



Testimony for the
Special Committee on Aging
U.S. Senate

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No Guarantees: As Pension Plans Crumble, can PBGC Deliver?

Testimony of

Rebecca Anne Batts

Inspector General
Pension Benefit Guaranty Corporation

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Pension Benefit Guaranty Corporation – Office of Inspector General
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Good afternoon Chairman Kohl, Ranking Member Martinez, and other Committee Members. My name is Rebecca Anne Batts and I am the Inspector General of the Pension Benefit Guaranty Corporation (PBGC), Office of Inspector General (OIG).

Thank you for the opportunity to testify today about the challenges that the Pension Benefit Guaranty Corporation (PBGC) is facing. These challenges affect important functions of the Corporation. On one hand, PBGC and its Board must deal with the need to make decisions about how to implement PBGC's investment policy, to include the possibility that certain decisions may need to be reconsidered. Additionally, PBGC may be called to address an unprecedented influx of large defined benefit pension plans, if companies can no longer afford to maintain the plans. We appreciate your interest in these issues and your request that we monitor PBGC's preparedness strategy. We have been working with PBGC officials to support and oversee their efforts and are in the process of assembling a team to review the steps that PBGC management is taking to prepare for the coming months and years.

Both the President and Congress have noted that the current economic crisis is the result of many years of irresponsibility, both in government and in the private sector. As the guarantor of pensions for many of the Nation's workers, PBGC will certainly be affected by the trends and events that shape our economic future. We appreciate this Committee's strong interest in vigilant oversight of the PBGC's investment activities and in its readiness to face the consequences of defined benefit plans on the brink of financial distress, with this hearing as just one of the many indicators of that support.

We realize that PBGC faces enormous challenges and note the commitment of the Acting Director, PBGC's senior leadership, and the PBGC Board to the success of PBGC's investment program and preparedness initiatives. PBGC's leadership has been proactive on several fronts. For example, PBGC's senior leadership has been engaged in contingency planning for a potential wave of pension plan trusteeships in the near future. The focus is on ensuring that PBGC's core functions -- insurance programs and benefits administration -- have the necessary resources (including staff, budget, and information technology) to address the incoming workload. PBGC staff has briefed us on initial assessments of the potential impact on PBGC if pension plans of various sizes terminate without sufficient assets to pay future benefits and PBGC becomes responsible for those benefits. Additionally, PBGC consistently monitors the conditions of multiple high-profile industrial sectors including retail, newspaper, pharmaceutical and auto.

Our statement today focuses on the specific challenges PBGC faces as it prepares for the future in a turbulent financial environment and on our strategy to promote integrity and support PBGC in its readiness efforts. Specifically:

- **PBGC must continue to work with its Board to determine how to ensure integrity as it contracts for investment services.** Earlier this month, we reported on serious questions relating to the integrity of the procurement process for Strategic Partnership contracts to manage \$2.5 billion in PBGC assets. We identified actions that PBGC and its Board should take to foster impartiality in future procurement activities and compliance with existing contracting laws and regulations (see attachment for full report.)¹ This interim report was issued as part of our ongoing monitoring of PBGC’s plans for implementing the new investment policy and included our assessment of allegations brought to our attention by a whistleblower. Based on our analysis, we concluded that the former PBGC Director, Charles E.F. Mr. Millard, had inappropriate contacts with bidders for the Strategic Partnership contracts and took actions incompatible with his role as Director. We recommended a Board-level decision as to whether the actions of the former Director cast enough doubt about the fairness, integrity, and openness of the procurement to warrant cancellation of the contracts. We also recommended the establishment of a Board-imposed requirement that future PBGC Directors maintain appropriate separation of duties, with special care given to situations that are likely to create the appearance of improper influence or bias. The Board responded quickly and appropriately to our recommendations.
- **Our audit and investigative initiatives must continue to examine areas that present the greatest risks and promptly notify PBGC, the Board, and Congress of actions needed to ensure effective governance and readiness for whatever the future brings.** We have begun working aggressively to position our office to handle the potential increase in oversight workload associated with current economic conditions. We initiated a three-phase approach to conducting this work. Earlier this month, in anticipation of changes that may come if companies can no longer afford their defined benefit plans and in response to a request from your committee, we initiated a review to assess PBGC actions to prepare for possible influx of defined pension plans with large numbers of participants in the near future. To meet this objective we will examine: (1) the steps PBGC management is taking to prepare for a possible increase in the number of terminated plans; (2) the extent to which an increase in the number of terminated plans presents challenges for PBGC management in both termination and benefit delivery processes; (3) the effectiveness of PBGC processes for identifying, prioritizing and obtaining needed resources, such as human capital; and (4) the steps PBGC management is taking to ensure continued customer service and effective Field Benefit Administration offices in the event of

¹ OIG Report No. AUD-2009-5/PA-08-63-1, “Former Director’s Involvement in Contracting for Investment Services Blurs Roles and Raises Fairness Issues,” May 15, 2009. OIG reports and testimonies are available on our website: www.oig.pbgc.gov.

termination increases. We plan to fast-track the most time-sensitive results of our work to ensure we provide PBGC, the Board, and Congress with timely and relevant information.

Phase 2 of our strategy is already underway and involves a systematic review of the strengths and weaknesses of PBGC's approach for executing the new investment policy and an assessment of the effectiveness of PBGC's plan to identify and manage key risks. We plan to begin reporting the results of this effort this summer through a series of advisories to PBGC. Phase 3 is a longer-term initiative in which we will drill down on high-risk areas that emerge as a result of our ongoing review.

I will now discuss these issues in further detail.

PBGC MUST CONTINUE TO WORK WITH ITS BOARD TO ENSURE INTEGRITY IN CONTRACTING FOR INVESTMENT SERVICES

Earlier this month, we issued an interim report (attached) as part of our ongoing review of the PBGC's implementation of its new Investment Policy. Our report discussed our findings and recommendations to ensure PBGC develops and implements internal controls to foster impartiality in future procurement activities and compliance with existing contracting laws and regulations. Further, our report recommended that the Board consider whether the inappropriate actions taken by the former PBGC Director had caused so much doubt about the fairness, integrity, and openness of the Strategic Partnership that the contracts should be cancelled.

The PBGC Board provided a positive response to our report and has committed to take appropriate corrective actions.

The actions taken by the former Director constitute a serious challenge to contracting integrity at PBGC. The former Director:

1. Assumed de facto responsibility for key procurement actions, violating the principle of separation of duties and rendering PBGC vulnerable to allegations of bias, improper influence, or conflict of interest.
2. Consulted with potential bidders about the impact of certain mandatory requirements on them and on others, as well as about proposed questions for PBGC procurement officials to ask during the bidders' oral presentations.
3. Had inappropriate contact with bidders during the "blackout" period when such contact was forbidden.
4. Sought employment assistance from an executive employed by one the winning bidders for a Strategic Partnership contract to manage \$700 million in private equity.

To address the serious issues discussed in this report, we recommended that the PBGC Board require future Directors to ensure appropriate separation of duties, to include refraining from service on technical evaluation panels and other de facto procurement activities, giving special attention to situations that are likely to create the appearance of improper influence or bias. The Board agreed with our recommendation and advised that it will be working with the PBGC to develop appropriate guidelines.

Today, I will highlight a few of the key areas that led to the need for action.

1. The Former Director Assumed De Facto Responsibility for Key Procurement Actions.

As part of his job, the former PBGC Director represented the Corporation before the investment community in person, traveling frequently to New York and maintaining continual telephone contact with major investment firms. However, at the same time, he inappropriately assumed de facto responsibility for key procurement activities necessary to implement the new investment policy, including evaluating many of the same investment firms with which he routinely dealt. The former Director's contact with bidders allowed some, but not all, to have frequent and in-depth access to a key procurement decision-maker. Further, the continuing contact provided an opportunity for some, but not all, bidders to enhance the former Director's level of confidence in their firms' knowledge and skills.

Federal Regulations Establish High Standards for Procurement actions .

Government-wide ethics rules are founded on fourteen principles, one of which requires all federal employees "to avoid any actions creating the appearance that they are violating the law."² In its own ethics handbook "*Public Service is a Public Trust*," PBGC sets forth these guiding principles of ethical conduct. The discussion about "Impartiality Issues" is written simply and lists examples of circumstances that could call impartiality into question; specifically noted is the evaluation of bids submitted by friends.

PBGC's procurement process is also subject to a variety of implementing guidance, including the Federal Acquisition Regulation (FAR), intended to ensure impartiality in contracting decisions. Examples include:

- "An essential consideration in every aspect of the System is maintaining the public's trust. Not only must the System have integrity, but the actions of each member of the Team must reflect integrity, fairness, and openness ..."³
- "Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with

² 5 C.F.R. § 2635.101(b)(14).

³ FAR § 1.102-2(c)(1).

preferential treatment for none. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct. The general rule is to avoid strictly any conflict of interest or even the appearance of a conflict of interest in Government-contractor relationships. While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions.”⁴

The former Director was intimately involved in the day-to-day details of contracts used to develop and implement the new investment policy.

