turn over control of asset management to a professional, independent investment manager. The trustees chose the second option, and the four holdover trustees resigned and four new trustees were appointed.

IRS and Labor imposed additional conditions on the trustees, and on April 26, 1977, the final Government conditions were explained in a letter IRS issued restoring the Fund's tax-exempt status. The letter said that the continued qualification of the Fund would depend on its effective operation, in accordance with ERISA, and compliance with the following eight conditions.

1. The trustees amend the trust agreement to have the Fund conform to ERISA and the Internal Revenue Code.

2. The Fund have in operation, not later than December 31, 1977, a data base management system that would be sufficient to determine "credited service" in accordance

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1/See footnote 2, page 1.

with the pension plan's requirements for all participants from 1955 to April 26, 1977, inclusive.

3. The Fund review all benefit applications that were originally rejected, but subsequently approved to insure that the effective date and amount of benefit payments were in accordance with the plan provisions in effect at the appropriate governing dates.

4. The Fund complete by May 1, 1978, an examination of all Fund loans and related financial transactions from February 1, 1965, to April 30, 1977, to determine whether the Fund has any enforceable causes of actions or other recourse as a result of the transactions.

5. The trustees amend the trust to provide a statement of investment policies and, annually, the trustees provide written investment objectives to the investment manager retained by the Fund.

6. The trustees amend the trust to establish a qualified Internal Audit Staff to monitor Fund affairs.

7. The trustees amend the trust to publish annually, in at least one newspaper of general circulation in each State, the annual financial statements, certified by the Fund's Certified Public Accountant.

8. The trustees place all Fund assets and receipts, including moneys derived from liquidation of existing investments (except funds reasonably retained by the Fund for payment of plan benefits and administrative expenses), under direct, continuing control of independent professional investment managers as defined by section 3(38) of ERISA. 1/

The IRS letter also required the (1) Fund to allow IRS, but not Labor, access to Fund records, reports, etc., and (2) trustees to submit monthly reports on the progress made in complying with the eight conditions.

1/ERISA defines an investment manager as any fiduciary (other than a trustee or fiduciary of the Fund) who (1) has the power to manage, acquire, or dispose of plan assets; (2) is a registered investment adviser under the Investment Advisers Act of 1940, a bank, or a qualified insurance company under the laws of more than one State; and (3) has acknowledged in writing that he or she (it) is a fiduciary of the plan.

Labor, after the Fund agreed to meet the Government's conditions, stated it would terminate that portion of its investigations focusing on the Fund's asset management procedures and review of the Fund's records and documents. Labor terminated the onsite phase of the investigation in May 1977 and shifted primarily to a civil litigative strategy.

LABOR AND IRS DID NOT OBTAIN A WRITTEN AGREEMENT

Although IRS' letter required the trustees to submit monthly progress reports, neither IRS nor Labor required the Fund's trustees to enter into a written agreement with Labor--such as a court-enforced consent decree--requiring them to abide by the terms of the requalification. In fact, IRS considered the press release issued by IRS on March 14, 1977, announcing its agreement with the Fund as the basic memorandum of an agreement.

The fact that Labor's and IRS' agreement with the Fund's trustees was oral and that the Government's conditions were not in a written document was of early concern to the House Subcommittee on Oversight. The following exchange during the Subcommittee's hearings held in March 1977, 1/ between a Subcommittee member and IRS' Assistant Commissioner for Employees Plans and Exempt Organizations--who was one of the IRS officials that negotiated the agreement with the Fund's trustees--demonstrates the Subcommittee's concern.

> Congressman: "Is it correct that the agreement reached between the parties was a verbal agreement with nothing in writing?"
>
> Assistant Commissioner: "Well, the press release that has been issued is in fact a part of the agreement and, of course, is in writing."
>
> Congressman: "Except for the press release, the rest of it is just a gentlemen's agreement as to what each of the parties will do?"
>
> Assistant Commissioner: "I wouldn't characterize it as a gentlemen's agreement. The press release contemplates certain actions being taken. The actions that are to be--the responsive actions of the agencies are predicated on the Fund taking the actions that are described in the press release."

1/See hearings on "Teamsters' Central States Pension Fund and General ERISA Enforcement" before the Subcommittee on Oversight of the House Committee on Ways and Means, 95th Cong., 1st sess., page 594 (Mar. 14 and 15, 1977), part 1.

Congressman: "The basis though for the agreement insofar as written reference is concerned is then the press release?"

Assistant Commissioner: "The press release is the basic memorandum of an agreement."

The Senate Permanent Subcommittee on Investigations, in its August and September 1980 hearings, expressed similar concern that Labor and IRS did not have an "enforceable" written agreement with the trustees. 1/ IRS and Labor officials agreed that there was no written agreement signed by IRS and the trustees. However, the Assistant Commissioner for Employees Plan and Exempt Organizations disagreed with the previous Assistant Commissioner's description of a press release as an agreement or a contract.

The Assistant Commissioner said that IRS does not view the press release as a written agreement at all. He said that issuing a press release is a normal thing IRS does after it has made certain decisions and taken certain actions. He said, actually, the requalification letter is conditioned upon the Fund's making every effort in completing, to IRS' satisfaction, the eight conditions in the requalification letter.

The Assistant Commissioner also said that the Internal Revenue Code does not provide for a written agreement between the trustees and the Government.

The Secretary of Labor also testified that the basic objection to Labor entering into a written agreement with the trustees was that it would make the Government liable for any possible violations of their fiduciary responsibilities. He said that Labor did not want trustees to be Labor trustees and he did not want trustees to subject the Government to that liability. The Secretary also said that he believed the way Labor and IRS arranged the agreement made it enforceable. He added that Labor's understanding with the trustees was in writing; it simply did not have the form of a contract between Labor and IRS and the trustees.

IRS needed a court order to resume onsite reviews at the Fund's headquarters to determine whether, in fact, the trustees had complied with all eight conditions of requalification. (See ch. 8.)

LABOR AND IRS PLAYED NO ACTIVE ROLE IN INSURING FOUR TRUSTEES APPOINTED IN APRIL 1977 MET STATED QUALIFICATIONS

Under their agreement with Labor and IRS, the four trustees who served before October 26, 1976, resigned in April 1977, and

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1/See footnote 2, page 1.

four new trustees were appointed. Labor and IRS, however, played no active role in insuring the four new trustees met the qualifications or characteristics they had established nor did they insist on the Government's approval of the persons selected. (See page 59.)

The trustees were selected by the Teamsters' Central and Southern Conferences and the trucking associations.

According to the Special Consultant to the Secretary who headed the negotiations with the Fund in February and March 1977, Labor's goal was to take the assets from the trustees, irrespective of who the new trustees were, so they would not have control or impact on investment or asset management decisions. One official said that Labor did not want to subject itself to possible criticism for having approved trustees who could later be found not to be upright or responsible.

The Associate Solicitor of Labor who also helped negotiate with Fund officials said that, in his opinion, under ERISA a person who chooses a fiduciary becomes a fiduciary. Thus, in the Associate Solicitor's opinion, if Labor helped select the Fund's trustees, Labor could place itself in the position of being a Fund fiduciary and thus be responsible for managing the Fund. The Secretary of Labor in September 1980 congressional hearings also stated that Labor wanted to avoid the Government's approval and liability for selecting people who may violate their fiduciary responsibilities. 1/

IRS officials also testified in August 1980 congressional hearings 1/ that the corrective actions formulated within it did not provide for restructuring the Fund's board of trustees or a veto over the selection of new trustees. IRS believed it did not have the authority to impose these two requirements on the Fund. Nevertheless, IRS stated that while a restructured board of trustees was not a condition of requalification, it agreed to present a unified Government position (with Labor) that the Fund restructure the board so that a majority would be independent, professional neutrals and the four original trustees should resign.

IRS said, however, Labor had decided not to get involved in the selection of trustees. Instead, the majority of independent, professional trustees would be selected jointly by the IBT union and the contributing employer associations and by a reputable consulting firm. IRS officials said that, based on their discussion with Labor, IRS expected the independent trustees would come from a variety of backgrounds and disciplines, including institutional trustees, such as banks or insurance companies.

1/See footnote 2, page 1.

However, this did not occur. There is evidence--as shown below--that the same people who allegedly mismanaged the Fund helped select the new trustees.

CONCERN THAT FORMER TRUSTEES CONTROLLED SELECTION OF NEW TRUSTEES

Concern was expressed in congressional hearings that the former trustees who resigned influenced the selection of the four new trustees and were trying to reassert control over the Fund.

For example, an IBT union member, speaking on behalf of the Teamsters for a Democratic Union, testified in June 1978 1/ that the former Fund trustees, who were forced to resign by Labor, selected four of the new trustees representing the unions. He testified that the four new trustees were named by the Central Conference of Teamsters whose director was a former trustee who was forced to resign. He said that the seven-person policy committee of the Central Conference ratified the director's choices and the committee was made up of four former trustees.

Also, at the same hearing members of the Professional Drivers' Council--a dissident group of IBT union members--expressed similar displeasure that Labor had apparently agreed to permit "elected" IBT union officials to continue to serve as trustees. The members charged the trustees who were responsible for (allegedly) mismanaging the Fund in the past would continue to direct, control, and influence the current trustees.

Because of its concern over the testimony, the Subcommittee requested comments from the Assistant Secretary for Labor-Management Relations. In his August 1978 response, the Assistant Secretary acknowledged that some of the former union trustees, who were forced to resign from the Fund, held offices in the Central and Southern Conference of the Teamsters' organizations. These organizations appointed the new trustees, and the former trustees participated in the selection of their successors. The Assistant Secretary stated, however, that the selection did not violate ERISA's provisions. Labor later became concerned about the former trustees' role and influence and cited it as a reason for making a second onsite investigation. (See chs. 7 and 8.)

CONCLUSIONS

Despite some apparent benefits from the Government's investigation, in our view, Labor's and IRS' dealings and agreements

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1/See hearings on "Central States Teamsters Fund," Subcommittee on Oversight, House Committee on Ways and Means, 95th Cong., 2nd sess., pages 4, 5, 14, 15, 76, and 77 (June 1978).

with the trustees had significant shortcomings and left numerous problems unresolved. Thus, we question whether the benefits and improvements imposed by the Government will result in lasting reforms to the Fund, without the continued diligent effort of Labor and IRS.

Further, we question whether the reforms and changes that Labor and IRS required the trustees to make in the Fund's operations were the best the Government could have achieved and the most advantageous for the Fund and its plan participants. In our opinion, Labor's and IRS' findings of alleged mismanagement and abuse by the former trustees and IRS' action of removing the Fund's tax-exempt status gave the Government a strong bargaining position and advantage in its dealings with Fund officials. However, Labor and IRS, in the final negotiations with the trustees, may not have gained lasting reforms and improvements to the Fund's operations or removed the influence and control exercised by the former trustees--who allegedly mismanaged the Fund.

We also question Labor's and IRS' decision not to require the trustees to enter into a written agreement, such as a consent decree. Without a court enforceable consent decree, Labor and IRS did not have an effective means to require the trustees to adhere to the conditions that they might otherwise have had. As the record shows, the current trustees did not satisfy all of the conditions the Government imposed when IRS requalified the Fund, and another investigation was needed. Moreover, because of the Fund's failure to cooperate, IRS needed to obtain a court-enforced summons before it was able to resume its investigation and determine whether the Fund had complied with the eight conditions.

Further, we question Labor's and IRS' decision not to play a more active role in insuring that the successor trustees were qualified and independent, particularly in view of the Fund's history of controversy and dissatisfaction expressed with the trustees, both within and outside the IBT organization. Concern was expressed about the influence of the former trustees over selection of the current trustees, but Labor said the selection did not violate ERISA. However, Labor belatedly recognized and became sufficiently concerned over the former trustees' influence and actions of the current trustees to resume its investigation.

We believe, therefore, that Labor, in consultation with IRS, should closely monitor the selection of future Fund trustees and establish qualifications, such as those considered in 1977--professional, independent, neutral, etc.--that future Fund trustees must meet. As part of this monitoring, Labor should retain the option of vetoing any selected trustees that they consider not qualified or not meeting their criteria.

RECOMMENDATION TO THE SECRETARY OF LABOR AND THE COMMISSIONER OF INTERNAL REVENUE

In view of the continuing concern over the influence and control of the current trustees and the Fund's operations by the former trustees who allegedly mismanaged the Fund, we recommend that the Secretary, in consultation with the Commissioner, require that future Fund trustees meet the criteria and qualifications similar to those established in 1977--independent, professional, and neutral, etc; closely monitor the selection of future trustees; and veto the selection of a trustee not meeting the criteria.

AGENCY COMMENTS

Labor said it concurs with the goals in our above recommendations and those in our recommendations on pages 83 and 84 to assure that the Fund is operated and managed prudently and to reorganize the way the Fund handles and controls the employers' contributions and other moneys to remove the trustees' control over any of these funds. Labor said it is attempting to achieve the goals in our recommendations through a comprehensive court-enforced consent decree agreeable to the Fund.

IRS said it does not believe that it has the authority to establish qualification requirements for the selection of trustees by the Fund. IRS said, however, it strongly agrees with our objective and believes it can best be accomplished under title I of ERISA. To this end, IRS said that the Task Force--created by the Secretaries of the Treasury and Labor and the Attorney General in March 1981--has been conducting negotiations with the Fund and, as a Labor official testified in October 1981 congressional hearings, the Task Force 1/ has requested the Fund to agree to the selection of unaffiliated (i.e., neutral) trustees as part of a comprehensive consent decree.

We discuss Labor's and IRS' actions--and our evaluation of their efforts--on pages 84 to 88 in chapter 7.

1/See footnote 1, page 20.

CHAPTER 7

TRUSTEES TRYING TO REASSERT CONTROL OVER FUND'S ASSETS AND INVESTMENTS

As another condition of requalification, the trustees agreed to appoint independent investment managers to handle the Fund's assets and investments. On June 30, 1977, the trustees entered into a series of contracts under which the (1) Equitable Life Assurance Society of the United States became overall or managing "fiduciary" for the Fund and investment manager for the Fund's real estate assets east of the Mississippi and (2) Victor Palmieri and Company, Incorporated became investment manager of the Fund's real estate assets west of the Mississippi. Both Equitable and Palmieri appear to be successfully managing the assets and investments.

As a result, the Fund's assets, managed by Equitable and Palmieri, grew from $1.6 billion to $2.9 billion and the investment income grew from $73 million to $151 million annually. However, despite Equitable's and Palmieri's performances, and contrary to its unwritten agreement with IRS and Labor, the trustees are trying to reassert control over the assets.

Also, although Equitable and Palmieri handle most of the Fund's assets and investments, the Fund's trustees still have control over all of the Fund's income from employer contributions as well as investments. Moreover, after transferring funds to the investment managers for investment, the trustees still control a substantial amount in the Benefits and Administration account (hereafter referred to as B&A account). Our review disclosed that Labor and IRS have not adequately monitored the B&A account to assure that the trustees are prudently using these funds.

FUND'S CONTRACTS WITH EQUITABLE AND PALMIERI

Condition eight of IRS' April 26, 1977, letter requalifying the Fund's tax-exempt status required that the trustees transfer management of the Fund's assets to a professional investment manager. Labor, in coordination with IRS, established certain qualifications for the investment manager and told Fund officials it would veto any firm chosen by the trustees that did not meet its qualifications.

During its negotiations with the Fund in March 1977, Labor and IRS told the trustees' representatives that the investment manager had to meet Labor's general criteria--independence, professionalism, and national stature. Labor also told the trustees that (1) they would have to be prudent in their choice of the manager, (2) they would not be relieved of their duties to monitor the investment manager's performance, (3) the manager selected would have to be competent and be able to withstand the

public scrutiny that would inevitably begin when the choice was made public, and (4) the contractural structure had to be workable and meet ERISA's requirements.

After negotiating with several firms, the Fund's trustees selected Equitable and Palmieri. Under the June 30, 1977, contracts, Equitable became the overall or managing "fiduciary" of the Fund as well as manager for Fund real estate east of the Mississippi and Palmieri became manager for Fund real estate west of the Mississippi. As managing fiduciary, Equitable had exclusive responsibility to (1) set investment policy and objectives for investment of assets, (2) select and monitor the performance of the securities managers (other than Equitable) and custodian of the Fund, and (3) allocate available investment funds among types of investments and managers.

The trustees are responsible for monitoring Equitable's performance and, with Equitable, for monitoring Palmieri's performance; establishing pension benefit levels; enforcing relevant collective-bargaining agreements; determining the qualification, eligibility, and payment of pension benefits; and the actuarial soundness of the Fund.

The trustees also are responsible for managing and determining an appropriate reserve for the B&A account. The trustees, after determining the amounts needed in the B&A account to pay benefits and administration expenses, turn over the excess ("new funds") to Equitable for investment. The contract does not define what an appropriate reserve is or the amount that the trustees should keep in the B&A account.

The Fund's contracts with Equitable and Palmieri are for 5 years. The Fund cannot terminate, change, modify, alter, or amend either Equitable's or Palmieri's appointments, in any respect, before October 2, 1982, except for cause and only upon written consent of the Secretary of Labor. However, after October 2, 1982, the Fund can terminate the contracts without Labor's consent.

Labor was satisfied with the Fund's arrangements with Equitable and Palmieri and did not exercise its veto. In fact, the Secretary of Labor stated in a September 28, 1977, letter to the Senate Committee on Human Resources that he believed the contracts provided a sound basis for future management of the Fund assets. He said that they contained great promise of ending years of suspicion, allegations, and wrongdoing that surrounded asset management of the Fund and persons associated with it.

EQUITABLE SHIFTS FUND'S INVESTMENTS FROM REAL ESTATE LOANS AND INCREASES THE FUND'S INCOME

One of the principal criticisms of the Fund's investment portfolio was the concentration of investments in real estate-related loans. Since Equitable has taken over, the Fund's assets have been largely redirected to investments in stocks and other securities. On October 3, 1977, when Equitable assumed control of the Fund's $1.592 billion in assets, about 60.6 percent ($966.0 million) of the assets was real estate and mortgage loans. The other estimated 39.4 percent ($626.2 million) was primarily invested in stocks and bonds.

However, on December 31, 1980, about 3 years after Equitable assumed control, the assets that it manages had grown to $2.865 billion, 1/ and the real estate and mortgage investments had decreased to about $631.2 million, or only about 22 percent of the total assets. (See app. IX for table showing the Fund's investments at Oct. 3, 1977--when Equitable took over--and at the end of calendar year 1980.)

Equitable's Summary Report for December 31, 1980, shows that Equitable and Palmieri control $1.305 billion, or almost half of the $2.865 billion in assets. Palmieri controlled $394.9 million and Equitable $910.4 million. The remaining $1.560 billion in assets are controlled by the other investment managers that Equitable had hired. (See app. X for table showing the assets controlled by all investment managers.)

Equitable substantially increases the Fund's income

Since Equitable assumed control of its assets, the Fund's investment income has steadily increased.

One of Equitable's investment objectives is to maintain a minimum annual rate of return overall for the Fund of at least 6.5 percent over a 4-year period. Equitable has exceeded its goal. To illustrate, Equitable has reported that from an investment standpoint, the increase in investment assets through December 31, 1980, was at an annualized rate of return equal to 10.38 percent, as compared to 4.5 percent in 1976.

For calendar year 1979, the Fund's total investment income was about $151.3 million, or more than double the $73 million

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1/In December 1981, Fund officials told us that, in addition to Equitable's and Palmieri's performances, other factors were involved in the asset increase, such as a positive cash flow (employer contributions greatly exceeding benefit payments and expenses), a general increase in interest rates, and the passage of time.

earned as reported by the Fund for 11 months in 1976, when the former trustees controlled the investments and assets. 1/ In calendar year 1980, Equitable reported investment income had increased to $191.9 million. In all, Equitable reports that the Fund has earned $477.2 million in investment income from October 3, 1977, to December 31, 1980.

TRUSTEES ATTEMPT TO COMPROMISE INDEPENDENCE OF INVESTMENT MANAGERS

Despite the investment managers' performance and the unwritten agreement with Labor and IRS, the current Fund trustees have repeatedly and openly sought to undermine the independence of Equitable and Palmieri and reassert control over the Fund's assets and investments.

The trustees' attempts to compromise the independence of Equitable and Palmieri came less than 6 months after the firms assumed control of the Fund's assets in October 1977. In March 1978, the trustees passed a series of resolutions which stated, among other things, that the trustees (1) could remove Equitable and Palmieri for cause, before the 5-year contract period had expired, without the Secretary's consent and (2) had to be notified at least 30 days before disposal of assets over $10,000.

According to the Assistant Secretary for Labor-Management Relations, these resolutions, if they became effective, could have had a potentially significant impact on the independent asset managers. Also, Equitable and Palmieri acknowledged that requiring them to give 30-day notice to the trustees before the disposal of real estate assets would restrict their independence so that they would no longer be independent investment managers.

1/In its December 1981 comments, the Fund agreed that this statement is substantially correct, but stated that it is very misleading to an uninformed reader since it implies that Equitable outdid the trustees by more than 200 percent. The Fund said this is not true. Equitable earned $151 million on an average investment of $2,145 million or 7 percent at a time when the average prime rate was 12.5 percent. Equitable therefore earned 56 percent of prime. The trustees earned $73 million on an average investment of $1,362 million or 5.9 percent at a time when the average prime rate was 6.8 percent. The trustees therefore earned 86.8 percent of prime. If the trustees' experience in 1976 was applied to 1979, they would have earned 10.9 percent as opposed to the 7 percent earned by Equitable or $84 million over and above what Equitable earned. Finally, it should be noted, the Fund said, that a comparison is being made between an 11- and 12-month period, and that, in general, performance is a function of asset mix and the market conditions existing during a specific period.

In an April 18, 1978, memorandum to the Secretary of Labor, the Assistant Secretary for Labor-Management Relations expressed concern about the trustees' resolutions and indicated the possibility that they were laying the groundwork to remove Equitable and Palmieri as their investment managers. The Assistant Secretary said Labor would take appropriate action if the dismissal occurred. Labor notified the trustees and investment managers that the resolutions were not enforceable.

Other actions taken by the current trustees to undermine the investment managers' function included having the Fund hire its own internal staff of real estate analysts. This staff, according to the Labor officials, duplicated much of the investment managers' work. Also, according to Palmieri, the trustees instructed the staff to perform independent inspections of all assets under Palmieri's management.

Further, the Fund's staff is managing a considerable amount of assets that apparently were acquired after Equitable became investment manager or were not turned over to Equitable. The Fund's annual reports showed that its staff managed $72.7 million as of December 31, 1977, and $100.5 million as of December 31, 1978, in securities. As of December 31, 1979, the amount managed by the Fund's staff increased to $157.2 million.

Trustees' impeded Palmieri's attempts to sell certain Fund real estate

Another indication of the trustees' attempt to compromise the investment managers' independence concerned actions by a current trustee and two former trustees in impeding Palmieri's sale of the Fund's Wonderworld Property. This property, carried by the Fund at a value of $960,000, is about 5.8 acres and located in the Las Vegas County Country Club Estates, Las Vegas, Nevada.

In late March 1978, Palmieri placed an advertisement in a national newspaper for solicitation of inquiries for the purchase of this property. During 1978 and the first half of 1979, Palmieri received several offers for the property; however, all offers were withdrawn because of the problems (financing, etc.) encountered by the prospective borrowers.

During the period it was attempting to sell Wonderworld Property, Palmieri was subjected to harrassment and attempts to compromise its independence. To illustrate, a current trustee and two former trustees (one of whom is the new president of the IBT union), along with two other defendants were criminally indicted by a Federal grand jury in Chicago for conspiring to bribe a U.S. Senator. According to the indictment, 1/ the five defendants

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1/See May 22, 1981, indictment, United States of America v. Allen M. Dorfman, Roy L. Williams, Joseph Lombardo, Thomas F. O'Malley, and Andrew G. Massa (also known as Amos Massa), 81 CRO 269 USDC, N.D. Ill.

allegedly conspired together to give the Senator the exclusive right to purchase the Wonderworld Property at a set price in return for his delaying the introduction and passage of a trucking deregulation bill.

The indictment stated that the defendants:

--Attempted to influence employees of Palmieri in their decision as to the purchaser and sales price of the Wonderworld Property.

--Allegedly caused other individuals and entities, not associated with the Senator, to withdraw bids made to Palmieri for purchase of the Wonderworld Property.

--Allegedly submitted to Palmieri bids for the property on behalf of the Senator and others associated with him without their knowledge.

The sale of the Wonderworld Property by Palmieri to the Senator and others did not go through, and the property was sold to other persons. On July 2, 1979, Palmieri sold the property for $400,000 in cash and a $1.2 million note bearing interest at 12 percent a year. Also, the trucking deregulation 1/ bill was passed by the Senate and eventually became law.

According to Justice officials, the indictment against the former and current trustees was still in pretrial activity and they do not expect the trial to start until May 1982.

Trustees' attempt to terminate Palmieri as investment manager

The trustees also attempted to have Palmieri reduce its management fees--which were fixed for the 5-year contract period--in light of the overall decline of assets managed by Palmieri. (Because of loan amortization and asset sales, the assets managed by Palmieri had declined from $550 million in October 1977 to $430 million as of August 1979.) Palmieri, however, refused.

