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NATIONAL RETIREE LEGISLATIVE NETWORK

Pension Plan 'De-Risking': Strengthening Fiduciary Duties to Protect Retirees

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Executive Summary

The steady decline in traditional defined-benefit pension plan sponsorship by corporate America took another alarming turn for the worse last year when three big blue chip companies moved to "de-risk" their pension promises by transferring billions of dollars in assets either directly to retirees (as lump sum buyouts) or to third party insurance companies (as group annuity buyouts). Although the share of the workforce covered by defined-benefit pensions has shrunk from 62% to less than 19% over the past three decades, retirees already receiving fixed monthly benefits believed that at least they had the security of ongoing protection against default, by the federal Pension Benefits Guaranty Corporation (PBGC), and ongoing disclosures and other fiduciary protections under the Employee Retirement Security Act of 1974 (ERISA). That may no longer be true, particularly if the newest and most abusive "de-risking" strategies are not tempered by the fiduciary obligations proposed in this white paper.

A number of factors have combined in recent years to give employers an incentive to reduce the overall risk and financial statement volatility associated with the accumulated pension liabilities earned by current and retired workers over decades. A 2012 study found that 44% of pension funds surveyed said they were likely to engage in risk transfers over the next two years. This impetus to manage and reduce risk can be positive or negative for plan participants, depending on the approach.

De-risking strategies take one of two forms. First, companies can retain the assets and liabilities in the plan, but change the investment mix to better insulate the company from market movements and even from longevity risk if retirees live longer than expected. This is generally called Liability Driven Investment (LDI) and typically means shifting a far greater proportion of assets into fixed-income securities. LDI strategies can include the purchase of fixed annuity contracts from insurance companies (guaranteed investment contracts, or GICs) that are held as plan assets and do not diminish protections for retirees or other participants. This is referred to as an "annuity buy-in" approach.

A very different approach to de-risking, and the subject of this paper, are strategies that transfer plan assets and liabilities to an insurance company (through an involuntary "annuity buy-out"), or directly onto plan participants (through a voluntary lump sum buy-out). Most alarming was Verizon's unilateral move last December that transferred $8.4 billion in pension obligations for a select group of 41,000 management retirees to Prudential with little notice and without complying with the laws 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 retirees have a choice. Even in that situation both adequate disclosure and adequate funding of the plan for remaining participants is vital, particularly for older retirees.

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 the PBGC as required by 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 safe harbor, 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 transfer, 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.

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Introduction

The steady decline in traditional defined-benefit pension plan sponsorship by corporate America took another alarming turn for the worse last year when three of the nation's big blue chip companies moved to "de-risk" their pension promises by transferring billions of dollars in assets either directly to retirees (as lump sum buyouts) or to third party insurance companies (as group annuity buyouts). Although the share of the workforce covered by defined-benefit pensions has shrunk from 62% to less than 19% over the past three decades, retirees already receiving fixed monthly benefits believed that at least they had the security of ongoing protection against default, by the federal Pension Benefits Guaranty Corporation (PBGC), and ongoing disclosures and other fiduciary protections enforced by the U.S. Department of Labor under ERISA. That may no longer be true, particularly if the newest and most abusive "de-risking" strategies are not tempered by the fiduciary obligations proposed in this white paper.

De-Risking and its Discontents

Plan sponsors are increasingly focused on reducing their company's exposure to volatility in pension funding and its negative impacts on corporate cash flow and financial statements. A perfect storm of large stock market losses during the recent deep recession, record-low interest rates (which exaggerate the estimated present value of projected benefit obligations), a statutory incentive to offer lump sums, and rising contributions and PBGC premiums, have all combined to encourage plan sponsors to adopt a variety of "de-risking" strategies. This recent impetus to manage and reduce the volatility associated with pension liabilities can be positive or negative for plan participants, depending on the strategy a plan adopts.

De-risking strategies take one of two forms. First, companies can retain the assets and liabilities in the plan, but change the investment mix to better insulate the company from market movements and even the longevity risk that retirees will live longer than expected. This is generally called Liability Driven Investment (LDI) and typically means shifting a far greater proportion of assets into fixed-income securities. LDI strategies can include the purchase of fixed annuity contracts from insurance companies (guaranteed investment contracts, or GICs) that are held as plan assets and do not diminish protections for retirees or other participants. "Investing in an annuity contract (also known as an '**annuity buy-in**') involves the use of plan assets to purchase a group annuity contract that is held by the plan to fund benefit payments . . . the plan remains liable to participants to pay pension benefits."[1] Although firms that completely de-risk in this fashion give up the opportunity to offset a larger share of the costs with equity returns (which historically have been higher than fixed-income returns), both the retirees and the assets covering their benefits remain in the plan, subject to ERISA and insured (subject to certain limits) by the federal Pension Benefit Guaranty Corporation (PBGC).