Despite warnings from his own advisors about the wisdom of doing so, the former Director actively participated in PBGC’s procurement of investment services contracts. Throughout his tenure, he enmeshed himself in the evaluative process. Examples include:

- Serving on a three-member evaluation panel, with two subordinate employees, to select **Rocaton** to assist in developing the new investment policy.
- Choosing evaluation panel members, and serving on the evaluation panel, with two subordinate employees, to select **Plexus** to provide advisory services for the development of transition management principles.
- Choosing evaluation panel members and serving on the evaluation panel, with two subordinate employees, to select **Ennis Knupp** as advisor for the upcoming strategic partnership procurement.
- Helping draft the Statement of Objectives for the Strategic Partnership contracts, including the 13 mandatory requirements; leading the bidders’ conference; helping draft the evaluation factors through which the winning firms would be selected; and serving on the evaluation panel to select the winning bidders.

2. The Former Director Consulted Directly with Some Firms Prior to Issuance of the RFP.

The former Director interacted with some, but not all bidders, in a manner that failed to reflect integrity, fairness, and openness, as required by the FAR⁵ and by government ethics regulations. His communications created, at a minimum, the appearance that bidders with whom he interacted would have an unfair advantage in seeking a Strategic Partnership with PBGC.

In the month preceding the issuance of the Strategic Partnership RFP, the former Director engaged in a two-day email exchange with a BlackRock Managing Director.⁶ The

⁴ FAR § 3.101-1.

⁵ FAR § 1.102-2(c)(1).

⁶ The Managing Director was noted as a key person on the Strategic Partnership contract for the management of up to \$900 million in real estate and private equity.

discussion centered on the standards to be used to evaluate bidders for the PBGC Strategic Partnerships. The emails include discussion of getting together in person and by phone.

The former Director asked the BlackRock executive about the “minimum number of employees a Strategic Partner should have globally.” After the executive failed to give a definite answer, the former Director explained the reason for needing a specific number: “... I think I need a cognizable cutoff future so that we can **winnow the field** easily.” [Emphasis added.]

In response the BlackRock executive wrote, “I will be self serving and say overall firm shld have at least 5,000 total employees. Getting more specific on global now, I wld suggest that at least 25 pct of total employees (and a minimum of 250 in total) shld be in non-US offices. I added the parenthetical **to eliminate the 100 person boutique firm with 30 people overseas from consideration.**” [Emphasis added.]

At that point the former Director responded, “Any idea who that includes or excludes?” Clearly, the purpose of the two-day email exchange was to allow the establishment of a specific criteria that would “winnow the field” and “eliminate [certain firms] from consideration.” This exchange of emails is inconsistent with the former Director’s responsibility as set forth in the FAR. “Government business shall be conducted in a manner above reproach and ... with complete impartiality and with preferential treatment for none.”⁷

At the August 8 bidders’ conference, the potential bidders who attended were reminded of the RFP’s mandatory “firm size” requirement and that no firm should submit a proposal for the Strategic Partnership work unless it had thousands of employees. To their credit, PBGC senior leaders, including the Procurement Department Director, the Procurement Deputy Director, and the PBGC Treasurer,⁸ questioned the criteria for size, as established in the RFP. According to the Deputy Director of Procurement, “Requiring employees numbering in the thousands may be unsupportable. If we hide from [answering a question raised by a bidder about minimum size], it may look as if we have no rationale to support the requirement...” Mr. Millard addressed the issue in an email stating, “I don’t see why we need change rfp. Says thousands, means thousands.”

3. The Former Director Had Inappropriate Contact with Bidders During the “Blackout” Period.

Although he was aware that he was prohibited from speaking with representatives of the firms that were attempting to become PBGC’s Strategic Partners, the former Director communicated with winning bidders by phone and by email during the time when proposals were being evaluated.⁹ Ordinarily, communications between the PBGC

⁷ FAR § 1.102-2(e)(1)

⁸ The Treasurer also served as Deputy Director of the Financial Operations Division.

⁹ Of the 16 firms submitting bids, calls were logged from the former Director’s phones with 8 firms during the “blackout” period, including calls with each of the successful bidders.

Director and executives of financial management firms would not be prohibited. However, in this case, because the former Director had been so involved in the details of the procurement process and was serving with subordinate employees on the technical evaluation panel, such contact violated regulations intended to ensure the integrity of the procurement process.

As an example of the communications during the blackout period, we found ten phone calls and at least five emails between the former Director and a managing director of JPMorgan. The emails show that the former Director was attempting to reach the JPMorgan executive by phone. The subject line of the emails was “Can I reac” [reach]. The JPMorgan executive replied with details of his hotel room number and telephone, his mobile phone number, and the phone number of his apartment, as well as times when he would be available. We were unable to determine conclusively whether the former Director and the JPMorgan executive ever actually spoke by phone and we do not have specific information about the topics the former Director planned to discuss. However, the day that winners of the Strategic Partnerships were selected, the email string continued. The subject line was changed from “Can I reac” [reach] to “Strat partnerships” and the message sent by the former Director was “U guys get 900 m. 600 real estate 300 private equity.” We concluded that the email message and the subject line provide a strong indication that the strategic partnerships were to be the topic of the phone conversation between the former Director and the JPMorgan executive.

During January 2009, as part of our audit, we interviewed the former Director about communications with bidders during the “blackout” period. Initially, he stated that he had been careful not to talk to any of the potential bidders during the period that the Strategic Partnership was “on the street” for bid. He also stated that he did not recall having any conversations with offerors during the procurement. OIG professional staff then showed the former Director his own telephone logs. At that time, he amended his prior statement and commented that, if he had spoken with an offeror, he definitely would not have discussed the Strategic Partnership procurement.

The former Director’s explanation about the phone calls continued to evolve throughout our audit. For example, he later provided the explanation that the phone calls to the JPMorgan executive were made to discuss a particular news article. We were unable to corroborate this explanation, as the news article to which he referred was dated after the first of the emails and phone calls – an indication that some other topic was under consideration. Subsequently, in a written statement addressing the issues in our report, the former Director asserted that he made the phone calls and emails to the JPMorgan executive as part of his work with the McCain transition team. He provided documentation to show that the JPMorgan executive had been under consideration for a cabinet level post, along with a number of other candidates. We attempted to corroborate the former Director’s explanation through an interview with the leader of the McCain transition team, who advised that named candidates were not called as part of the process in which the former Director was involved. In a further attempt to corroborate the former Director’s explanation, we identified the person or company associated with each phone number called from the former Director’s cell phone and from his direct line during the

relevant time period. Except for the calls to the JPMorgan executive, there were no phone calls to either the homes or the businesses of any of the individuals identified by the former Director as potential candidates for political appointment, based on the listing he provided us.

4. The Former Director Sought Employment Assistance from an Executive of One of the Winning Bidders.

Our review of the former Director's voluminous email records disclosed extensive communication with a Goldman Sachs executive, occurring after the award of the \$700 million Strategic Partnership contract. While we did not identify any evidence that the former Director was attempting to obtain employment directly with Goldman Sachs (or with any of the winning firms), we did find 29 emails between a senior Goldman Sachs official and Mr. Millard to assist him in his search for employment. For example, the former Director provided his resume, bio, and six news articles to the Goldman Sachs executive, who in turn forwarded the materials to others in the financial community. Employment assistance provided by the Goldman Sachs executive to the former Director included personal meetings, strategic advice, introductions to potential employers, and help with meeting arrangements. In one email the executive wrote:

... It was great to see you this afternoon. I spoke with [the CEO of a financial services firm] after our mtg. He would love to meet with you in NY. I told him I would forward your info when I receive it and then you can feel free to coordinate with his assistant at any time after that. Separately, I spoke with [--] and he confirmed for tomorrow morning. I will keep you posted on the others that we discussed.

The evidence of the 29 emails tends to contradict the written statement of the former Director, in which he asserted, "... around the time I became aware of this audit, I became aware of a rumor that I was pursuing the Strategic Partnerships in order to increase my chances at post-PBGC employment with large financial services firms. This was ridiculous, as I already had numerous contacts at such firms and had worked in senior roles at two of them in the past."

The former Director advised us that the assistance was provided due to a "deep personal relationship" between him and the executive. He had also previously asserted that the executive was not actually involved in bidding for the Strategic Partnership contract. While the executive was not listed as "key personnel" in the Goldman Sachs bid, the former Director had requested, via email, that a subordinate provide the RFP to the executive. Further, on the day that Strategic Partnership contracts were awarded, the former Director sent the Goldman Sachs executive an email with the subject "Strat partner" stating, "U guys got 700 m in private equity." We concluded that the receipt of employment assistance from a winning bidder raises serious ethical concerns.

A Special “Thank You” to the Whistleblower

Reporting concerns about fraud, waste, or abuse to the Inspector General requires a lot of courage. The task is even more difficult when the issues of concern are subjective, involving questions of fairness, of impartiality, or of “appearance.” I am grateful to the PBGC employee who first reported the questionable actions of the former Director to my office. Disregarding concern about how well the Whistleblower Protection Act could protect his/her identity, this loyal employee made a choice to put PBGC’s interests above the employee’s own interest to be free from possible retaliation. That choice will help the PBGC Board and PBGC leadership make the changes needed to maintain the public’s trust. This employee deserves our gratitude and thanks.