In August 1979, the trustees passed a resolution demanding that (1) Palmieri enter immediate negotiations to reduce its fee and (2) Equitable and the Fund's custodian bank stop paying contracted fees until Palmieri agreed to renegotiate. Labor notified the trustees and Equitable that the resolutions were not enforceable. Also, according to Labor officials, the fees were paid to Palmieri.

1/On July 1, 1980, "The Motor Carrier Act of 1980" (Public Law 96-296) was enacted which partially deregulated the trucking industry by reducing substantially Federal economic regulation over the industry.

Finally, the Fund's trustees on November 23, 1979, submitted a request to Labor for an advisory opinion on whether Palmieri should renegotiate its fees and whether the Fund could terminate, without Labor's consent, Palmieri's contract because it refused to renegotiate the fees.

On May 7, 1980, Labor issued an opinion stating that (1) Palmieri's management fees were not unreasonable and the Fund should continue to pay them, (2) because Palmieri's fees were not deemed unreasonable, the trustees did not have cause for terminating Palmieri, and (3) the requirement of written consent of the Secretary to terminate Palmieri's appointment as investment manager was still valid and enforceable.

According to the Fund's counsel, the request for the advisory opinion reflected a genuine effort by the trustees to resolve serious ERISA issues without resorting to other available remedies. The counsel also stated that the trustees' request would not diminish their right and opportunity to resort, in the future, to one or more of other remedies, after the "advisory" opinion was analyzed. The Fund's letter did not provide information on what other remedies it would take.

The trustees' attempt to compromise the investment managers' independence was also vividly expressed in a report prepared by Labor's Office of the Solicitor in February 1980, which concluded that the performance to date demonstrated significant disregard of the participants and beneficiaries. The report stated that perhaps the most serious threat of the new trustees to the interest of participants and beneficiaries of the Fund is the trustees' apparent determination to compromise or terminate the activities of the independent managers.

TRUSTEES STILL CONTROL THE FUND'S INCOME

Although the Fund transferred substantial funds to Equitable for investment--about $665 million from October 1977 to December 1980--the trustees retained a signficant amount of the Fund's income in the B&A account.

To illustrate, during calendar year 1979 the trustees transferred $186 million to Equitable. However, on December 31, 1979, the trustees controlled $142 million in the B&A account.

The B&A account only shows the income the Fund receives through employer contributions and excludes the Fund's investment income. For example, it excludes investment income earned by Equitable and other investment managers on the Fund's investments. In 1980, for example, Equitable earned investment income of $191.9 million. Equitable, to December 31, 1980, had earned interest income of $477.2 million since it became the Fund's

investment manager. Equitable, under its contract with the Fund, is required, if requested by the Executive Director, to transfer the investment income, partially or wholly, to maintain an appropriate reserve in the B&A account.

Equitable does not have any responsibility for the B&A account. Thus, the trustees have sole responsibility for the account. The fact that the trustees would still control substantial income through this account, and the need for adequately monitoring it, was recognized early by the Senate Permanent Subcommittee on Investigations. Labor officials, including the Secretary of Labor, in July 1977 testimony acknowledged the need for adequate monitoring and assured the Subcommittee members that Labor would continually monitor and review the trustees' handling of the funds they control. 1/

LABOR DID NOT ADEQUATELY MONITOR B&A ACCOUNT

Contrary to the Secretary of Labor's and other officials' testimony, Labor did not adequately monitor the B&A account.

Labor's SIS was responsible for monitoring the account, but it performed little monitoring. In fact, Labor left the Fund's site in May 1977, several months before the B&A account was set up, and Labor's monitoring consisted of reviewing monthly and annual reports at Labor's headquarters, plus information from other agencies, such as IRS.

The acting director of SIS in 1979 agreed that there was little monitoring. He said there was little time for Labor to do any monitoring before the civil lawsuit was filed in February 1978. After the suit was filed, the Fund stopped cooperating with Labor. He said that Labor would have had to issue a subpoena to obtain records from the Fund. He also said there were no allegations regarding mishandling of this money, or any evidence of mishandling in the annual reports. Labor did not issue a subpoena for records on the B&A account until April 1980.

Further evidence on the lack of adequate monitoring of the Fund's B&A account by Labor was noted in the November 1979 report entitled "Central States, Southeast and Southwest Areas Pension and Health and Welfare Funds," which was prepared for the Deputy Assistant Secretary of LMSA by an LMSA Atlanta Deputy Assistant Regional Administrator. Regarding the financial operation of the Fund, the report stated:

1/See footnote 1, page 8.

"There is virtually no information available on the current financial operation of the fund.

"The methods by which a determination is made as to how much money should be transferred to the assets managers, how expenses are approved, what authority is delegated to the executive director, and in general, how the Fund operates financially are all unknown at the present time.

"We have very little knowledge of the details of how much money is actually received by the Fund, how much money is transferred to the asset managers, or how money being held by the Fund is managed."

According to the report, Labor should investigate to determine the actual moneys maintained by the Fund, the moneys transferred to asset managers, and the reasons why the Fund needs to maintain an estimated $100 million in escrow in the B&A account since it can request and receive any moneys from the asset managers needed for the account. The report also said Labor needs to review how well the Fund is managing the assets it controls.

The continuing congressional concern over the lack of effective monitoring and the size of the B&A account was expressed in March 1980 congressional hearings. 1/ The Secretary of Labor was asked if Labor knew the size of the account and whether there was a problem with the size. The Secretary said that he did not have any information that would lead Labor to believe the account was unreasonably large. He said information received from IRS showed that the B&A account had about $65 million as of June 1979. He said that this figure did not appear to (1) be unreasonable in view of the size of the payments the Fund makes or (2) violate ERISA. He concluded that "It is up to the asset managers to determine whether the amount is in violation of the asset management agreements."

However, Equitable's contract with the trustees specifically states that Equitable is not responsible for the B&A account. Moreover, the November 1979 report by the Deputy Assistant Secretary, LMSA, acknowledges that Equitable has no control over, or responsibility for, the B&A account and that the trustees can request any amount desired from Equitable for the account, and Equitable is bound to honor the request.

In addition, the B&A account balance had grown to $142 million as of December 31, 1979, or more than double the $65 million considered reasonable by the Secretary.

1/See footnote 1, page 46.

A further indication of the lack of adequate monitoring is shown in comments made in April 1980 by the Fund's assistant executive director in response to the following question by a congressional subcommittee. 1/

> "Has IRS, the Department of Labor or the investment managers questioned the size of the Benefits and Administration Account, and whether such size was in fact reasonable, within the past year?"

The assistant executive director stated that two inquiries were made, one by Equitable in January 1980 asking why the balance had grown by $28 million during 1978 and another by IRS in March 1980 requesting information regarding the amounts retained in the B&A account. He said that the Fund responded to both inquiries within several weeks.

The assistant executive director concluded that "other than the inquiries above, the Fund is not aware of any other inquiries regarding the B & A account."

The continuing congressional concern over inadequate monitoring of the B&A account was also expressed in September 1980 congressional hearings. 2/ In reply to criticism concerning the lack of monitoring, the Secretary testified that Labor was monitoring the account from information obtained through confidential sources and IRS. He added that Labor now has information that provides a monthly summary of the low and high balance transfers to Equitable and benefits paid. It comes from various sources.

He acknowledged, however, that at the end of December 1979 the B&A account contained $142 million. He said there was an extraordinary accumulation of funds for paying a one-time supplemental benefit payment of $315 per beneficiary. Following this extraordinary payment he said the level of the account has steadily declined.

Its interesting to note that the Secretary said Labor relied on IRS for information on monitoring the B&A account. Yet, at the same congressional hearing, IRS officials testified that, in August 1979, the Fund stopped sending in monthly reports on its compliance with the conditions for requalification and, in effect, barred IRS from conducting audit activities at the Fund's premises to determine the trustees' compliance with the requalification conditions. IRS was not allowed back on the premises until about July 1980. (See ch. 8, p. 98.)

1/See footnote 1, page 46.

2/See footnote 2, page 1.

TRUSTEES ALLEGEDLY ACTED IMPRUDENTLY IN AN ATTEMPT TO USE THE B&A ACCOUNT TO MAKE QUESTIONABLE LOAN

According to information gathered by Labor, as well as statements made by the Fund's former assistant executive director, the moneys in the B&A account are invested in certificates of deposit (normally 6-months maturity) and commercial paper that allowed the Fund to earn the current market rate. 1/

Fund trustees, however, in one case, apparently intended to use the moneys in the B&A account to make a $91 million loan, as part of an out-of-court settlement of a suit against them for failing to fulfill a loan commitment. In this case, the trustees in January 1975 had approved a commitment to loan a prospective borrower--the M&R Investment Company, Inc., controlled by Morris Shenker--$40 million to renovate the Dunes Hotel in Las Vegas, Nevada, and to construct a 1,000-room addition. The borrower had previously received loans from the Fund. However, in June 1976 the trustees rescinded the commitment because the loan would have been a "prohibited transaction" under ERISA. This arose because the prospective borrower's firm is related to a contributing employer and, as such, is disqualified from receiving a loan under the act.

The prospective borrower, in June 1976, sued 2/ the trustees, seeking approval of the loan and $100 million in damages. The case continued for several years, and in September 1979, the trustees and the prospective borrower proposed a settlement by the Fund making an additional $85 million loan plus $6 million to restructure the old loan. The settlement was conditioned on approval by the court and the Fund's counsel, in presenting the proposed settlement to the court, stated:

> "I might state for the record that the position of the Fund is that we are not, in addressing this lawsuit, in the business of asset managing. We are not seeking to make real estate loans or acquire real estate. We are attempting to extricate the Fund from the litigation as I have previously stated in the status report and we consider this to be an administrative matter."

1/In December 1981, Fund officials told us that the rate of return on the moneys in the B&A account was 8.33 percent in 1978, 11.08 percent in 1979, 12.52 percent in 1980, and 16.67 percent for the first 9 months of 1981.

2/M&R Investment Company, Inc., v. Fitzsimmons, et al., No. LV-76-114 in U.S. district court, Las Vegas, Nevada.

Before the submission of the proposed settlement, all parties to the litigation, including Labor, would be notified. Labor, which had intervened in the suit to protect the Fund's interest, stated, however, it was not made aware of the settlement until the Fund proposed it. Labor strongly objected to the settlement and suggested to the court that Labor and Equitable review the proposed settlement. At the court's request, Labor and Equitable reviewed the proposed settlement and both objected to it, stating that the loan would not be an appropriate transaction. As a result, the court did not approve the proposed transaction.

Also, in January 1980, the court ruled for the Fund holding that the proposed initial $40 million loan was unlawful under ERISA's prohibited transaction provisions. The court also denied the prospective borrower's claims for damages. The prospective borrower has appealed the court's ruling, and as of December 1, 1981, the appeal was still pending.

According to Labor officials, in the transparent attempt to circumvent the authority of the investment managers, the trustees planned to increase the balance of the Fund's B&A account sufficiently to fund the $91 million loan.

In April 1981, Labor added this transaction to its civil suit as another example of an alleged imprudent action by the trustees. Labor stated the trustees made the original loan commitment even though the prospective borrower was a party in interest to the plan, and the loan therefore was illegal per se. As a result, the trustees caused the Fund to incur litigation expenses of $1 million which have not been recovered.

SENATE PERMANENT SUBCOMMITTEE CONCERNED ABOUT FORMER TRUSTEE NOW PRESIDENT OF IBT

In May 1981, Mr. Roy Lee Williams, one of the former trustees, who is one of the defendants in Labor's civil suit for alleged imprudent actions, was appointed interim president of the IBT union to succeed Mr. Frank Fitzsimmons who died on May 6, 1981. 1/ The Senate Permanent Subcommittee on Investigations on May 20, 1981, issued an interim report on its concern about Mr. Williams' past activities, his fiduciary responsibilities at the Fund, and the need for Labor to take further action against Mr. Williams. 2/

1/In June 1981, Mr. Williams was formally elected president of the IBT union.

2/See the Interim Report of the Permanent Subcommittee on Investigations regarding its "Oversight Inquiry of the Department of Labor's Investigation of the Teamsters' Central States Pension Fund," Senate Report 97-122, 97th Cong., 1st sess., May 20, 1981.

The Subcommittee's report stated that Mr. Williams served as a union trustee on the Fund's Board of Trustees from 1955 to 1977 and he was one of the four holdover trustees who were forced to resign in April 1977 under pressure from Labor. Although he left the Board, Mr. Williams retained his posts as president of Teamsters' Local 41 in Kansas City, Missouri, vice president of the Teamsters' International union, and a member of the Central Conference of Teamsters--which helped select the current trustees.

The report cited Mr. Williams' past activities including his indictments for alleged embezzlement of union funds--for which he was acquitted--and his involvement in the attempt to persuade the new trustees to manipulate the Fund's B&A account to complete the loan to Morris Shenker, which had been blocked by a Federal district court.

The Subcommittee's report also cited evidence charging that Mr. Williams is controlled by a reputed organized crime leader in Kansas City and exercises great influence with the Fund for this organized crime figure. The report said the document containing this charge was authenticated by the Organized Crime and Racketeering Section in Justice's Criminal Division.

Mr. Williams was called on to testify at the Subcommittee's hearings in August 1980 on Labor's handling of the investigation of the Fund and on the influence of the former trustees on the Fund and its current operations. 1/ The Subcommittee members asked Mr. Williams many questions concerning his past activities and his alleged attempts to influence the current trustees and their attempts to compromise the Fund's investment managers. The report stated, however, that Mr. Williams refused to answer the Subcommittee's questions and invoked the U.S. Constitution's Fifth Amendment privilege 23 times by refusing to answer on the grounds his testimony may tend to incriminate him.

The report pointed out that Labor was able to persuade another former trustee of the Fund (Mr. William Presser) to resign because he refused to answer Labor's questions about his fiduciary conduct. Labor's position was that trustees are obliged to account for their conduct as fiduciaries, and if they refuse, Labor can accuse them as being unsuitable to continue to serve as a fiduciary. Labor's position is that a fiduciary, a person entrusted with the money of union members, is accountable as to how the money is handled. The Subcommittee believed Labor should apply the same legal reasoning to Mr. Williams and his fiduciary conduct. The Subcommittee's report said:

> "By federal statute any official position in a labor organization as well as a position of trustee of an employee benefit plan is described as a fiduciary

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1/See footnote 2, page 1.

position. A union officer, as a statutory fiduciary, has the same duties as a trustee; that is, to hold the assets of the union for the sole benefit of the union members, to handle the assets of the union members, to handle the assets prudently and to account for his actions."

Therefore, the Subcommittee's report recommended that:

"Because of the allegations concerning his fiduciary conduct, because he refuses to account for his affairs as a fiduciary and because of unanswered charges that he represents organized crime syndicates like the Kansas City mob, issues which reflect on his fiduciary duties, a serious question has arisen as to whether or not Roy Lee Williams has any place in any position of trust in the Labor movement."

* * * * *

"The Labor Department and the federal courts should give Roy Lee Williams another opportunity to answer questions about his conduct as a fiduciary.

"The Subcommittee recommends that the Department of Labor evaluate the conduct of and the allegations against Williams and then determine whether or not he is suitable for high office in the Teamsters Union.

"An administrative proceeding should be convened and Williams should be asked appropriate questions about his current fiduciary duties. If his responses are not adequate, the Labor Department should petition the federal court seeking the removal of Roy Lee Williams from his fiduciary position. This would provide Williams with a full and fair due process hearing. Such court should consider each and every factual allegation concerning Mr. Williams as well as his refusal to respond to allegations which reflect adversely on his fiduciary status.

"The Subcommittee recommends that the Labor Department pursue this course of action and inform the Subcommittee of its actions within 60 days after the filing of this report."

On July 9, 1981, the Secretary of Labor sent a letter to the Subcommittee which stated that Labor did not have the authority to carry out the Subcommittee's recommendation. The letter stated that the Solicitor of Labor has determined that Labor has no authority to seek the removal of Mr. Williams or to otherwise challenge his

incumbency as president of the IBT union. Unlike ERISA, the letter stated the Labor Management Reporting and Disclosure Act of 1959--which covers union and union officers--does not provide any procedure for removal of officers of international unions by civil or administrative proceedings which Labor could institute. If Williams should be convicted of conspiracy, the Secretary stated, to commit bribery, a crime for which he has been indicted, he would be automatically required to relinquish his union office under section 504 of the act. This provision, the Secretary stated, is enforced only by criminal prosecution and, therefore, is not subject to civil or administrative action by Labor.

In its final report issued on August 3, 1981, 1/ the Subcommittee said:

> "while it still believes that the Labor Department does have the authority to remove union officers for alleged fiduciary breach, the Subcommittee feels that Congressional intent should be apparent beyond the shadow of a doubt. Therefore, the Subcommittee recommends that Congress pass legislation which declares that the Department of Labor has statutory authority to apply to federal court to remedy any breach of fiduciary duty by a labor union official, including the ability to seek removal of such an official."

As of December 1, 1981, the Congress has not passed the recommended legislation.

CONCLUSIONS

We believe that Labor, in consultation with IRS, should continue to take action to remove the trustees' control over and influence on all the moneys the Fund receives. Labor should, based on its current evidence and further evidence to be developed under its new investigation, consider proposing a reorganization of the way the Fund handles and controls the employers' contributions and its other moneys to remove the trustees' control over any of these funds.

We believe, for example, that the Fund should continue to use an independent investment manager for the best interests of the Fund and its plan participants. The present investment managers are successfully managing the Fund's assets. Despite their successful performance, however, the trustees have continuously tried to reassert control over the Fund's assets.

1/See final report of the Permanent Subcommittee on Investigations regarding its "Oversight Inquiry of the Department of Labor's Investigation of the Teamsters Central States Pension Fund," Senate Report 97-177, 97th Cong., 1st sess., August 3, 1981.

In our view, therefore, it is imperative for Labor, during the current investigations and future negotiations with the Fund, to assure the continued management of the Fund's assets by a responsible, independent asset manager, through and beyond the terms of the 5-year contracts with the present managers which end October 1982.

Labor, in consultation with IRS, should try to obtain a written commitment from the trustees that they continue to employ a professional, independent asset manager indefinitely under contractual arrangements. If the trustees should decide to consider managers other than the present managers, Labor should require the same selection criteria as in the past--independence, professionalism, and national stature--and should insist on using its enforcement responsibility under ERISA to veto any firm or firms not meeting the criteria.

We believe that Labor and IRS should also insist that the trustees' appoint a financial institution as custodian to handle the B&A account, pay administrative expenses and pension benefits, and transfer excess funds to the investment manager. Labor and IRS should confine the trustees' role to setting investment policies, deciding on the investment manager and the custodian, and determining pension benefit levels and eligibility requirements. Other State and local pension plans have successfully used this concept.

Finally, we believe that any agreement that Labor negotiates with the Fund's trustees should be in the form of a consent decree agreed to and signed by Labor and the Fund's trustees. As mentioned earlier, a consent decree would be an effective means of ensuring compliance with the agreed to terms. Such a document would insure that the Government's position is clear and unequivocal, and in our opinion, it would help assure future reforms are long lasting.

RECOMMENDATIONS TO THE SECRETARY OF LABOR AND THE COMMISSIONER OF INTERNAL REVENUE

To help assure that the Fund is operated and managed prudently and for the exclusive benefit of the plan participants and beneficiaries, as required by ERISA, we recommend that the Secretary, in consultation with the Commissioner, obtain an enforceable commitment (e.g., consent decree) from the trustees for the Fund to (1) continue to have an independent investment manager to control and manage the Fund's assets and investments after the present managers' contracts expire in October 1982 and (2) use the same selection criteria and qualifications as in the past--independent, professional expertise, and national stature--should the trustees decide to replace the present investment managers after October 1982.

We further recommend that the Secretary, in consultation with the Commissioner, obtain a further written enforceable commitment from the trustees to reorganize the way the Fund handles and controls the employer contributions and its other moneys to remove the trustees' control over any of these funds. The proposed reorganization should provide for

--the Fund to employ a financial custodian (an independent bank or other financial institution) with professional expertise and national stature to receive and control all moneys due the Fund, pay the Fund's administrative expenses and pension benefits, retain an appropriate reserve, and turn over the remainder to the investment managers;

--IRS and Labor to have a veto power over the selection of the independent investment manager and financial custodian, if the trustees' selections do not meet the Government's qualifications; and

--limiting the trustees' roles and responsibilities to establishing overall investment objectives, determining eligibility requirements for pension benefits and employers' contributions, monitoring the investment managers' and custodian's activities, and administering relevant collective-bargaining requirements.

We further recommend that the Secretary, also in consultation with the Commissioner, take action to require that the above-proposed reorganization and any other reforms imposed on the Fund, be included in a formal written, enforceable agreement (e.g., consent decree) signed and agreed to by Labor and IRS and the Fund's trustees.

AGENCY COMMENTS AND OUR EVALUATION

Labor and IRS stated that they concur with the goals in the above recommendations and our recommendation on page 67 regarding the selection of independent trustees and stated they are attempting to achieve the goals.

Labor said, however, it must be understood, that neither Labor nor any other Federal agency may unilaterally require--through regulation, order, or otherwise--the safeguards recommended. Labor said that there are only two ways to achieve enforceable requirements regarding independent trustees, independent asset management, a limited role for trustees, and similar reforms: (1) a voluntary undertaking by the trustees incorporated in a consent decree or (2) the imposition of a court order following successful litigation. Labor said it has vigorously pursued both courses as noted below.

First, Labor has proposed to the Fund a consent decree making mandatory and judicially enforceable the reforms that we have recommended. Labor said, unfortunately, the Fund has declined to enter into the decree and has stated it will not agree to any consent decree absent a full settlement, which would include large and entirely unacceptable concessions by the Government.

Secondly, Labor has instituted and will continue to pursue litigation to achieve the aims set forth in the recommendations. Labor said substantial resources have been and continue to be invested in the cases which surround the Central States Teamsters' Pension and Health and Welfare Funds.

Labor said litigation is generally a protracted process and it is particularly so here where the present and former trustees and the Fund are represented by experienced counsel, who have missed no opportunity to contest every claim, request, or motion (including those seeking discovery) brought by Labor. Notwithstanding this vigorous defense, Labor said it has made substantial progress in the cases: more than 70 people have been deposed, almost 2 million pages of documents have been reviewed, and actions are proceeding in Chicago and Tallahassee against former and present trustees.

Labor concluded that it is, of course, impossible to predict the outcome of hard-fought litigation. However, Labor said it is prepared to press litigation in the current actions aggressively and to file new actions, as necessary, to ensure to the fullest extent possible that the substance of the recommended reforms can be achieved.

IRS stated that it continues to believe in the importance of having most Fund assets subject to the control of independent asset managers. IRS said that, after coordinating with Labor, on November 11, 1981, IRS issued a new determination letter to the Fund that included a condition requiring the continuation of an independent asset manager arrangement. IRS said that the Fund has agreed to this determination letter. IRS' November 11, 1981, determination letter continues the Fund's tax-exempt status for its pension plan and sets forth several additional conditions for the Fund.

As part of the Fund's December 2, 1981, comments on our draft report, the Fund's executive director gave us a copy of the letter--which also included the Fund's approval of the terms. (See app. XVI.)

IRS also said that while it is clear that a consent decree would provide the Government with a more effective remedy against the Fund, IRS has no authority under the Internal Revenue Code to secure such decrees. In addition, IRS has determined that it does not have authority to (1) enter into an enforceable contract

related to the qualification requirements under the Code or (2) commence other litigative action against the Fund.

IRS' remedies against the Fund are limited to disqualification and the imposition of excise taxes in cases of violations of the minimum funding or prohibited transaction requirements. IRS stated, however, that it has cooperated closely with Labor in joint negotiations with the Fund by the Task Force in an effort to impose reforms on the Fund as part of a comprehensive consent decree.

The Fund, in commenting on our draft report, said that the trustees have stated an unequivocal intent to enter into a consent decree which would institutionalize the concept of retaining an independent investment manager for at least a 10-year period. The Fund also stated that it is currently attempting to carry out our recommendation that it continue to use an independent investment manager as evidenced by the fact that the trustees have executed a proposed new 5-year successor agreement with Equitable. This agreement--which the trustees signed on August 19, 1981--was with Labor for approval at December 1, 1981.

We agree with Labor and IRS that a voluntary undertaking by the Fund's trustees, incorporated in a consent decree enforceable in court, would provide the Government with an effective remedy to reform the Fund. This course would also avoid litigation which probably would be protracted, costly, and time consuming for both sides. We fully agree and support Labor's efforts.

We are also encouraged by the Fund's intent to continue using an independent asset manager for 10 years and its actions in proposing to renew its contracts with Equitable. However, we are concerned about some of the changes the trustees propose to make in the new agreements with Equitable.

We noted that the new agreements take essentially the same form as the 1977 agreements. However, the new master agreement is between only the trustees and Equitable, with Palmieri consenting thereto in writing, and the new Palmieri investment management agreement is between Equitable and Palmieri, with the trustees consenting thereto in writing. 1/

Under the 1977 agreements, essentially all existing Fund real estate-related assets located east of the Mississippi River are managed by Equitable and those located west of the Mississippi are managed by Palmieri. Further, 25 percent of all securities-related assets and all new funds becoming available for investment are allocated to Equitable for management, and the remaining

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1/See appendix XVII for Equitable's comparison of the current and proposed new agreements.