A more recent and very different approach to de-risking, and the focus of this paper, are strategies that transfer a portion of the assets and liabilities of an ongoing plan to a third party (typically an insurance company), or directly onto retirees in pay status through a voluntary lump sum buy-out. Plans frequently offer a lump sum distribution option to deferred vested participants (who are not yet eligible to commence monthly benefits) or, last year at GM and Ford, to retirees in pay status. By contrast, "[i]n a transaction involving the distribution of annuity certificates (also known as an '**annuity buy-out'**), the plan purchases a group annuity contract from an insurance company and distributes certificates that enable the participants to enforce their rights to benefits directly against the insurance company. After an individual's pension benefits are settled, the individual ceases to be a participant in the plan, ERISA ceases to govern the benefit, and the PBGC no longer insures the benefit."[2] A 2012 study found that 44% of pension funds surveyed said they were likely to engage in risk and asset transfers over the next two years, with lump sum buy-outs most popular.[3]

Lump sum buy-outs, such as the offers implemented by GM and Ford last year, are by law voluntary in nature, which reduces the concern since at least retirees have a choice. Even in that situation, however, both adequate disclosure and adequate funding of the plan for remaining participants is vital. On the other hand, the GM and Ford offers were unusual – and controversial – because they offered lump sum payments to retirees who were already receiving fixed monthly benefit payments, some of them for many years. An increasing number of companies – including Equifax, JC Penney, Sears and NCR during 2012 – have recently offered lump sums to former employees who are *not* in pay status (typically because they are not retirement age) as part of a de-risking program. However, GM and Ford extended buy-outs in a more controversial direction by becoming the first very large companies to entice thousands of retirees to give up the security of their federally-insured monthly benefit for life in return for a lump sum they will need to manage and invest. Although these retirees have a choice, the Pension Rights Center and other advocates for retirees have raised eldercare concerns about older seniors who may no longer be competent to make decisions about if and how to accept and reinvest a lump sum in place of guaranteed monthly income.

Far more alarming was Verizon's unilateral move last December to implement a group annuity buy-out that transferred $7.4 billion in pension obligations for a select group of 41,000 retirees to Prudential Insurance Company (Prudential), at a cost of $8.4 billion, with little notice and without complying with the laws governing voluntary (standard) plan terminations under ERISA. Outraged retirees, led by the Association of BellTel Retirees Inc., filed a class action lawsuit on behalf of both the 41,000 management retirees transferred out of the pension plan and the roughly 50,000 plan participants who remained in the plan, which the complaint argued had paid excessive fees to Prudential that left all 91,000 participants worse off as a result. In June 2013, Dallas Federal District Court Judge Sidney Fitzwater dismissed the class action, reasoning that in its role as plan sponsor, Verizon had the discretion to decide to "settle" its liabilities with any subset of participants so long as they continued to receive an irrevocable annuity and no reduction in monthly payments.

It's important to note that transferring risk does not make it disappear. When plan sponsors purchase group annuity contracts, they pay an insurance company a premium to assume the investment and longevity risk that would otherwise be borne by the plan. In testimony before the ERISA Advisory Council in June, the Chief Actuary of the Vanguard Group, Evan Inglis, stated that "the cost of securing payments for already retired participants is about 108% - 112% of the liability calculated by most plan sponsors for accounting purposes, while the plan is ongoing."[4] Inglis added that the cost of a group annuity for active participants is higher still – typically in the range of 115% - 130% of the ongoing liability. Indeed, a major reason why there are not more large group annuity buy-outs – and a reason Verizon chose to expel only management retirees from its plan – is because even if a plan is 100% funded on an ERISA basis, the firm would need to contribute an additional 15-to-20% of the projected liability to make the transfer sufficiently profitable for an insurance company like Prudential.

Why Companies are De-Risking

Historically, large companies with skilled, full-time workforces found defined-benefit pensions to be an economical way to encourage retention and manage retirement incentives. However, a number of factors have combined in recent years to give employers an incentive to reduce the overall risk and financial statement volatility associated with the accumulated pension liabilities earned by both current and retired workers over decades. As the American Benefits Council testified before the ERISA Advisory Council's June 2013 hearing on de-risking, for decades defined-benefit pension plans "were viewed as long-term liabilities of the plan sponsor . . . based on long-term expected investment returns . . . [and] accounting rules [that] took a long-term view toward pension liabilities and required contributions."[5] Unfortunately, a series of legislative and regulatory changes, along with increased volatility and historically low interest rates, have put plan sponsors under increasing short-term pressure to adopt strategies that "de-risk" the plans from a quarter-to-quarter financial perspective.