THE OFFICE OF INSPECTOR GENERAL WILL CONTINUE TO EXAMINE AREAS THAT PRESENT THE GREATEST RISKS AND PROMPTLY NOTIFY PBGC, THE BOARD, AND CONGRESS OF ACTIONS NEEDED TO IMPROVE EFFECTIVENESS AND MINIMIZE FRAUD, WASTE, AND ABUSE

Our office supports PBGC in its various initiatives. We are in the process of developing a risk-based strategy that will target the highest risk areas and emphasize timely reporting of results. To that end, we are evaluating PBGC’s implementation of its investment policy and providing oversight for PBGC’s preparations for the potential influx of new large defined benefit pension plans. Our work is being coordinated with the Government Accountability Office to avoid duplication of effort and maximize accountability coverage. In addition, we have a number of ongoing audits and reviews that directly relate to the challenges of operating a government corporation such as PBGC. We have also begun several actions to enhance our capacity to assist PBGC in ensuring accountability; these actions include the recent hiring of an experienced audit manager and high-performing criminal investigator from other Offices of Inspector General to help us handle our increased audit and investigations workload.

The Office Of Inspector General Is Working With PBGC To Ensure Implementation Of Outstanding Audit Recommendations.

Audit recommendations are the heart of any audit report. No matter how interesting the findings may be, a report is not effective unless the recommendations are implemented and the problems reported fully addressed. Last month, my office undertook a comprehensive review of the status of outstanding audit recommendations and we identified 130 outstanding recommendations for corrective action that have not yet been implemented by PBGC. We noted the following:

- Some recommendations were quite old; for example, the need to implement an integrated financial management system was first reported twelve years ago, in 1997. The issue has been included in each subsequent year’s financial statement audit, including the audit for FY 2008.

- As another example of a corrective action that is long overdue, recommendations from an audit report issued in 2003 relate to PBGC's Premium Accounting System and are not scheduled to be completed until June 2010.
- Progress is being made on some old recommendations, however. For example, our FY 2004 financial statement audit included a recommendation for the development of a comprehensive procedures manual for processing and estimating premiums – an action that is scheduled to be complete sometime this summer.
- As good news, we noted that 50 of the 130 open recommendations were issued within the last year – most of these are in the process of being implemented as we speak.
- Our recommendations focus on helping PBGC do its work better. About three-fourths of the recommendations are intended to improve PBGC's internal controls or governance.

The Office of Inspector General Is Conducting a Review to Identify Vulnerabilities and Any Needed Changes in PBGC's Approach to Executing its Investment Policy.

Ongoing audit work is examining the strengths and weaknesses of PBGC's approach for executing its investment policy. As part of that review, we are also evaluating the effectiveness of PBGC's plan to identify and manage key risks that could affect investment performance or limit anticipated benefits. We have already issued one report, the interim report discussed above. That report addressed PBGC's vulnerability to one of those risks and raised serious questions about the integrity of the procurement process for the Strategic Partnership contracts.

PBGC has committed to working with the Board to make important decisions, including whether Strategic Partnerships fit into the investment approach going forward. We plan to expedite our reporting to ensure that PBGC, the Board, and Congress have real-time information related to our work, as decisions are being made about potential changes to PBGC's approach to implementation. That is, if we identify any issues that warrant immediate attention, we will issue advisories to highlight those issues.

The final phase of our strategy involves using the results of the work mentioned above to identify areas that warrant additional effort and reporting, based on potential risks. We will use this information to develop a long-term plan outlining our investment-related audit and investigative initiatives. We remain committed to protecting PBGC's investment portfolio over the long term.

Other Ongoing Audit and Investigative Initiatives

Our investigators have been proactive in their deterrence efforts, recognizing that the risk of fraud or other criminal behavior increases at times of stress and change. Ongoing activities include:

- Investigation into post-award contacts between the former Director and executives at companies that were awarded Strategic Partnership contracts. As described earlier in my testimony, our audit determined that the former Director had sought placement assistance in the weeks following the contract announcements; in part, our investigation will address the extent to which these conversations took place in personal emails and telephone calls. We are doing this work at the bipartisan request of Senators Kennedy, Baucus, Enzi, and Grassley.
- Fraud Awareness briefings to several Pension Benefit Guaranty Corporation (PBGC) departments and Field Benefit Administration Offices throughout the country. We conducted these fraud briefings to educate employees and contractors about the roles and responsibilities of the Office of Inspector General. Specifically, the Office of Investigations focused on raising awareness to potential indications of fraud, and discussed mechanisms for reporting allegations to the Office of Inspector General.
- Non-voting participation on PBGC's Internal Control Committee. The Assistant Inspector General for Investigations provides insight gained through his experience as criminal investigator to the committee responsible for oversight and accountability of PBGC internal controls. Effective control systems may detect fraud or deliberate non-compliance with policies, regulations, or laws.
- Distributing materials, such as our newly designed Hotline posters and periodic electronic Fraud Alerts, to PBGC employees and contractors and to retirees receiving their pensions through PBGC.

Our strategy also involves emphasizing the investigation of allegations of fraud in any of the pension plans that PBGC takes on as a result of the potential influx of new plans. We will be vigilant in presenting cases to the Department of Justice (DOJ) for prosecution and participating in resulting prosecutions. We will also focus on ensuring that PBGC officials do not inadvertently take actions that compromise potential prosecutions. For example, we have already established a regular periodic meeting between the Office of Inspector General and the PBGC General Counsel at which we will discuss coordination of efforts to ensure effective deterrence. As needed, our efforts are coordinated with the Department of Labor Office of Inspector General and the Employee Benefits Security Administration. Further, we are reaching out to our investigative counterparts in other federal agencies and in state and local governments.

The Office of Inspector General is Taking Action to Best Position Itself for Future Change.

The issues under discussion today have presented our office with resource challenges. We are a small Inspector General office, especially when considered in relation to the large dollar amounts at stake and the sophistication of the businesses (including Wall Street investment firms) with whom PBGC deals. Accordingly, we are making the most of the resources provided to our office.

- We contract for assistance when we do not have enough staff or the necessary technical background to address important questions. For example, last week we issued a discussion draft report on PBGC's management of its securities lending program, a complex issue. To meet our objectives in this review, we obtained contract assistance from a well-respected financial services advisor to perform the detailed and substantive review.
- We are in the process of hiring up to three new audit managers. Bringing high-caliber leaders on board is critical so we can deploy them to track the potential influx of defined benefit plans and deal with the increased workload of complaints that is likely to occur as we continue to publicize our Hotline.
- In the very near future, we will begin conducting systematic outreach with Congressional and other stakeholders, including the staff of the Special Committee on Aging and the staffs of our authorization and appropriations committees in the House and Senate. We have been pleased with the support shown to our office by the committees and we intend to keep the lines of communication open. We know that PBGC has many other stakeholders -- beneficiaries in terminated pension plans, participants in ongoing plans that PBGC insures, the employers who pay premiums, and the policymakers who oversee the federal insurance programs. We plan to reach out to these important stakeholders, as well.
- In response to upcoming challenges, our office is updating its comprehensive strategic plan so that our audits and investigations are more clearly tied to an overarching strategy. This strategy will reflect and support PBGC's strategic goals of safeguarding the federal pension insurance system, providing exceptional service to customers and stakeholders, and exercising effective and efficient stewardship of PBGC resources.
- Finally, we are developing new reporting formats that will allow us to expeditiously issue the results of our work so that action can be taken in a timely manner. We are also focused on presenting our work in user-friendly, understandable manner to maximize the impact of our findings and recommendations. Additionally, we are making it simple to learn about our new reports and written products as they are issued. Subscribers to our New Reports Notification feature, displayed on our website at www.oig.pbgc.gov can be alerted, via email, whenever we post a new report.

CONCLUSION

The coming months will bring tremendous challenges and opportunities to PBGC as it manages its investment portfolio and works with the Board to make important decisions, including whether Strategic Partnerships fit into the investment approach going forward. Further challenges are posed by the current economic situation and concerns that some large defined benefit plans may be on the brink of financial distress. We are in complete

alignment with the Committee's commitment to ensure that PBGC management is taking steps to strategically prepare the Corporation for the possible influx of such plans and their participants.

PBGC will need sustained efforts to ensure that integrity, accountability, efficiency, and effectiveness are maintained as it moves forward. To that end, we acknowledge current PBGC leadership, including the acting Director, for their ongoing contingency planning and the focus on ensuring that PBGC core functions - insurance programs and benefits administration - have the necessary resources including staff, budget and information technology to address workload associated with the potential wave of pension plan trusteeships in the near future. We are focused on assisting PBGC officials in their efforts by identifying vulnerabilities and making recommendations for improvements, where needed.

It is important that we ensure accountability to help restore the trust that may have been damaged through the misconduct of the former Director. As PBGC moves forward, it has a unique opportunity to reconsider its approach to implementing the investment policy and make any needed adjustments. Further, if it can meet the challenge of its increased workload with efficiency, transparency, and integrity, PBGC has an opportunity to reassure the American people about the basic soundness of our Nation's economy. We are committed to helping PBGC do just that.