75 percent of such assets and new funds were allocated by Equitable to other securities-related investment managers. However, under the proposed new agreements:

--All real estate cash flow (i.e., essentially the excess of cash proceeds from Fund real estate investment activities over cash disbursement to such activities) plus 25 percent of new funds (funds derived from employer contributions and made available for investment) will be allocated to Equitable to make new investments in equity real estate, construction and long-term mortgage loans, and interests in real estate joint ventures and partnerships.

--Equitable will continue to manage the securities-related assets of the Fund currently under its control and an additional 15 percent of all new funds will be allocated to Equitable for investments in securities-related assets.

--Equitable will have full discretionary authority to transfer funds under its management between the securities and real estate investment accounts that it will maintain for the Fund.

--Equitable's (and Palmieri's) real estate management fees will be percentage fees based upon the values of the assets under their management as compared to fixed fees under the current agreements.

--The trustees and Equitable will jointly develop investment policies and objectives of the Fund. Under the 1977 agreements, Equitable has exclusive responsibility for developing the Fund's investment policies and objectives.

Finally, either party to any of the new agreements--the trustees, Equitable, or Palmieri--will be permitted to terminate it, with or without cause, by giving a 180-day notice to the other party. The proposed agreement does not mention obtaining the Government's consent to terminate. Under the 1977 agreements, before October 2, 1982, the trustees could terminate Equitable and Palmieri only for cause and only with the consent of the Secretary of Labor.

In our opinion, the adoption of the above provisions would weaken the investment managers' current agreements and could create areas of potential abuse by the trustees. For example, the proposed agreement would return the trustees to a substantial role in determining and developing the Fund's investment policy and objectives. In addition, the proposed agreement provides for the Fund, through Equitable, to embark on a new program of real estate, mortgage and construction loans, and investments. Theoretically, Equitable could invest 40 percent of the Fund's assets in such investments. Moreover, the proposed fee arrangements with Equitable make it almost inevitable that Equitable will emphasize real

estate investments over other types, such as securities since its fees depend on the real estate it controls.

We expressed our concerns with the proposed provisions and arrangements to the Permanent Subcommittee on Investigations October 1981 hearings. 1/ We stated that the Fund appears to be returning to real estate mortgage type investments, the area in which most of the alleged abuses by former trustees occurred. Also, the trustees will be able to more readily influence Equitable because of its greater role in setting and developing investment policy.

However, the provision which gives us the most concern is the one allowing the trustees to terminate Equitable or Palmieri with or without cause and without the consent of Labor or IRS. In view of the attempts by the trustees to compromise Equitable's independence and their attempts to terminate Palmieri--as documented in this report--this provision, if allowed to stand, could seriously impede long-lasting reforms at the Fund. Despite the trustees' and Fund officials' cooperative and changed attitude, the possibility exists that the Fund's assets could again be subjected to misuse or mismanagement to the detriment of the pension plan participants.

We believe, therefore, that Labor, in consultation with IRS, should, in its negotiations with the Fund, continue to stress and insist on reforms which will remove the trustees' control over and influence on all the moneys the Fund receives. We also believe Labor should insist that the Fund revise the proposed agreement with Equitable to prevent the weakening of the 1977 agreements.

1/See footnote 1, page 20.

CHAPTER 8

LABOR AND IRS DID NOT INVESTIGATE UNRESOLVED PROBLEM AREAS OF ALLEGED MISMANAGEMENT

During its original onsite work at Fund headquarters (from Jan. 1976 to May 1977), Labor decided to concentrate its investigation on the practices Fund fiduciaries used to make real estate mortgage and collateral loans. However, Labor's investigators also identified patterns of apparent abuse of the Fund by former trustees and raised questions of potential civil and criminal violations in the Fund's other operations. However, because of Labor's decision to concentrate on reviewing the Fund's loan activities, these other problem areas were not and will not be investigated.

Also, IRS has responsibility to assure that the Fund complied with the eight conditions of the April 1977 requalification letter. However, IRS was not able to adequately investigate the Fund's activities or compliance after August 1979 because the Fund notified IRS on August 24, 1979, that they would no longer submit the required progress reports and the Fund, in effect, barred IRS from conducting audit activities on the Fund's premises.

As a result of the current trustees' actions and the Labor internal reports recommending investigation of the Fund's operations not covered in the original investigation, in April 1980 Labor renewed its investigation of the Fund. After securing a court order, IRS also renewed its investigation at the Fund in about July 1980.

Labor's new investigation, however, will not cover all of the potential areas of abuse and mismanagement by the former trustees. Also, despite comments that they are coordinating their efforts, both IRS and Labor are reviewing the same activities.

LABOR DID NOT INVESTIGATE ALL PROBLEM AREAS

In addition to numerous indications of apparent loan and investment practices that constituted fiduciary breaches under ERISA, Labor's initial investigation disclosed other problem areas or patterns of apparent abuse, including:

--Lack of controls over rental income.

--Failure to properly manage real estate and non-real-estate-related investments.

--Reasonableness of administrative expenses.

--Failure to properly manage fees the Fund charged borrowers for loans.

--Propriety of payments made to the former trustees for allowances and expense claims--some of which could involve potential criminal violations.

--Reasonableness of payments to firms providing services to the Fund.

SIS' chief auditor, in 1976, indicated that full-scale audits were justified in most of the above-mentioned areas. To illustrate, the Fund charged borrowers a fee for loans. The fee was usually a percentage of the loan commitment. SIS' investigation showed that the Fund established neither a receivable account for these fees when it issued loan commitments nor the necessary accounting controls to assure collection of these fees. Also, the Fund had no uniformity on when or how the borrowers were to pay the fees. SIS uncovered instances where the Fund had reduced, waived, or refunded the fees.

SIS investigators also raised questions of potential criminal violations in two areas. One dealt with the apparent impropriety of payments made to Fund trustees for allowance and expense claims. The Fund's records showed that former trustees received about $345,000 and $394,000 in allowances and expenses for 1974 and 1975, respectively. The second area dealt with payments, averaging about $11 million annually, to firms or others providing services to the Fund.

One of the improprieties concerned the possibility that trustees were receiving payments for travel expenses from both the Fund and the Teamsters' union. Another impropriety dealt with the possibility that companies providing services were billing the Fund twice for the services. These improprieties could possibly constitute a violation of section 664, title 18, U.S.C., which prohibits theft or embezzlement of assets of pension plans covered under ERISA.

SIS investigators also disclosed other problem areas, including the appropriateness of the Fund's liquidity position and allegations of improprieties regarding how the Fund determines eligibility for pension benefits and how it makes benefit payments.

SIS, however, did not finish its work on these areas. According to a Labor official, staff was limited and the available staff was directed to review the Fund's real estate loans. As a result of this decision, the investigation was not completed and questions of alleged mismanagement and potential criminal violations went uninvestigated.

Failure to investigate the National Bank of Georgia

During our review, we noted another unresolved area where SIS apparently had a valid allegation and wanted to investigate it, but Labor officials denied the request. In February 1976, the trustees adopted an investment program under which the Fund gave six banks a total of $200 million to invest. Each bank invested its share at its sole discretion. The National Bank of Georgia was one of the six banks, and it received $17.5 million from the Fund.

In August 1977, the former director of SIS received information from press reports and other sources indicating that the National Bank of Georgia's rate of return and the general performance of the investments was poorer than other Fund banks and did not meet the Fund's investment criteria. SIS also received allegations that the Bank was selected by the former trustees rather than the Fund's investment advisor and that the Fund's transfer of the $17.5 million to the Bank was, or may have been intended, as a compensatory balance to either collateralize a loan which the Fund would not make directly, or help the Bank's financial condition, or a combination of both.

Accordingly, the former director intended to immediately initiate a thorough review and investigation of the National Bank of Georgia's investment program. He also coordinated the pending investigation with Justice's Criminal Division.

SIS initiated the investigation by requesting pertinent documents from the Fund. The Fund, however, did not comply with the SIS request for records. The Fund maintained that Labor had previously agreed in March 1977 to confine its investigation to obtaining information from third parties, and the documents requested were outside the scope of Labor's investigation. The former director planned to advise the Fund that if it did not voluntarily comply with the request, Labor would issue a subpoena for the requested records.

However, before he could issue the subpoena, the former director was advised that the Assistant Secretary, LMSA, wanted to put a "hold" on the investigation and not to pursue the matter any further. As directed, SIS did not pursue the investigation.

On September 29, 1980, the Secretary of Labor testified in congressional hearings 1/ that Labor declined to approve the subpoena because, among other considerations (1) other investigative techniques had not been attempted, (2) the need for an investigation did not appear pressing--given that at least three other

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1/See footnote 2, page 1.

governmental agencies including Justice were then investigating the National Bank of Georgia--and (3) the information received by Labor did not clearly suggest any fiduciary violations.

The Secretary also said that, since the Fund had already indicated that it would resist the subpoena, Labor was not eager to give the trustees any excuse to delay the final closing of the asset management contracts with Equitable, a closing which was then set for September 30 and which was actually accomplished on October 3, 1977.

The Secretary said further that the former director was free to pursue the investigation through any means other than issuance of a subpoena to the Fund, including obtaining information from the bank and other agencies. However, the former director left Labor shortly thereafter and the Secretary stated the matter was later reviewed in light of the available information and the investigation by other Government agencies. He said that, when Equitable took over the asset management, the previous bank program was disbanded, and the Fund's relationship with the National Bank of Georgia and two other banks was severed in late 1977. Therefore, the Secretary said a decision was made that no investigation by Labor was warranted.

It appears to us, however, that the fact that Equitable disbanded the previous bank program was not a sound reason for not pursuing the investigation to determine the accuracy of the allegations concerning the National Bank of Georgia's investment program.

LABOR REPORTS RECOGNIZE INCOMPLETENESS OF ITS INVESTIGATION

Labor decided to investigate new areas of abuse in late 1979, almost 4 years after Labor's initial onsite investigation began and about 2-1/2 years after it ended. The impetus came from the two reports prepared in May and November 1979 on the investigation for the Deputy Assistant Secretary of LMSA.

Kotch-Crino report cites areas not investigated by SIS

The Kotch-Crino report prepared for the Deputy Assistant Secretary, LMSA, in May 1979 pointed out the lack of SIS' investigation into the other areas of potential abuse.

To illustrate, the report stated that although SIS' early investigation revealed a variety of possible issues, a policy decision by SIS leadership in October 1976 focused investigative efforts and resources solely on investment loans as the most productive area. At that time, the report stated, SIS had completed considerable basic accounting work in such areas as trustee and

administrative expenses and public relations costs; however, SIS disregarded those areas to concentrate on investment loans. It said investigating the benefit claims was never initiated because of IRS' jurisdiction. The report stated that SIS started preparing for civil litigation in December 1976 and all its efforts since that time have dealt exclusively with investment loans and real estate transactions.

The SIS acting director, according to the Kotch-Crino report, had wanted to at least explore such new issues as employer contributions, questionable practices of the trustees' investments in stocks, purchase of certificates of deposit involving personal gain, and trustee expenses and certain actions of the new trustees. However, the report stated that the Office of the Solicitor, which the report stated was running SIS, rejected SIS' suggestions for additional investigations because it believed, among other things, any new investigation may give the appearance of harassment and jeopardize Labor's civil suit filed in February 1978.

The Kotch-Crino report stated that Labor's filing of the civil suit effectively terminated all SIS investigation activity of the Fund. Furthermore, the report concluded that SIS has been directed by the Office of the Solicitor to support the civil suit litigations--and do nothing else.

Second LMSA report suggests Labor investigate other areas of alleged mismanagement

On November 19, 1979, the Deputy Assistant Secretary, LMSA, received another report on the investigation entitled "Central States Southeast and Southwest Areas Pension and Health and Welfare Funds." According to the LMSA Atlanta Deputy Regional Administrator who made the review, the report was written to provide background and operating information on each Fund, the scope of the investigations, the issues which appear to warrant investigation, and the staff needed to conduct the investigation.

The report also pointed out that the scope of the original investigation was reduced substantially because of the then critical need to gather evidence on asset management and because of this, together with the filing of lawsuits, SIS had never investigated a number of issues. It said Labor had reached the point where it was critical to develop an understanding through investigation of how all aspects of the Fund are being administered under the current trustees.

Regarding the financial operation of the Fund, the report stated there is virtually no information available on the current financial operation of the Fund and the method by which the Fund operates financially is presently unknown. The report

stated Labor should investigate to determine the moneys maintained by the Fund and how well the Fund is managing the assets it controls.

The report recommended that Labor review the areas of the Fund's operations that were not completed in the original investigation. Four specific areas were recommended for investigation.

--The first covered the appropriateness of the B&A account and administrative expenses for trustee allowances, employees' salaries, legal fees, valuation services, consulting services, and other expenses.

--The second covered a determination that all employer contributions were collected. It said the Fund has 19,000 contributing employers and the Fund had made little effort to insure that contributions were received. Numerous complaints from Fund participants alleged a lack of diligence by trustees to enforce collection of contributions.

--The third covered management of the Fund's assets including a determination that the independent managers are complying with their contracts and properly managing Fund-owned assets, and the current trustees are prudently managing the assets not transferred to the independent managers.

--The fourth covered the purchase of a new aircraft for $3 million which, according tc the report, may have been a potential fiduciary violation.

The LMSA Atlanta official who made the review said that, if all the issues related to the Pension and Health and Welfare Funds are investigated, Labor would need a minimum of 7 to 10 investigators for 1 to 2 years. The official said that it is critical that Labor give serious consideration as to who will make the investigation. He said:

> "I do not feel the investigations can be effectively conducted from the National Office. The location of the Fund and the lack of quality investigators in the National Office would cause many of the problems experienced in the past three years to continue."

He recommended that LMSA's Chicago Area Office handle the investigation.

Also, officials in Labor's Office of the Solicitor in its February 1980 report to the Secretary of Labor indicated that the performance of the new trustees had demonstrated significant disregard for the interests of the participants and beneficiaries.

The report seemed to indicate to us the need for Labor to investigate some of the areas of the Fund's operations, including some of those cited in the report to the Deputy Assistant Secretary.

LABOR RESUMES INVESTIGATION AT THE FUND

As a result of the current trustees' actions and the above reports, Labor investigators on April 28, 1980, returned to the Fund's headquarters to start a second onsite investigation. Also, contrary to Labor's first investigation where it accepted the Fund's offer of voluntary cooperation, Labor issued a subpoena to the Fund on April 11, 1980, requesting all records, documents, and data relating to the areas of the new investigation.

The scope of the new investigation included areas not initially completed as well as other areas of the Fund's operations that were never investigated. Labor, for example, will review all administrative expenses incurred by the Fund since January 1977, including those for employee salaries, legal fees, and payments to (1) trustees for travel allowances and expenses and (2) firms or others providing the Fund services. The last two items are areas of potential abuse identified by SIS in the original investigation in the summer of 1976.

According to Labor's current plans, however, the investigation will not cover payments to trustees and firms providing services incurred before January 1977. As a result, the investigators will not review the payments made to the 12 former trustees that resigned in 1976. Labor, therefore, may lose an opportunity to develop information of potential violations, which occurred before 1977, on payments to the former trustees or the service providers.

Labor also will review (1) the B&A account to determine what the trustees are doing with the excess cash in the account, (2) employer contributions to assure employers are making proper contributions, (3) the retention of an old aircraft and the purchase of a new aircraft--costing about $3 million--and to determine whether the purchase may be a prohibited transaction under ERISA, and (4) foreclosure actions by the current trustees on a $7 million loan to Indico Corporation to determine whether the purchase price paid by the Fund for property used as collateral was in excess of the appraised value and therefore was an imprudent use of Fund assets.

As recommended in the Deputy Assistant Secretary's report, the LMSA Chicago Area Office is performing the investigation at the Fund. However, the Deputy Administrator, Pension and Welfare Benefit Programs Office (in the Washington, D.C., headquarters), has overall responsibility for directing the investigation. The Deputy Administrator told us that the Chicago Area Office is performing all investigative work, but the investigative plans and completed investigation reports are reviewed in the headquarters, and the

schedules for conducting and completing various aspects of the investigation are agreed to between the Chicago Area Administrator and him. He also said that he monitors the progress of the investigation and refers completed investigation reports to the Office of the Solicitor for a decision as to whether any legal action is warranted.

The Deputy Administrator said that the investigation began in April 1980 with a staff of eight consisting of the Area Administrator, six professionals (one supervisor and five investigators), and one clerk. On June 30, 1981, he told us that the Chicago staff consisted of eight professionals and one clerical member.

We tried to update the status of the new investigation with the Deputy Administrator in June 1980 and 1981. On both occasions, he told us that Labor does not want information to become public which could affect its investigation and prejudice any litigative action which could result from the investigation.

We noted, however, that on July 10, 1981, the Deputy Administrator, LMSA, wrote to the Fund's attorneys concerning Labor's investigation of the Fund's ownership and use of an aircraft. The Deputy Administrator's letter stated that, based on Labor's review of all pertinent evidence, it had concluded that the airplane purchase apparently was a "prohibited transaction" under ERISA. Labor found that the Fund had purchased the airplane from the Central Conference of Teamsters, an employee organization with a party in interest in the Fund. ERISA prohibits a pension plan from engaging in a transaction with a party in interest.

The Deputy Administrator's letter stated Labor was prepared to enter into a consent decree, together with the Fund, in a court which would, among other things, order the Fund and the Central Conference of Teamsters to rescind the airplane purchase transaction.

In response, the Fund's trustees on July 15, 1981, requested an advisory opinion from Labor that the Fund's purchase of the airplane was not a prohibited transaction or in the alternative, grant the Fund an exemption, for the airplane purchase, from ERISA's requirements. Labor, on July 24, 1981, denied the Fund's request because, among other things, Labor said generally advisory opinions are issued only with respect to prospective transactions. Labor's letter also indicated it was still reviewing the request for an exemption, but indicated it would not grant the requested exemption.

As a result, on October 20, 1981, the Fund's trustees filed a suit against 1/ the Secretary of Labor requesting the court to declare the Fund's purchase of the airplane was not a prohibited transaction under ERISA and awarding the trustees costs incurred in Labor's action. As of December 1, 1981, the Fund's suit was pending in court.

We also noted that on August 18, 1981, Labor filed a suit against 2/ 17 defendants and an unnamed defendant who are present or former trustees and certain attorneys, agents, and other Fund fiduciaries, concerning the foreclosure actions on the $7 million loan made to the Indico Corporation, which was secured by certain real estate located in Bay County, Florida. This loan is another of the areas covered in Labor's second investigation. (See p. 95.)

The suit alleges that the defendants caused the Fund to purchase the property, at the foreclosure sale, for $6.7 million, a price far in excess of its fair market value, thereby diminishing possible recovery by the Fund against the debtors and guarantors. In making the bid and final purchase price, the suit alleges all defendants, both the trustess and nontrustees, 3/ imprudently ignored certain information in their possession, based on what they knew, or should have known, that the actual fair market value of the land at the time of the sale was significantly less than either the opening bid of $5 million or the final bid of $6.7 million.

On December 1, 1981, the suit was still in the preliminary stages.

1/McDougall, et al., v. Raymond J. Donovan, Secretary of Labor; C.A. 81 C5891 USDC, N-D, Ill. The suit listed the following Fund trustees as plaintiffs, Howard McDougall, Thomas F. O'Malley, R. V. Pulliam, Sr., Robert J. Baker, Loran W. Robbins, Marion M. Winstead, Harold J. Yates, and Earl L. Jennings, Jr., and John Doe.

2/Donovan v. William J. Nellis, et al., MCA 81-0245.

3/The suit lists six current trustees--Robert J. Baker, Howard McDougall, Thomas F. O'Malley, Marion M. Winstead, Harold J. Yates, Loran W. Robbins; one former trustee--Earl N. Hoekenga; five Fund attorneys--William J. Nellis, James L. Coghlan, Ronald Guild, David Magee, and Nathan Wolfberg; and five former Fund officials or agents--Clinton E. Foster, James Green, John Hank, Daniel Shannon, and Jack Yarbrough.

IRS DID NOT COMPLETE THE INVESTIGATION OF THE FUND'S COMPLIANCE WITH CONDITIONS FOR REQUALIFICATION

After issuing the requalification letter in April 1977, IRS was responsible for assuring the Fund complied with the eight conditions under which IRS requalified the Fund's tax-exempt status. However, IRS was unable to adequately investigate or monitor the Fund's activities after August 1979 because the Fund stopped submitting to IRS the required monthly reports and barred IRS from conducting audit activities on the Fund's premises.

The requalification letter required the Fund to provide monthly reports to IRS on the Fund's efforts to comply with the conditions in the letter. IRS used the reports to review the Fund's affairs. IRS agents from the Chicago District Office also made onsite visits at the Fund's offices to verify statements made in these reports.

However, during 1979 the Fund's cooperation with IRS' audit activities began to deteriorate, and on August 24, 1979, the Fund sent a letter to the Chicago District Office stating the trustees had determined that, in light of the Fund's extensive past compliance and other circumstances, further submission of the monthly reports would not be in the Fund's best interest and the reporting procedure should be discontinued.

IRS officials also stated in testimony 1/ that the Fund, in effect, barred IRS from conducting audit activities on the Fund's premises. Because the Fund's records and administrative personnel were located there, IRS said this was a serious limitation on its ability to investigate and monitor the Fund.

On September 10, 1979, the Fund had submitted a new application for tax-exempt status based on changes to the plan which had been negotiated with the employers' associations during 1979. According to IRS, this application was incomplete in several respects, lacking, for example, essential data on plan participants. With the Fund's refusal to permit onsite examination and the filing of the incomplete application, IRS believed it had become evident that the Fund would not cooperate fully and provide information for its monitoring and examination activities.

Therefore, IRS decided that summons action was necessary, and on November 19, 1979, IRS issued a summons to the Fund for examination of its records. In December 1979, the Fund responded, but IRS considered the response wholly unsatisfactory. After extended discussions with Fund representatives, IRS concluded that its audit and monitoring activities would be significantly hampered without enforced cooperation by the Fund.

1/See footnote 2, page 1.

IRS, therefore, attempted to resume its onsite investigation of the Fund's operations at the same time Labor resumed its investigation. In fact, both agencies sent letters dated April 7, 1980, to the trustees announcing the onsite investigation. In its letter to the Fund, IRS stated that:

> "* * * The seriousness of the Fund's past problems, coupled with the Fund's recent refusal to allow on-site review and to provide monthly reports showing compliance with the conditions of the April 26, 1977, letter requalifying the Fund's tax-exempt status compel the Service to review the Fund's current activities."

However, again the Fund refused to cooperate, and IRS on April 14, 1980, issued another summons to the Fund.

However, the Fund still refused to cooperate, and on May 13, 1980, Justice filed a suit on IRS' behalf in the U.S. district court in Chicago to enforce the April 14 summons. The Fund filed a counterclaim in the district court. Finally, on July 21, 1980, the court entered an order dismissing the Fund's counterclaim with prejudice and retaining jurisdiction over the summons enforcement case until IRS' examination of the Fund's books and records as described in the summons was completed. Thus, IRS' investigation did not begin at the Fund until almost a year after the Fund notified IRS it would no longer cooperate.

The Fund, in August 1979, had advised IRS that it would no longer send the required monthly reports because the Fund considered the eight 1/ conditions substantially satisfied. IRS disagreed, and as of August 1980, IRS believed the Fund satisfied conditions 1, 3, 5, and 6, but it had not taken action to fully satisfy the other four conditions, as shown below.

--Condition 2 - to have an adequate data base in operation to determine creditable service and benefits for all participants. IRS' review showed that only 50 percent of the retiring employees' benefit applications are processed using the improved data base. IRS said it is reviewing the data base to determine its capabilities and possible areas of improvement.

--Condition 4 - to review all loans and related transactions from February 1, 1965, to April 30, 1977, to determine whether the Fund had causes of actions against its former trustees or against third parties. Delays in the loan review program occurred, and no progress was made until October 1977. At that time, the Fund had 35 loans in

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1/See pages 60 and 61 for the eight conditions.

various stages of review, and it referred 6 to outside legal counsel for consideration. In January 1978, the Fund advised IRS it had suspended further efforts in complying with this condition until the Fund resolved its concerns about whether the loan review was justified (cost). Although IRS advised the Fund that it was not relieved of its duty to pursue any known or suspected losses, the Fund's trustees indefinitely suspended compliance with this condition in August 1979 because of what they termed unreasonable and unjustifiable expenses.

--Condition 7 - to publish financial information on the Fund in newspapers. The Fund issued a news release containing the required financial statements in July 1978. However, in August 1979, the trustees passed a resolution to terminate the newspaper publication of its financial information.

--Condition 8 - to decide on the appropriate reserve amount in the B&A account. In June 1979, the Fund decided that $65 million was an appropriate reserve. IRS did not have information to determine the amount retained or to determine whether it exceeds the amount reasonably needed to pay plan benefits and administration expenses. According to IRS, the amount of assets the Fund should maintain in the B&A account was under review by IRS.