First, over the past decade the regulatory environment has become extremely hostile to both the accounting and funding of defined-benefit pension plans. Most significantly, in 2007 new pension accounting rules issued by the Financial Accounting Standards Board (FAS 158) required plan sponsors to measure assets and liabilities on a mark-to-market basis and report any shortfall on their balance sheet as part of annual SEC disclosures to shareholders. This came on top of an earlier FASB rule from the late 1980s that required companies to include a projection of pension costs (on a gain or loss basis) in their annual income statement. This change impacted reported earnings and annual executive incentive compensation tied to reported earnings. Although companies sometimes manipulated this rule to boost reported earnings – by projecting phantom pension gains that sometimes never materialized – the overall impact of both FASB changes has been to increase financial statement volatility and put increasing short-term pressure on executives to reduce exposure to pension liability.

Exacerbating this, the Pension Protection Act of 2006 (PPA) phased in accelerated contribution requirements generally requiring plans that dropped even temporarily below 90% funding to amortize the underfunding over seven years and to calculate liabilities using a fairly conservative high-grade corporate bond yield curve.[6] Although Congress has twice passed temporary contribution relief measures, the general impact has been to leave companies with less flexibility to avoid the cash flow squeeze of higher pension contributions.

A second and more proximate combination of factors fueling the de-risking trend are declines in assets due to the recent deep recession and record low interest rates during the drawn-out recovery, leading to persistent funding deficits. Historically, pension funding levels have closely tracked stock markets. Between year-end 2007 and March 2009, the average corporate plan funding status fell from 96% to 70%.[7] Although the stock market regained most of its lost ground by 2012, record-low interest rates – maintained by the Federal Reserve to stimulate what has been a slow and jobless recovery – lowered funding ratios and triggered substantially higher contributions. The average discount rate among large pension plans dropped 73 basis points during 2012, from 4.78% to 4.05%, greatly inflating the present value of estimated liabilities. As recently as 2008 the discount rate was 6.45%.[8] As a result, despite rising stock markets, the funded ratio for plans sponsored by S&P 1500 firms stood at 74% at the end of 2012, according to a survey by Mercer. This situation is finally improving in 2013: as stock prices and interest rates rise in tandem, funded levels rose to an average 82% by the end of March 2013.

A third factor cited by some old-line companies is the size of the pension fund relative to the capitalization of the firm. For example, as companies such as GM and Lucent Technologies (now a division of Alcatel-Lucent) have substantially downsized, their pension assets and the financial volatility reflected on the income statement and balance sheet (due to the FASB reforms noted above) increase financial risk, such as the availability and cost of credit.

A final factor cited by industry is increases in PBGC premiums, which were increased roughly 20% as part of the MAP-21 legislation that gave plan sponsors temporary funding relief in the summer of 2012. In addition, the President's 2014 federal budget proposal includes an additional $25 billion in risk-based (variable) PBGC premiums that are proposed to fall on plans that the PBGC determines pose the most significant risks of resulting in a distress termination.[9]

All of these factors together lead many industry analysts to project continued de-risking activity. At the recent ERISA Advisory Council hearing on de-risking, the American Benefits Council witness concluded that if funding, accounting and PBGC premium obligations "are not addressed, it is possible that the volume of de-risking transactions will accelerate in the coming years, particularly when funding improves and/or interest rates rise."[10]

Lump Sum Buyouts: GM and Ford

While pension funds must pay annuity providers a substantial premium to take over the ongoing investment and longevity risks, individual retirees who agree to a lump sum buy-out "can be viewed as representing about a 10% to 20% *savings* over keeping the obligation for a participant in the plan," according to Inglis.[11] The biggest reason is that Congress, in the Pension Protection Act of 2006, substantially increased the interest rate assumption that employers use to calculate lump sum pension payments. And the higher the allowed discount rate, the lower the lump sum payment. As Vanguard's Chief Actuary explained in his testimony, "[p]rior to PPA lump sums were calculated using 30-year treasury [bond] rates which provided more generous, expensive lump sums . . . [whereas] the new lump sum rules provide payments that are about 10% - 50% less generous (depending on age) than under the old rules."[12] Similarly, Prudential, in a 2011 report on de-risking strategies, observed: "By virtue of closely aligning the lump sum basis with the ongoing liability basis, ***PPA essentially created a cost effective 'de-risking' strategy for plan sponsors***."[13]

