William Kadereit

President, National Retiree Legislative Network

ERISA Advisory Council

United States Department of Labor

Hearing on

PRIVATE SECTOR PENSION DE-RISKING AND PARTICIPANT PROTECTIONS

August 29, 2013

Introduction

I thank the ERISA Advisory Council for this opportunity to testify regarding pension de-risking and, from the plan participant's point of view, the threat it poses to retirees' income security. My name is William Kadereit, and I am president of the National Retiree Legislative Network, also known as the NRLN. The NRLN serves as a federation of 32 retiree organizations and individual members who retired from 168 U.S. companies and public entities, representing over 2 million retired Americans in all 50 states and 70% of our U.S. Congressional Districts. I myself retired in 1995 after 35 years with Western Electric Company, later known as AT&T Network Systems, then Lucent Technologies, and now Alcatel-Lucent.

The NRLN's members tell us in our annual surveys that threats to their income security is their number one fear. Our 2013 survey told us that 96% of those responding from across the country are extremely concerned about their financial security, especially in light of the increasing trend toward pension de-risking by plan sponsors. We have catalogued personal hardship stories that support what our statistics show about the harsh realities of what the various forms of income destruction really means to retirees, and de-risking greatly increases the threat level.

While retiree income security risks occur in several ways, our focus today is on those that de-risking creates through the offering of lump sums, or through involuntary transfer from the pension plan to third-party annuities. Both trends are disturbing in that they remove the stability offered by pension plans, and the protections of the Pension Benefit Guaranty Corporation ("PBGC"), after retirees have already made their financial plans for retirement, have reduced income options, and are already in pay status.

Each case presents operational differences, but to the retiree, the result is the same: They've had the rug pulled out from under them and they are placed at great financial risk through no fault of their own. This isn't de-risking but risk-shifting, where, in some cases, participants involuntarily assume the financial risk when they are already vulnerable due to age, lack of income options and lack of expertise.

Risks of De-Risking

Earlier this year, the NRLN set out to examine de-risking practices with an emphasis on the strategies that transfer plan assets and liabilities for selected subgroups of retirees to an insurance company (through an involuntary "annuity buy-out"), or directly onto plan participants (through a voluntary lump sum buy-out). These actions have had a direct impact on large numbers of retirees who were ill-prepared to handle the changes financially, and, in one notable case, the participants had little option but to sit back and ponder the ramifications after the fact.

Last December, Verizon took the unprecedented step of transferring $8.4 billion in pension obligations for a select group of 41,000 management retirees to Prudential with little notice and in a manner that avoids the protections governing voluntary (standard) plan terminations under ERISA. In Verizon's case, the 41,000 management retirees were carved out from among more than 91,000 participants and stripped of both PBGC guarantees and other ERISA protections without being given an option to remain in the plan (which continues to pay benefits to other retirees).

Direct buy-outs, such as the lump sums offered by GM and Ford last year are, by law, voluntary in nature, which reduces the concern since at least those retirees have a choice. In contrast, Verizon's select participants had no choice, nor did the remaining plan participants who face potential risk with the regard to the funding and stability of the pension plan after the separation of the targeted group.

A related adverse consequence of annuity buy-outs for retirees is that while ERISA insulates qualified pension benefits from claims of creditors, including in bankruptcy, not all states protect annuity payments from creditors.

More broadly, since the annuity contracts are no longer held by a qualified plan, retirees and other plan participants lose annual disclosure reports and the minimum funding and fiduciary duty protections required under ERISA.

The Verizon case provides a chilling preview of what may happen to more retirees in the future. Verizon retirees in pay status believed that, unless Verizon went into bankruptcy or filed for a standard termination, their monthly benefits would remain securely under the protection of the PBGC. The involuntary transfer from an ERISA-regulated and PBGC-insured pension plan to the account book of a commercial insurance carrier is de facto, if not technically, a benefit reduction in that it constitutes a substantial reduction in income security. Although ERISA ensures that the nominal dollar amount of the monthly annuity payment is not reduced, the reality is that retirees terminated from any ongoing defined-benefit plan suffer a number of losses.

The importance of the PBGC to retirees on fixed incomes, particularly older retirees, cannot be overstated. While the protection is limited and retirees often lose a portion of vested but non-guaranteed benefits, the PBGC offers a far higher guaranty level, on average, and certainty far more than many participants would receive under state guarantees if the annuity provider fails. The present value of the benefits guaranteed by the PBGC – which at age 65 has a present value of $763,000 for a single life annuitant without survivor benefits – ranges from 50% to 700% more than the widely varying level of protection provided by state insurance guaranty funds (which have a lifetime maximum ranging from $100,000 to $500,000).