IRS also testified in August 1980 1/ that it will need to review the Fund's records and documents before it can judge whether the Fund has complied with the agreement and all eight conditions of requalification. Since IRS has refused to talk to us about its investigation of the Fund--because of the restrictions imposed by section 6103 of the Internal Revenue Code--we do not know the status of its investigation.

On November 2, 1981, however, IRS officials testified in congressional hearings 2/ that IRS believes that the Fund is now in a degree of compliance with all eight conditions, and/or IRS has changed its position on the need for the Fund to meet some of the conditions. In regard to the four open conditions discussed above the IRS Chicago district director testified as follows.

--Condition 2 - IRS has decided that the Fund has made sufficient progress from a practical sense on its data base to deal with the requirements of benefit claims.

1/See footnote 2, page 1.

2/See footnote 2, page 20.

--Condition 4 - IRS believes that time and circumstances have so mitigated against the possibility of the Fund's recoupment of losses under the loans, it has administratively concluded that the Fund has reasonably pursued and accomplished the required review of the loans.

--Condition 7 - IRS agreed with the Fund's viewpoint that it was an unnecessary expense for the Fund to publish its financial information in various newspapers and would be redundant since the financial statement of the Fund is available to the public.

--Condition 8 - IRS believes that the Fund fully satisfied this requirement by hiring independent asset managers (i.e., Equitable and Palmieri) to manage its assets.

In regard to condition 8, however, the Chicago district director failed to mention that the open item under this condition was the appropriate reserve for the B&A account. He and other IRS officials testified later at the hearings that this issue was still in dispute and under review by Labor and IRS.

IRS' AND LABOR'S SECOND ONSITE INVESTIGATIONS COVERING THE SAME AREAS

IRS' April 7, 1980, letter stated that its investigation would cover all operational matters pertaining to the Fund's requalification, including--but not limited to--the Fund's administrative expenses, such as travel and entertainment. The letter stated IRS would also review all aspects of the Fund's investment activities (both the Fund and independently managed assets), the Fund's involvement in the M&R Investment Company litigation, the payment of pension benefits, and the B&A account. Most of these areas are similar to the areas Labor stated it would investigate, as noted on page 95.

Also, as with the initial investigation, the new investigation has coordination problems between Labor and IRS. Labor and IRS told the Fund that they are coordinating their new investigations and both agencies testified at congressional hearings in 1980 1/ that they are fully coordinating. Labor officials also told us it was coordinating with IRS. Despite these comments, we found both agencies issued a subpoena or a summons for the same records and are reviewing the same activities and operations in the new investigation. For example, both agencies are reviewing the Fund's management of the B&A account.

CONCLUSIONS

We believe that both Labor and IRS need to take heed of the coordination problems and shortcomings in the original investigation

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1/See footnote 2, page 1.

and in the negotiations with the Fund to assure that these mistakes are not repeated in their current investigations and in future dealings with the trustees. In our opinion, Labor and IRS need to more closely cooperate to prevent (1) coordination problems, (2) duplication and overlap between their investigations, and (3) giving the Fund an excuse not to cooperate because the Government's "house is not in order."

In addition, Labor should assure that the current investigation includes all areas not reviewed in its initial investigation. Labor, for example, should review its decision not to cover payments made and services provided to trustees which were incurred before January 1977. Labor may lose an opportunity to develop information of potential violations, which occurred before 1977.

Also, we believe that Labor should assure that the Chicago staff performing the current investigation are (1) provided the proper training, particularly in detecting potential fiduciary violations, (2) instructed to pursue criminal violations it may detect and coordinate these efforts with Justice, and (3) allowed to complete third-party investigations on loans or other transactions where the staff finds significant fiduciary violations and imprudent practices. Finally, the Deputy Administrator, Pension and Welfare Benefit Programs Office, should take action to effectively coordinate his investigative staff's activities with those of the Office of the Solicitor.

As noted in our review--and in the Kotch-Crino report--the above areas were significant weaknesses in SIS' investigative efforts and, in our opinion, contributed significantly to the problems SIS experienced in carrying out its investigation and in the ineffective coordination, and often extremely caustic relationship, with the Office of the Solicitor.

RECOMMENDATIONS TO THE SECRETARY OF LABOR AND THE COMMISSIONER OF INTERNAL REVENUE

To assure that past mistakes identified in our review, as well as Labor's internal reviews, are not repeated in the current investigation, we recommend that the Secretary of Labor and the Commissioner of Internal Revenue direct their respective investigative staffs to more closely cooperate to prevent coordination problems, duplication between the investigators, and giving the Fund an excuse not to cooperate because the Government is not speaking in one voice. Further, in view of the past controversy over the size and use of the B&A account, we recommend that the Secretary and the Commissioner direct their investigative staffs to review the trustees' management and use of the B&A account to determine the appropriate reserve the Fund should maintain in the account.

We also recommend that, during its current investigation at the Fund, the Secretary of Labor direct LMSA to:

--Assure that the LMSA Chicago staff performing the investigation receive proper training, and use all investigative techniques and procedures, particularly third-party interviews, to detect and develop potential criminal violations for referrals to Justice.

--Effectively coordinate its investigation efforts with the Office of the Solicitor.

AGENCY COMMENTS AND OUR EVALUATION

Labor and IRS generally concurred with our recommendation on the need for closer coordination on their current investigations at the Fund.

IRS said that, since the revocation of the Fund's qualified status in 1976, the Chicago IRS and Labor field offices have coordinated closely in conducting their simultaneous examinations of the Fund. IRS said that procedures for sharing information about the Fund's operations have been established and the investigators from the two agencies are in almost daily contact.

Labor also said that the two staffs are now fully cooperating on the investigations. Labor said that each agency reviews the Fund's documents for its own purposes, i.e., IRS for considering tax qualification issues and Labor for determining fiduciary violations, and when one agency requests that a document be provided by the Fund, the other agency is accorded an opportunity to review that document for its purposes before the document is returned to the file. In this way, Labor states that the Fund need not retrieve and produce the same document twice.

Moreover, since the staffs generally sit in the same room during the review process, Labor said that there are constant discussions so that any problems are resolved quickly, and as far as Labor is aware, the Fund has no difficulty with the present procedure and both Labor and IRS find it to be fully satisfactory.

Labor and IRS also concur with the goal of our recommendation on the trustees' management and use of the B&A account.

Labor said, however, achieving control over these moneys, which would be under the direct control of the trustees, must be approached in the context of the other Labor recommendations and actions. Its proposed consent decree would have set a cap on the amount of moneys which could be retained by the trustees in the B&A account and would have imposed further restrictions on the uses of the funds and the manner in which they may be invested. However, the Fund declined to enter into such an agreement.

Labor stated, moreover, that there are obvious difficulties associated with achieving these goals quickly through litigation. Labor pointed out, however, that partly because of the pressures exerted upon the Fund by Labor, such restrictions may be voluntarily imposed, and Labor will continue to vigorously pursue all available avenues to achieve these goals.

IRS stated it was also concerned about the possible abuse of assets which are in the B&A account for payment of current benefits and administrative expenses and are not subject to the control of the independent manager. IRS stated that, in addition to monitoring the trustees' management and use of the B&A account as part of its current examination, IRS considered the question of the appropriate amount of the B&A account in connection with its review of the Fund's new application for determination.

As a result, IRS said that its November 11, 1981, determination letter contained a condition limiting assets retained by the Fund to those the Fund actually determines are necessary for benefits and administration expenses, considering assets available from the independent managers. According to IRS, under the condition, the Fund must (1) use an overriding formula that requires B&A assets not to exceed 2-1/2 times the sum of the previous month's benefit payments and administrative expenses and (2) manage and invest the B&A assets in accordance with the advice of qualified independent managers. As stated previously, the Fund, as part of its comments on our draft report, gave us a copy of IRS' letter. (See app. XVI.)

We believe that Labor's and IRS' new cooperative arrangements, if continued, should improve coordination between the agencies and the chances of a successful second investigation. We are also encouraged by Labor's and IRS' efforts to improve the control over the trustees use and management of the B&A account. We believe that the IRS conditions and requirements in its November 11 determination letter should, if properly implemented and adhered to by the Fund, improve the management and use of the B&A account. However, because of the ongoing investigation, we are precluded from determining whether IRS' and Labor's cooperative arrangements are fully effective. Therefore, we are retaining our recommendations in the report.

In regard to our recommendation concerning its current investigation at the Fund, Labor said that it concurs substantially with the goals of the three part recommendation and, in fact, to the extent of Labor's concurrence, these goals have already been achieved.

Labor believes that it has achieved the goal of the second part of this recommendation, that is, assuring that the LMSA Chicago staff is prepared and able to meet its responsibilities in the criminal area. Labor said that the LMSA staff in Chicago

is well-trained and highly competent, and the staff of the Office of the Solicitor has made itself available to assist in developing plans for sworn testimony and interviews. Labor said, moreover, third parties are being interviewed and, where necessary, their stenographic statements are being taken under oath and attorneys from the Office of the Solicitor sit in on these proceedings whenever it appears that their presence would be helpful.

Labor said it should be emphasized that it has a firm policy, consistent with ERISA, that information which may warrant consideration in a criminal context be fowarded to Justice. Labor believes that its staff is complying with this policy and statutory requirement in an exemplary fashion.

Labor also said it believes that it has met the goal of the third part of this recommendation regarding coordination with the Office of the Solicitor. Labor said the Solicitor has greatly improved communications between the agencies within Labor which have responsibilities for various aspects of the Central States Teamsters' investigations and litigation. Despite whatever problems may have occurred in the past, Labor said the relationship between the Office of the Solicitor and its client agencies is now one of cooperation rather than confrontation.

Labor said that Special Litigation Task Force members are in daily communication with the investigators and policymakers at the Pension and Welfare Benefits Programs Office and its representatives regularly attend the high-level litigation strategy meetings. Further, Labor said memorandums concerning ongoing investigations are often forwarded at the draft stage to the Special Litigation Task Force for comment, and likewise, the input of the Pension and Welfare Benefit Programs Office is frequently sought in the preparation of pleadings and memorandums by the Special Litigation Task Force.

Again, we agree with and applaud Labor's action in improving the training and investigative efforts--particularly regarding third-party interviews and potential criminal violations--of the Chicago staff and the relationship and coordination between the Office of the Solicitor and the Pension and Welfare Benefits Programs Office's staff in Washington, D.C. Such efforts, if properly implemented, should help chances for a successful investigation.

But as indicated previously, because we are precluded from reviewing Labor's and IRS' ongoing investigations, we are retaining our recommendations in the report.

In our draft report, we also recommended that, during its current investigation, the Secretary of Labor direct LMSA to assure that the unresolved matters from the initial investigation are thoroughly investigated and resolved. In particular, LMSA should review questions of possible improprieties of payments made

to former and current Fund trustees and officials and to service providers, including those made before January 1977, and coordinate this work with Justice because of the potential criminal nature of certain transactions.

Labor said, however, that it does not concur with this recommendation. Labor said that it does not know of any usable evidence of fraud or concealment in connection with payments made to Fund trustees and officials, and thus, Labor's right to bring a lawsuit with respect to these payments is questionable. Under these circumstances, Labor believes that prudent management of its law enforcement resource requires that investigations of current activities (in which there is a much higher likelihood of successfully commencing litigation) be pursued, rather than reopening 4- to 5-year-old, stale investigations in cases where the chances of ever being able to bring lawsuits are slim. Nevertheless, Labor said it should point out that, in response to its actions, including the constant threat of intervention, the Fund itself has filed a number of lawsuits to recover losses that occurred during this period.

We recognize that the information developed by Labor's investigators in the initial investigation on potential criminal and civil violations by the former trustees is dated and old, and would require extensive investigative efforts to develop a successful litigative case. We also agree with Labor that, under the current circumstances, investigating these areas may not be a prudent use of its law enforcement efforts. Nevertheless, Labor's decisions not to pursue these alleged abuses and mismanagement in the initial and second investigations of the Fund means that Labor has lost the opportunity to develop information of potential civil and criminal violations in these areas.

CHAPTER 9

THE FUND'S FINANCIAL SOUNDNESS: IMPROVED BY RECENT INVESTMENT PERFORMANCE BUT PENSION PLAN IS STILL THINLY FUNDED

ERISA requires that employee pension plans satisfy minimum funding standards each year and that each plan submit an annual report which includes actuarial information. IRS is to use the annual reports and actuarial data to enforce ERISA's minimum funding standards.

Since 1975, the trustees have had five actuarial valuations of the Fund's financial soundness, and the last report issued on April 3, 1981, stated that the current funding should satisfy ERISA's requirements and that the Fund is operating on a sound financial basis. However, the actuary's report decribed some problems and situations that could have serious financial implications for the Fund. Consequently, the actuary recommended that, until the effects of deregulation on the trucking industry and the Multiemployer Amendments Act of 1980 can be evaluated, the Fund now adopt a conservative posture with respect to any liberalizing of benefits.

Moreover, the actuary's April 1981 report showed that the Fund's unfunded accrued liability for current and future pension benefits was about $6.05 billion at January 1, 1980. 1/

IRS needs to closely monitor the financial status of the Fund to assure that it, in fact, meets ERISA's funding standards in 1981 and in the future.

ERISA FUNDING REQUIREMENTS

Sections 302 and 1013 of ERISA, as amended, require that employee pension plans satisfy minimum funding standards each year. Under the act, employers are required to pay the annual normal or current costs of a pension plan and to amortize the unfunded liability by equal annual payments of principal and

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1/The unfunded accrued liability represents a pension plan's liability for pension benefits for all present members and active and retired (and their beneficiaries) and future administrative expenses in excess of the value of the plan's assets.

interest. 1/ For collectively bargained multiemployer plans--such as the Fund--the 40-year amortization period is applicable. Also, the act's funding standards did not become applicable for the Fund until 1981.

In September 1980, ERISA's minimum funding standards for multiemployer plans were modified by the Multiemployer Pension Plan Amendments Act of 1980 (Public Law 96-364, Sept. 26, 1980). The amendments require, among other things, that multiemployer plans shall amortize any actuarial gains or losses over a period no longer than 15 years--previously the maximum period was 20 years. Also, if a plan is changed to increase pension benefits, the amendments require the Fund to amortize the cost increases over a period no longer than 30 years instead of the previous 40 years.

ERISA also requires that each plan administrator of a defined benefit plan 2/ submit an actuarial report for the first plan year beginning after December 31, 1975, and each third year thereafter. The act requires that an enrolled actuary--i.e., one who meets the qualifications of the Joint Board for the Enrollment of Actuaries, established by Labor and IRS--prepare the plan's actuarial report. The report shall contain a (1) description of the funding method and actuarial assumptions used to determine costs under the plan and (2) statement opinion that the report is complete and accurate and that the actuarial assumptions, in the aggregate, are reasonable and represent the actuary's best estimate of anticipated experience under the plan.

In addition, ERISA requires most pension plans--including the Fund--to submit an "Annual Return/Report of Employee Benefit Plan (with 100 or more participants)," Form 5500, which contains basic plan financial and operational information. As part of the annual report, IRS requires employers or pension plan administrators to submit information on the plan's actuarial valuations, employers' contributions, and funding methods on Schedule B "Actuarial Information" of the Form 5500. IRS also requires a statement on Schedule B, or on an attachment, by the plan's enrolled actuary that to the best of the actuary's knowledge the information on the schedule and any accompanying statement is complete and accurate, and in the actuary's opinion, the assumptions used in the aggregate (1) are reasonably related to the experience of the plan and to

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1/In estimating future pension costs, the actuary makes assumptions about future experience, such as yield from investments, retirement rates, death rates, disability rates, termination rates, and salary increase rates. Later valuations may compare the actuarial assumptions with actual experience under the plan. Differences between actual and expected experience give rise to actuarial gains and losses.

2/See footnote 1, page 5.

reasonable expectations and (2) represent the actuary's best estimate of anticipated experience under the plan.

IRS uses the annual reports and Schedule B in discharging its responsibility for enforcing the funding standards. ERISA also requires Labor and IRS to coordinate the use of the actuarial reports.

FUND'S ACTUARIAL VALUATIONS--FROM SOUND TO UNSOUND TO CONDITIONALLY SOUND

Although the Fund was not covered by ERISA's funding requirements until 1981, the trustees apparently retained the same actuarial firm, the American Actuarial Pension Consultants, Inc., to make annual actuarial valuations from the Fund's inception in 1955 through 1975. Later, the Fund hired two other actuarial firms--the Wyatt Company and Dan McGinn & Associates, Inc.--to make valuations in 1976, 1979, and 1980. Also, IRS purportedly made an audit of the Fund in 1976. We reviewed the actuarial valuations made by the three firms. Since we did not have access to IRS' records on the Fund, we did not review the purported IRS' audit report.

First actuary indicated the Fund is financially sound

In June 1975, the first actuary, American Actuarial Pension Consultants, Inc. (hereafter referred to as American), completed the 20th annual actuarial valuation of the Fund based on data as of January 31, 1975. American's report stated that the Fund's unfunded accrued liability had risen from $106 million in 1955 to $5.9 billion in 1975. This was caused by (1) increases in benefits, (2) a reduction in the assumed normal retirement age from 60 to 57, (3) a transfer of participants from a lower to a higher benefit class, and (4) an increase in the number of employees covered by the Fund. American stated, however, that its valuation indicated that expected employer contributions and excess investment income--based on earnings of 4-1/2 percent per annum--would be sufficient to meet the normal costs and the accrued unfunded liability.

American's report also stated that the trustees had requested the firm to compute the additional costs to the Fund, based on the changes the trustees made in the pension plan, to comply with ERISA's requirements. According to the American's report, the Fund would need an additional weekly contribution for the various benefit classes ranging from $4.17 to $7.15. For all classes combined, American said an additional weekly contribution of $6.15 was needed to comply with ERISA.

According to the Fund's then executive director, the actuary said to Fund officials that, in his opinion, the Fund was actuarially sound. However, the executive director disagreed and believed the Fund had a funding problem. He, therefore, asked the trustees to obtain a second actuary's opinion on the Fund.

Second actuary states Fund is financially unsound

As a result, the trustees hired the Wyatt Company to audit American's January 31, 1975, valuation results and report. In a June 4, 1976, report, Wyatt disagreed with American and concluded that the Fund was not financially sound. Wyatt's report stated it could not agree with American's actuarial assumptions. It said, for example, that American based its assumptions on an average retirement age of over 62 years, whereas the Fund's actual experience over the past 5 years showed employees retiring closer to age 60.

Wyatt's report also stated that results of its audit valuations showed the need for significantly higher employer contributions than indicated by American. Wyatt determined that an additional weekly employer contribution of about $18 (for a total contribution of $40 a week) was necessary. Wyatt projected that, if the required employer contribution increases were not negotiated in 1979 contract talks, the Fund's assets would begin to be reduced by 1983 and be depleted by 1994, based on the present level of membership, benefits, and asset investment performance.

Wyatt concluded that, based on its findings and valuation, the Fund was in serious trouble on the basis of present participants and benefit levels provided in relation to contributions to the Fund.

First actuary disagrees and states that IRS agrees the Fund is financially sound

In December 1976, American issued its 21st annual actuarial valuation of the Fund, which included an analysis of Wyatt's audit. American's report stated that it had reviewed Wyatt's report in great detail and had made special studies to determine the validity of Wyatt's actuarial assumptions.

American said it disagreed with Wyatt's actuarial assumptions based on Wyatt's (1) census of plan participants was incorrect because it overstated both the age and the years of service of the participants and (2) actuarial assumptions to arrive at its actuarial costs were not based upon the experience of the Fund, but were adopted on the basis of judgment.

American's report stated, furthermore, the conclusions drawn by Wyatt conflicted with those drawn by IRS on the basis of IRS' audit of the American records and studies developed over the years

that it served as the Fund's actuary. According to American's report, the IRS Chicago district director, as part of the audit that IRS was making at the Fund, requested that an actuarial audit be made at American's offices for the 3 plan years ended January 31, 1975.

The report said, as a result, the IRS actuary during the week of January 26, 1976, visited American's office and reviewed in detail all of the studies, worksheets, etc., supporting its reports and actuarial assumptions. The report also said that the IRS actuary reviewed the computations used by American to establish the additional contributions the Fund would need to comply with ERISA.

American's report stated that:

> "The Actuary of the Internal Revenue Service concluded at the completion of his audit that the actuarial assumptions used in the last three years' valuations were valid in the aggregate and that the last three years' valuation results were correct. Furthermore, he stated that the increased contributions which were recommended to comply with ERISA together with the effect of the changes in the Plan provisions introduced since 1969 (450 weeks of contributions and 100-250 weeks of contributions to move to higher benefit class) would enable the Fund's to meet the funding requirements under ERISA."

American concluded, therefore, that the costs which it had established to comply with ERISA requirements and its actuarial assumptions in the aggregate were correct.

In light of the restrictions imposed by section 6103 of the Internal Revenue Code on IRS' disclosure of its investigation concerning a single taxpayer, we were unable to review the purported IRS report or to verify the accuracy of the above-mentioned statements in American's report. It is interesting to note that, during testimony before various congressional committees from 1977 to 1980 (at which the actuarial soundness was usually discussed), the IRS officials never mentioned the purported audit of the Fund.

Third actuary agrees with second that the Fund is not financially sound

Because of the disagreement between American and Wyatt, the trustees hired Dan McGinn & Associates, Inc., to prepare an analysis and valuation of the Fund and to break the tie. McGinn agreed with Wyatt that the Fund was financially and actuarially unsound, and employer contributions were inadequate.

In a preliminary report issued to a Fund official in December 1976, McGinn stated, in its opinion, based on the material developed at that time, the weekly contribution rates developed by American were inadequate to maintain the plan if the investment earnings of the Fund continue indefinitely at 4-1/2 percent per annum. McGinn concluded that, if the investment earnings of the Fund remain at the 4-1/2-percent level, Wyatt's opinion that the Fund's weekly contribution rates will need to be increased substantially is valid.

According to the then executive director of the Fund, Wyatt and McGinn also concluded in their reports that the Fund's unfunded liabilities were reaching staggering proportions.

Fourth actuarial report shows the Fund's soundness was conditional

As a result of the above audits, McGinn and Wyatt, in early 1977, developed a revised plan of benefits and employer contributions for the trustees which, in the firms' opinion, would be actuarially sound. The plan recommended that, to maintain the maximum monthly pension benefit at $550, the Fund would need a $37 weekly contribution rate from the employers. At that time, the collective-bargaining agreement required that the employers' maximum contribution would be $31 weekly at the end of a 3-year period. This rate had been set in the collective-bargaining agreement negotiated in early 1976 by the IBT union and the employer associations.

Subsequently, the IBT union and employer associations entered into a new collective-bargaining agreement covering from April 1979 to 1982, which increased the weekly employer contribution rates to $41 in 1979, $46 in 1980, and $51 in 1981. The agreement also increased the maximum monthly benefits from the previous monthly $550 to $675 in 1979, $725 in 1980, and $775 in 1981.

After it adopted the revised benefit and contribution schedules, the trustees had McGinn make another review of the Fund. McGinn's report, issued on March 3, 1980, stated that the current funding should satisfy ERISA's funding requirements during 1981, but the funding policy allowed very little margin for error and that, if actual experience differed, funding problems would occur after ERISA standards became effective for the Fund in 1981.

ERISA requires that a pension plan fund on an annual basis the normal or current costs of a pension plan. According to McGinn's report, the Fund met this requirement. For example, for the year ended December 31, 1978, the Fund had an excess of income over benefits payments and expenses for the year of $321 million. McGinn's report stated that this excess should rise sharply in the future, and thus, the Fund should meet ERISA standards.

ERISA also requires that such multiemployer pension plans as the Fund are to make annual installments, not exceeding a 40-year period, to amortize the unfunded accrued liability. According to the McGinn's calculations, the Fund had an unfunded accrued liability of $7.6 billion as of January 1, 1979.

Although the Fund's unfunded accrued liability was great, McGinn concluded that the new contribution rates established in April 1979 shoud allow the Fund to meet ERISA's minimum funding standards for the 1981 plan year. McGinn stated it determined weekly contribution rates based on an assumed 6-1/2-percent annual investment earnings rate and used a 40-year amortization period in calculating the unfunded actuarial values. It concluded that, in the aggregate, the scheduled contribution rates are adequate, and it expects that the plan will have an amortization period of about 38 years in 1981.

McGinn concluded, however, that this funding policy allows very little margin for error. Its report stated that:

> "If actual experience follows a pattern which is substantially different from our assumptions, the Plan could have funding problems after ERISA's standards apply. For example, when ERISA's standards apply, experience gains and losses will have to be amortized over 15 years if current legislative proposals are enacted. Likewise, if and when the plan is amended to provide improved benefits, the cost increases will have to be amortized over a period of 30 years or less. If a plan fails to satisfy ERISA's funding standards and a "deficiency" develops, there will be an obligation for the contributing employers to eliminate the deficiency within a specified time following receipt of a notice from the IRS. In view of these considerations, we are proposing that you consider adopting a future funding policy which will restrict benefit improvement costs to those that can be amortized over a 20 year period. This should allow adequate margins for experience deviations from assumptions and will hasten the funding of vested benefits."

Since we did not visit the Fund's headquarters or interview its officials during our review, we do not know whether the trustees have adopted McGinn's recommendation. However, McGinn's latest reports, discussed on the next page, show apparent improvement in the funding policy.