Indeed, it's no coincidence that the first large-scale lump sum buy-out offers (GM and Ford) occurred in 2012, since that's when PPA's less generous lump sum calculation fully phased in. "Plan sponsors waited for these new rules to be fully phased in, in 2012, before beginning significant risk transfer activity," Inglis testified. Congress, in effect, used the PPA to lay the groundwork for the final dismantling of the nation's defined-benefit pension system by making it less expensive for companies to give participants lump sums than to continue administering monthly pension payments for life, which impose additional administrative, regulatory and PBGC insurance premium costs. By encouraging companies to reduce a plan's overall liability by offering lump sum buy-outs, Congress also (perhaps inadvertently) encouraged group annuity risk transfers as well. For example, since General Motors had both a well-funded plan and saved money on every retiree who accepted a lump sum, it made it more affordable to purchase a group annuity from Prudential for those who did not accept the lump sum offer.

As a result, mass offers of lump sum buy-outs to retirees took off during 2012. Before and even during 2012, virtually every other plan sponsor offering lump sums to smooth volatility and reduce plan overhead limited the offers to deferred annuitants – that is, to mostly former employees who were not yet old enough or otherwise eligible to receive a monthly benefit. For example, during 2012 major companies including J.C. Penney, Sears, Kimberly Clark and Archer Daniels Midlands extended lump sum offers limited to tens of thousands of former employees not yet receiving monthly pension checks.

That all changed when two recovering automakers – General Motors and Ford – asked the Treasury Department for an exemption from the general rule that "offering lump sums to retirees generally is prohibited under IRS regulations (unless the plan is terminating).[14] In response, the IRS issued a Private Letter Ruling to each company permitting lump sum offers to retirees already receiving fixed monthly benefits – some for decades.[15] Vanguard Chief Actuary told the ERISA Advisory Council at its June hearing that until 2012 "certain IRC sections had been interpreted as prohibiting offering a lump sum choice to already retired participants except in the case of a plan termination."[16] The IRS came up with the rather incredible rationale that "a one-time offer of a lump sum to retirees [during a 60 or 90 day window period} would be treated as a benefit increase resulting from a plan amendment," since regulations permit plan amendments that increase annuity payments.[17]

The irony in this ruling is that since the PPA's higher discount rate for calculating lump sums became fully effective in 2012, plan sponsors save money when retirees accept a lump sum and participants generally lose money. On an economic value basis, the reason is that lump sums calculated under the PPA's new higher discount rate (which lowers the dollar value of the lump sum), is by definition worth less than the cost of purchasing an identical annuity in the market (which insurance companies price far higher for individuals than for pension plans and other bulk, wholesale purchasers). Among other reasons, the lump sum value does not include insurance company administrative costs and profits, which will be built into the premium that an individual will pay to purchase a comparable benefit.[18]

From the plan sponsor's perspective, as noted above, even though the lump sums pay out at the same cost as the projected benefit obligations that are taken off the books, there are other cost savings, including administrative costs and PBGC premiums. "We estimate that the present value of savings from these variable costs may approach $2,000 to $3,000 per participant when it comes to being paid out immediately vs. remaining in the plan for decades," concluded Prudential in its 2011 de-risking strategy advisory for plan sponsors.[19]

Through this combination of Congressional incentive and Treasury Department exemption, GM and Ford became the first large corporations to offer lump sums as a settlement offer to massive numbers of retirees already receiving monthly benefits. GM initially offered a voluntary lump-sum buy-out to a subgroup of 44,000 of its 118,000 U.S. salaried retirees. After 13,000 accepted the offer (just under 30%), GM implemented a group annuity buy-out for the rest. For its part, Ford offered a lump sum to 90,000 retirees and although it has not revealed the take-up rate, the buyouts reduced its pension liability by $1.2 billion. Ford's plan remained $18.7 billion underfunded at year-end 2012.[20]

Offering lump sum buy-outs to retirees is also likely to increase the cost of the plan due to adverse selection among those accepting the offer. "Those already retired, generally of ages 60 to 85, will on the whole have better knowledge about how long they might live than younger participants, . . . introducing a choice allows participants to select against the plan," Vanguard's Inglis testified.[21] Similarly, a Prudential advisory on de-risking strategies concluded that "[e]ven if the amount of funding liability released through a lump sum cash-out equals the amount of the lump sum distributed, sponsors of underfunded pension plans will experience a decrease in the funded status of the plan."

