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Meeting Number 155
The Advisory Committee of the
Pension Benefit Guaranty Corporation
December 14, 1999

I. Attendance

Advisory Committee:

Member:
Milton Irvin
28 Woodmere Drive
Summit, NJ 07901

Consultant

Consultants:
Teresa Ghilarducci
Department of Economics
University of Notre Dame
Notre Dame, Indiana 46556

M. Sharon Cassidy (by phone)
United States Steel and Carnegie
Pension Fund
767 5th Avenue, 9th Floor
New York, NY 10153

Beverly Fisher White
3082 Shamrock North
Tallahassee, FL 32308

Representative of the
Secretary of Commerce
Jane Molloy

Representative of the
Secretary of Labor
Rudy Nuissl

Representative of the
Secretary of the Treasury

Ed DeMarco
Patrick Garabedian

Wilshire Associates

Eileen Neill
Michael Schlachter

Pension Benefit Guaranty Corporation

David Strauss, Executive Director
Joseph Grant, Deputy Executive Director and Chief Operating Officer
Tony Calhoun, Deputy Executive Director and Chief Financial Officer
Andrea Schneider, Director Corporate Finance and Negotiations Department
Terrence Deneen, Principal Deputy General Counsel Office of General Counsel
Hazel Broadnax, Director Financial Operations Department (FOD)
Ted Winter, Deputy Director, FOD
Lou Faircloth, Deputy Treasurer, FOD
Barbara Byington, FOD
Judy Welles, Director Communications and Public Affairs Department
Stuart Sirkin, Director Corporate Policy and Research Department (CPRD)
David Gustafson, CPRD
Jim Marion, CPRD
Deborah Forbes, CPRD
Aisha Parson, CPRD
Debbra Snow, CPRD
Jim Bloch, CPRD

John Seal

II. Opening Remarks

Mr. Irvin called the meeting of the PBGC Advisory Committee to order at 1:35 p.m. After the Committee unanimously approved the minutes of the last meeting, Mr. Irvin recognized Mr. Strauss for the Executive Director's Report.

III. Executive Director's Report

Mr. Strauss started by discussing the Inspector General's recent audit of PBGC's computer systems, and the press reports concerning the penetration of the system. The Executive confirmed that the Inspector General's test had identified vulnerabilities common in complex networks, and that PBGC, acting immediately upon learning the results, had taken the necessary corrective actions to keep the systems secure. The Executive Director noted that PBGC agreed to the test, and that the Inspector General's report stated that management recognized the seriousness of the issues and was working to protect participant data. The Executive Director also pointed out that PBGC had a secondary system to prevent unauthorized benefit payments, and there was no risk to participant data on benefit payments. Mr. Strauss asserted that PBGC would continue to be vigilant, and that PBGC was considering hiring additional contractors to validate computer security.

The Executive Director then discussed defined benefit plan trends in the hospital and retail industries. Between 1994 and 1998, there were 127 plan terminations in the hospital industry and 228 plan terminations in the retail industry, affecting 100,000 and 50,000 participants, respectively. Mr. Strauss noted that approximately 5% of these terminations were distress terminations, and that in general the ongoing pension plans in these industries were adequately funded.

The Executive Director reviewed trends in the hospital industry, noting that the hospital system was under pressure due to its recent restructuring, e.g., changes in government reimbursements, declining occupancy rates, the increase in hospital outpatient services, and managed care. Mr. Strauss stated that PBGC insured 1,100 hospital plans covering 2.2 million participants, with estimated plan underfunding of $1.2 billion. Mr. Strauss noted that two hospital plans were on PBGC's "reasonably possibles" list (i.e., companies with below-investment grade bond ratings), with total underfunding of $87 million and participants numbering 6,000. Mr. Strauss also reviewed the AHERF situation, where PBGC has taken over four plans, one of which is a cash balance pension plan with 9,100 participants and estimated underfunding of $40 million.

The Executive Director then reviewed trends in the retail industry, explaining that in certain segments of the industry there was excess capacity, i.e., too many stores were selling the same products, causing prices to be driven down for some retailers. Mr. Strauss added that no one knew what impact electronic commerce would have on the industry. Mr. Strauss stated that PBGC insured 112 retail/department store plans covering about one million participants, with estimated plan underfunding of about $2.8 billion. (Of this $2.8 billion, about $2 billion is concentrated in two retail chains.) Mr. Strauss noted that nine retail companies were on PBGC's "reasonably possibles" list, with total underfunding of $1.325 billion and participants numbering 318,100. Mr. Strauss also reviewed the Caldor situation, where PBGC has taken over two traditional pension plans and a cash balance pension plan, with the cash balance plan having 1,500 participants and estimated underfunding of $10 million.

Mr. Strauss mentioned that he had attended meetings for participants in terminated plans of Flushing Hospital, Zurbrugg Memorial Hospital, and Caldor Corporation. Mr. Strauss explained that participant meetings have been one of his main priorities, and that he had gone to 53 meetings. The Executive Director wants to find out what participants know about PBGC, what participants think of PBGC, and how they react to information from PBGC. The Executive Director noted that PBGC was trying to present information as efficiently as possible at these meetings so that participants get the information they need and are not overwhelmed.