LATEST ACTUARIAL REPORT SHOWS SOME IMPROVEMENTS, BUT INDICATES PLAN IS STILL THINLY FUNDED

On February 11 and April 3, 1981, McGinn issued its preliminary and final actuarial reports on the Fund's plan as of January 1, 1980. McGinn's reports show a significant improvement in the Fund's financial condition.

For example, according to the McGinn's reports, the Fund's total actuarial liability decreased from $9.587 million as of January 1, 1979, to $9.456 million in the preliminary valuation of January 1, 1980, and to $8.478 million in the final valuation. Assets increased from $1.997 million to $2.432 million. Consequently, the Fund's unfunded actuarial liability decreased from $7.6 million to $7.0 million and finally to $6.05 million. In addition, the amortization period for the unfunded liabilities was reduced from 39.7 to 27.0 years.

The following table compares the unfunded accrued liabilities and other principal actuarial results shown in McGinn's reports as of January 1, 1979, and 1980.

the suits and the allowance (if any) for loss in its financial statements and that the determination of the allowance and the resulting net assets available for benefits is the responsibility of the auditor. The actuary, under ERISA, is permitted to accept the auditor's findings.

In view of the apparent questionable financial soundness of the Fund and the considerable unfunded liabilities of $6.05 billion, we believe that IRS should continue to determine whether the Fund is being funded in accordance with ERISA's requirements and, if not, take whatever action is needed to assure that the Fund meets the requirements.

RECOMMENDATION TO THE COMMISSIONER OF INTERNAL REVENUE

To help assure the financial soundness of the Fund and its ability to meet commitments for paying current and future pension benefits, we recommend that the Commissioner direct IRS officials to closely monitor the Fund's financial operations to ascertain that the Fund meets the minimum funding standards of ERISA in 1981 and in the future and, if not, take whatever action is needed to assure that the Fund meets the act's requirements.

AGENCY COMMENTS AND OUR EVALUATION

IRS said that the ERISA minimum funding standards will not become applicable to the Fund until the end of 1981, and it would not be appropriate to examine a plan concerning compliance with the funding standards before receiving the plan's return. IRS said that the Fund's Schedule B (Form 5500) will not be due until July 1982, and the contributions necessary to satisfy the minimum funding standards are not required to be made until September 15, 1982. The Commissioner said that, upon receipt, IRS expects to thoroughly examine the Fund's Schedule B to ensure compliance with the minimum funding standards.

We believe that IRS' comments that it intends to monitor the Fund's compliance with ERISA is a step in the right direction and should help assure that the Fund meets the standards in 1981 and will continue to do so in the future, if actual experience is as anticipated. As a part of its monitoring, we believe IRS should review the latest actuarial report on the Fund, ascertain whether the Fund should adopt the actuary's proposal on revising or liberalizing the benefits at this time and, if so, take action to assure that the Fund implements the proposal. IRS should also monitor the progress of the various lawsuits and potential losses pending against the Fund, taking into consideration the possible adverse impact on the ability of the Fund to meet the minimum funding standards.

Our analysis of McGinn's February 11, 1981, preliminary and April 3, 1981, final valuation reports as of January 1, 1980, indicates that the improvements in the unfunded actuarial liabilities were attributed almost entirely to changes in actuarial assumptions. To illustrate, McGinn adopted higher mortality rates for the retirees on the basis of an experience study it performed. McGinn's February 1981 report stated that its study demonstrated that the previous assumptions were overly conservative and the mortality rates anticipated for the retired population were too low.

Also, in the February 1981 report, McGinn used a 6.5-percent investment earnings assumption. However, in its April 1981 final report, McGinn changed the earnings assumption from 6.5 percent to a schedule starting at 8.5 percent in calendar year 1980, remaining at over 8 percent to 1984, and gradually decreasing to 6.50 percent in 1990 and remaining level thereafter. McGinn's report stated that, in its opinion, for the long term, a 6.5-percent investment earnings rate assumption is reasonable and prudent for determining the relationship between expected contributions and benefits levels provided under the plan.

McGinn's final report of April 3, 1981, stated that the Fund's estimated amortization period has been reduced considerably by the application of the revised investment earnings assumption, and that, if its assumptions prove to be reasonably close to actual experience, the Fund's actuarial liability could be fully funded in about 27 years. The report also stated investment earnings significantly higher than anticipated would cause a reduction in the expected amortization period whereas lower earnings would cause an increase. McGinn concluded that "This amortization period based on the forecast investment rates is evidence that the Fund is operating on a sound financial basis."

Although our analysis of McGinn's report and other information shows that McGinn's assumptions appear to be reasonable and the report describes facts which point to a soundly funded plan, the report also calls attention to some potentially serious situations and problems. For example, the February 1981 report pointed to a decline in active participants and employer contributions as follows.

> "Information from administrative data indicates that in the first half of 1980, the active population suffered a decline of approximately 40,000 individuals, and there appears to have been about a 9% decline in expected contributions. A significant and sustained decrease in active participants and contributions can have serious implications for the Plan's funding status and its ability to meet ERISA's minimum standards on a continuing basis."

In addition to the problem of the decline in the number of active participants in 1980, the February report stated:

> "The average number of weeks worked among active participants has decreased from 46.6 weeks in 1978 to 45.6 weeks in 1979. If this decline continues, it could have significant impact on the amount of contribution income realized in the future."

McGinn's February preliminary report also pointed out the problem of incomplete records, as follows.

> "Although on the surface the quality of census data appears to be improving ('incomplete' records accounted for 12% of participants as of 12/31/79 as opposed to 23% for the previous year), extensive data analysis indicates that there is a large pool of past service among participants that has not been accounted for. This poses a very serious problem--especially in the determination of the unfunded vested liability to be assigned to a withdrawing employer."

McGinn's report stated it had made an adjustment where records were incomplete, based on data from complete records. Problems with the data are not unusual in valuing pension plans, in our view, but incorrect or incomplete data introduce an uncertainty into the valuation, besides causing administrative problems.

In its transmittal letter on the February 1981 report, McGinn stated that the funding status of the plan had improved considerably since the last valuation, but pointed out there was a significant decline in both membership and expected contributions and, if this decline becomes permanent, it will alter the funding status of the plan. McGinn stated, however, in its actuarial calculations, it assumed the decline would not be permanent.

The final report, according to McGinn, based on more optimistic investment earnings assumptions, would develop somewhat lower estimated liabilities and should compensate for the cost effects of all or a portion of the decline if it becomes permanent.

In its transmittal letter on the April 3, 1981, final report, McGinn stated that the overall effect of its changes in investment earnings assumption has been a reduction in the Fund's unfunded actuarial liability of $978 million (from $7.0 to $6.05 billion), or about 13.9 percent. McGinn's letter said, however, as in the February report, it has assumed a stable work force, and as pointed out previously, a permanent decline in the active population would have serious financial implications. McGinn's letter concluded:

"Therefore, until the effects of deregulation [1/] on the trucking industry and the recent Multiemployer Act [2/] can be evaluated, I recommend a conservative posture with respect to any liberalization of benefits at this time."

POTENTIAL IMPACT OF LITIGATION ON FUND'S FINANCIAL CONDITION

The Fund is involved in several civil litigation cases which if it loses could possibly have an adverse impact on its financial condition.

For example, the Fund's trustees, as discussed on page 78, are being sued by the M&R Investment Company, Inc., controlled by Morris Shenker, seeking approval of a $40 million loan (which had been canceled by the trustees) and $100 million in damages. The court ruled for the Fund holding that the proposed initial $40 million loan was unlawful under ERISA's prohibited transaction provisions and denied the prospective borrower's claims for damages. However, the M&R Investment Company has appealed to the U.S. Court of Appeals for the Ninth Circuit from the judgments of the district court, which it was still pending as of December 1, 1981.

On June 12, 1980, two related complaints were filed in the U.S. district court for the District of Nevada, one by I.J.K. Nevada, Inc., which is reported to be the owner of about 35 percent of the common stock of Dunes Hotel and Casino, Inc., and the other by Morris A. Shenker, reported to be the 100-percent owner of IJK. The complaints seek damages of $30 million and $50 million, respectively, as contractual compensation.

According to the Fund's annual report for 1980 (submitted to IRS in October 1981) the Fund's legal counsel is satisfied--in the M&R Investment Company litigation--that the district court's judgments are supported by the facts and the law and is of the opinion that the possibility of a successful appeal in this matter is remote. The report also stated that the Fund's legal counsel is of the opinion that the probability of a significant recovery against the Fund as a result of two related complaints is remote. Despite the Fund's counsel's optimistic forecast, there is a possibility the Fund could lose both cases and thus may be liable to pay up to $180 million in damages and claims.

The Fund is also named as a defendant in two purported class actions filed in the U.S. district court for the Northern District

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1/See footnote 1, page 73.

2/See footnote 1, page 13 (Public Law 96-364, Sept. 26, 1980).

of Illinois. 1/ In both actions, it is alleged by plaintiffs (plan beneficiaries) that the Fund's pension plan provisions were arbitrary and unreasonable and operated to deny or limit benefit eligibility for a great number of participants on whose behalf years of employer contributions were paid to the Fund in accordance with collective-bargaining agreements.

In October 1981 congressional testimony, 2/ the Fund's Executive Director stated that a memorandum of understanding signed by counsel for the private plaintiffs, counsel for the Fund, and counsel for the IBT union was presented to the district court on October 21, 1981, as a major step toward settlement of these related lawsuits. He testified that, although Labor is not yet a party to the memorandum of understanding, the comprehensive settlement proposal contemplates Labor's participation, and the memorandum of understanding between private plaintiffs and the Fund is dependent on Labor's participation in the final settlement.

The Executive Director testified that the components of the memorandum of understanding to settle the Dutchak and Sullivan litigation are several and significant as follows:

--The agreement provides that the Fund will establish a segregated pool of assets to fund payment of increased benefits under the terms of the settlement. The segregated asset pool will be invested in Government or Government-guaranteed obligations.

--The Fund will commit itself to retroactive application of the current vesting and break in service ERISA-qualified terms of the pension plan for the entire period of the plan's existence. The increased benefits that will become available to members as a result of the retroactive ERISA application will be funded by the segregated assets invested in Government obligations.

--To the extent that the pension benefits contemplated under this settlement are overdue, the Fund will pay beneficiaries interest at 6 percent, and past due benefits will be available to the heirs of a deceased participant.

--The agreement further contemplates creation of a hardship remedy to provide relief in the situation where a member has many years of service and contribution, yet a technicality

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1/Dutchak v. International Brotherhood of Teamsters Central States, Southeast and Southwest Areas Pension Fund, et al., 76C 3803, N.D. ILL filed October 1976, and Sullivan v. Fitzsimmons, et al., 79C 1725, N.D. ILL filed April 1979.

2/See footnote 1, page 20.

not contemplated by the spirit of the rules requires denial of benefits. The hardship provision will permit the trustees, in the exercise of discretion, to award pension benefits in such a situation.

--The agreement, finally, in principal, provides that the Fund will increase total and permanent disability benefits by 10 percent.

The Executive Director testified that increased benefit payments resulting from these provisions are estimated to reach $140 million and that the present Fund assets to be segregated and invested in Government obligations for payment of these benefits as they become due have been actuarily calculated at $40 million.

As of December 1, 1981, the proposed settlement had not been finalized.

IRS AND LABOR HAVE NOT REVIEWED THE FUND'S FINANCIAL SOUNDNESS

Other than the purported audit report prepared by IRS' Chicago District Office, neither IRS nor Labor has reviewed the financial soundness of the Fund.

Labor, in fact, said it does not have responsibility under ERISA to determine the Fund's soundness. In 1978 congressional hearings, 1/ Labor officials, in response to questions from Subcommittee members, said they did not know whether the Fund was actuarially or financially sound. Moreover, Labor said that IRS is primarily responsible under ERISA for determining whether plans are sound from a funding viewpoint and, if there is a funding deficiency, IRS is responsible to secure compliance from the contributing employers to make the Fund financially sound.

IRS' position on the financial and actuarial soundness was also presented in congressional hearings in 1977, 2/ 1978, 3/ 1980, 4/ and 1981. 5/ In 1977 hearings, for example, the then

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1/See hearings on "Central States Teamsters' Fund," Subcommittee on Oversight, House Committee on Ways and Means, 95th Cong., 2nd sess., page 103 (Mar. 1978).

2/See hearings on "Teamsters' Central States Pension Fund and General ERISA Enforcement" before the Subcommittee on Oversight, House Committee on Ways and Means, 95th Cong., 1st sess., page 681 (April 5 and July 19 and 20, 1977), Part 2.

3/See footnote 1, page 65.

4/See footnote 2, page 1.

5/See footnote 1, page 20.

Assistant Commissioner for Employees' Plans and Exempt Organizations was asked by the Chairman, House Subcommittee on Oversight, why IRS requalified the Fund's plan, when there was serious doubt in IRS' mind and the Chairman's mind, about the actuarial soundness of the plan. The Assistant Commissioner said that actuarial soundness is not a qualification or a requalification factor in a plan. Therefore, he said IRS lacked authority to deny requalification. The Assistant Commissioner stated further that actuarial soundness is not a requalification circumstance or requirement:

> "* * * and because it is not, we are not able to make it a condition of our requalification, but we are interested in the actuarial soundness, and we will be looking at the minimum funding standards to be sure they are observed, and under the limits of our authority, we will continue to monitor actuarial soundness of this plan as it is a function of funding."

In the 1978 hearings, however, in response to a question as to whether a 1977 increase in employer contributions would make the Fund financially sound, the Acting Assistant Commissioner for Employees' Plans and Exempt Organizations provided information that stated:

> "The Service [IRS] has no authority to determine whether a plan is actuarially sound. The statutory authority of the Service relating to whether a plan satisfies the minimum funding standards enacted by ERISA does not give the Service jurisdiction to determine whether a plan is solvent or insolvent. The minimum funding standards provide only that the Service will make determinations as to whether the annual funding of the plan satisfies one of several specified statutory standards. These standards permit the funding of plan liabilities over 30 years, 40 in the case of a multiemployer plan, and thus cannot insure that a plan is solvent at any one particular point in time."

The Acting Commissioner's information also stated that, when the minimum funding standards become applicable to the Fund in 1981, IRS will then review the accuracy of the actuarial assumptions of the Fund in the aggregate as part of its consideration of whether the plan satisfies ERISA's minimum funding standards.

In the 1980 and 1981 congressional hearings, IRS officials reiterated that ERISA's minimum funding standards do not insure actuarial soundness and that IRS does not have statutory authority to determine that a plan is actuarially sound. However, the director of IRS' Actuarial Division testified in 1980 that the changes in ERISA's funding requirements made by the Multiemployer Pension

Plan Amendments Act of 1980 to require more rapid funding should help in the case of multiemployer plans that are beginning to slide downhill.

IRS officials also said that until ERISA becomes applicable to the Fund, it could not question the Fund's compliance with the minimum funding standards. In addition, IRS officials said, before the Fund's filing the actuarial information form, IRS could not project whether the Fund will satisfy the minimum standards when they become applicable in 1981. IRS officials said that IRS intends to monitor the Fund's compliance with ERISA's minimum funding standards when they become applicable.

CONCLUSIONS

In the past, several actuaries have indicated that the Fund was financially unsound. The most recent actuarial report indicated that the Fund would meet ERISA's minimum funding standards in 1981, providing actual experience does not differ substantially from the actuary's assumptions. The actuary also recommended that the Fund's trustees adopt certain funding positions to assure compliance with ERISA in the future.

In our opinion, McGinn's reports for 1980 and 1979 appear to be very thorough and the conclusions and recommendations follow logically from the material presented. We, however, get the impression of a plan which has been, and still is, thinly funded despite the fact that the reports show that the plan satisfies the minimum funding requirements of ERISA.

We believe also that continued annual improvement to the extent indicated by the valuations cannot be expected. Similar gains from mortality and investment income are not likely to recur regularly. The Fund's actual yield on investments in 1980 was 14.33 percent. This was a significant increase over the 9.4 percent of the previous year. Present indications, however, are for generally lower rates in the future.

Finally, because the Fund's plan is apparently already liberal and the potential effect of things beyond the control of the trustees, such as the deregulation of the trucking industry, and the effect of the Multiemployer Act of 1980, we believe that the trustees should thoroughly study and understand the material in the actuarial reports and the reasons for the recommendations made. Also, we believe under the circumstances, a conservative funding policy will best serve the interests of the participants.

In addition, we could find no mention in the actuarial reports of the various lawsuits pending against the Fund or any allowance for the potential loss of hundreds of million dollars in the reports. We recognize that the Fund did disclose the existence of

the suits and the allowance (if any) for loss in its financial statements and that the determination of the allowance and the resulting net assets available for benefits is the responsibility of the auditor. The actuary, under ERISA, is permitted to accept the auditor's findings.

In view of the apparent questionable financial soundness of the Fund and the considerable unfunded liabilities of $6.05 billion, we believe that IRS should continue to determine whether the Fund is being funded in accordance with ERISA's requirements and, if not, take whatever action is needed to assure that the Fund meets the requirements.

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We believe that IRS' comments that it intends to monitor the Fund's compliance with ERISA is a step in the right direction and should help assure that the Fund meets the standards in 1981 and will continue to do so in the future, if actual experience is as anticipated. As a part of its monitoring, we believe IRS should review the latest actuarial report on the Fund, ascertain whether the Fund should adopt the actuary's proposal on revising or liberalizing the benefits at this time and, if so, take action to assure that the Fund implements the proposal. IRS should also monitor the progress of the various lawsuits and potential losses pending against the Fund, taking into consideration the possible adverse impact on the ability of the Fund to meet the minimum funding standards.

CHRONOLOGY OF KEY EVENTS IN THE GOVERNMENT'S INVESTIGATION OF THE FUND JANUARY 1, 1975 TO DECEMBER 1, 1981

	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
1975	**ERISA** EFFECTIVE						LABOR FORMS TASK FORCE TO COLLECT DOCUMENTS ON FUND FROM VARIOUS SOURCES AND IDENTIFIES PATTERNS OF ABUSE. LABOR PLANS STRATEGY FOR ON SITE INVESTIGATION.		LABOR INVITES JUSTICE & IRS TO JOIN INVESTIGATION. IRS REFUSES.	LABOR MEETS WITH FUND TO ADVISE THEM OF INVESTIGATION. FUND OFFERS VOLUNTARY COMPLIANCE. LABOR ACCEPTS.		EXECUTIVE HEARINGS HELD BY PSI LABOR FORMS **SIS**: LABOR & JUSTICE SIGN MEMO OF AGREEMENT TO COORDINATE INVESTIGATION.
1976	**SIS** BEGINS ON SITE INVESTIGATION AT FUND'S CHICAGO HEADQUARTERS.	**SIS** ANALYZES FUND'S OPERATIONS, POLICIES, PROCEDURES, & RECORDS AND FOCUSES REVIEW ON SELECTED FUND LOAN PRACTICES & RECORDS.		FUND TRUSTEES DECIDE NOT TO MAKE ANY NEW LOANS.		IRS REVOKES FUNDS TAX EXEMPT STATUS.	LABOR SUBPOENAS 7 TRUSTEES IN CONNECTION WITH CERTAIN LOAN CONGRESSIONAL HEARINGS HELD.		**SIS** EXPLORES THE POSSIBILITY OF LIMITING THE TRUSTEES MANAGEMENT OF FUND ASSETS BY LEGAL MEANS. 1 TRUSTEE RESIGNS.	11 TRUSTEES RESIGN.		
1977	LABOR MEETS WITH IRS & JUSTICE TO DISCUSS REMEDIAL ACTION AGAINST TRUSTEES TO PROTECT FUND'S ASSETS. CHANGEOVER IN LABOR'S ADMINISTRATION.	LABOR MEETS WITH FUND TRUSTEES AND PRESENT GOVERNMENT'S DEMANDS. TRUSTEES ACCEPT THE GOVERNMENT'S DEMANDS	CONGRESSIONAL HEARINGS HELD	4 HOLDOVER TRUSTEES RESIGN. IRS REQUALIFIES FUND'S TAX EXEMPT STATUS	**SIS** TERMINATES ON SITE WORK	FUND SIGNS CONTRACT WITH INVESTMENT MGR TO TAKEOVER FUNDS ASSETS	CONGRESSIONAL HEARINGS HELD BY PSI. **SIS** PLANS TO FOCUS ON 3rd PARTY INVESTIGATIONS.			INVESTMENT MANAGERS TAKE OVER REAL ESTATE & SECURITIES RELATED ASSETS.		
1978		LABOR FILES CIVIL SUIT AGAINST 17 TRUSTEES AND 2 **FUND** MGRS TO RECOVER LOSSES FOR ALLEGED FIDUCIARY BREACHES.	**SIS** CONTINUES TO ANALYZE LOAN RECORDS & CONDUCT 3rd PARTY INVESTIGATIONS FOR CIVIL SUIT. FUND FORMALLY TERMINATES VOLUNTARY COOPERATION WITH LABOR CONGRESSIONAL HEARINGS HELD.	LABOR COMMENCES DISCOVERY PROCEEDING STAGE OF ITS SUIT.	TRUSTEES FILE MOTION TO DISMISS LABOR'S SUIT.	CONGRESSIONAL HEARINGS HELD LABOR FILES MEMO IN OPPOSITION OF DEFENDANTS MOTION TO DISMISS.					COURT DENIES TRUSTEES' MOTION TO DISMISS SUIT.	
1979	**SIS** CONTINUES TO ANALYZE LOAN RECORDS & CONDUCT 3rd PARTY INVESTIGATIONS FOR CIVIL SUIT. LABOR FILES MOTION TO ADD THE FUND TO ITS SUIT AS AN INVOLUNTARY PLAINTIFF.	FUND FILES MEMORANDUM IN OPPOSITION TO LABOR'S MOTION.						FUND STOPPED COMPLYING WITH REQUALIFICATION TERMS & BARRED IRS FROM MAKING ONSITE AUDIT.			IRS ISSUES SUMMONS TO PERMIT ONSITE MONITORING AT THE FUND.	
1980	**SIS** AND **SLS** CONTINUE TO ANALYZE LOAN RECORDS & CONDUCT 3rd PARTY INVESTIGATIONS FOR CIVIL SUIT.		CONGRESSIONAL HEARING HELD.	LABOR STARTS NEW INVESTIGATION AT FUND. IRS ISSUES SUMMONS TO BEGIN ONSITE INVESTIGATION.	**SIS** DISBANDED. SPECIAL LITIGATION STAFF (**SLS**) ESTABLISHED. SUIT FILED TO ENFORCE IRS SUMMONS.		IRS STARTS ONSITE INVESTIGATION UNDER COURT ENFORCED SUMMONS.	CONGRESSIONAL HEARINGS, IRS, GAO & ROY WILLIAMS TESTIFY.	CONGRESSIONAL HEARINGS, LABOR TESTIFIES.	GAO ISSUES TO HOUSE SUBCOMMITTEE LETTER REPORT ON LABOR'S INVESTIGATION.		
								LABOR AND IRS CONTINUE SECOND INVESTIGATION AT FUND.				
1981	LABOR AND IRS CONTINUE SECOND INVESTIGATION AT THE FUND AND SLS CONTINUES TO ANALYZE LOAN RECORDS & CONDUCT THIRD PARTY INVESTIGATIONS FOR CIVIL SUIT.			LABOR REQUESTS COURT TO ADD 9 LOANS TO CIVIL SUIT.	ROY WILLIAMS INDICTED.	ROY WILLIAMS ELECTED PRESIDENT IBT.		PSI ISSUES REPORT. LABOR FILES SECOND CIVIL SUIT.		CONGRESSIONAL HEARINGS. COURT DENIES APRIL 1981 MOTION. LABOR APPEALS.		LABOR'S CIVIL SUITS AND APPEAL PENDING.