Of course, there are two advantages to a lump sum buy-out from the retiree perspective. One is choice. Unlike an annuity buy-out, such as Verizon imposed unilaterally on 41,000 management retirees (discussed further below), a retiree can consider their financial and family situation, their health and likely longevity, and make a choice they believe to be in their best interest. If a retiree has serious medical conditions that strongly suggest a shorter-than-average life expectancy, such an individual and their family may well be better off choosing a lump sum. A second advantage is that although Congress in the PPA lowered the value of lump sums by 10 to 50%, depending on interest rate spreads, they do allow a retiree and especially other retirees not yet in pay status to receive the full present value of their earned and vested benefits. This is an advantage at a financially weak company, since if there is a distress termination and pension plan is taken over by the PBGC, a substantial and growing number of participants permanently lose benefits due to both statutory limits and the PBGC's adoption of discretionary policies aimed at reducing its liability for certain vested benefits.[22]

Unfortunately, these two advantages – choice and locking in the present value of the full vested benefit – are far more precarious for the most elderly or incapacitated retirees. For example, many retirees already in pay status are far older than they were when they began receiving monthly annuity payments and may have a diminished capacity for making good choices about the relative value of the lump sum versus continued annuity payments, about whether or not to roll it into an IRA (not doing so triggers immediate tax liability), and about how best to invest the money. As Prudential asked in a client report on de-risking strategies, "is a 90-year-old really capable of making a decision to switch from monthly income to a lump sum that could be quickly depleted?"[23] Older retirees may be more subject to manipulation by financial advisors, or to pressure from relatives who could benefit from a lump sum payout but not from an annuity (which terminates with the death of the retiree and/or the surviving spouse). A choice to terminate the annuity could also endanger a spouse. ERISA protects a spouse by requiring her to consent to a benefit that does not include a survivor annuity – but now that choice is revisited at an age when the spouse, being older, may be less aware or able to defend her interests.

Selective Group Annuity Buyouts: The Case of Verizon

There is no question that 2012 was a watershed year for pension group annuity transfers, which totaled just under $36 billion. In 2011 the total was only $920 million.[24] What changed in 2012 was $34 billion in group annuity buyouts attributable to just two companies: GM and Verizon. Prior to the Verizon and GM annuity purchase contracts with Prudential in 2012, the largest defined-benefit pension annuity buy-out on record was just over $1 billion. "Historically, the annuity market for DB plans has been almost entirely driven by small to medium size plans," according to Stephen A. Keating, co-founder of Penbridge Advisors, in his June testimony before the ERISA Advisory Council.[25] In 2012, 98% of group annuity contracts sold were for transactions under $250 million.

GM combined the two liability transfer strategies – voluntary lump sum buy-outs and mandatory group annuity transfers for those declining the lump sum – to move $28 billion in total pension liabilities off its books during 2012. Among the 118,000 non-union (salaried) retirees, "GM first offered a voluntary lump sum payout to a subgroup of 44,000 (13,000 accepted) and then annuitized the pensions for the rest."[26] However, leaving aside the pros and cons of offering a lump sum to retirees already receiving insured monthly benefits for life (discussed above), GM's annuity purchase was more traditional. Unlike Verizon, GM implemented a standard plan termination, which requires following certain notice and review procedures that help to ensure the irrevocable annuity contract is a fully paid substitute for the plan's annuity payments. GM also negotiated with Prudential for the additional protection of placing the annuities in a separate account, which insulates the retirees' assets from losses in Prudential's general account (although, of course, it doesn't protect retirees from the risk that investment losses will leave the separate account unable to meet its obligations).

Verizon did not offer a lump sum option, or terminate the plan. Instead, it purchased a group annuity contract from Prudential for a minority of the plan's participants – 41,000 management retirees – and declared that the retirees were no longer plan participants. Verizon's rationale is that the group annuity contract settled its obligations in full, just as if the plan had complied with the statutory notice, disclosure and PBGC review process for terminations under ERISA Section 4041. Because insurance companies like Prudential demand a premium over the projected liability of the plan's future benefit obligations in return for assuming 100% of the investment and longevity risk associated with issuing a fixed annuity contract, Verizon paid an estimated $8.4 billion to settle $7.4 billion in liabilities for the 41,000 retirees transferred to Prudential.

From the perspective of most individual retirees (or other plan participants), the involuntary transfer from an ERISA-regulated and PBGC-insured pension plan to the account book of a commercial insurance carrier is, if not technically a benefit reduction, clearly it is a substantial reduction in retirement 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. In Verizon's case, management retirees were carved out and stripped of both PBGC guarantees and other ERISA protections without being given an option to remain in the plan (which continues to pay monthly benefits to other retirees).