That concludes my statement, Mr. Chairman. Once again, I thank the Committee for its support of our efforts. I will be happy to answer any questions you or other Members of the Committee may have.

A copy of the audit report, "Former Director's Involvement in Contracting for Investment Services Blurs Roles and Raises Fairness Issues, AUD-2009-5 / PA-08063-1, is attached.



Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

**Former Director's Involvement in
Contracting for Investment Services
Blurs Roles and Raises Fairness Issues**

May 15, 2009

AUD-2009-5 / PA-08-63-1



Pension Benefit Guaranty Corporation

Office of Inspector General

1200 K Street, N.W., Washington, D.C. 20005-4026

May 15, 2009

MEMORANDUM AUDIT REPORT

TO: The Honorable Hilda L. Solis, Secretary of Labor
Chair of the PBGC Board of Directors

The Honorable Timothy F. Geithner, Secretary of Treasury
Member of the PBGC Board of Directors

The Honorable Gary Locke, Secretary of Commerce
Member of the PBGC Board of Directors

FROM: Rebecca Anne Batts *Rebecca Anne Batts*
Inspector General

SUBJECT: Former Director's Involvement in Contracting for
Investment Services Blurs Roles and Raises Fairness Issues

This report describes findings identified during our ongoing audit of the Pension Benefit Guaranty Corporation's (PBGC) implementation of its new Investment Policy. While conducting this audit, we became aware of serious allegations about former PBGC Director Charles E.F. Millard's involvement in the procurement process used to select the investment managers responsible for executing aspects of the new policy. The objectives of this report include:

- Determining whether the Director's¹ direct involvement in the procurement process compromised the perception of impartiality in contracting for strategic investment partners;
- Determining whether the Director and other procurement officials made improper contacts with offerors during investment management source selections; and
- Determining whether Procurement Department standard operating procedures were inappropriately modified during investment management procurement.

The report discusses our findings and recommendations to ensure PBGC develops and implements internal controls to foster impartiality in future procurement activities and compliance with existing contracting laws and regulations. Our recommendations are made to the PBGC Board of Directors, as the actions that are needed will require implementation at a level higher than the PBGC Director.

¹ At that time we began this audit, Charles E.F. Millard was the PBGC Director. He resigned his position effective January 20, 2009.

RESULTS IN BRIEF

Serious questions about the integrity of the procurement process for the Strategic Partnership contracts were raised when the former PBGC Director inappropriately communicated with bidders during the time when such contact was forbidden by PBGC policy and the Federal Acquisition Regulation (FAR). Phone records and emails show that the former Director was communicating directly with some bidders at the same time that he was actively evaluating their Strategic Partnership proposals, a clear violation of the prohibition of contact with potential offerors. Further, the former Director took an unprecedented role in the procurement process, to include serving on Technical Evaluation Panels (TEP) to formally assess some of the same Wall Street firms with whom he was in frequent contact; at a minimum, this violated the principle of separation of duties. However, it should be noted that our audit did not identify evidence of criminal activity on the part of any bidders.

The former Director was advised that his actions could cast doubt on the integrity of the procurement process, but he did not heed these warnings. Because the former Director's subordinates were unable to prevent the activities described in this report and because internal guidance could be changed by a future Director, it is unlikely that PBGC employees can take effective action to prevent similar abuses by future Directors. Therefore, our recommendations were made to the PBGC Board of Directors (Board), in recognition of their important oversight role of PBGC and the PBGC Director. The Board is the final accountability authority for PBGC activities.

The PBGC Board provided a written response to our report. That response, which is included in its entirety as Appendix C to this report, notes that the Board will take appropriate action in response to the recommendations. We agree with the actions proposed by the Board and appreciate their commitment to ensuring that PBGC has the internal controls it needs to meet its critical mission.

BACKGROUND

PBGC is a wholly-owned Federal government corporation, established under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), with a three-member Board of Directors comprising the Secretaries of Labor, Commerce, and Treasury. The Secretary of Labor serves as the Board Chair. The Board establishes policy and provides oversight to PBGC and its Director. The Pension Protection Act of 2006 (PPA 2006) established a Presidentially-appointed and Senate-confirmed Director to administer the Corporation in accordance with policies established by the Board. PBGC also has an advisory committee appointed by the President to, among other things, advise on investments.

PBGC's By-Laws require the Board to review the Investment Policy Statement every two years and approve the Investment Policy Statement every four years. The purpose of the Board review is to ensure that the objectives of the Investment Policy continue to be

aligned with PBGC operational objectives, that PBGC is implementing investment strategies that are consistent with the investment objectives, and that PBGC's Investment Policy is implemented in a manner consistent with the principles of ERISA.

In February 2008, PBGC executives presented to the Board a proposed revised investment policy. PBGC's Board unanimously approved the policy, which is less conservative than the prior policy and involves transferring billions of dollars from fixed income treasury securities to marketable equities, real estate, and private equity. Our conclusions about the implementation of the investment policy will be presented in another audit report to be issued in the near future.

PBGC has begun the process of reallocating its \$48.4 billion² investment portfolio. While the Corporation continues to evaluate implementation options, planned actions include the use of strategic partners to manage portions of PBGC's alternative portfolios and the interim use of passive index managers. Strategic partnership contracts awarded in October 2008 called for the purchase of nearly \$2.5 billion in real estate and private equity. Total fees for the three strategic partnership contracts, over the ten year period, could exceed \$100 million.

PBGC's procurement process incorporates a number of internal controls designed to ensure that business is conducted in a manner that is impartial, non-preferential, and avoids conflict of interest or even the appearance of a conflict of interest in the Government/contractor relationship. Steps in the procurement process include identification of the procurement requirements by the program office, performance of market research, preparation of a requirements package, solicitation of offers, establishment of a TEP to evaluate and report on solicitations, negotiation by the contracting officer, legal review, and awarding of the contract.

The TEP is part of the procurement process for selection of investment managers and advisers. This step in the procurement process is intended to ensure that impartial, independent and knowledgeable subject matter experts at PBGC evaluate offerors' proposals against PBGC's stated requirements and determine which proposal represents the best value. A TEP normally consists of three voting members, one of whom is designated as the Chair. TEP members are generally nominated by the program office and appointed by the Contracting Officer.

AUDIT RESULTS

Finding 1: The Former Director had Inappropriate Contacts with Bidders

The former Director violated the FAR and PBGC policy by communicating directly with bidders during the source selection period, also known as the "blackout period." He was aware of the prohibition against speaking with representatives of the firms that were

² As of September 30, 2008.

attempting to become PBGC's strategic partners – an opportunity that could lead to more than \$100 million in fees and management of up to \$2.5 billion in PBGC assets. As a result, the former Director's improper actions raise serious questions about the integrity of the process by which the winners of the strategic partnership contracts were selected.

To maintain the integrity of the procurement, the FAR establishes certain controls over contacts between agency personnel and offerors during the procurement process.³ In essence, all contact between agency personnel involved in the procurement and bidders is to go through the contracting officer; individual conversations or communications with bidders are strictly prohibited.

The former Director was aware that he should not be in contact with bidders during the procurement process. Prior to each TEP on which he served, he was provided a verbal briefing. Procurement officials stated that in these verbal briefings they made clear the rules prohibiting contact between the TEP members and potential offerors. Further, a written memorandum which described the prohibition on contact with offerors was provided to each member of the TEP, including the former Director. The Director of Procurement stated that she asked each member of the TEP to read the memorandum in front of her, so that she could be certain that each person understood the importance of following the rules. Finally, the Director of Procurement stated that she had advised the former Director multiple times that he should not have contact with potential vendors and that he should cut off any ongoing contact once a Request for Proposal (RFP) was released.

The source selection period for the strategic partnership procurement began when the RFP was issued on July 31, 2008 and ended on October 31, 2008, when three contracts were awarded. During this 3-month communications blackout period, we identified the following contacts:

- Nine phone calls were made between the former Director's phones and **Goldman Sachs**, a firm that was awarded a strategic partnership contract to invest up to \$700 million in private equity. Three calls were incoming calls and six were outgoing. Six of the nine calls were with the phone of a manager who was noted as a key person in the strategic partnership contract and whose involvement in bidding for the strategic partnership included making presentations at PBGC and in New York, and conducting the final price negotiations.
- Six phone calls were made between the former Director's phones and **BlackRock**, a firm that was awarded a strategic partnership contract to invest up to \$600 million in real estate and up to \$300 million in private equity. The calls included one incoming call and one outgoing call with an unknown party at BlackRock and four

³ FAR Part 15.303 states that agency heads are responsible for source selection. The contracting officer is designated as the source selection authority unless the agency head appoints another individual for a particular acquisition or group of acquisitions. FAR 15.303(c) requires the contracting officer to: (1) serve as the focal point for inquiries from actual or prospective offerors after release of the solicitation, and (2) control exchanges with offerors after receipt of proposals.

outgoing calls to the phone of a Managing Director, who was also noted as a key person on the strategic partnership contract.