APPENDIX I

APPENDIX II

PRINCIPAL OFFICIALS INVOLVED IN THE GOVERNMENT'S INVESTIGATION OF THE FUND

	Tenure of office From	To
DEPARTMENT OF LABOR		
Office of the Secretary of Labor		
Secretary of Labor:		
Raymond J. Donovan	Feb. 1981	a/Present
Ray Marshall	Jan. 1977	Jan. 1981
William J. Usery, Jr.	Feb. 1976	Jan. 1977
Consultant to the Secretary:		
Eamon M. Kelly	Feb. 1977	June 1977
Office of the Solicitor		
Solicitor of Labor:		
Timothy Ryan	Feb. 1981	Present
Carin A. Clauss	Mar. 1977	Jan. 1981
Alfred Albert (acting)	Jan. 1977	Mar. 1977
William J. Kilberg	Apr. 1973	Jan. 1977
Associate Solicitor, Division of Plan Benefits Security:		
Monica Gallagher (note b)	Nov. 1977	Present
Steven J. Sacher	Feb. 1975	Aug. 1977
Counsel for SIS:		
Robert Gallagher (note b)	Oct. 1977	May 1980
Richard Carr	June 1978	May 1980
Special Litigation Task Force, Director:		
David H. Feldman	July 1981	Present
Richard O. Patterson (acting)	Mar. 1981	July 1981
Mike Stewart	Oct. 1980	Feb. 1981
Monica Gallagher (acting) (note b)	May 1980	Sept. 1980

	Tenure of office	
	From	To
Labor-Management Services Administration		
Assistant Secretary for Labor-Management Relations:		
Donald L. Dotson	May 1981	Present
William Hobgood	July 1979	Jan. 1981
Francis X. Burkhardt	Mar. 1977	Jan. 1979
Bernard E. DeLury	Apr. 1976	Feb. 1977
Deputy Assistant Secretary for Labor-Management Relations:		
Ronald J. St. Cyr	May 1981	Present
Hilary M. Sheply (acting)	Jan. 1981	May 1981
Rocco C. DeMarco	Apr. 1979	Aug. 1980
Administrator, Pension and Welfare Benefit Programs:		
Jeffrey Clayton	Dec. 1981	Present
Ian David Lanoff (note c)	May 1977	Dec. 1981
J. Vernon Ballard (acting)	Jan. 1977	May 1977
William J. Chadwick	Oct. 1976	Jan. 1977
James D. Hutchinson	June 1975	Oct. 1976
Deputy Administrator, Pension and Welfare Benefit Programs:		
Morton Klevan	Mar. 1980	Present
J. Vernon Ballard	Dec. 1974	Dec. 1979
SIS (note d)		
Director, SIS:		
Norman E. Perkins (acting)	Oct. 1977	May 1980
Lawrence Lippe	Dec. 1975	Oct. 1977
LMSA Investigation Staff--Chicago		
Administrator Area Office:		
Ronald Lehman (acting)	Dec. 1981	Present
James M. Benages	Apr. 1980	Nov. 1981
Rhonda T. Davis, Track supervisor (note e)	Apr. 1980	Present

APPENDIX II

	Tenure of office	
	From	To
DEPARTMENT OF JUSTICE		
Attorney General of the United States:		
William French Smith	Jan. 1981	Present
Benjamin R. Civiletti	Aug. 1979	Jan. 1981
Griffin Bell	Jan. 1977	Aug. 1979
Edward H. Levi	Feb. 1975	Jan. 1977
Assistant Attorney General, Criminal Division:		
D. Lowell Jensen	Apr. 1981	Present
Phillup Heymann	July 1978	Jan. 1981
John C. Keeney (acting)	May 1978	July 1978
Benjamin R. Civiletti	Mar. 1977	May 1978
Richard L. Thornburgh	July 1975	Mar. 1977
John C. Keeney (acting)	Jan. 1975	July 1975
Chief, Organized Crime and Racketeering Section:		
David Margolis	June 1979	Present
Kurt W. Muellenberg	Oct. 1976	Apr. 1979
William S. Lynch	Aug. 1969	Oct. 1976
Liaison, Justice-Labor:		
Jerald Toner	Dec. 1979	Present
Hamilton B. Fox	June 1979	Dec. 1979
David Slattery	Dec. 1975	June 1979
DEPARTMENT OF THE TREASURY		
Secretary of the Treasury:		
Donald G. Regan	Jan. 1981	Present
G. William Miller	Aug. 1979	Jan. 1981
W. Michael Blumenthal	Jan. 1977	Aug. 1979
Commissioner of Internal Revenue:		
Roscoe L. Egger, Jr.	Mar. 1981	Present
William E. Williams (acting)	Nov. 1980	Mar. 1981
Jerome Kurtz	May 1977	Nov. 1980
William E. Williams (acting)	Feb. 1977	May 1977
Donald C. Alexander	May 1973	Feb. 1977
Regional Commissioner--Midwest Region:		
Roger Plate	Oct. 1980	Present
Charles F. Miriani (acting)	Dec. 1979	Oct. 1980
Edwin P. Trainor	Oct. 1971	Dec. 1979

	Tenure of office	
	From	To
DEPARTMENT OF THE TREASURY (continued)		
District Director--Chicago:		
Donald E. Bergherm	Dec. 1979	Present
Charles F. Miriani	July 1979	Dec. 1979

a/Present means to December 1981.

b/Ms. Gallagher's and Mr. Gallagher's formal involvement in Labor's investigation of the Fund ceased in October 1980.

c/Because he was formerly counsel for the IBT union, Mr. Lanoff disassociated himself from Labor's investigation of the Fund, and therefore, Mr. Ballard and his successor acted in his place.

d/Labor abolished SIS on May 5, 1980, and transferred its personnel to the Office of the Solicitor and other units in LMSA.

e/Chicago staff also had seven other professionals on June 30, 1981.

APPENDIX III

THE FUND'S TRUSTEES AS OF OCTOBER 26, 1976

Employer trustees	Tenure From	Tenure To	Affiliations
1. Albert D. Matheson	(a)	10/76	National Automobile Transporters Labor Council
2. Thomas J. Duffey	6/62	10/76	Motor Carriers Employers Conference-Central States
3. John F. Spickerman, Sr.	2/62	4/77	Southeastern Area Motor Carriers Labor Relations Association
4. Herman A. Lueking, Jr.	12/66	10/76	Cartage Employers Management Association
5. William J. Kennedy	7/69	10/76	(a)
6. Jack A. Sheetz	4/67	10/76	Southwest Operators Association
7. Bernard S. Goldfarb	12/72	10/76	Cleveland Draymen Association, Inc., and Northern Ohio Motor Truck Association, Inc.
8. Andrew G. Massa	1/74	4/77	Motor Carriers Employers Conference-Central States
Union trustees			
1. Frank E. Fitzsimmons (note b)	2/62	4/77	General President, IBT union
2. Roy L. Williams (note c)	(a)	4/77	Central Conference of Teamsters, Central States Drivers Council, and IBT Local Union No. 41
3. William Presser (notes b and d)	(a) 2/76	2/75 (e)	IBT Local Union No. 410
4. Robert Holmes (note d)	4/67	10/76	IBT Local Union No. 337
5. Donald Peters (note d)	10/67	10/76	IBT Local Union No. 743

APPENDIX III

Union trustees	Tenure From	Tenure To	Affiliations
6. Joseph W. Morgan (note d)	4/68	10/76	Southern Conference of Teamsters
7. Frank H. Ranney	4/68	10/76	(Retired IBT official)
8. Walter W. Teague	9/74	10/76	Georgia-Florida Conference of Teamsters

a/Information not available from Labor.

b/Deceased.

c/In June 1981, Mr. Roy L. Williams was elected President of the IBT union succeeding Mr. Frank E. Fitzsimmons.

d/Also, International Vice President of the IBT union.

e/Mr. William Presser also served as trustee from February 1976 to about September 1976 when he resigned because he would not answer Labor's questions concerning his fiduciary duties and invoked his Fifth Amendment privileges under the U.S. Constitution.

Source: Department of Labor and the Fund.

THE FUND'S TRUSTEES FROM

OCTOBER 26, 1976, TO APRIL 30, 1977 (note a)

	Employer trustees	Tenure From	Tenure To	Affiliations
1.	John F. Spickerman, Sr.	2/62	4/77	Southeastern Area Motor Carriers Labor Relations Association
2.	Leroy L. Wade (note b)	10/76	4/78	National Automobile Transporters Labor Council
3.	Howard McDougall	10/76	Present	Cleveland Draymen Association, Northern Ohio Motor Truck Association, Inc., and Cartage Employers Management Association
4.	Andrew G. Massa	1/74	4/77	Motor Carriers Employers Conference--Central States
5.	Robert J. Baker	10/76	Present	Motor Carriers Employers Conference--Central States
	Union trustees			
1.	Frank E. Fitzsimmons (note b)	2/62	4/77	General President, IBT union
2.	Hubert L. Payne (note b)	10/76	7/78	Secretary Treasurer, IBT Local No. 519
3.	Loran W. Robbins	10/76	Present	President, Indiana Conference, Joint Council 69, and IBT Local No. 135
4.	Robert E. Schlieve (note b)	10/76	7/79	Secretary-Treasurer, IBT Local No. 563
5.	Roy L. Williams (note c)	(d)	4/77	Central Conference of Teamsters and IBT Local Union No. 41

a/Although the amendment to the trust agreement reducing the board from 16 to 10 was effective October 26, 1976, the new trustees were not appointed until October 29, 1976.

b/Deceased.

c/In June 1981, Mr. Roy L. Williams was elected President of the IBT union succeeding Mr. Frank E. Fitzsimmons.

d/Information not available from Labor records.

Source: Department of Labor and the Fund.

THE FUND'S TRUSTEES FROM MAY 1, 1977, TO DECEMBER 1, 1981

	Employer trustees	Tenure From	Tenure To	Affiliations
1.	Leroy L. Wade (note a)	10/76	4/78	National Automobile Transporters Labor Council
2.	Howard McDougall (note b)	10/76	Present	Cleveland Draymen Association, Northern Ohio Motor Truck Association, Inc., and Cartage Employers Management Association
3.	Robert J. Baker (note b)	10/76	Present	Motor Carriers Employers Conference-Central States
4.	Thomas F. O'Malley (note b)	4/77	Present	Motor Carrier Employers Conference-Central States
5.	Earl N. Hoekenga (note b)	4/77	2/78	Southeastern Area Motor Carriers Labor Relations Association and Southwest Operators Association
6.	Rudy V. Pulliam, Sr. (note b)	2/78	Present	Southeastern Area Motor Carriers Labor Relations Association and Southwest Operators Association
	Union trustees			
1.	Hubert L. Payne (note a)	10/76	7/78	Secretary-Treasurer, IBT Local No. 519
2.	Loran W. Robbins (note b)	10/76	Present	President, Indiana Conference, Joint Council 69, and IBT Local No. 135
3.	Robert E. Schlieve (note a)	10/76	7/79	Secretary-Treasurer, IBT Local No. 563
4.	Harold J. Yates (note b)	4/77	Present	President, IBT Local No. 120
5.	Marion M. Winstead (note b)	4/77	Present	President, IBT Local No. 89
6.	Earl L. Jennings, Jr. (note b)	10/78	Present	Southern Conference of Teamsters

a/Deceased.

b/Also, a trustee of the Teamsters' Central States, Southeast and Southwest Areas Health and Welfare Fund.

GAO note: As part of its December 2, 1981, comments on our draft report, the Fund gave us a copy of its Board of Trustees' resolution, approved August 5, 1979, which reduced the Board's members to eight (four appointed by the union and four by the employers).

Source: Department of Labor and the Fund.

THE TEAMSTERS' UNION ORGANIZATIONS AND TRUCKING ASSOCIATIONS THAT SELECTED THE FUND'S TRUSTEES TO OCTOBER 26, 1976

Number of employer trustees selected (note a)	Trucking associations making selections	Number of union trustees selected	Union organizations making selections
1	Southeastern Area Motor Carriers Labor Relations Association	(b)	Central Conference of Teamsters
1	Southwest Operators Association	(b)	Central States Drivers Council
1	National Automobile Transporters Labor Council	(b)	Southern Conference of Teamsters
1	Cleveland Draymen Association and Northern Ohio Motor Truck Association, Inc.		
2	Cartage Employers Management Association		
2	Motor Carriers Employers Conference-Central States	—	
Total 8		8	

a/Per information in Labor's records, the employer trustees were designated by the six trucking associations listed on the schedule.

b/Per information in Labor's records, the union trustees were designated jointly by the three organizations listed on the schedule.

THE TEAMSTERS' UNION ORGANIZATIONS AND TRUCKING ASSOCIATIONS THAT SELECTED THE FUND'S TRUSTEES FROM OCTOBER 26, 1976, TO AUGUST 15, 1979 (note a)

Number of employer trustees selected (note b)	Trucking associations making selections	Number of employer trustees selected	Union organizations making selections (note b)
1	Southeastern Area Motor Carriers Labor Relations Association and Southwest Operators Association	(c)	Central Conference of Teamsters
		(c)	Southern Conference of Teamsters
1	National Automobile Transporters Labor Council		
1	Cleveland Draymen Association, Northern Ohio Motor Truck Association, Inc.; and Cartage Employers Management Association		
2	Motor Carriers Employers Conference-Central States	—	
Total 5		5	

a/On October 11, 1976, the Board of Trustees approved a resolution, which was to be effective October 26, 1976, reducing the Board members to 10 (5 appointed by the union and 5 by the employers).

b/Per information in Labor's records, the employer trustees were designated by the four trucking organizations listed on the schedule.

c/Per information in Labor's records, the union trustees were designated jointly by the two organizations listed on the schedule.

THE TEAMSTERS' UNION ORGANIZATIONS AND TRUCKING ASSOCIATIONS THAT SELECTED THE FUND'S TRUSTEES FROM AUGUST 15, 1979, TO DECEMBER 1, 1981 (note a)

Number of employer trustees selected (note b)	Trucking associations making selections	Number of employer trustees selected	Union organizations making selections (note c)
1	Southeastern Area Motor Carriers Labor Relations Association and Southwest Operators Association	(c)	Central Conference of Teamsters
		(c)	Southern Conference of Teamsters
1	Cleveland Draymen Association, Northern Ohio Motor Truck Association, Inc.; and Cartage Employers Management Association		
2	Motor Carriers Employers Conference--Central States	—	
Total 4		4	

a/On December 2, 1981, the Fund gave us a copy of the August 15, 1979, resolution approved by the Board of Trustees, which was to be effective immediately, reducing the Board members to 8 (4 appointed by the union and 4 by the employers).

b/The Board's August 15, 1979, resolution also changed the trucking associations designating the trustees to the three associations listed on the schedule.

c/The Board's August 15, 1979, resolution retained the definition of the union in section 2, article 1 which designated the two conferences listed on the schedule to select the employee trustees.

Source: The Fund.

CLASSIFICATION OF FUND ASSETS

MANAGED BY EQUITABLE

AS OF OCTOBER 3, 1977, AND DECEMBER 31, 1980

The schedule below shows the Fund's investments Equitable took over at October 3, 1977, and at the end of 1980.

Classification	As of October 3, 1977 Amount	As of October 3, 1977 Percent of total funds	As of December 31, 1980 Amount	As of December 31, 1980 Percent of total funds	Increase or (decrease) from 10/77
	(millions)		(millions)		
Mortgage loans	$ 818.9	51.4	$ 514.1	17.9	$ (304.8)
Real estate	147.1	9.2	117.1	4.1	(30.0)
Subtotal	966.0	60.6	631.2	22.0	(334.8)
Common stock	117.9	7.4	1,114.4	38.9	996.5
Publicly trade bonds	402.4	25.3	773.4	27.0	371.0
Short-term obligations	51.4	3.2	263.5	9.2	212.1
Subtotal	571.7	35.9	2,151.3	75.1	1,579.6
Horizon Communication, Inc.	29.7	1.9	40.6	1.4	10.9
Interest Guarantee contracts	20.0	1.3	32.1	1.1	12.1
Cash and short term (new funds)	4.8	.3	10.3	.4	5.5
Subtotal	54.5	3.5	83.0	2.9	28.5
Total	$1,592.2	100.0	$2,865.5	100.0	$1,273.3

Source: Monthly reports by Equitable submitted to the Fund and Labor.

Note: The dollar amounts and percentages will not reconcile in all cases because of the rounding off process.

APPENDIX X

THE FUND'S ASSETS CONTROLLED BY

THE INVESTMENT MANAGERS AS OF DECEMBER 31, 1980

	Dollars	Percent	Total funds	Percent of total funds
Real estate investment management contracts				
Equitable:				
Mortgage loans	167,979,068	5.8		
Owned real estate	68,306,966	2.4		
Total	236,286,034	8.2		
Victor Palmieri and Company:				
Mortgage loans	346,102,283	12.1		
Owned real estate	48,777,025	1.7		
Total	394,879,308	13.8		
Subtotal			$ 631,165,342	22.0
Securities investment management contracts				
American National Bank	65,200,741	2.3		
Crocker Investment Management Company	198,105,581	6.9		
Lazard Freres & Company	170,186,800	5.9		
Mercantile National Bank at Dallas	110,616,494	3.9		
Equitable Life	601,372,196	21.0		
Harris Trust & Savings Bank	230,033,637	8.0		
Massachusetts Financial Services	240,213,569	8.4		
Mellon National Bank	131,365,850	4.6		
Bankers Trust Company	179,293,137	6.3		
State Street Bank	121,308,796	4.2		
BEA Associates	51,346,408	1.8		
Oppenheimer	49,515,981	1.7		
State Street - STIF Fund	2,702,536	.1		
Subtotal			2,151,261,726	75.1

APPENDIX X

	Dollars	Percent	Total funds	Percent of total funds
Other asset management				
Equitable-Group Annuity Contracts	$32,135,416	1.1		
Equitable-Horizon	40,592,625	1.4		
American National Bank-New Funds Account	10,343,702	.4		
Subtotal			$ 83,071,743	2.9
Total assets under fiduciary management			$2,865,498,811	100.0

Source: Monthly Equitable report for December 1980 submitted to Labor and the Fund.

Note: The dollar amounts and percentages will not reconcile in all cases because of the rounding off process.

STATUS OF LABOR'S CIVIL SUIT AGAINST FORMER TRUSTEES AND OFFICIALS TO RECOVER LOSSES RESULTING FROM THEIR ALLEGED MISMANAGEMENT

On February 1, 1978, Labor filed a civil suit in the U.S. district court for the Northern District of Illinois, Eastern Division, 1/ against 17 former Fund trustees and 2 officials 2/ to recover losses resulting from their alleged mismanagement and breaches of their fiduciary duties.

The Secretary of Labor filed the suit against the former trustees and officials under the authority of section 502(a)(2) of ERISA, which authorizes him to bring a civil action seeking appropriate relief from any fiduciary who breaches any of the responsibilities, obligations, or duties imposed on fiduciaries by title I of ERISA. Labor's suit alleges that the defendant trustees, by their mismanagement of Fund assets and in breach of their fiduciary duties, have caused great financial harm to the plan and its participants and beneficiaries.

According to the complaint, the defendant trustees allegedly breached their fiduciary obligations under ERISA by failing to manage the Fund solely in the interest of its participants and beneficiaries and with the care, skill, prudence, and diligence that a prudent person would, by, among other things:

--Failing to adhere to procedures designed to, and which would ensure that, adequate information was available to them to consider when making decisions in managing plan assets.

--Failing to employ, retain, and consult with an adequate staff of persons whose professional background, skill, and experience would enable them to make appropriate recommendations in managing plan assets.

--Entering into commitments to disburse, and disbursing plan assets, for ventures as to which they had, at the time of such action, insufficient information to make a prudent judgment as to the economic feasibility of such ventures, the degree of risk and the probable security of plan assets devoted thereto.

1/See footnote 1, page 11.

2/See footnote 2, page 28.

--Failing to enforce the plan's right to compliance, by borrowers of plan assets, with the terms of loan agreements and other undertakings, when compliance with such undertakings by the borrowers would have tended to benefit the plan.

--Modifying agreements controlling the obligations of borrowers of plan assets, granting moratoria on the payment of principal and interest required by such original agreements, and making new extensions of credit and otherwise restructuring the terms of such agreements to the advantage of borrowers and the disadvantage of the plan, when such modifications were not calculated to increase the likelihood of repayment, the value of the plan's security or the return on its investment.

--Failing to monitor the use of loan proceeds by borrowers of plan assets.

--Causing the payment of plan assets to persons and, on behalf of persons, having no claims against the plan and without consideration to the plan.

ALLEGED FIDUCIARY VIOLATIONS

In its February 1, 1978, complaint, Labor listed 15 transactions as examples of the alleged fiduciary violations. On April 21, 1981, Labor filed a motion to amend the complaint to add 9 additional transactions to the previous 15 examples of alleged imprudence by the defendants. The 24 allegedly imprudent transactions consisted of 19 real estate mortgage and collateral loans and 1 loan commitment to the following entities or individuals and 4 other financial transactions to individuals.

	Amounts of transactions involved (millions)	
ALSA Land Development Corporation	$ 3.1	loan
Alvin and Deborah Malnik	2.2	loan
C&S Golf and Country Club	4.5	loan
Hyatt Corporation	30.0	loans
Indico Corporation	7.0	loans
Moorefield Enterprises Limited Partnership	16.2	loan
Telesis Corporation	28.0	loans and investment in stock
National Development Corporation	4.0	loan
Valley Die Corporation	.3	loan guaranty
Beverly Hills, California Health Club	.1	loan
Argent Corporation	25.0	loan
I.J.K. Nevada, Inc.	1.5	loan repayment
Aladdin Hotel Corporation	39.0	loans
Drake Hotel	4.2	loans
Hudson Properties	15.6	loans
La Costa Land Company, Inc., and Rancho La Costa, Inc.	67.0	loans and investments in stock
M&R Investment Company	40.0	commitment fee
Penasquiotas	100.0	loans and stock
UFLIC Reis Corporation	9.0	loans
Washlands, Inc.	7.0	loans
Total (value of 20 transactions)	$403.7	

Source: Department of Labor

The four other financial transactions included in the complaint involved the trustees' payments of large sums of money (amounts were not listed) by the plan to several individuals and entities (Alvin Baron, S. H. Stern, James M. Payton, and James Eckenburg and Hestba, Inc.) who, according to the complaint, had no legal claim or entitlement to the payments, and the trustees' failure to adequately protect the plan's rights and interests in property leased to Lorrin Industries, Inc.

Labor intends to recover losses the Fund incurred or is expected to incur. Labor did not estimate the Fund's past or future losses because of the nature of the real estate market, the lack of specific information on the current status of some investments, and the fact that many investments would not mature until some time in the future. Labor stated that it will identify losses during litigation and will not make a firm estimate of the losses until the suit is scheduled for trial.

STATUS OF CIVIL SUIT

Labor said there were numerous delays during the first 2 years of the litigation, due to (1) discovery disputes among Labor, the defendants, and the Fund and (2) the fact that the case was assigned and reassigned to four different judges. In addition, Labor said the case has been complicated by the consolidation of discovery with the discovery in several other suits involving the Fund which were brought by private litigants.

Labor said the case has now been permanently assigned to a U.S. district judge, and on April 21, 1981, Labor filed a motion to amend the complaint to (1) add nine more loan transactions to the case as an example of the defendants' alleged imprudence, (2) add the Fund (an entity distinct from its former officials) as a party to the litigation, and (3) clarify that the case seeks injunctive relief in the form of modified investment procedures for the Fund, in addition to monetary recovery from defendants.

On October 7, 1981, the court issued an order granting and denying, in part, the provisions of Labor's April 1981 motion. The court (1) permitted Labor to specify the nine additional loan transactions in the complaint and (2) authorized Labor's request to specify the injunctive and equitable relief it sought. The court, however, rejected Labor's proposal to include the Fund as a defendant to the suit.

In addition, the court severed the nine additional transactions from the complaint and ordered a separate trial for them. It also stayed discovery on the nine transactions pending completion of the trial on the 15 transactions in the original complaint. Also, while permitting Labor access to the Fund's microfilmed documents on the nine additional transactions and certain other transactions, the court indicated Labor could not introduce into evidence or otherwise rely upon these additional documentary materials during the trial on the original complaint.

Labor, because it believes certain aspects of the court's order are based upon misimpressions of fact, submitted a motion on October 22, 1981, requesting the court to reconsider, clarify, and amend its October 7 order. As of December 1, 1981, the court had not ruled on Labor's motion.

LIST OF HEARINGS HELD, AND REPORTS ISSUED, FROM JULY 1, 1976, TO JUNE 30, 1981, BY CONGRESSIONAL SUBCOMMITTEES ON THE GOVERNMENTS INVESTIGATION OF THE FUND

Hearings

1. "Investigation of Alleged Irregularities in the operation of the Teamsters' Central States Pension Fund", Subcommittee on Labor, Senate Committee on Labor and Public Welfare, 94th Congress, 2nd session, July 1, 1976.

2. "Federal Pension Law Enforcement in case of Teamsters' Central States Pension Fund," Subcommittee on Oversight, House Committee on Ways and Means, 95th Congress, 1st Session, March 14 and 15, 1977.

3. "Federal Pension Law Enforcement in case of Teamsters' Central States Pension Fund", Subcommittee on Oversight, House Committee on Ways and Means, 95th Congress, 1st Session, April 5 and July 19-20, 1977.

4. "The Teamsters Central States Pension Fund," Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, 95th Congress, 1st Session July 18 and 19, 1977.

5. "Central States Teamster's Fund," Subcommittee on Oversight, House Committee on Ways and Means 95th Congress, 2nd Session, March 22, 1978.

6. "Central States Teamsters Fund", Subcommittee on Oversight, House Committee on Ways and Means, 95th Congress, 2nd Session July 17-18, 1978.

7. "Central States Teamsters Pension Fund," Subcommittee on Oversight, House Committee on Ways and Means, March 24, 1980.

8. "Teamsters Central States Pension Fund, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, 95th Congress, 2nd Session, August 25-26 and September 29-30, 1980.

Report

1. "Interim Report of the Permanent Subcommittee on Investigations Regarding Its Oversight Inquiry of the Department of Labor's Investigation of the Teamsters Central States Pension Fund." Senate Report 97-122, 1st Sess. 97th Cong. May 1981.

Reports

1. Interim report of the Permanent Subcommittee on Investigations regarding its "Oversight Inquiry of the Department of Labor's Investigation of the Teamsters Central States Pension Fund," Senate Committee on Governmental Affairs, Senate Report 97-122, 97th Congress, 1st Session, May 1981.