"We were told in late October that by mid-December (2012) our benefits would be paid by Prudential and that we were to look to state law to determine coverage amounts should Prudential falter because the PBGC was no longer our backstop," Jack Cohen, Executive Vice President of the Association of BellTel Retirees, testified to the ERISA Advisory Council. "The protections provided by ERISA and the Pension Benefit Guaranty Corporation (PBGC) are gone forever and so goes our peace of mind," he stated.[27]

Within five weeks after Verizon gave its short notice that the 41,000 retirees were being separated from the plan, the retirees' association filed a class action lawsuit. The suit, *Lee, et al. v. Verizon Communications Inc., et al.,* was filed on behalf of two distinct groups of plan participants: one class consisted of the 41,000 management retirees who were transferred out of the plan to Prudential; the other class consisted of about 50,000 participants and other beneficiaries who remain in the plan but complained that excessive fees ($1 billion) were paid to Prudential from the pension fund, depleting plan assets, when Verizon should have paid those fees using corporate operating revenues.[28]

Although the Federal district court in Dallas certified the class action, Judge Sidney Fitzwater dismissed the suit in June, stating his belief that Verizon did not engage in a "fiduciary function" when it decided to purchase the annuity contract to settle claims, but rather engaged in a "settlor function" related to Verizon's discretion as plan sponsor to decide whether and how to fund the plan.[29] "Excluded from fiduciary responsibility are decisions of a plan sponsor to modify, amend, or terminate a plan," the court stated in its opinion.[30] For the same reason, the court concluded that the Prudential annuities did not violate the fiduciary duty to diversify assets, since it found the annuity contracts were not an "investment" but rather a distribution of benefits. In addition, the court found it could not "reasonably infer" that the $1 billion premium that Verizon paid to Prudential over and above its projected liabilities, as calculated under ERISA's assumptions, was "unreasonable" in the context of the commercial market for irrevocable group annuity contracts of this magnitude.[31]

On the other hand, as discussed further below, the court acknowledged but only cursorily addressed the entirely separate (and unsettled) question of whether Verizon could "remove[] a group of participants and beneficiaries from a plan without terminating the plan" and following the notice, disclosure, PBGC review and approval process mandated under ERISA Section 4041.[32] Indeed, the Federal District Court explicitly stated that although it found no statutory language or regulation that explicitly prohibits a selective annuity buy-out, "neither does the authority on which Verizon relies expressly authorize an annuity purchase in these circumstances."[33]

The Problem with Selective Annuity Buy-Outs by an Ongoing Plan

Selectively transferring groups of retirees from a pension plan and into a group annuity insurance product has a variety of adverse impacts:

First, and most significant, is the loss of federal PBGC insurance that guarantees the payment of a monthly benefit for life (up to the statutory maximum). If an insurance company fails or is otherwise unable to make good on the annuity payments, the retiree's benefits are backed solely by state guaranty associations (SGAs). Stephen Keating, a pension consultant and co-founder of Penbridge Advisors, LLC, estimates that the present value of the benefits guaranteed by the PBGC ranges from 50% to 700% more than the widely varying level of protection provided by state insurance guaranty funds.

> [T]he PBGC's maximum guarantee in 2013 for a life annuity with no survivor benefits of $57,477 yearly at age 65 equates to $763,672 on a present value basis. This compares to the baseline guaranty association protection of $250,000.[34]

Since the maximum coverage of state guaranty associations vary widely – and range from $100,000 to $500,000 per person per lifetime – the PBGC insures against far greater losses for the typical retiree (depending on state of residence and age). SGAs are also not pre-funded. When an insurer's remaining assets are insufficient to meet its obligations, the SGAs must rely on a fee assessed on other insurers in the state who write the same type of insurance to cover the shortfall.[35] Since neither state nor federal governments stand behind what are essentially voluntary insurance industry guaranty funds, if there was ever a systemic failure that caused multiple companies to fail, it's not clear that even the lower guaranty associations protections would hold up.