Insurance companies view de-risking as an extremely attractive business opportunity and continue to seek out more annuity contracts as companies strategize to get these liabilities off the table. This raises a significant concern about the financial health of these insurance companies as they take on more annuity contracts. In the last decade we have witnessed corporate fatalities among stalwarts on Wall Street and elsewhere due to high-risk business ventures that lacked adequate regulatory oversight. Companies with solid ratings collapsed, leaving consumers in dire straits and the federal government picking up the pieces.

Given recent history, we have absolutely no reason to believe that this couldn't happen to the companies operating annuities in this arena, their current status notwithstanding. We see little reason to believe that what occurred in 2007 could not occur again. Nor do we have reason to believe that these same companies won't be seeking opportunities among public sector pension plans, raising the risk level for retirees even higher as insurance companies take on even larger contracts than perhaps they can manage long-term.

The NRLN's Proposals to Protect Retirees

As part of the NRLN's examination, we commissioned a white paper on the issue of de-risking which was released in July of this year. With your permission, I wish to submit the full white paper, as well as the executive summary, for the record.

The NRLN respectfully urges the Council to please give the following proposals every possible consideration upon advising the Employment Benefits Security Administration within the Department of Labor regarding this issue. The NRLN understands that not all of these proposals would fall within the jurisdiction of the Department of Labor but include those that do not in order to emphasize the need for EBSA, the PBGC and Congress to work together to cover all possible contingencies in order to protect participants.

With respect to purchases of fixed-income annuity contracts, the NRLN urges the Department of Labor to amend and extend its "safe annuity" rules relating to the fiduciary standards under ERISA for selecting an annuity provider, as set forth in Interpretive Bulletin 95-1, as follows:

- If the plan is ongoing and not terminated after review by PBGC pursuant to ERISA Section 4041, the plan has a fiduciary duty to continue to hold the annuity contracts as a plan asset, so that retirees do not lose PBGC or other protections. The issue is unsettled: In *Lee et al. v. Verizon*, the federal District Court concluded in June 2013 that nothing in ERISA either expressly permits or forbids a plan from using an annuity buy-out to involuntarily separate a subgroup of participants from the plan. The IRS should simultaneously provide guidance that the distribution of a group annuity contract is an alternative form of benefit distribution and requires participant consent.

- Alternatively, the plan sponsor can choose to permanently transfer its liability for individual retirees to a qualified annuity provider, as if the plan were terminated, but only if it complies with one of the following safe harbor requirements:

    - The plan obtains the affirmative consent of individual retirees. Like a lump sum buy-out offer, retirees who do not consent to be transferred to the annuity provider must have the option to remain participants in the ongoing pension plan.

or

    - The plan can purchase reinsurance from a separate, highly-rated insurer that guarantees the payment of benefits, in case of default, of each individual participant's loss to the extent it is not covered by state insurance guarantee associations (SGAs). The protections afforded by SGAs fall far short of PBGC maximum coverage levels and vary widely from state to state.

As part of either of these two safe harbors, two additional protections should be required:

- First, the purchase of the annuity contract – and any reinsurance purchased to satisfy the safe harbor above – should be reviewed and approved by the Department of Labor (DOL) based on the criteria in the safe annuity rule adopted in DOL's Interpretive Bulletin 95-1.

- Second, the plan sponsor should send a formal notification to all plan participants at least 90 days prior to the transaction, with specific disclosures about the impact on participants and on the plan's funding status, as well as any alternatives available to the participant (such as choosing not to participate).

If the agencies do not act, Congress should at a minimum require plan sponsors to maintain back-up insurance, either from the PBGC or a highly-rated reinsurance carrier.

- In addition, the agencies should require that following any transfer of assets to settle liabilities for a subgroup of plan participants – whether by group annuity purchases or by lump sum buy-outs – the on-going plan must be at least as well funded as it was prior to the transaction. This ensures that any premium paid to transfer the liabilities associated with a group of retirees does not worsen the funding level for all other participants. This is relevant primarily for group annuity transfers, which are 10 to 15% more costly than the funding liability for the ongoing plan.

- With respect to lump sum buy-outs, DOL should clarify fiduciary responsibilities to make complete and plain English disclosures concerning the financial trade-offs, including tax consequences and the higher cost of purchasing an individual annuity contract.

Conclusion

Ladies and gentlemen of the Council, retirees in pay status have already made their financial plans for retirement. Very few have generous options for income during their elder years. Changing the framework of their financial arrangements and allowing additional risk to be added to the mix in an already volatile economy is a reduction in retirement security, is patently unfair and is bad public policy. The NRLN urges you to consider our proposals in order to provide participants the security of knowing that the framework within which they made their financial plans and elections will not be unfairly altered without reasonable protections.

Thank you very much for this opportunity to appear before you and I am happy to answer any questions you may have.