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Report to the Chairman, Committee on Government Operations, House of Representatives

May 1991

PENSION PLANS

Fiduciary Violations in Terminated Underfunded Plans

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Human Resources Division

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May 13, 1991

The Honorable John Conyers, Jr.
Chairman, Committee on Government
Operations
House of Representatives

Dear Mr. Chairman:

In response to your January 1990 request and subsequent discussions with your staff, we have reviewed fund abuses in pension plans for which the Pension Benefit Guaranty Corporation (PBGC) assumed responsibility. In December 1990 we briefed your office and agreed to prepare a report on the results of our work at PBGC. In this report we discuss (1) the extent to which fund abuses by pension plan fiduciaries[1] had occurred in the plans, (2) whether PBGC had identified the abuses, and (3) the adequacy of PBGC's actions in pursuing legal remedies, including recovering misused funds. As further agreed, we will perform follow-up work at the Department of Labor and the Internal Revenue Service (IRS) regarding their actions when pension plan reports contain information that indicates the possible misuse of funds.

Results in Brief

Fiduciaries' fund abuses totaling about $9.2 million had occurred in over 25 percent, or 11 of the 40 plans we reviewed. One individual who owned businesses that sponsored three of the plans was responsible for $7.5 million of the misused funds. The abuses mostly involved prohibited loans of plan funds to the sponsoring business or the owners using such funds for personal expenses. For some plans, PBGC was alerted to the possible misuse of funds by plan participants. In most of the other cases PBGC staff identified the abuses when inquiring into the plans' status or reviewing the financial data.

In our review, PBGC's actions to recover the misused funds were reasonable, given its untimely involvement with most of the plans. Contrary to legal requirements, four plan administrators did not notify PBGC when certain events occurred, such as the sponsors' bankruptcy filings. Because PBGC learned of these events much later, when few assets remained, it has not been able to recover $1.4 million in prohibited

[1]A fiduciary generally is anyone who exercises discretionary control over plan management or provides investment advice to it. Fiduciaries typically include plan administrators, trustees, and investment managers.

loans. In four other plans, PBGC and Labor although not properly notified, learned of the misuse of $7.8 million in time to obtain a restitution agreement on three plans and partial recovery on the other. The misuse of funds in another plan had been settled by the court before PBGC's involvement with the plan.

PBGC is developing procedures for implementing legislation authorizing it to fine plan administrators up to $1,000 per day for not complying with the notification requirement. PBGC officials believe that the penalty provision will result in better compliance.

Background

PBGC administers an insurance program, established by the Employee Retirement Income Security Act of 1974 (ERISA), that protects the benefits of participants in private pension plans. If a plan terminates with insufficient funds to pay for the benefits earned by its participants, PBGC takes over (trustees) the plan and administers it. Through fiscal year 1990 PBGC reported that it had trusteed over 1,500 plans and estimated a $1.8 billion deficit from its insurance operations.[2]

PBGC insures defined benefit pension plans, which provide for a specific retirement benefit that is generally based on a worker's years of service, earnings, or both. To help ensure that plans have sufficient funds, employers are required to make minimum annual contributions to the plans. Premiums the plans pay PBGC, assets PBGC recovers from trusteed plans, and investment earnings fund the insurance program.

To help ensure that plan assets are adequately safeguarded, ERISA generally (1) provides that plan fiduciaries are to use plan assets solely for the benefit of participants, (2) lists specific asset transactions that are prohibited, and (3) requires bonding of individuals handling plan funds. Violations of these requirements are considered to be fiduciary breaches that may be subject to both civil and criminal penalties. ERISA also requires plans to file periodic financial reports[3] showing how assets are being used, including whether prohibited uses have occurred.

[2]On January 3, 1991, we advised PBGC's Board of Directors that we could not express an opinion on its financial statements because PBGC's estimated liability for guaranteed benefits was unauditable. PBGC's estimated deficit is based on the estimated liability for guaranteed benefits.

[3]ERISA requires most employee benefit plans to file annual reports with IRS showing various financial, actuarial, and demographic data. Plans report using the form 5500 series, Annual Return/Report of Employee Benefit Plan.

The responsibility for enforcing ERISA provisions for ongoing plans is shared by Labor and IRS. Labor is primarily responsible for oversight of the fiduciary and periodic reporting requirements, and IRS responsibilities include ensuring that plans comply with the funding requirements. Also, PBGC can refer ERISA violations it finds to the Department of Justice for criminal prosecution.