There are also concerns about the capacity of even top-rated insurance companies to absorb tens of billions (and possibly hundreds of billions) of dollars in additional benefit obligations from pension plans. The recent economic downturn demonstrated that even the largest and most established financial institutions are no longer "too big to fail." The BellTel Retirees have argued that "[t]he list of once iron-clad and too-big-to-fail financial powerhouses have included AIG, Executive Life, Kentucky Central Life Insurance Company, The Equitable Life Assurance Society (Equitable Life), Lehman Brothers, Bear Stearns and more."[36]

In fact, the Federal Reserve Board recently designated Prudential as one of a small number of financial institutions that poses unique risks to the financial system. *The Washington Post* reported on July 3, 2013, that "Prudential is one of the first companies that regulators have designated as a systemically important financial institution, or SIFI, a label that would place it under the purview of the Federal Reserve."[37] The designation means Prudential could face "higher capital requirements and other restrictions that could eat into a firm's profitability."[38] More worrisome for retirees are the smaller annuity providers that will not be under any special scrutiny by the Fed and not subject to stricter capital requirements and other safeguards.

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

Third, and more broadly, since the annuity contracts are no longer held by a qualified pension plan, retirees and other participants lose the disclosures, minimum funding and fiduciary duty protections required under ERISA. For example, unless the pension plan happens to negotiate special protections (which would likely raise its costs), there would be nothing except possibly state insurance regulations in certain states (and not in others) that would prevent the annuity provider from selling or transferring the annuities to another possibly less secure insurance company anywhere in the world.[39]

Fourth, the participants who are *not* transferred out of the plan are likely to find that the plan is less securely funded. Absent a large infusion of cash into the plan, "to the extent that the plan was at all underfunded before the liability transfer, it will become even more underfunded simply as a result of the transaction."[40] For example, in 2012, although Verizon contributed $3.7 billion to its pension plans, after closing the annuity buy-out it reported a funding ratio of 68.5% at year end – down from 78.8% at year-end 2011. Although most of the decline in its funding ratio is attributable to lower interest rates, it also paid out $8.4 billion to Prudential to purchase annuity contracts to transfer the 41,000 management retirees – including a $1 billion premium above projected benefit costs for the retirees transferred.[41] In its testimony to the ERISA Advisory Council in June, the Communications Workers of America (CWA) noted that a partial buy-out that significantly reduces plan funding for remaining participants can be "especially problematic because current rules [enacted as part of the Pension Protection Act of 2006] require that if a plan is less than 80% funded, certain benefit restrictions must go into effect. . . . Under 60% funding, the plan must freeze benefit accruals, and all lump sum payouts are prohibited."[42]

With respect to the loss of PBGC insurance, could the negative impact be avoided if the PBGC itself provided back-up insurance coverage if the retirees are no longer plan participants? Yes, but this is not an option under longstanding PBGC interpretations of its statutory authority. The PBGC at one time took the position that it would provide guarantees if an insurance company issuing termination annuities later failed (this was also prior to the widespread establishment of state insurance guaranty associations). The PBGC retracted this position by issuing an opinion letter in 1991 which "concluded that the statute does not authorize PBGC to guarantee benefits distributed in the form of irrevocable annuity contracts from insurance companies." The PBGC's Opinion Letter 91-1 went on to explain its reasoning:

> . . . Nowhere in the statute is PBGC authorized to pay benefits upon the occurrence of any other event, such as the failure of an insurance company.
>
> In a "standard" termination, where plan assets are sufficient to satisfy all of the plan's benefit liabilities, the plan administrator is required to distribute all plan assets in satisfaction of all plan benefits. [citations omitted] This final distribution of all plan assets completes the plan termination process, and accordingly extinguishes the PBGC's statutory guarantee obligation.

The PBGC's position is clear with respect to assets distributed to a third party (*viz.*, an insurance company) "pursuant to a termination procedure" and generally when the individual is no longer a plan participant. Where the plan sponsor is no longer under an obligation to pay PBGC premiums, both ERISA's language and logic suggest the agency would no longer guarantee the benefit. However, if the ongoing plan retained the annuity contract as an asset and continued to pay a premium to the PBGC – what is commonly known as a "buy-in" strategy for de-risking – then retirees and other participants would retain their more protective federal PBGC insurance.

A related negative impact of the Verizon selective buyout strategy is the undermining of PBGC's financial position and the undermining of the DB pension system as a whole. Because plan sponsors typically need to be fairly well-funded *and/or* contribute additional corporate resources to avoid a substantial decline in the funded level for remaining participants, transactions like Verizon's are a form of "reverse selection" that deprive the agency of premium revenue from companies that are unlikely to go bankrupt and dump their obligations on the agency. Dallas Salisbury, president of the Employee Benefits Research Institute, has stated that his greatest concern about pension de-risking is the loss of PBGC protection for retirees and the loss of premium income to PBGC.[43] "The Verizon transaction alone is expected to result in an annual loss to the PBGC of $1,722,000" in insurance premium revenue, BellTel's Jack Cohen testified to the ERISA Advisory Council.[44] Although PBGC's projected actuarial deficit is grossly inflated due to the artificially low insurance industry interest rate it uses to discount its long-term benefit liabilities to present value,[45] it's certainly true that the loss of premium income from better funded plans like Verizon and GM, should the trend become widespread, threatens to undermine its solvency.