- Ten phone calls – five outgoing from the former Director’s PBGC phone lines, three outgoing from the former Director’s cell phone, and two incoming – were made during the blackout period between the former Director’s phones and a managing director of **JP Morgan**, a firm that was awarded a strategic partnership contract to invest up to \$600 million in real estate and up to \$300 million in private equity.

Of the 16 firms submitting bids, calls were logged from the former Director’s phones with 8 of the firms during the blackout period, including the four firms deemed to be “finalists” from which the three successful bidders were selected. He communicated via e-mail with one of the eliminated firms only to say, “The rules of ethics prevent me from having our lunch meeting.”

During January 2009 as part of the audit, we interviewed the former Director about communications with bidders during the blackout period. Initially, he stated that he was careful not to talk to any of the potential bidders during the period that the Strategic Partnership was “on the street” for bid. He also stated that he did not recall having any conversations with offerors during the procurement. We then showed the former Director his telephone logs. At that time, he amended his prior statements and commented that, if he had spoken with an offeror, he definitely would not have discussed the procurement on which he was a TEP member. He advised us that he did not keep records, notes, or other documentation of his phone calls or other contacts.

As an example of the contacts, at least five emails document communications during the blackout period between the former Director and the JP Morgan executive referenced above. Our review of the email string showed that, beginning on October 24, 2008 (during the blackout period), the former Director was attempting to contact the JP Morgan executive by phone. The subject line of the emails was, “Can I reac” [reach]. The JP Morgan executive replied with details of his hotel room number and telephone, his mobile phone number, and the phone number of his apartment, as well as times when he would be available. It is unclear from the emails whether the former Director and the JP Morgan executive ever actually spoke by phone and we do not have specific information about what topics the former Director planned to discuss. However, on the day that winners of the strategic partnerships were selected, the email string continued. The subject line was changed from “Can I reac” [reach] to “Strat partnerships” and the message sent by the former Director was, “U guys got 900m. 600 real estate 300 private equity.” We concluded that the email message and subject line provide a strong indication that the strategic partnerships were to be the topic of the phone conversations between the former Director and the JP Morgan executive.

During March 2009 we discussed the details of these phone calls and emails with the former Director, at his request. He asserted that the JP Morgan executive has been his friend since the mid- 90’s and the discussions did not involve PBGC business or the

strategic partnerships. Nevertheless, we noted that the former Director sent an email to a subordinate, instructing the subordinate to provide the Strategic Partnership RFP directly to this JP Morgan executive, an act that further links the executive with the Strategic Partnership process.

The former Director's explanations about these particular contacts during the blackout period evolved during the course of our audit. For example, in his April 28 written statement⁴ addressing the issues included in this report, he provided a new explanation for certain contacts during the blackout period for communication with bidders for the Strategic Partnerships.⁵ That statement, which is included in its entirety as Appendix B, contained the following explanation for 5 phone calls and 5 emails with a JP Morgan executive that occurred between October 24 and October 29, 2008 According to the statement, "I was working at that time on the McCain presidential team's potential transition. I had responsibility for developing lists of names of individuals to be Secretaries and Under Secretaries at various agencies including Treasury, Commerce, Labor, Education and HUD. The person I was reaching via these emails was someone I wanted to put on one of these lists and whose advice I sought about other possible individuals."⁶

We attempted to corroborate the former Director's explanation for his calls and emails to the JP Morgan executive. We confirmed that the executive was listed as a potential candidate for cabinet level office on the document titled, "Top Tier Presidential Appointment Process Overview" as provided to us by the former Director. We spoke with the leader of the McCain Transition Planning Team to understand the process used by the former Director in developing the list of names. According to the team leader, the list was developed through a highly confidential process using public information; any necessary phone calls were made from the legal offices of the Republican Transition Team headquarters in Washington DC. The team leader advised that named candidates were not called as part of the process. This tended to conflict with the former Director's assertions about phone calls to the JP Morgan executive.

In a further attempt to corroborate the former Director's explanation, we identified the person or company associated with each phone number called on the former Director's cell phone and on his direct line during the relevant time period. Except for the calls to the JP Morgan executive, there were no phone calls to either the homes or businesses of any of the individuals identified by Mr. Millard as potential candidates for political appointment, based on the listing he provided us. When we told Mr. Millard the results of our corroboration efforts, he confirmed he had not contacted any other potential candidate.

⁴ We note the former Director's April 28 statement is unsigned, however, when his attorney forwarded the statement to the OIG via email he stated: "attached please find a PDF of Mr. Millard's statement., we submit this statement as final and without restriction as to circulation." To date, we have not received a signed copy.

⁵ The former Director had previously provided different explanations for these phone calls, including the wish to discuss a particular news article and a discussion of New York politics; we were also unable to corroborate those explanations.

⁶ Page 5 of Appendix B, Statement of Former PBGC Director Charles E.F. Millard (page 20 of this report).

We advised the current Acting Director and PBGC's General Counsel about the former Director's improper contacts with bidders, as well as the post-award assistance with his job search that he received from an executive of at least one of the awardees, as noted in the following finding. The General Counsel advised that these facts, taken together, raised serious ethical concerns of which she would apprise the Board.

Also, according to the General Counsel, the career Board staff requested that PBGC slow down the implementation of the private equity and real estate allocations of the strategic partnerships because political appointees are not yet in place to serve as PBGC's Board Representatives. The General Counsel reports that PBGC is continuing with planning and training activities contemplated by the contracts.

In another recent procurement, PBGC officials reacted strongly to a much less serious violation of the prohibition on contact with bidders during the blackout period. A PBGC employee who was serving as the Chair of a TEP contacted bidders during the blackout period to seek clarification about their pricing proposals. The employee documented all contacts and obtained supervisory concurrence with the proposed actions. However, the Procurement Department Director reported to OIG that the procurement had been compromised, noting that, "it is a violation of the FAR for any TEP member to contact any firm during the progress of a procurement regarding any matter involving that procurement. Once a procurement is on the street, only the Procurement Department may contact any vendor regarding that procurement in order to ensure that all vendors are treated fairly, equally, and without bias." When this occurred, the former Director met with the employee to reiterate the seriousness of contact with bidders during the prohibited time.

Certain senior level leaders in PBGC asserted their belief that the former Director's motivations for making contact with the bidders were inappropriate. While our audit did not identify evidence of criminal activity by any of the bidders, the former Director's improper contacts cast serious doubt on the integrity of the procurement process.

OIG RECOMMENDATION

The PBGC Board should determine whether inappropriate actions of the former Director, as described in this report, cast enough doubt about the fairness, integrity and openness of the procurement to warrant cancellation of the strategic partnership contracts. If so, the Board should instruct PBGC to cancel the contracts. **(OIG Control Number: Board-1)**

PBGC BOARD RESPONSE

The PBGC Board has asked the Acting Director of the PBGC to provide the Board with his recommendation for PBGC action in response to the draft report. The Board will review the Acting Director's recommendation and ensure that appropriate action is undertaken.

OIG EVALUATION

The Board's response meets the intent of our recommendation.

Finding 2: The Former Director's Dual Roles Raised Concerns About Impartiality

The former PBGC Director represented the Corporation before the investment community in person, traveling frequently to New York and maintaining continual telephone contact with major investment firms. The former Director recounted significantly detailed and frequent discussions with these firms over a period of time. Contemporaneously, he assumed de facto responsibility for key procurement activities necessary to implement the new investment policy, including evaluating many of the same firms with which he routinely dealt. Although PBGC has not placed a specific prohibition on the Director's participation in the procurement process, proper separation of duties would prevent his service in both roles.

Separation of duties is required for effective management control and the lack of separation leaves PBGC vulnerable to concerns of real or perceived bias. Due to the former Director's frequent contact with bidders coupled with his participation in the procurement process, senior level staff expressed doubts about the fairness of his decisions and the selection of winners for the strategic partnership contracts. The former Director's contact with bidders allowed some, but not all, to have frequent and in-depth access to a key procurement decision-maker. Further, the continuing contact provided an opportunity for some, but not all, bidders to enhance the former Director's level of confidence in their firms' knowledge and skills. Finally, the post-award assistance he received from an executive of one of the winning bidders raises serious ethical concerns.

The Controls

PBGC's procurement process is subject to the Federal Acquisition Regulation (FAR) and PBGC's implementing guidance. The FAR's specific regulations are based on guiding principles which caution that business must be conducted with integrity, fairness, and openness.

An essential consideration in every aspect of the System is maintaining the public's trust. Not only must the System have integrity, but the actions of each member of the Team must reflect integrity, fairness, and openness.... (FAR § 1.102-2(c)(1)).

FAR § 3.101-1 states:

Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with preferential treatment for none. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct. **The general rule is to avoid strictly any conflict of interest or even the appearance of a conflict of interest in Government-contractor relationships. While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions.** [Emphasis added.]

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, notes that appropriate separation of duties is necessary for effective management control. Key duties and responsibilities should be separated among individuals. GAO's *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1, explains that separation of duties is necessary to reduce the risk of error, waste, or wrongful acts.