2. Final report on "Oversight Inquiry of the Department of Labor's Investigation of the Teamsters Central States Pension Fund," Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, Senate Report 97-177, 97th Congress, 1st Session, August 1981.

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.

OCT 26 1981

Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
Washington, D. C. 20548

Dear Mr. Comptroller General:

This is in reply to Mr. Ahart's letter dated October 8, 1981, requesting comments on the draft GAO report entitled "Inadequate, Ineffective, and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund." 1/ In view of the importance of the matters contained in the report, I felt it appropriate to address this response to you.

At the outset, I would like to applaud the great effort that went into preparing this report, which will be of meaningful assistance to the Department in its future work on matters involving the Pension Fund.

The Department agrees with the thrust of your report and recommendations. Indeed, because your recommendations comport entirely with my determination to enforce ERISA vigorously and to cooperate fully with other agencies having coordinate enforcement responsibilities, many of them have already been independently implemented at my instance.

For example, on March 4, 1981, I met with the Attorney General and the Secretary of the Treasury to discuss coordination of our efforts in this area. Each of us recognized that this had been a problem in the past. As a result of this meeting, a high level task force consisting of representatives from all three departments was created and, since March, has met on more than twenty occasions. Through these meetings, we have been able to maintain communication, assure interdepartmental cooperation, and coordinate activities. Recently, the three department heads met again and renewed our pledge of coordination.

1/The report is now entitled "Investigation To Reform Teamsters' Central States Pension Fund Found Inadequate."

APPENDIX XIII

These and other recent developments are not detailed in the report, and they need not be. Rather, the final report and recommendations should be prefaced by a statement that they address primarily events that took place in the past. Specifically, the statement should indicate that the investigation that led to the report's issuance was essentially concluded by mid-1980 and dealt principally with the events of the mid-1970's.

In short, the report should not purport to be a summary or evaluation of what is happening now. If the report were to suggest that it does address the present, it would be misleading. For these reasons, the Department requests that the final version of the report specify clearly the time periods applicable to the events described and expressly disavow any intention to comment on activities occurring after your thorough investigation.

Similarly, inasmuch as the report deals with the events of the past, the Department believes that it would not be productive to address its accuracy in detail. We do believe, however, that it is important for the Department to respond specifically to your recommendations for the future, and we have done so in a separate document, which is enclosed. I would only reiterate here that the Department supports these recommendations in large measure.

I appreciate the opportunity to comment on this report, and I hope that this letter and the Department's response will assist you in discharging your responsibilities to the leadership of the Permanent Subcommittee on Investigations. Please let me know if the Department can be of further assistance to you.

Sincerely,

Raymond J. Donovan

Raymond J. Donovan

cc: Honorable William French Smith
Honorable Donald T. Regan
Mr. Gregory J. Ahart

U. S. DEPARTMENT OF LABOR'S RESPONSE TO THE DRAFT GENERAL ACCOUNTING OFFICE REPORT ENTITLED -- "INADEQUATE INEFFECTIVE AND UNCOORDINATED INVESTIGATION TO REFORM THE MULTI-BILLION DOLLAR TEAMSTERS' CENTRAL STATES PENSION FUND" 1/

1/See footnote 1 on page 147.

APPENDIX XIII

Recommendation (page 51):

To help maintain effective coordination between Labor and Justice, we recommend that the Secretary of Labor and Attorney General take action to have their December 1978 coordination agreement revised to define the "higher officials" who should or would resolve the litigation strategy problems the working group members cannot resolve, or in lieu of that, consider reestablishing an Interdepartmental Policy Committee similar to the one established in 1975.

Response:

The Department concurs with the goal of this recommendation. The establishment of the high level task force, discussed in our accompanying letter, responds to this concern about lack of coordination. The task force is made up of Secretary of Labor Donovan, Attorney General Smith and Secretary of the Treasury Regan. The task force working group is chaired by the Solicitor of Labor, and includes representatives of the Internal Revenue Service, the civil and criminal divisions of the Department of Justice (including the Organized Crime Strike Force), and the relevant program agencies within the Department (including the Labor Management Services Administration). Others have been invited to attend particular meetings depending on the topics discussed.

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 55):

To ease another continuing coordination problem, we recommend the Secretary emphasize to the Solicitor's Office the need for Labor to fully cooperate with Justice's Criminal Division by providing attorney analyses on various Fund transactions which indicate potential criminal violations. We further recommend that the Attorney General caution the Justice attorneys that these are internal drafts and should be treated as such.

Response:

The Department concurs. The Department recognizes its obligation to provide to the Department of Justice information which may be found to warrant consideration for criminal prosecution. Investigators are aware of the criminal provisions of ERISA, and are instructed to be alert to possible uses of information for criminal investigations. Pursuant to that practice, the Department will continue to make all relevant information, including attorney analyses of Fund transactions, available to the Department of Justice. In certain instances where attorney analyses are privileged and sensitive, or where uncontrolled disclosure to or by the Department of Justice might jeopardize ongoing litigation, we have, with the agreement of the Department of Justice, imposed safegards on such disclosures.

1/See footnote 1 on page 147.

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 51):

In view of the continuing controversy on the actual referrals Labor made to Justice, we recommend that the Secretary of Labor direct the Solicitor's Office to establish a formal system to document referrals of potential criminal violations to Justice.

Response:

The Department does not concur with this recommendation, because a formal system already exists and an effective informal system is also being utilized. When an investigator discovers possible criminal violations, a memorandum is prepared to LMSA's National Office of Enforcement through the Area Administrator. The National Office then contacts the Justice Department representative, and in a meeting or by telephone, they determine the appropriate approach to follow. When cases involving criminal matters are determined to be appropriate for referral to Justice, a formal referral memorandum is sent. In addition, there is an informal system of contacts between the Justice and Labor Departments in Washington and in the various regions throughout the country. See response to Recommendation at pages 153 and 154 below.

1/See footnote 1 on page 147.

APPENDIX XIII

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 51):

Finally, we recommend that the Secretary also direct the Solicitor's Office to carry out the recommendations in the Kotch-Crino report to honor the memorandum of understanding (agreements) with Justice, by (1) establishing a formal written system of referring potential criminal violations to Justice, (2) suggesting a single Justice coordinator for all Fund activities, (3) establishing procedures wherein Justice periodically orients and briefs Solicitor's Office officials, (4) suggesting one designated receiver in Justice for all Fund records, and (5) establishing a system wherein the Solicitor's Office automatically forwards to Justice pertinent additional records regarding any matter previously referred.

Response:

The Department concurs in part, as stated below. This recommendation contains 5 parts. As to part (1), we note that there is a formal written system for referring criminal violations to the Department of Justice. In the context of the Central States Teamsters' investigations and litigation, the need for cumbersome formal referrals has been obviated by the close coordination that exists between the departments. Thus, materials which might be relevant to ongoing grand jury proceedings or other criminal investigations are forwarded directly to the individuals at the Department of Justice who can put the information to best use, and the transfer of information is recorded in an appropriate manner. We believe that prudent management of our

1/See footnote 1 on page 147.

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coordinate law enforcement responsibilities is best served by this more direct transfer of information. As to parts (2), (3) and (4), the Department notes that it is certainly willing to cooperate with any designated Justice Department officials. Of course, this Department cannot respond directly to the willingness of Justice to implement this recommendation; Justice will have to do that. We do note, however, that in Chicago, DOJ has specified one representative with whom the investigative track supervisor meets on a regular basis. Moreover, task force representatives have been designated by DOJ. As to part (5), the Department believes that the current system of cooperation satisfies the concerns of the report.

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U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

The next four recommendations have been combined for purposes of response.

Recommendation (page 67):

In view of the continuing concern over the influence and control of the current trustees and the Fund's operations by the former trustees who allegedly mismanaged the Fund, we recommend that the Secretary and Commissioner establish criteria and qualifications requiring that future Fund trustees be independent, professional, and neutral, etc.; closely monitor the selection of future trustees; and veto the selection of a trustee not meeting the criteria.

Recommendation (page 83):

To help assure that the Fund is operated and managed prudently and for the exclusive benefit of the plan participants and beneficiaries, as required by ERISA, we recommend that the Secretary and Commissioner obtain a commitment from the trustees for (1) the Fund to continue to have an independent investment manager to control and manage the Fund's assets and investments after the present managers' contracts expire in October 1982, and (2) to use the same selection criteria and qualifications as in the past--independent, professional expertise and national stature--should the trustees decide to replace the present investment managers after October 1982.

Recommendation (page 83):

We further recommend that the Secretary and Commissioner consider obtaining a further commitment from the trustees to reorganize the way the Fund handles and controls the employer contributions and its other moneys to remove the trustees' control over any of these funds. The proposed reorganization should provide for

> --the Fund to employ a financial custodian--an independent bank or other financial institution--with professional expertise and national stature--to receive and control all moneys due the

1/See footnote 1 on page 147.

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Fund, and pay the Fund's administrative expenses and pension benefits, retain an appropriate reserve, and turn over the remainder to the investment managers;

--IRS and Labor to have a veto power over the selection of the independent investment manager and financial custodian, if the trustees' selections do not meet the Government's qualifications; and

--Limiting the trustees' role and responsibilities to establishing overall investment objectives, determining eligibility requirements for pension benefits and employers' contributions, monitoring the investment managers' and custodian's activities, and administering relevant collective bargaining requirements.

Recommendation (page 84):

We further recommend that the Secretary and Commissioner take action to assure that the above proposed reorganization, and any other reforms imposed on the Fund, be included in a formal, written, enforceable agreement signed and agreed to by Labor and IRS and the Fund's trustees.

Response:

The Department concurs with each of the goals expressed in these recommendations, and is attempting to achieve them. It must be understood, however, that neither the Department nor any other federal agency may unilaterally require--through regulation, order, or otherwise--the safeguards recommended. There are only two ways to achieve enforceable requirements regarding independent trustees, independent asset management, a limited role for trustees, and similar reforms: a voluntary undertaking by the trustees incorporated in a consent decree, or the imposition

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of a court order following successful litigation. The Department has vigorously pursued both courses.

First, it has proposed a consent decree (a copy of which is attached) 1/ making mandatory and judicially enforceable the reforms that GAO has recommended. Unfortunately, the Fund has declined to enter into the decree, and has stated it will not agree to any consent decree absent a full settlement which would include large and entirely unacceptable concessions by the government.

Second, the Department has instituted and will continue to pursue litigation to achieve the aims set forth in the recommendations. Litigation is generally a protracted process; it is particularly so here where the present and former trustees as well as the Fund are represented by experienced counsel, who have missed no opportunity to contest every claim, request or motion (including those seeking discovery) brought by the Department. Notwithstanding this vigorous defense, the Department has made substantial progress in the cases: more than 70 people have been deposed, almost 2,000,000 pages of documents have been reviewed, and actions are proceeding in Chicago and Tallahasee against former and present trustees.

1/We have excluded the consent decree because it is a draft and subject to change during further negotiations between Labor, IRS, and the Fund.

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U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 84): 2/

Should the Fund trustees refuse to voluntarily go along with the above reforms, we recommend that the Secretary and Commissioner consider whether such a decision, along with any evidence of misconduct that may be developed during the current investigation, warrants speedy and appropriate litigative action, as authorized by ERISA, against the trustees to require retention of an independent professional manager beyond the October 1982 contract termination date, and the other, or similar, reforms suggested above.

Response:

The Department concurs. As noted in the response to recommendations at pages 67, 83, and 84 of the report, we have sought through extended negotiations a decree by consent which would be enforceable in court and responsive to the concerns outlined by this report. Moreover, litigation is not only contemplated, it is underway. Substantial resources have been and continue to be invested in the cases which surround the Central States Teamsters' Pension and Health and Welfare Funds. A full-time litigation unit, headed by an Associate Solicitor of Labor who is an experienced and aggressive litigator (and who reports directly to the Solicitor), and staffed by a team of outstanding lawyers, is devoted exclusively to Central States litigation.

1/See footnote 1 on page 147.

2/This recommendation has been deleted from the final report.

APPENDIX XIII

It is, of course, impossible to predict the outcome of hard-fought litigation. But it can be stated emphatically that the Department is prepared to press litigation in the current actions aggressively, and to file new actions as necessary, to ensure to the fullest extent possible that the substance of the recommended reforms can be achieved.

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 102):

To assure that past mistakes identified in our review, as well as Labor's internal reviews, are not repeated in the current investigation, we recommend that the Secretary of Labor and the Commissioner of Internal Revenue direct their respective investigative staffs to more closely cooperate to prevent coordination problems, duplication between the investigators and giving the Fund an excuse not to cooperate because the Government is not speaking in one voice.

Response:

The Department concurs. The Department and Internal Revenue Service (IRS) staffs are currently fully cooperating on the investigations. Each agency reviews the Fund's documents for its own purposes, i.e., the IRS for considering tax qualification issues and this Department for determining fiduciary violations. When one of these agencies requests that a document be provided by the Fund, the other agency is accorded an opportunity to review that document for its purposes prior to the document being returned to the file. In this way the Fund need not retrieve and produce the same document twice. Moreover, since the staffs generally sit in the same room during the review process, there are constant discussions so that any problems are resolved quickly. As far as we are aware, the Fund has no difficulty with the present procedure, and both the Department and IRS find it to be fully satisfactory as well.

1/See footnote 1 on page 147.

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 102):

Further, in view of the past controversy over the size and use of the B&A account, we recommend the Secretary and Commissioner direct their investigative staffs to review the trustees' management and use of the B&A account to determine the appropriate reserve the Fund should maintain in the account.

Response:

The Department concurs with the goal of this recommendation. However, achieving control over those monies which would be under the direct control of the trustees must be approached in the context of the other recommendations and actions of the Department. The consent decree proposed by the Department would have set a cap on the amount of monies which could be retained by the trustees in the "B&A" accoun and would have imposed further restrictions on the uses of the funds and the manner in which they may be invested. But, as noted in our response to the recommendations on pages 67, 83, and 84 of the report, the Fund declined to enter into such an agreement. Moreover, there are obvious difficulties associated with achieving these goals quickly through litigation. It should be pointed out, however, that partly because of the pressures exerted upon the Fund by the Department, such restrictions may be voluntarily imposed. The Department will continue to vigorously pursue all available avenues to achieve these goals.

1/See footnote 1 on page 147.

U. S. Department of Labor's Response to the Draft General Accounting Office Report Entitled -- "Inadequate Ineffective and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund" 1/

* * *

Recommendation (page 103):

We recommend also that during its current investigation at the Fund, the Secretary of Labor direct LMSA to

> --Assure that the unresolved matters from the 2/ initial investigation are thoroughly investigated and resolved. In particular, LMSA should review questions of possible improprieties of payments made to former and current Fund trustees and officials and to service providers including those made prior to January 1977, and coordinate this work with Justice because of the potential criminal nature of certain transactions.
>
> --Assure that the LMSA Chicago staff performing the investigation receive proper training, and use all investigative techniques and procedures, in particular third party interviews, to detect and develop potential criminal violations for referrals to Justice.
>
> --Effectively coordinate its investigation efforts with the Solicitor's Office.

Response:

The Department concurs in substantial part with the goals of this three part recommendation. In fact, to the extent of the Department's concurrence, these goals have already been achieved.

The only part of the recommendation that the Department does not concur in is the first, which urges that investigations of matters that were not resolved by the initial

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1/See footnote 1 on page 147.

2/This recommendation is now on page 105 of the final report.

investigation be reinstituted. The Department does not know of any usable evidence of fraud or concealment in connection with payments made to Fund trustees and officials, and thus the Department's right to bring a lawsuit with respect to these payments is questionable. See ERISA § 413, 29 U.S.C. § 1113. Under these circumstances, the Department believes that prudent management of its law enforcement resource requires that investigations of current activities -- in which there is a much higher likelihood of successfully commencing litigation -- be pursued, rather than reopening 4 to 5 year-old, stale investigations in cases where the chances of ever being able to bring lawsuits are slim. Nevertheless, the Department should point out that in response to its actions, including the constant threat of intervention, the Fund itself has filed a number of lawsuits to recover losses that occurred during this period.

Next, the Department believes that it has achieved the goal of the second part of this recommendation, that is, assuring that the LMSA Chicago staff is prepared and able to meet its responsibilities in the criminal area. The LMSA staff in Chicago is well-trained and highly competent. The staff of the Solicitor's Office has made itself available to assist in developing plans for sworn testimony and interviews.

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Moreover, third parties are being interviewed and, where necessary, their stenographic statements are being taken under oath. Attorneys from the Solicitor's Office sit in on these proceedings whenever it appears that their presence would be helpful.

It should be emphasized that the Department has a firm policy, consistent with ERISA § 506, that information which may warrant consideration in a criminal context be forwarded to the Department of Justice. As we noted above, the Department believes that its staff is complying with this policy and statutory requirement in an exemplary fashion.

Finally, the Department believes that it has also met the goal of the third part of this recommendation. The Solicitor has greatly improved communications between the agencies within the Department which have responsibilities for various aspects of the Central States Teamsters' investigations and litigation. Whatever problems may have occurred in the past, the relationship between the Solicitor's Office and its client agencies is now one of cooperation rather than confrontation. Members of the Special Litigation Task Force ("SLTF") are in daily communication with the investigators and policymakers at PWBP and, as noted above, PWBP

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representatives regularly attend the high level litigation strategy meetings. Further, memoranda concerning ongoing investigations are often forwarded at the draft stage to the SLTF for comment. Likewise, the input of PWBP is frequently sought in the preparation of pleadings and memoranda by the SLTF.

U.S. Department of Justice

Washington, D.C. 20530

NOV 17 1981

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

This is a response to your letter of October 8, 1981, to the Attorney General asking for comments from the Department of Justice on your draft report concerning the Government's investigation of the Teamsters' Central States Pension Fund, hereafter referred to as the "Fund."

Because the major portion of the draft report deals with matters arising from the civil investigation of the Fund by the Department of Labor and the Internal Revenue Service (IRS), we anticipate that these matters will be fully discussed in separate responses from the Labor Department and IRS. Further, the Secretary of Labor has testified concerning these matters during his appearance before the Senate Permanent Subcommittee on Investigations on October 28, 1981. Therefore, the following comments are directed primarily at the recommendations addressed to the Department of Justice in Chapter 5 of the draft report.

1. Resolution of Litigation Strategy Problems

With respect to the recommendation that the Secretary of Labor and the Attorney General take action to define the "higher officials" who would resolve litigation strategy problems, or consider "reestablishing" an Interdepartmental Policy Committee similar to the one established in 1975, we note that the signatories of the letter which embodied the December 1978 coordination agreement, to which the draft report refers, were the former Assistant Attorney General of

APPENDIX XIV

the Criminal Division and the former Assistant Secretary of Labor for Labor Management Relations. We have therefore assumed that the officials in these two positions would become involved in the resolution of any major litigation strategy problems which the mid-level working group members could not resolve. Indeed, during the past year the Assistant Attorney General, Criminal Division or his representatives, which often included the Chief of the Organized Crime and Racketeering Section, met personally on several occasions with the Solicitor of Labor in order that the Solicitor of Labor could advise them directly concerning the present status of civil litigation being currently pursued by the Department of Labor against the Fund and former trustees of the Fund. The former Acting Assistant Attorney General of the Civil Division and his representatives have also attended these meetings. The Attorney General and Associate Attorney General have been briefed personally by the Secretary of Labor and the Solicitor concerning these matters.

As the former Deputy Assistant Attorney General, Criminal Division, testified in March 1980, before the Subcommittee on Oversight, House Committee on Ways and Means, whose hearings are referred to by the draft report, the role of the Department of Justice under the Employee Retirement Income Security Act (ERISA) is limited. The primary thrust of the statute is the protection of employee benefit plan participants through civil means, with the Secretary of Labor possessing broad enforcement power. However, criminal prosecutions, which are the responsibility of the Department of Justice, are an important complement to these civil remedies and, of course, can reach many other kinds of labor racketeering not covered by ERISA. As the former Deputy Assistant Attorney General also testified in 1980, although there may have been friction in the past between the Departments of Justice and Labor concerning the coordination of parallel criminal and civil investigations of the Fund, the parallel investigations appeared to be proceeding smoothly. We have had no reason to change our view since March 1980. We believe that the mid-level working group has been able to deal with any problems of coordination which have not already been resolved at the operational, investigative levels in the field. We believe that coordination has been facilitated by the dissemination to field personnel of written guidelines concerning cross-notification between the two Departments prior to the initiation of court action, use of subpoenas, depositions, etc. The higher officials in the Department of Justice, whom I have mentioned, have been and will continue to be available to resolve coordination problems which can not be satisfactorily resolved at lower levels.

2. Labor Department Attorney Analyses

In regard to the recommendation that the Solicitor of Labor provide the Criminal Division with attorney analyses of various Fund transactions which indicate potential criminal violations, I am advised that the incident to which the draft report refers resulted in the Department of Justice attorney obtaining access to the material which he sought to review and copies of the particular analyses which he thought were relevant to his investigation. With respect to the use of the Labor Department analyses by Justice Department attorneys, we note that internal Government memoranda of this kind would normally be exempt from discovery in a criminal prosecution under Rule 16 of the Federal Rules of Criminal Procedure, subject, of course, to the duty of Government prosecutors to disclose any underlying exculpatory material within the control of the Government and not otherwise available to a criminal defendant.

3. Formal System of Criminal Case Referrals

The Department of Justice favors any system which assists in the accurate tracking of criminal case referrals and is willing to assist in the improvement of systems now in effect. The Special Investigations Task Force which is currently in charge of the Labor Department's litigation involving the Fund has been careful to furnish all such referrals in writing. We would expect that any such referrals would continue to be directed to the Chief of the Organized Crime and Racketeering Section, Criminal Division. We favor the format now used by the Office of Pension and Welfare Benefit Programs, namely, a summary report of investigation which lists witnesses, documents and their location, and appropriate field personnel who can be contacted for further details.

With respect to the draft report's tally of case referrals involving Fund loans, we note the report states at page 48 that only one of the "formal referrals" was still under criminal investigation as of August 1980. Our letter of August 18, 1980, to your office, however, indicated that seven of the eleven matters were still under investigation at that time. At page 46, the draft report discusses an additional 15 matters involving 14 Fund loans which were investigated and/or prosecuted by the Justice Department during 1978-1981. The report states that eight of these matters had been closed without indictment as of June 1981.

Our correspondence with your office, however, indicates the following tally with respect to the 15 matters as of June 1981: one conviction, one acquittal, one dismissal, one trial, five open investigations, two open investigations that were likely to be closed, and four matters closed without indictment.

We emphasize that the above matters relate directly or indirectly to Fund loans. As of the date of our last correspondence with your office on June 23, 1981, thirteen matters, which directly or indirectly involved the Fund, including loan matters, were the subject of criminal investigation by the Department of Justice.

4. Single Justice Department Coordinator

In regard to the draft report's recommendation that there be a single Justice Department coordinator "for all Fund activities," we note that the Chief of the Organized Crime and Racketeering Section, Criminal Division, is the responsible official who currently acts as the coordinator for all criminal investigations relating to the Fund. The Director of the Federal Programs Branch for General Litigation, Civil Division is currently responsible for the oversight of civil litigation involving the Fund pursuant to the Memorandum of Understanding between the Department of Justice and Labor, dated December 1, 1975. We believe that this arrangement represents an appropriate division of responsibilities.

5. Procedures For Justice Orientation and Briefing of the Office of the Solicitor of Labor

In testimony before the House Oversight Subcommittee in 1980, to which we have referred above, the Criminal Division advised that it was prepared to provide any assistance requested by the Labor Department to familiarize civil investigators with the kind of activities which may constitute a potential criminal violation. Subsequently, attorneys from the Criminal Division met in Washington, D. C. with personnel from the Labor Department's Area Offices to brief them on developments in the Federal criminal law governing employee benefit plans. This presentation was similar to that provided to criminal investigators in the Office of the Inspector General, Department of Labor, and the Federal Bureau of Investigation. Moreover, information of this kind has routinely been furnished to representatives of the Solicitor's Office by means of the mid-level working group.

With respect to the draft report's statement that no "target list of organized crime names and activities" was provided during the Special Investigation Staff's investigators of the Fund, we have no way of determining precisely what information may have been referred to Labor investigation at the operational level concerning prior criminal investigations of the Fund. While the Department of Justice has apprised labor investigators and attorneys of persons who were the subjects of overt criminal investigation, that is, investigation not involving electronic surveillance or undercover operations, there are valid reasons why criminal prosecutors should not attempt to direct the tactical focus of parallel civil investigations, and especially where such investigations have resulted in litigation. Such direction leaves the Government open to the charge that it has improperly used criminal investigative procedures in order to pursue the civil case or that it has otherwise abused the rule of secrecy surrounding grand jury proceedings.

6. Single Justice Department Receiver for All Fund Records

Although we are willing to assist the Labor Department in tracking the transfer of Fund documents between the two Departments, we object to the routine physical transfer of all Fund records through a receiver at the Department of Justice in Washington, D. C. or any other single location. We believe that such a procedure, if required in all cases, would greatly impair the ability of personnel at operational levels to expeditiously pursue their investigations. Members of the mid-level working group have implemented procedures whereby copies of documents are routinely made and retained at their source so that investigators working parallel criminal and civil investigations do not confront each other over simultaneous access to documents. Procedures of prior cross-notification are also in effect with respect to Fund investigations concerning the use of subpoenas, depositions, etc.