ERISA requires plan administrators to notify PBGC within 30 days after becoming aware of an event that may indicate a need to terminate the plan. Under PBGC regulations, reportable events include actions that put the plan at financial risk, such as the sponsoring business filing for bankruptcy. ERISA was amended effective December 17, 1987, to provide that PBGC may assess a penalty of up to $1,000 per day for failure to report such an event or comply with any other PBGC notification requirement.

ERISA also establishes trusteeship procedures and requirements. To determine whether a plan should be trusteed, PBGC obtains and reviews financial information about the plan and the sponsoring business and plan participant data.

Scope and Methodology

We reviewed the 40 plans that PBGC trusteed as underfunded in fiscal year 1990, as of June 30, 1990. We selected these plans to review PBGC's most current experience. The number of plan participants ranged from 4 to 2,149, but most of the plans were small, having fewer than 100 participants. PBGC's total estimated liability from these plans was about $123 million, which included $31.1 million in unpaid contributions. One plan accounted for about $94.2 million of the total liability. (See app. I.)

We reviewed information that PBGC had obtained about the plans during trusteeship processing using audit guidelines that focused on identifying abuses in the receipt and disbursement of plan funds. We developed the guidelines with the assistance of our Office of Special Investigations, Labor investigators, and others experienced in reviewing pension plan activities for fund abuses. We also consulted publications that provided guidance on auditing pension plans. The data reviewed in PBGC's files included form 5500 reports, bank statements showing plan fund transactions, agreements with plans' fiscal agents, actuarial valuations, and other related plan documents. We also interviewed PBGC staff involved in trusteeing the plans.

The results of our review apply only to the 40 plans that we reviewed. Moreover, because our work was based on trusteed plans, the results may not be indicative of the extent and nature of violations in ongoing plans.

Our review was performed between August 1990 and February 1991 in accordance with generally accepted government auditing standards.

Fiduciary Breaches Totaled $9.2 Million in 11 Plans

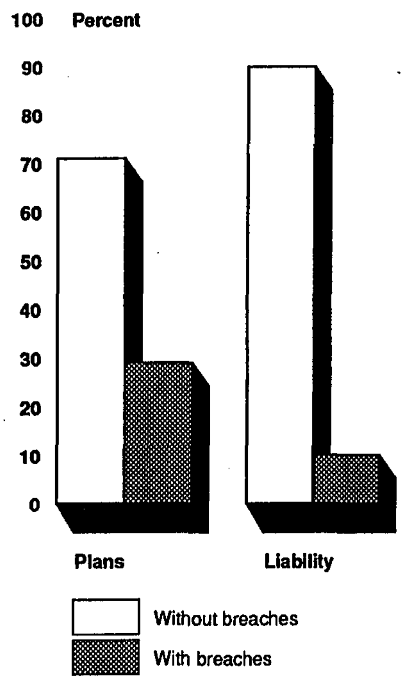
Fiduciary breaches totaling about $9.2 million had occurred in 11 of the 40 plans we reviewed. We did not find any breaches in 27 plans, and could not conclude whether breaches had occurred in 2 plans. PBGC's files for the two plans had incomplete information about the receipt and disbursement of plan funds because the plans had kept poor records, and PBGC had not been able to obtain additional records from other sources.

The fiduciary breaches in the 11 plans involved the following ERISA violations:

- Six plans had made prohibited loans totaling about $1.4 million to the sponsoring businesses. Five of the sponsors used the funds in their businesses, mostly to help keep them in operation. The sixth business owner used the funds to purchase real estate for personal benefit.
- Four plans had a total of about $7.8 million in funds removed by the owners. One individual, who owned three of the businesses, removed about $7.5 million from their pension plans for personal use. The owner of the fourth business embezzled $250,000 from the plan.
- The remaining plan's trustee, who was also an official of the sponsoring business, had used $25,000 of plan funds to buy property for the business.

Although about 29 percent of the 38 plans had breaches, they accounted for just about 10 percent of PBGC's total liability from these plans. (See fig. 1.)

Figure 1: Comparison of Plans With and Without Breaches



PBGC Had Identified the Breaches and Pursued Remedies

PBGC identified or learned of the fiduciary breaches in all 11 plans either before or during its processing of the plans for trusteeship. Although not properly notified, PBGC's timely discovery of breaches totaling about $7.5 million in three plans led to a restitution agreement. For most of the other plans PBGC did not receive timely notification of reportable events, such as business liquidations and bankruptcy filings. Consequently, PBGC has been unable to collect on $1.4 million of prohibited loans.