De Facto Responsibility for Key Procurement Activities

The former Director was intimately involved in the day-to-day details of the contracts used to develop and implement the new investment policy. His active participation began before the first contractor was selected to help develop PBGC's new investment policy and continued throughout his tenure at PBGC, despite warnings from his own advisors about the wisdom of such involvement. Examples of his activities at each stage of the contracting process include:

- Serving on a three-member evaluation panel, with two subordinate employees, to select **Rocaton** as the contractor hired to assist in developing PBGC's new investment policy.
- Choosing the TEP members, and serving on the evaluation panel, with two subordinate employees, to select **Plexus** to provide advisory services for the development of transition management principles.
- Choosing the TEP members, and serving on the evaluation panel, with two subordinate employees, to select **Ennis Knupp** as advisor for the upcoming strategic partnership procurement.
- Helping draft the Statement of Objectives, including the 13 mandatory requirements; leading the bidders' conference; helping draft the evaluation factors through which the winning firms would be selected; choosing the TEP members and serving on the evaluation panel, with two subordinate employees, to select **BlackRock, Goldman Sachs, and JP Morgan** as the winning bidders for strategic partnerships to invest up to \$2.5 billion of PBGC assets.

Responsibility to Represent PBGC

The former Director continued to represent PBGC before the investment community at the same time that he was serving a significant role in the procurement process, to include evaluating the contract proposals of those with whom he was in frequent contact. According to his official position description, one of the Director's major duties is serving as chief PBGC spokesperson with the presidents and chief operating officers of major corporations and heads of various associations. From February 12, 2008 when the Board approved the new investment policy, through July 31, 2008 when the RFP was issued to solicit for strategic partners, the former Director's calendar shows that he met with many firms who were potential bidders in planned procurements to implement the investment policy. In some of these meetings, PBGC staff attended with the former Director while in others the former Director met separately with the Wall Street entities.

The former Director also communicated extensively with the investment community by telephone. Records show that, between July 2007 and October 2008, hundreds of calls were logged to and from the former Director's phones with various Wall Street firms, including hundreds of calls with the successful bidders for strategic partnerships. Some of the phone calls were very short (less than a minute). The assistants to the former Director acknowledge making some calls, with the objective of scheduling visits and other routine administrative activities. Because the former Director did not keep notes or otherwise document his phone calls, we were unable to conclusively determine how many completed calls he held with bidders. However, the number of calls made (e.g., at least 172 to Goldman Sachs, 95 to JP Morgan, and 45 to BlackRock) demonstrate a persistent intention to speak with these firms rather than mere incidental or casual contact. Except for the phone calls made during the blackout period as noted in the prior finding, phone contact between the former Director and bidders would not have been inappropriate, if he had not been substantively involved in the procurement process.

We asked the former Director for notes or other details to document the nature of the telephone calls made from his phones. He initially asserted that he had made some of the calls as part of conducting market research for the various contracts related to the strategic partnerships. However, we were unable to corroborate his explanation, as he did not provide any documentation of the information he developed during the market research. FAR requires agencies to document any market research performed and the PBGC General Counsel advised the former Director of the need to document his research.

The former Director made multiple phone calls to Goldman Sachs in the three days before the strategic partnership RFP was issued. He characterized the calls as "intensive market research," but acknowledged that there was no documentation of that research. Since market research is conducted to determine whether there are firms capable of performing the work the agency requires, it is unlikely that the former Director was conducting market research, as defined in the FAR. After he left PBGC, we met again with the former Director to discuss these calls. At that time, he explained that the calls were made to two Goldman Sachs executives who he asserted were not actually involved in bidding for the strategic partnership. Neither executive was listed as "key personnel" in Goldman Sachs' bid. However, the former Director had specifically requested, via email, that the RFP be sent to one of the Goldman Sachs executives he had described as "uninvolved." This email, and others, tends to contradict the former Director's assertion and links the executive with the strategic partnership bidding process.

A whistleblower alleged that the former Director contacted certain executives in order to enhance his future employment prospects. We found that the Goldman Sachs executive noted above provided active and substantial assistance to the former Director as he searched for post-PBGC employment. However, in his written statement,⁷ the former Director asserted in part "... around the time I became aware of this audit I became aware of a rumor that I was pursuing the Strategic Partnerships in order to increase my changes at post-PBGC employment with large financial services firms. This was ridiculous, as I

⁷ Page 3 of Appendix B, Statement of Former PBGC Director Charles E.F. Millard (page 18 of this report).

already had numerous contacts at such firms and had worked in senior roles at two of them in the past.”

Our review of the former Director’s email records disclosed extensive communication with the Goldman Sachs executive, occurring after the award of the \$700 million Strategic Partnership contract. While we did not identify any evidence that the former Director was attempting to obtain employment directly with Goldman Sachs (or with any of the winning firms), we did find 29 emails between a senior Goldman Sachs official and the former Director, assisting him in his search for employment. For example, the former Director provided his resume, bio, and six news articles to the Goldman Sachs executive, who in turn forwarded the materials to others in the financial community, including those with whom Goldman Sachs had a business relationship.

Employment assistance provided by the Goldman Sachs executive to the former Director included personal meetings, strategic advice, introductions to potential employers, and help with meeting arrangements. For example, in one email the executive wrote, “... It was great to see you this afternoon. I spoke with [the CEO of a financial services firm] after our mtg. He would love to meet with you in NY. I told him I would forward your info when I receive it and then you can feel free to coordinate with his assistant at any time after that. Separately, I spoke with [---] and he is confirmed for tomorrow morning. I will keep you posted on the others that we discussed. ...” The former Director advised us that the assistance was provided due to a “deep personal relationship” between him and the executive and did not have any connection with the recent contract award. However, we concluded that the receipt of employment assistance from a winning bidder raises serious ethical concerns; the PBGC General Counsel advises she shares these concerns.

As another example of questionable contact, three days before issuance of the RFP, email records show that the former Director received an email from an executive at JP Morgan on the subject “Sample Strategic Partnership RFP Questions.” The email included an attachment comprising ten pages of proposed questions for PBGC procurement officials to ask bidders for the strategic partnerships during their oral presentations. When we asked the former Director about this email, he explained that he likely had discussed proposed questions with several firms, prior to issuance of the RFP. We also asked whether the file name of the attachment “JPMorgan Sample RFP Questions Strategic Partnership v5.doc” might indicate that this was the fifth version of an ongoing collaboration. He stated he did not know. However, he confirmed that he had discussed the potential strategic partnership in detail, including questions to ask, with parties external to PBGC. We concluded that allowing some bidders to propose sample questions could offer an unfair advantage to those bidders. Interacting through discussions and emails with some, but not all, bidders creates the appearance that those bidders who had prior knowledge of the questions could be better prepared and therefore more effective in delivering their oral presentations.⁸

⁸ PBGC officials identified an additional instance in which a different bidder provided sample questions. According to the email, the bidder “appreciated the opportunity...to share our thoughts re additional questions you might raise in your pending RFP for Strategic Partnerships.” The email contained an attachment titled “PBGC Sample RFP Questions.doc.” Our subsequent review identified an additional email from the bidder regarding sample RFP questions.

Alteration of Established Review Criteria

Another example of the former Director's direct involvement with procurements occurred when he established an additional review criterion after the evaluation panel issued their final recommendation. The former Director instructed a top-level official to review the TEP evaluations of the Fixed Income Investment Manager and the Index Fund Manager solicitations after the TEP had documented their final conclusions. Senior level PBGC officials were concerned about this change; the PBGC Chief Management Officer acknowledged that there was not a specific prohibition against adding such a review, but he also noted that, "... inserting this during the end of the process rather than at the beginning brings about risk from an IG review perspective and possible bidders should they find out."

The Director of Procurement was so troubled by the change in established operating procedures that she requested a legal opinion to address the issue. In response, the PBGC General Counsel opined, in part: "... a formal source selection organization is usually established prior to proposal review. However, the FAR does not prohibit ... consulting with ... an advisor at any particular point in the procurement."

We agree with the General Counsel that the FAR does not specifically prohibit consulting an advisor. However, our concern arises from the establishment of additional review criteria that were not established until evaluations had been completed and presumptive winning bidders identified. A procurement official said that the former Director was concerned that the TEP members might not see the "big picture" or consider PBGC's needs and future direction. In addition, the former Director noted that the reviewer might have personal knowledge of a negative nature about a key individual or about the bidding firm that would not be represented in the company's proposal.

FAR § 15.203 requires that the factors and subfactors used to evaluate bids, as well as their relative importance, be included in the RFP. PBGC Standard Operating Procedures require that the factors or criteria and the methodology used to evaluate proposals be identified at the same time the requirements are defined to allow inclusion in the solicitation package. The ad hoc review process mandated by the former Director, including asking the senior official to use personal knowledge as an evaluation criteria, was not anticipated or described as part of either solicitation.

Because the reviewer was asked to consider any personal knowledge of a negative nature about a key individual or the bidding firm, the ad hoc review requested by the former Director created an additional review criterion. Changing a procurement criterion during the course of a procurement may be viewed as interference with or preference to offerors, which could result in a challenge to the procurement decision.