In response to a question from Mr. Irvin concerning whether PBGC had the capacity to handle a 50% increase in the number of participants and underfunding, Mr. Grant affirmed that PBGC had the capacity to handle that scenario. Mr. Grant also pointed out that the "reasonably possibles" list for the retail industry illustrated the potential episodic nature of claims against PBGC, and noted that about one-half of PBGC's losses over 25 years have come from only ten large plans.

In response to a question from Ms. Ghilarducci concerning trends in the defined benefit world, Mr. Grant stated that PBGC watched troubled plans, and that industry restructurings caused PBGC to review carefully those industries. Mr. Strauss concluded by stating that when one looked at PBGC's "reasonably possibles" exposure, it put PBGC's surplus cushion in perspective, because the exposure still was significantly greater than PBGC's cushion.

IV. Anthony Calhoun, Deputy Executive Director and Chief Financial Officer

Mr. Calhoun began his presentation with an economic overview, stating that the Federal Reserve Open Market Committee raised the Fed Funds rate by 25 basis points to 5.5% and adopted a neutral stance toward future rate changes; the Commerce Department revised upward its estimate of third quarter GDP growth to 5.5%; the unemployment rate stayed at 4.1% in November, but Average Hourly Earnings rose by only 0.1% month-over-month, easing inflationary concerns; and the Labor Department reported that third quarter productivity increased 4.9% over the year ago period, thus signaling to financial markets that recent strong economic growth was less inflationary than previously thought.

Mr. Calhoun then proceeded with a review of PBGC's Investment Performance as of November 30, 1999. For the fiscal year to date, PBGC's equity managers posted a return of 8.9%, compared to 9.9% for the Wilshire 5000. In November, PBGC's total equity composite return was 3.2%, underperforming the Wilshire 5000 by 20 basis points. Mr. Calhoun observed that Small Cap stocks outperformed Large Cap stocks for both the one-month period and fiscal year periods, and that Growth stocks outperformed Value stocks over the same periods.

Mr. Calhoun reported that for November, three managers outpaced their style benchmarks: Ark Specialty Growth (by 670 basis points), BGI Alpha Tilts (30 basis points), and Brinson (20 basis points). Five managers underperformed their style benchmarks, with the largest underperformers being Fayez (by 400 basis points) and Mellon (400 basis points).

Mr. Calhoun then turned to the performance of the domestic bond market. PIMCO's return of -0.7% in November equaled the Lehman Long-Term Treasury Index benchmark. For the fiscal year to date, PIMCO returned -0.7%, underperforming its benchmark by 10 basis points.

Mr. Calhoun reported that PBGC's Total Fund Composite returned 0.9% for November and 3.2% for the fiscal year to date. Mr. Calhoun observed that the fiscal year return was primarily the blended result of a strong domestic equity market and a weak Treasury bond market. The fund's asset allocation is approximately 2% in cash, 56% in long-term U.S. Treasuries, and 42% in U.S. equities.

In response to a question from Ms. Cassidy concerning PBGC's portfolio investment strategies, Mr. Calhoun stated that PBGC was reviewing the structure of its portfolio in general, and that the results would be reported upon completion of the review. Ms. Cassidy added that the Internet had changed the future of the investment markets, and suggested that PBGC review this structural change individually with PBGC's investment managers.

In response to a question concerning the acquisition of PIMCO by Allianz Insurance, Ms. Faircloth confirmed that PBGC had reviewed the deal's structure (e.g., management incentives), and that PBGC was satisfied that the current PIMCO management team would retain control over key decisions.

Following the discussion of PBGC's investment portfolio and results, Mr. Jeffrey Diermeier and Ms. Allison Grant Williams of Brinson Partners (Brinson) spoke about their investment strategy. Mr. Diermeier stated that the firm had had its worst quarter ever, and attempted to explain these investment results by observing that the firm's value approach was out of

favor with a myopic market, and that the market was being driven by a very few stocks. Reacting to a question about its investment results, Mr. Diermeier declared that he believed that Brinson's value approach to investing made sense in the long run. Currently, Brinson manages approximately $542 million of assets for PBGC.

V. Stuart A. Sirkin, Director, Corporate Policy and Research Department
David Gustafson, Chief Policy Actuary, CPRD

Mr. Sirkin and Mr. Gustafson explained how cash balance plans work in general, and reviewed special issues affecting PBGC when PBGC takes over a cash balance plan.

VI. Terrence Deneen, Principal Deputy General Counsel

Mr. Deneen briefed the Advisory Committee on important areas of on-going litigation and recent court decisions, including the Pan Am, White Consolidated Industries, Copperweld, Caskey, and Raytech cases.

VII. Andrea Schneider, Director
Corporate Finance and Negotiations Department

Ms. Schneider stated that there were no settlement agreements in the previous two months.

VIII. Scheduling

The Advisory Committee agreed to the following schedule of meetings for 2000:

February 22
April 25
June 27
August 22 (phone conference)
October 24
December 12

IX. Adjournment

The meeting adjourned at 4:25 p.m.