In summary, we believe that the major problems concerning the coordination of parallel criminal and civil investigation of the Fund have been resolved. The Department of Justice looks forward to further cooperative efforts.

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We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact us.

Sincerely,

Kevin D. Rooney
Assistant Attorney General
for Administration

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

NOV 24 1981

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

I appreciate the opportunity to review your draft report entitled "Inadequate, Ineffective, and Uncoordinated Investigation to Reform the Multi-Billion Dollar Teamsters' Central States Pension Fund." 1/ I have enclosed our comments on each of the recommendations affecting the Internal Revenue Service. As you know, I testified concerning the Service's role in the investigation of the Central States Pension Fund, along with other representatives of the Service, before the Senate Permanent Subcommittee on Investigations on November 2. Our testimony before the Subcommittee elaborated on our comments concerning the recommendations in this draft report.

I also have a serious concern with the type of recommendations that you have made. Our experience is that GAO comments on past Service actions and makes recommendations on procedures and programs. Your report makes very specific recommendations about future actions IRS should take with respect to a specific taxpayer. I do not believe that future Service action concerning a specific taxpayer is an appropriate area for GAO recommendation and that such recommendations could establish a precedent for GAO involvement in individual cases which the Service would find difficult, if not impossible, to live with in the future. [See GAO note, below.]

With kind regards,

Sincerely,

1/See footnote 1 on page 147.

GAO note: We agree in general with the thoughts expressed by the Commissioner in this paragraph and will continue to follow our general policy of avoiding recommending actions with respect to a specific taxpayer. Because this report deals with the Government's investigation of a specific entity, rather than the Government's procedures and/or policies in a broader context, our recommendations in this case are of necessity for actions related to that entity.

IRS COMMENTS ON GAO RECOMMENDATIONS IN DRAFT REPORT ENTITLED "INADEQUATE, INEFFECTIVE, AND UNCOORDINATED INVESTIGATION TO REFORM THE MULTI-BILLION DOLLAR TEAMSTERS' CENTRAL STATES PENSION FUND" 1/

As we have indicated in testimony before the Senate Permanent Subcommittee on Investigations on November 2, the Service's examination of the Central States Fund was the first major examination of a multiemployer plan after the enactment of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA is a law of great complexity, and at the time of the revocation of the exempt status of the Fund, the dual jurisdiction provisions of Titles I and II of the Act presented substantial coordination problems. Further, there was limited experience under ERISA when functional responsibility for the examination of the Fund was taken over by the EP/EO Division of the Chicago District Office in 1975. These problems have been addressed by Reorganization Plan No. 4 of 1978 and the administrative actions taken by the Service and the Labor Department. Accordingly, some actions taken by the Service at that time, such as disqualifying the Fund without prior notice to the Labor Department, would not be repeated now or in the future. It is fair to say, however, that the Fund's independent asset manager arrangement grew out of this disqualification, since one of the conditions of the requalification letter required the great majority of the Fund's assets to be placed under the control of Equitable and several other independent managers.

1/See footnote 1 on page 147.

Page 67, Recommendation 1

We recommend that Secretary and Commissioner establish criteria and qualifications requiring that future Fund trustees be independent, professional, and neutral, etc., closely monitor the selection of future trustees; and veto the selection of a trustee not meeting the criteria.

Comments

We do not believe that the Internal Revenue Service has the authority to establish qualification requirements regarding the selection of trustees by the Fund. In this regard, it should be noted that the draft GAO report does not cite any authority under the Internal Revenue Code that the Service can utilize to achieve the recommended result. However, we strongly agree with this objective and believe it can best be accomplished under Title I of ERISA. To this end, the Litigation Strategy Task Force created by the Secretaries of the Treasury and Labor and the Attorney General on March 5, 1981, has been conducting negotiations with the Fund. As the Solicitor of the Labor Department testified before the Investigations Subcommittee on October 28, the Task Force has requested the Fund to agree to the selection of unaffiliated (i.e., neutral) trustees as part of a comprehensive consent decree.

Page 83, Recommendation 1

We recommend that the Secretary and Commissioner obtain a commitment from the trustees for (1) the Fund to continue to have an independent investment manager to control and manage the Fund's assets and investments after the present managers' contracts expire in October 1982, and (2) to use the same selection criteria as in the past — independent, professional expertise and national stature -- should the trustees decide to replace the present investment managers after October 1982.

Comments

The Service continues to believe in the importance of having most Fund assets subject to the control of independent asset managers. After coordination with the Labor Department, on November 11, 1981, the Service issued a new determination letter to the Fund that included a condition requiring the continuation of an independent asset manager arrangement. The Fund agreed to this determination letter.

Page 83, Recommendation 2

We further recommend that the Secretary and Commissioner consider obtaining a further commitment from the trustees to reorganize the way the Fund handles and controls the employer contributions and its other moneys to remove the trustees' control over any of these funds. The proposed reorganization should provide for:

-- the Fund to employ a financial custodian -- an independent bank or other financial institution -- with professional expertise and national stature, -- to receive and control all moneys due the Fund, and pay the Fund's administrative expenses and pension benefits, retain an appropriate reserve, and turn over the remainder to the investment managers;

-- IRS and Labor to have a veto power over the selection of the independent investment manager and financial custodian, if the trustees selections do not meet the Government's qualifications; and

-- limiting the trustees role and responsibilities to establishing overall investment objectives, determining eligibility requirements for pension benefits and employers' contributions, monitoring the investment managers' and custodian's activities, and administering relevant collective bargaining requirements.

Comments

We believe that most Fund assets should be subject to the control of independent asset managers. In addition, we are concerned about the possible abuse of assets which are held in a separate account for the payment of current benefits and administrative expenses (B&A account), and are not subject to the control of the independent managers. The determination letter issued to the Fund on November 11, 1981, contained a condition limiting assets retained by the Fund to those the Fund actually determines are necessary for benefits and administration expenses, taking into account assets available from the independent managers. Under the condition, B&A assets must be managed and invested in accordance with the advice of qualified independent managers. The condition also includes an overriding formula that requires B&A assets not to exceed 2½ times the sum of the previous month's benefit payments and administrative expenses.

The question of adequate protection of B&A assets was also discussed by the Fund and the Litigation Strategy Task Force in connection with the negotiations for a comprehensive consent decree. However, it would be inappropriate for the Service to comment on these ongoing negotiations.

Page 84, Recommendation 3

We further recommend that the Secretary and the Commissioner take action to assure that the above proposed reorganization, and any other reforms imposed on the Fund, be included in a formal, written, enforceable agreement signed and agreed to by Labor and IRS and the Fund's trustees.

Comments

While it is clear that a consent decree would provide the Government with a more effective remedy against the Fund, the Service has no authority under the Internal Revenue Code to secure such decrees. In addition, we have determined that the Service has no authority to enter into an enforceable contract related to the qualification requirements under the Code. However, as previously stated, we have cooperated closely with the Labor Department in joint negotiations with the Fund by the Litigation Strategy Task Force in an effort to impose reforms on the Fund as part of a comprehensive consent decree.

Page 84, Recommendation 4 1/

Should the Fund trustees refuse to voluntarily go along with the above reforms, we recommend that Secretary and Commissioner consider whether such a decision, along with any evidence of misconduct that may be developed during the current investigation, warrants speedy and appropriate litigative action, as authorized by ERISA, against the trustees to require retention of an independent professional manager beyond the October 1982 contract terminations date, and the other, or similar, reforms suggested above.

Comments

The Service has no authority under the Code to commence such litigative action against the Fund. IRS remedies against the Fund are limited to disqualification and the imposition of excise taxes in cases of violations of the minimum funding or prohibited transaction requirements.

1/This recommendation has been deleted from the final report.

Page 102, Recommendation 1

We recommend that the Secretary of Labor and the Commissioner of Internal Revenue direct their respective investigative staffs to more closely cooperate to prevent coordination problems, duplication between the investigators and giving the Fund an excuse not to cooperate because the Government is not speaking in one voice. Further in view of the past controversy over the size and use of the B&A account, we recommend the Secretary and the Commisisoner direct their investigative staffs to review the trustees' management and use of the B&A account to determine the appropriate reserve the Fund should maintain in the account.

Comments

Since the revocation of the Fund's qualified status in 1976, the Chicago IRS and Labor Department field offices have coordinated closely in conducting their simultaneous examinations of the Fund. Procedures for sharing information about the Fund's operations have been established and the investigators from the two agencies are in almost daily contact. In addition to monitoring the trustees' management and use of the B&A account as part of its current examination, the Service considered the question of the appropriate amount of the B&A account in connection with our review of the Fund's new application for determination. Moreover, as previously indicated, controls on the amount and management of the B&A account were the subject of joint negotiations with the Fund by the Litigation Strategy Task Force. In addition, Reorganization Plan No. 4 of 1978 has improved our procedures. Section 103 of the Reorganization Plan precludes the Service from disqualifying a plan because of a violation of the "exclusive benefit rule" under the Internal Revenue Code without approval by the Labor Department in a case that also involves the fiduciary standards under Title I of ERISA.

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Page 123, Recommendation 1

We recommend that the Commissioner direct IRS officials to closely monitor the Fund's financial operations to ascertain that the Fund (1) meets the minimum funding standards of ERISA in 1981 and future years, and if not, take whatever action is needed to assure that the Fund meets the Act's requirements, and (2) remains actuarially sound.

Comments

The ERISA minimum funding standards will not become applicable to the Fund until the end of 1981. It would not be appropriate to examine a plan concerning compliance with the funding standards prior to receiving the plan's return. The Fund's Schedule B (Form 5500) will not be due until July, 1982, and the contributions necessary to satisfy the minimum funding standards are not required to be made until September 15, 1982. Upon receipt, we expect to thoroughly examine the Fund's Schedule B to ensure compliance with the minimum funding standards. As we indicated in testimony before the Senate Permanent Subcommittee on Investigations on November 2, 1981, the Service does not have the statutory authority to determine that a plan is "actuarially sound."

APPENDIX XVI

Internal Revenue Service | Department of the Treasury

District Director November 11, 1981

230 S. Dearborn St., Chicago, Illinois 60604

Trustees of Central States,
Southeast and Southwest
Areas Pension Fund
8550 West Bryn Mawr
Chicago, Illinois 60631

Case Number: 36928343
Name of Plan: Central States, Southeast and Southwest Areas Pension Fund
Application Form: 5303
Date Adopted: March 16, 1955
Date Amended: October 22, 1980
Employer Identification Number: 36-6514764
Plan Number: 001
File Number: 30026

Gentlemen:

Based on the information supplied in connection with your application, Form 5303, we have determined that the plan of Central States, Southeast and Southwest Areas Pension Fund, as amended through October 22, 1980, is qualified under Section 401, I.R.C., and the trust established under this plan is exempt under Section 501, I.R.C. This determination applies to plan years beginning after December 31, 1977. Please keep this letter in your permanent records.

Continued qualification of the plan will depend on its effect in operation under its present form. (See section 1.401-1(b)(3) of the Income Tax Regulations.) The status of the plan in operation will be reviewed periodically.

The enclosed Publication 794 describes some events that could occur after you receive this letter that would automatically nullify it without specific notice from us. The Publication also explains how operation of the plan may affect a favorable determination letter, and contains information about filing requirements.

This letter relates only to the status of your plan under the Internal Revenue Code. It is not a determination regarding the effect of other Federal or local statutes.

This determination is not an indication that the Internal Revenue Service is in any way passing on the actuarial soundness of the plan or on the reasonableness of the actuarial computations. It is not a determination that current contribution levels will result in the satisfaction of the minimum funding requirements of Internal Revenue Code section 412, nor is it a determination that contributing employers will not be subject to the Internal Revenue Code section 4971 excise tax for failure to meet the requirements of Internal Revenue Code section 412.

SOURCE: The Fund.

APPENDIX XVI

This determination letter is conditioned on:

1) The continued improvement of informational content and maintenance of the Data Base previously constructed, to enable you to:

   (a) Establish the eligibility of a participant to receive a pension or other form of benefit.

   (b) Comply with the mandatory benefits information reporting requirements of the Employee Retirement Income Security Act.

2) (a) The transfer of all assets received by the Fund to qualified independent asset managers, as defined in section 3(38) of ERISA, 29 U.S.C. section 1102(38), except as provided in paragraphs 2(b) through 2(d) below.

   (b) The Fund may retain assets which it has determined for a particular month are reasonably necessary for the payment of benefits and administrative expenses. The Fund's determination shall take into account sums that could be made available to the Fund by the independent asset managers and may include a reserve for benefits or administrative expenses which might become payable during the month. Assets retained for the payment of benefit and administrative expenses must be used exclusively for those purposes. The Fund's determination for each month shall be made during the last ten days of the preceeding month and shall include a report setting forth the reasons for the determinations, with supporting computations. Copies of the report shall be made available on request.

   (c) Notwithstanding the preceeding paragraph, for each month the average daily balance of all assets retained by the Fund, including assets held pending transfer to the independent asset managers, (determined as of the close of business each day) shall not exceed 2½ times the sum of the benefits paid in the preceeding month and the previous month's administrative expenses. In no event will the disbursements for administrative expenses for any month exceed 2½ times the administrative expenses in the previous month.

   (d) Funds held for benefit and administrative expenses shall be managed and invested in accordance with the advice of a qualified investment manager as defined in ERISA section 3(38).

APPENDIX XVI

3) The Fund's maintaining a qualified Internal Audit Staff to monitor its affairs. Responsibilities of the staff will include the review of benefit administration, administrative expenditures, and allocations of pension plan receipts as to investments and administration. The staff, in cooperation with the Executive Director of the Pension Plan, will prepare monthly reports setting forth their findings and recommendations, copies of which will be made available on request.

4) Relief has been granted under section 7805(b) for plan years ending 12/31/76 through 12/31/80 regarding the defect in the plan involving the discriminatory coverage of certain employees of the Teamsters' Union. This means your plan will not fail to be treated as qualified for the trust, the deductibility of contributions and for all participants for plan years ending 12/31/76 through 12/31/80 because of this defect.

We have sent a copy of this letter to your Representatives as requested in your application.

Very truly yours,

Donald E. Bergherm
District Director

Enclosure

Agreed and approved for Central States, Southeast and Southwest Areas Pension Fund

by _____ Date 11-11-81

APPENDIX XVI

Internal Revenue Service

Department of the Treasury

District Director

November 11, 1981

230 S. Dearborn St., Chicago, Illinois 60604

Trustees of Central States,
Southeast and Southwest
Areas Pension Fund
8550 West Bryn Mawr
Chicago, Illinois 60631

Name of Plan: Central States, Southeast and Southwest Areas Pension Fund

Plan Number: 001
Date Amended: October 22, 1980
Year: 7612 and 7712
Form Number: 5500
Person to Contact: M. Pfahler
Contact Telephone: (312) 886-4711
File Folder NO.: 30026

Gentlemen:

We are pleased to tell you that we have accepted as filed the returns identified above. This decision was made after a review of the plan in operation and consideration given to your efforts to comply with the requirements of our determination letter issued April 26, 1977. During our examination certain plan deficiencies have been corrected by amendments.

We have granted relief under Section 7805(b) of the Internal Revenue Code for the above plan years. This means we will treat your plan and trust as qualified, as well as the deductibility of the contributions to the plan and to all participants, for the above plan years.

Please keep this letter in your permanent records.

If you have any questions about this matter, please contact the person whose name and telephone number are shown above.

Thank you for your cooperation.

Sincerely yours,

Donald E. Bergherm
District Director

cc: Alan M. Levy, Esq.
James G. Walsh, Esq.
William J. Nellis, Esq.
Russell N. Luplow, Esq.

GAO'S CONSIDERATION OF COMMENTS PRESENTED ON DECEMBER 2, 1981, BY THE TEAMSTERS' CENTRAL STATES, SOUTHEAST, AND SOUTHWEST AREAS PENSION FUND ON GAO'S DRAFT REPORT "INADEQUATE, INEFFECTIVE AND UNCOORDINATED INVESTIGATION TO REFORM THE MULTI-BILLION DOLLAR TEAMSTERS' CENTRAL STATES PENSION FUND" 1/

On October 22, 1981, we furnished the Fund a copy of our draft report. At the request of the Fund's Executive Director, on December 2, 1981, we met with him and an attorney representing the Fund to discuss the Fund's comments on the draft report.

We have not included a copy of the Fund's comments in our final report because, for the most part, the Fund's comments (1) were editorial in nature (i.e., pointing out inaccuracies or inconsistencies in the draft) or (2) provided additional or updated data on the Fund's operations. We did, however, generally make the corrections and updating suggested by the Fund or clarified the report where we believe necessary.

Certain of the Fund's comments dealt with substantive issues or information, and for these we made appropriate references to and/or comments in the final report. These references are in the digest on page v and in the body of the report on pages 1, 5, 13, 70, 71, 78, 85, 86, 104, 134, and 137.

1/See footnote 1 on page 147.

COMPARISON MADE BY EQUITABLE OF THE FUND'S 1977 AGREEMENTS AND THE PROPOSED NEW AGREEMENT WITH THE INDEPENDENT INVESTMENT ASSET MANAGERS

In a letter to LMSA's Pension and Welfare Benefit Programs Office dated August 18, 1981, an attorney for Equitable submitted an application requesting the (a) reaffirmation of certain exemptions and advisory opinions issued by Labor in 1977 to Equitable and Palmieri regarding the independent management of the Fund's assets and (b) issuance of a new exemption which would permit Equitable to transfer funds between the two investment accounts--one for real estate investments and one for securities related investments--it will manage on behalf of the Fund under the new asset management agreements.

In the letter, Equitable's attorney stated that the trustees, Equitable and Palmieri have agreed to enter into a series of proposed new asset management agreements upon Labor's issuance of the reaffirmation and the new exemption requested by Equitable. The attorney said the new agreement takes the form of amendments and restatements of the 1977 agreements between the trustees, Equitable and Palmieri. In support of the requests, Equitable's attorney included, among other things, copies of the new agreements and the following comparison of the new agreements to the 1977 agreements.

COMPARISON OF THE 1977 AGREEMENTS TO THE NEW AGREEMENTS

The 1977 agreements consist of a Master Agreement between the trustees, Equitable and Palmieri that sets forth the general structure of the Fund's independent asset management arrangements, and individual investment management agreements for each of the investment managers of Fund assets, including Equitable and Palmieri. The new agreements take essentially the same form as the 1977 agreements; however, the new master agreement is between only the trustees and Equitable, with Palmieri consenting thereto in writing, and the new Palmieri investment management agreement is between only Equitable and Palmieri, with the trustees consenting thereto in writing.

Important points of similarity and difference between the 1977 agreements and the new agreements include the following:

Source: Attorneys for Equitable.

(1) Oversight. As under the 1977 agreements, Equitable will continue in its role as named fiduciary of the Fund with exclusive authority and responsibility to retain, monitor and remove asset managers and the Fund's asset custodians. Under the new agreements, Equitable will also have exclusive authority and responsibility to oversee, and remove or replace, Palmieri. (Under the 1977 Agreements, oversight of Palmieri was shared by Equitable and the trustees.) Equitable's activities and performance as both named fiduciary and investment manager will continue to be monitored solely by the trustees.

(2) Allocation of assets. Under the 1977 agreements, essentially all existing Fund real estate-related assets (a) located east of the Mississippi River were allocated for management to Equitable, (b) located west of the Mississippi River were allocated for management to Palmieri. Further, 25 percent of all securities-related assets and of all new funds becoming available for investment were allocated to Equitable for management, and the remaining 75 percent of such assets and new funds were allocated by Equitable to other securities-related investment managers.

Under the new agreements, all real estate cash flow (i.e., essentially the excess of cash proceeds from Fund real estate investment activities over cash disbursements related to such activities) plus 25 percent of new funds (funds derived principally from employer contributions and made available for investment) will be allocated to Equitable for the purpose of making new investments in equity real estate, construction and long-term mortgage loans, and interests in real estate joint ventures and partnerships. Equitable will have full investment discretion with respect to these new, real estate-related investments.

Equitable will continue to manage the securities-related assets of the Fund currently under its control and an additional 15 percent of all new funds will be allocated to Equitable for investment in securities-related assets. Under the new agreements, Equitable will have full discretionary authority to transfer funds under its management between the securities and real estate investment accounts that it will maintain for the Fund.

The other securities-related asset managers of the Fund will continue to manage the assets currently allocated to them. In addition, the remaining 60 percent of new funds not allocated to Equitable will be allocated by Equitable to the Fund's securities-related asset managers (other than Equitable).

Palmieri will continue to manage the Fund's existing real estate-related assets located west of the Mississippi River and will take over (from Equitable) the management of most of the existing real estate-related assets located east of the Mississippi River.

(3) Investment policies. Under the 1977 agreements, Equitable has exclusive responsibility for the development of investment policies and objectives for the Fund. These policies and objectives are reviewed periodically by the trustees. Under the new agreements, Equitable and the trustees will jointly develop investment policies and objectives for the Fund. In this regard, Equitable and the trustees will jointly agree to an initial set of policies and objectives concurrently with the execution of the new agreements. These policies and objectives will be reviewed periodically by Equitable and the trustees, but can be modified only by joint agreement of Equitable and the trustees.

(4) Termination and amendment of agreements. Under the 1977 agreements, the trustees, until October 3, 1982, can terminate or amend the appointment of Equitable and Palmieri as named fiduciary and investment managers only for cause and by giving 60 days' notice to the Secretary of Labor, the Commissioner of Internal Revenue, Equitable and Palmieri, and receiving the consent of the Secretary to the termination or amendment. After October 2, 1982, such termination or amendment may, on 60 days' notice, occur with or without cause, and the constent of the Secretary is not required. Equitable, Palmieri and the other asset managers are permitted under the 1977 agreements to resign on 60 days' notice to the trustees, the Secretary and the Commissioner.

The new agreements are expressly effective for a five-year period and will be automatically extended for additional five-year periods unless 180 days prior to the end of any such five-year period one of the parties gives notice to the other that automatic extension will not take place. Further, after October 3, 1982, either party to any of the new agreements will be permitted to terminate it, with or without cause, by giving 180 days' notice to the other party. Prior to October 3, 1982, the termination provisions of the 1977 agreements will continue to apply.

Under the new agreements, Equitable and Palmieri will each have the right to resign at any time upon 180 days' notice. Amendments to any of the new agreements will be permitted only with the full concurrence of the parties to the agreement.

(5) Plan administration. As under the 1977 agreements, neither Equitable nor any of the investment managers will have any authority or responsibility under the new agreements with respect to administration of the Fund or the investment or disposition of any Fund assets held by the trustees in the Fund's Benefits and Administration Account.

(6) Real estate asset management fees. The new agreements contemplate the continuance of essentially the same real estate management services that were provided under the 1977 agreements, except that under the new agreements Equitable will be acquiring and managing new real estate-related investments for the Fund, and Palmieri will be managing essentially all of the existing real estate-related assets of the Fund, including most of those now under Equitable's management. The real estate asset management fees for Equitable and Palmieri will be percentage fees based upon the values of the assets under their management (as compared to fixed fees under the 1977 agreements). These asset management fees, which will be paid on a monthly basis as under the 1977 agreements, will be subject to renegotiation and change from time to time upon the consent of the parties.

In addition, if Palmieri's new agreement is terminated by Equitable without cause after October 3, 1982, but within the first year of the new agreement, Palmieri will be paid, in lieu of a "start-up" fee for expenses incurred in taking over the management of assets currently managed by Equitable, the amount of $400,000 (in addition to its percentage fee as computed above). If Palmieri's agreement is terminated by Equitable without cause in the second year of the agreement, Palmieri will be paid a share of $400,000 that is proportionate to the length of Palmieri's service for the Fund during such second year. No such amounts will be paid if Palmieri's agreement is terminated by Equitable after the second year of the new agreements.

In sum, the attorney's letter stated, the new agreements are designed to accomplish several objectives, all of which are expected to provide long-term stabilization of the Fund's independent asset management arrangements. First, the new agreements reflect the fact that, in view of the success of the Fund's current independent asset management arrangements, the trustees have gained a large measure of confidence in these arrangements. Thus, the new agreements are designed to establish a framework for continuing these arrangements indefinitely into the future.

Second, the new agreements reflect the parties' belief that it is appropriate for the trustees to share in the responsibility for the development of overall Fund investment policies.

Third, the new agreements provide for an appropriate notice period (6 months) for terminations or resignations, so that replacements can be found or other appropriate action taken if a termination or resignation occurs.

Fourth, the new agreements reflect the fact that the Fund's investment portfolio has been substantially re-aligned since 1977, so that now only 21.8 percent of the Fund's assets are invested in real estate, and the desire of the Fund trustees to participate in the excellent yields currently available in the real estate market. Thus, while the Fund will continue to dispose of some of its existing real estate-related assets in the future, the trustees and Equitable believe that it is now appropriate for the Fund to make new real estate investments.

Finally, the new agreements contain new real estate management fees that are based on percentages of the values of the assets under management rather than being fixed in amount. These percentage fees are more in line with the type of fees customarily charged for real estate management. While flat fees were appropriate for the Fund in past years, the trustees, Equitable, and Palmieri believe that percentage fees will be more suitable in the future.

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