Proper separation of duties was not maintained between the former Director's authorized roles as spokesman for PBGC and the role he assumed of performing key procurement activities for government contracts to implement the new investment policy. The former Director's performance of incompatible duties made PBGC vulnerable to allegations of bias, improper influence, or abuse of position.

Some PBGC employees familiar with management of the investment portfolio believed that the former Director made some decisions based on his relationship with certain industry members and not on the merits themselves. In addition to frequent contacts, another factor that supported this belief was the speed with which multiple investment decisions and the subsequent procurements were made. Because the former Director did not document the reasons for his visits, calls, emails and the market research that he claimed to have performed, we could not determine whether the former Director's communications with Wall Street firms had any impact on his decisions.

The former Director strongly denies that there was anything improper in the dual roles that he fulfilled. He asserted that he set an aggressive course of action to implement the new investment policy and that he believed in talking to lots of people to understand what they have done and to discuss possibilities. He also said that he needed to be directly involved in the procurements to ensure that they actually took place; his involvement was appropriate because, in his view, he had the best knowledge of the issues and firms to be considered.

Advisors to the former Director cautioned him against serving on TEPs, explaining that his participation could create the appearance that he could dominate the panel, given that the panel members were all subordinate employees. However, the former Director was also advised that his participation did not specifically violate any provision of law or regulation. The former Director concluded that he would participate in the panels, as he did not consider that his actions would appear to be improper. During the course of this audit, he confirmed his view that he was free to participate in the evaluation panels, as long as his participation was not illegal.

RECOMMENDATION

The PBGC Board should require future Directors to ensure appropriate separation of duties, to include refraining from service on technical evaluation panels and other de facto procurement activities. Special attention should be given to situations that are likely to create the appearance of improper influence or bias. **(OIG Control Number: Board-2)**

PBGC BOARD RESPONSE

The Board agrees with the recommendation and will work with the PBGC to develop appropriate guidelines.

OIG EVALUATION

The Board's response meets the intent of our recommendation.

OBJECTIVES, SCOPE, AND METHODOLOGY

This interim report is issued as part of our ongoing monitoring of PBGC's plans for implementing the new investment policy. Matters came to our attention concerning possible procurement improprieties in activities to implement the new investment policy. In response, we developed the following audit objectives to guide our examination of these matters:

- Determine whether the Director's direct involvement in the procurement process compromised the perception of impartiality in contracting for strategic investment partners;
- Determine whether the Director and other procurement officials made improper contacts with offerors during investment management source selections; and
- Determine whether Procurement Department standard operating procedures were inappropriately modified during investment management procurement.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform this audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was conducted between October 2008 and May 2009. Nothing came to our attention during our field work to cause us to conclude that any procurement officials had improper contacts during the source selection blackout period, except for the instances noted in this report.

The following scope and methodology was used in conducting this review. The scope of our audit includes procurement activities related to the investment policy, from February 2008 through February 2009. We also assessed allegations made by a whistleblower regarding possible procurement improprieties related to the selection of investment consultants and managers.

We interviewed the former PBGC Director while he was still in office, certain members of the Executive Management Committee, and key management officials within the Financial Operations Department and the Procurement Department. We also met with the former Director, at his request, to allow him to provide additional comments and clarifications in relation to the issues described in this report. We agreed to receive a written statement from him and have attached that statement, in its entirety, as Appendix B of this report. The statement is unsigned, but was accompanied by a note from the former Director's attorney stating, in part, "... we submit this statement as final and without restriction as to circulation." Because the statement included certain new information, we performed additional tests intended to corroborate that information. We also evaluated available documentation related to the investment transition, with emphasis on the solicitation and selection of contractors to provide investment services, to include the strategic partnerships.

This audit did not include detailed analysis of these materials, but we did look for and resolve inconsistencies as necessary to achieve our objectives.

To address whistleblower allegations concerning improper contacts with bidders, we obtained the former Director's electronic contact list, as well as the phone records for his direct PBGC phone line, the phone lines of his two assistants, and his government-issued cell phone. After we determined that he had been in contact with bidders during the blackout period, we also obtained his PBGC email records.

Our phone record analysis included reviewing the former PBGC Director's calendar, including telephone contacts made, and comparing them to his electronic contact list to identify the contact's employer and telephone number. Additionally, we verified the employer and telephone number through internet search services.

PBGC's Office of Information Technology provided copies of the former Director's e-mail records for the May 2007 to January 2009 period. We used automated tools to sort the emails by dates, companies, and names to identify emails for further review. We reviewed the emails related to the Strategic Partnership procurement process and to post-award contact with winning bidders for Strategic Partnership contracts.

Statement of Former PBGC Director Charles E.F. Millard

Charles E. F. Millard
Rye, New York

April 28, 2009

VIA EMAIL AND U.S. MAIL

Inspector General
Pension Benefit Guaranty Corporation
Office Number 4823
1200 K Street NW
Washington, DC 20005

Deborah Stover Springer
Pension Benefit Guaranty Corporation
Office Number 4823
1200 K Street NW
Washington, DC 20005

Dear Becky and Deborah:

I am writing concerning the IG audit of the implementation of the PBGC's investment policy, specifically as it relates to my involvement.

The Inspector General has not permitted me to review the actual draft report. However, I will do my best to address the issues in that draft as I understand them.

There appear to be two subjects to address: first, the policy question involved in my decisions to sit on certain Technical Evaluation Panels (TEPs) involved in Requests For Proposals (RFPs) for various investment-related services to the PBGC; second, the relationships and contacts I had with firms involved in these processes. In both areas, my conduct was appropriate as a policy matter, based firmly on agency regulation and advice of agency counsel, and undertaken in good faith by me to advance the goals of the PBGC.

This letter can therefore be summarized as follows: a) I sought advice from agency counsel and from the Chief Procurement Officer at PBGC before becoming involved in the selection process; b) I *never* discussed matters pertaining to the RFP with any participant during the pendency of the RFP; and c) I acted in what I believed to be the best interests of PBGC to implement desperately needed reforms of PBGC investment policy.

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A. THE DIRECTOR'S PARTICIPATION IN TEPs IS PERMITTED UNDER THE LAW AND IS A POLICY QUESTION

Before deciding to participate in any TEP, I made sure to consult the Chief Procurement Officer of the PBGC and/or the General Counsel. I was given clear and unequivocal guidance that there was (and to my knowledge is) no prohibition against a PBGC Director's sitting on a TEP.

Thus, the question regarding service on TEPs is a policy question. The law and regulations allow it, and I chose to take a hands-on approach to the pressing and important matters that were my responsibility as Director of the PBGC. In each instance, I added numerous hours and meetings to my own schedule, solely because I felt a need to insure the best possible stewardship of the PBGC's billions in assets that it holds in trust for the retirees it insures.

It is important to understand the situation the PBGC faced during most of the time period in question. Starting in late spring of 2008 through the conclusion of the Strategic Partnership RFP in late October 2008, three things were clear: (1) PBGC had a new investment policy to implement (which we did in a very careful and deliberate manner); (2) the capital markets were in a state of tremendous upheaval; and (3) the economy was likely to present the PBGC with corporate bankruptcies of tremendous size, possibly including companies from the automobile industry.

At the same time, the PBGC itself was dealing with over \$50 billion in investible assets with a staff of approximately fifteen people. On numerous occasions, the approach I took to dealing with our challenges evoked staff resistance. But besides staff resistance, it was also quite obvious that a staff of fifteen people was insufficient to deal with problems of the order of magnitude the PBGC faced.

Moreover, the organization had developed a reputation for an inability to get things done. When the investment policy was adopted, there were two asset-manager selection RFPs in the marketplace that I believe were over a year old already. It had become an embarrassment to the corporation. When I asked senior staff for work on additional projects, I was repeatedly told that they did not have time and that anything new would mean delaying the conclusion of those RFPs which were due to be completed in late September of 2008.

It was clear to me that the PBGC needed better resources and better information flow. The staff and the existing consultant had been working together for over ten years. I came to believe on repeated occasions that the staff was resistant to or threatened by the kinds of changes that were needed to put PBGC on sounder footing to face the challenges that were coming.

I acted in the best interests of the agency. I had nothing to gain and in fact was developing resources that would principally benefit the PBGC in the future and that would be available to

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future Directors, since I fully expected that, regardless of who won the presidential election, I would be leaving PBGC in January 2009.

Around the time the IG's audit began, I began to hear about complaints from the staff. They did not like the idea of new advisors being brought in. For years the senior finance staff had a close relationship with PBGC's consultant, and I often had difficulty obtaining the information I felt a responsibility to have. I felt that the Director who bears ultimate responsibility for the organization needed more access to better advisors who were committed to more transparent information flow. I believe many of the complaints about Strategic Partnerships were the result of the staff feeling threatened. However, I knew that we needed more resources and felt my responsibility was not to please the staff but to make the right decisions for the good of the PBGC.

Also around the time I became aware of this audit I became aware of a rumor that I was pursuing the Strategic Partnerships in order to increase my chances at post-PBGC employment with large financial services firms. This was ridiculous, as I already had numerous contacts at such firms and had worked in senior roles at two of them in the past. I also fully understood that, under the ethics rules, I would not be able to work at any of the firms that we selected.