PBGC and Labor's joint investigation of three plans resulted in an agreement requiring restitution of misused funds. The same individual owned the businesses of these plans. PBGC received allegations from participants about fund misuse in one of these plans. During PBGC's initial inquiries about the plan, its staff learned that Labor had received the same allegations and was also conducting an investigation. This resulted in a joint investigation that revealed the embezzlement of about $7.5 million from the three plans by the owner. After criminal charges were filed, the owner consented to an agreement requiring restitution to the plans. At the time of our review the amount of restitution had not been settled because the court had not yet finalized the agreement.

The administrator of a fourth plan notified PBGC and Labor upon discovering that the owner, who also had been the previous plan administrator, had embezzled $250,000. A criminal conviction was obtained and the individual was sentenced to prison for 9 years. Also, the bonding company paid the plan $50,000, the face amount of the bond.

The breach in the fifth plan had been identified by plan participants and settled in bankruptcy court before PBGC involvement. The court had sealed the settlement agreement, so details were not available in PBGC files.

In the six remaining plans, PBGC has not been able to recover about $1.4 million of prohibited loans. The administrators of four of the plans did not notify PBGC of the businesses' bankruptcy filings or liquidations as required. Instead, PBGC learned of these events from 5 months to over 3 years later, when looking into plan participants' complaints or questions. PBGC staff identified the prohibited loans while inquiring into the plans' status and reviewing their financial data. By that time, however, there were no business assets left, the owners had died or could not be located, and one owner's business and personal assets had been seized by IRS for back taxes.

In the remaining two of the six cases, PBGC learned of the business bankruptcies soon after they occurred but had not collected on the loans. In one case the recovery of any funds appeared doubtful because the owner was considering filing for personal bankruptcy. In the other the bankruptcy court had not yet released available assets to pay creditors, including PBGC. At the time of our review, PBGC was still considering civil remedies on all six plans and had not yet decided whether any of the cases warranted referral to the Department of Justice for criminal prosecution.

Given the circumstances of the cases involving fiduciary breaches, PBGC's actions appear reasonable.

PBGC Developing Procedures for Assessing Penalties

PBGC needs to receive timely notification of reportable events as required for it to effectively identify and pursue fiduciary breaches on plans that it trustees. PBGC officials said that they were currently developing procedures for carrying out the $1,000-per-day penalty provision for noncompliance with the notification requirement. They believe that implementation of the penalty provision will assist the agency in receiving timely notification of events that place plans at financial risk.

Three of the six plans with prohibited loans were terminated after the penalty provision became effective. In one case PBGC learned of the bankruptcy filing from a plan participant shortly after it had occurred. The other two plans' sponsors had no assets remaining and, therefore, attempting to impose the penalty was not a realistic option.

GAO to Follow Up on IRS and Labor Actions

The information in PBGC files indicated that some of the plans' form 5500 reports on file with Labor and IRS had shown the employers' failure to make contributions and had also shown some prohibited loans. However, the information was incomplete on actions taken by Labor and IRS. As agreed with your office, we will perform work at the two agencies to determine (1) what actions they took regarding these plans and (2) their current procedures for identifying and following up on information in reports that show the possible existence of violations.

We did not obtain written comments on this report. However, we discussed its contents with PBGC representatives and incorporated their comments where appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report for 30 days. At that time we will send copies of the report to interested congressional committees, the Executive Director of PBGC, the Secretaries of Labor and the Treasury, and other interested parties, and will make copies available to others on request. If you have any questions concerning this report, please call me at (202) 275-6193. Other major contributors to the report are listed in appendix II.

Sincerely yours,

Joseph F. Delfico

Joseph F. Delfico
Director, Income Security Issues

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Abbreviations

ERISA	Employee Retirement Income Security Act of 1974
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation

Data on the Reviewed Plans

Table I.1: Number of Large and Small Plans

	Plans		Participants	
Number of participants	**Number**	**Percent**	**Number**	**Percent**
1-99	30	75.0	882	16.7
100 or more	10	25.0	4,393	83.3
Total	**40**	**100.0**	**5,275**	**100.0**

Table I.2: Estimated PBGC Liability From Large and Small Plans[a]

Number of participants	Due and unpaid employer contributions	Plan underfunding	Total
1-99	$4,127,547	$6,770,946	$10,898,493
100 or more[b]	26,940,039	84,901,189	111,841,228
Total	**$31,067,586**	**$91,672,135**	**$122,739,721**

[a]PBGC's estimated liability from the 40 plans is the total of (1) due and unpaid employer contributions and (2) the amount by which plan liabilities for benefits earned exceeded the value of plan assets at plan termination.

[b]One large plan accounted for 2,149 participants, $24,619,026 of unpaid contributions, and $69,549,700 of plan underfunding.

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