I considered recusing myself from the Strategic Partnership RFP in order to retain these employment possibilities and to avoid the criticism that I knew would come from this decision that was not supported by staff. However, I reviewed certain aspects of the ethics training I received when I arrived at PBGC, and I recalled that I was instructed that I owed a duty of "undivided loyalty" to the PBGC while I was working there.

I was the PBGC employee most knowledgeable about the firms we would be interviewing and about Strategic Partnerships. Senior staff did not have the time to carry out this assignment. I knew that my involvement would insure that we completed the task. The capital markets and the economy were presenting increasing challenges to the PBGC. Those challenges urgently required greater resources. For these reasons, I put myself on the Strategic Partnership TEP. I did not feel that I would be carrying out my duty of undivided loyalty if I left myself off the TEP in order to protect future employment possibilities or avoid unfounded criticisms.

I consulted with the Chief Procurement Officer and the General Counsel of the PBGC and was told that there was no prohibition against my sitting on the TEP, and so I decided to do so. At the conclusion of this TEP, no challenge was made to the fact that the Director had been a member of the TEP. This issue was not raised in any bidder's challenge, and the fact that the Director had been a member of the TEP was known to everyone and was not a bar to the General Counsel's determination of legal sufficiency.

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B. IN EACH OF THESE RFPs, I SCRUPULOUSLY COMPLIED WITH ALL LEGAL, REGULATORY AND ETHICAL OBLIGATIONS

I understand that the IG's report is also likely to address contacts from my office with investment firms that were participating in the RFP during the time the TEP was evaluating their proposals. Regarding my contacts with employees of firms bidding on the Strategic Partnership RFP: I was well aware of the prohibition against discussing the substance of the RFP or the RFP process outside the actual RFP process itself, and did not do so. To my knowledge, no one at PBGC, including the IG, has claimed otherwise.

The one form of communication that I have been presented in this matter that is even remotely relevant here is the requests my office made from two firms for suggested questions that might be asked during an RFP process. These requests were wholly appropriate exercises of market research. They in no way disclosed to others what we would ask or think or decide. They simply requested the kinds of suggestions that market research is designed to elicit. These requests were made before the RFP went out and were requested before the RFP was released — specifically because the RFP release date was coming shortly and the market research would have to cease.

I was also aware that it is permitted, indeed it is expected, that individuals will sometimes have contacts at bidding firms and that those contacts will continue during the pendency of an RFP. I understood clearly that such contacts are permissible but that they must not involve discussion of the RFP. I fully complied with those rules.

The IG has been informed that numerous calls made from my office were made by my assistants for scheduling purposes. I rarely placed phone calls myself; frequently calls would be placed when the person being called was not available, and in September and October, my assistants were involved in numerous calls relating to the logistics and scheduling of eight six-hour presentations at the PBGC and four seven-hour presentations at the bidders' offices in New York. The changing logistics of those situations required constant schedule and other planning changes. Moreover, I have asked the IG's office to compare these phone calls to my calendar to determine whether I was even in the building when these calls were placed. To my knowledge, such a comparison has not been made by the IG, meaning that many of the calls I supposedly made or received were in fact handled by someone else while I was out of the office.

One lengthy call in which I did participate in late October was brought to my attention at my last meeting with the IG. I explained that this call probably related to urgently finding information regarding the auto industry from senior individuals who had no involvement with the RFPs. I explained to the IG that additional time on that call was likely spent discussing politics, as the presidential election was a week away. The news article that prompted that call regarding the auto industry and the identity of the person I spoke with about the auto industry have been provided to the IG.

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In the process of writing this letter, I recalled a specific reason that I was trying to reach this party with some urgency in the "Not business" set of emails just before the GM article, and I informed the IG of this verbally today.

I was working at that time on the McCain presidential team's potential transition. I had responsibility for developing lists of names of individuals to be Secretaries and Under Secretaries at various agencies including Treasury, Commerce, Labor, Education and HUD. The person I was reaching via these emails was someone I wanted to put on one of these lists and whose advice I sought about other possible individuals. I have today provided documentary evidence of my involvement in this process as well as documentary evidence that I did in fact use the name of this individual and some of his advice in this process.

One last point about the October discussions with this individual: They all happened *after* the Strategic Partnership presentations and papers had all been made and submitted. All of the TEP on-site visits were concluded. This is not to say that RFP-related discussions would have been acceptable at that time; rather, they would have been useless. The TEP had all the information it was permitted to use. If I was coaching the firm, it could not act on my coaching; if I was seeking information to use in the TEP discussions, I would have had to bring that new information to TEP sessions and utilize it to persuade fellow TEP members in sessions that were overseen by the Chief Procurement Officer.

As an indication that I was following ethical guidelines scrupulously, I point to my email with one of the other bidders. I had a personal relationship with the chairman of the firm and he and I had spoken, before the RFP, about the idea that I might work with his firm in the future. We had arranged a lunch to discuss it. I had no idea his firm would be bidding on the Strategic Partnership RFP. As soon as I realized that his firm had bid, I consulted with the General Counsel about what to do and sent a short email that stated: "The rules of ethics prevent me from having our lunch meeting." I was aware that I needed to be clear, curt, and unequivocal, and I had no further discussions of any kind with this individual until the RFP was concluded. I stayed out of discussions with him because he *was* personally involved in the RFP process and we *had* had a discussion about employment. I shared these details with the General Counsel and followed her advice.

The part of this process that troubles me is the following: the rules state that I may have non-RFP-related contact with persons I know at the bidding firms. I had a limited amount of such contact, but that contact is now described as creating an "appearance" issue. An example: It is normal for PBGC staff to have years-long relationships with fixed-income investment managers. Yet, when a contract for fixed income management is re-bid, it is also normal for some of the same PBGC staff to have business contact one day and RFP-only contact another day. There is no appearance issue in such circumstances, and there is none here.

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Finally, it is part of job of the Director to have contact and relationships with the investment industry. I had numerous such relationships and had non-RFP-related contact with six of the eight bidders involved in the RFP during the time the RFP was pending. Additionally, one of the eight was requested to suggest possible RFP questions just before the RFP was. Yet, since only three bidders were selected, it is difficult to imagine in what way these contacts could possibly have tainted this process. I have described these contacts to the IG.

In conclusion: 1) I always acted in the best interests of the agency. I exercised my authority and judgment in ways that were sometimes counter to staff's wishes, and I took on additional work personally because I saw the need to change certain practices and to provide greater resources to an agency facing tremendous looming challenges with a limited staff. 2) I sought guidance from General Counsel and the Chief Procurement Office regarding the legal issue relating to whether I was permitted to serve on TEPs. 3) I did not discuss the RFP with anyone outside the agency who was in any way involved in the process. My non-RFP-related contacts were legal and ethical. It is my hope that the IG's report bears out these facts.

Very truly yours,

Charles E.F. Millard

PBGC Board of Directors' Response



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

MAY - 8 2009

Ms. Rebecca Anne Batts
Inspector General
Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W.
Washington, DC 20005

Dear Ms. Batts:

As the members of the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC), we thank you for the opportunity to comment on the PBGC Office of Inspector General (OIG) draft report entitled, "Former Director's Involvement in Contracting for Investment Services Blurs Roles and Raises Fairness Issues."

We appreciate the work that your audit team has performed in conducting this important audit of the procurement to select contractors for the implementation of PBGC's new investment policy. We have reviewed the draft report and appreciate the information that you have provided about former PBGC Director Charles E.F. Millard's involvement in the procurement process. The Board will take the appropriate action in response to the recommendations.

OIG Recommendation 1:

The PBGC Board should determine whether inappropriate actions of the former Director, as described in this report, cast enough doubt about the fairness, integrity and openness of the procurement to warrant cancellation of the strategic partnership contracts. If so, the Board should instruct PBGC to cancel the contracts.

The PBGC Board has asked the Acting Director of the PBGC to provide the Board with his recommendation for PBGC action in response to the draft report. The Board will review the Acting Director's recommendation and ensure that appropriate action is undertaken. The OIG has advised the PBGC Board agencies that this approach meets the intent of the OIG recommendation.

PBGC Board of Directors' Response

OIG Recommendation 2:

The PBGC Board should require future Directors to ensure appropriate separation of duties, to include refraining from service on technical evaluation panels and other de facto procurement activities. Special attention should be given to situations that are likely to create the appearance of improper influence or bias.

The Board agrees with the recommendation and will work with the PBGC to develop appropriate guidelines.

Again, thank you for the opportunity to comment on the draft version of the OIG report. We appreciate your work in reviewing this important area. As the new Board members begin their work, we look forward to assuring that PBGC has adequate internal controls to help it meet its critical mission.

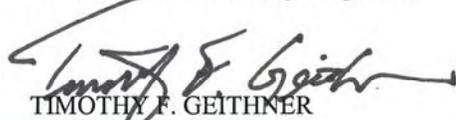
Sincerely,



HILDA L. SOLIS
Chair of the Board
Pension Benefit Guaranty Corporation



GARY LOCKE
Member of the Board
Pension Benefit Guaranty Corporation



TIMOTHY F. GEITHNER
Member of the Board
Pension Benefit Guaranty Corporation

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