To be sure, these reductions in the risk-adjusted value of retiree benefits would also occur if Verizon had formally terminated the pension plan. One unique feature of ERISA is that it was intended to safeguard vested worker and retiree benefits in the context of what remains fundamentally a *voluntary* system. Employers decide whether to maintain a pension plan and, at any time, can freeze new benefit accumulations or even terminate the plan entirely. However, to protect retiree interests, ERISA Section 4041 is very specific about defining the process that governs the only two situations the statute describes by which an employer can involuntarily terminate the plan's ongoing obligations to continue administering, paying for and insuring monthly benefit payments.

One situation is a so-called "distress" or "involuntary" termination, which typically occurs when a company is bankrupt and the PBGC and/or a federal bankruptcy court agrees an extremely underfunded plan would not be able to meet its obligations even if it emerges from bankruptcy. Although fairly uncommon, ERISA also gives the PBGC authority, under Section 4042, to seek federal court approval for the *involuntary termination* of a plan that is becoming increasingly and dangerously underfunded. The PBGC must demonstrate that "the possible long-run loss [to the PBGC] with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."[46] Underfunded plans that terminate in distress (under §4041), or involuntarily (under §4042), are taken over by the PBGC, which guarantees most (although by no means all)[47] earned and vested benefits up to an annual maximum that is currently $57,480 per year for a 65-year-old in 2013 (but substantially lower – or higher – for individuals younger or older than 65 on the plan termination date).

ERISA permits companies to terminate any ongoing obligation for promised benefits in only one other circumstance: a "standard" termination, which is instituted voluntarily at the plan sponsor's initiative. MetLife's most recent (June 2013) annual study of pension plan risk management behavior describes "pension buyouts" as traditionally limited to the settlement of obligations in the context of a plan termination:

> A traditional pension buyout usually involves an annuity contract that transfers all future mortality, longevity, expense, early retirement, market and investment risks to an insurance company in return for a single lump sum payment. . . . **This type of pension risk transfer is generally done in conjunction with a plan termination.**[48]

Section 4041 of ERISA permits plan sponsors to voluntarily terminate a plan if they comply with detailed disclosure requirements and if the PBGC, after a compliance review, certifies that plan assets are sufficient to purchase irrevocable annuity contracts that will pay 100% of the plan's benefit obligations. As it does generally in ERISA, Congress is very specific about the process and conditions that apply to a standard plan termination. Among the requirements and protections mandated under Section 4041 are the following:

- **A Notice of Intent to Terminate must be sent to all plan participants** "at least 60 days and no more than 90 days before the proposed termination date."[49] The statute mandates very detailed disclosures about the terms of the termination, its impact on benefits, and an explicit statement that "the PBGC no longer guarantees that participant's or beneficiary's plan benefits."[50]
- **A detailed "notice of annuity information" requires a list of specific disclosures** that must be provided to participants, including an explanation that instead of federal PBGC insurance, state guaranty associations are "responsible for all, part, or none of the annuity if the insurance company cannot pay," and that the dollar limits vary widely from state to state.[51]
- **A "standard termination notice, consisting of the PBGC Form 500," must be submitted to the PBGC within 180 days for its review**.[52] This must include an enrolled actuary's certificate from the plan administrator stating that there are sufficient assets to settle all plan benefits as of the proposed distribution date.[53] The PBGC can request additional information and has 60 days under the statute to review the termination for compliance with ERISA.
- **After review, the PBGC can issue a "notice of non-compliance"** if the notice or distribution of benefits does not meet the ERISA requirements and deadlines, although the primary reason would be if the agency determines that "plan assets will not be sufficient to satisfy all plan benefits under the plan."[54]
- **Consequences of a PBGC Notice of Noncompliance:** "A notice of noncompliance ends the standard termination proceeding, nullifies all actions taken to terminate the plan, and renders the plan an ongoing plan."[55] Retirees remain plan participants and both PBGC insurance and other ERISA protections remain in place.

Proposed Reforms: Taking the Risk Out of De-Risking

The Department of Labor needs to clarify that because of the adverse impact on retirees, plan sponsors cannot selectively terminate retirees in pay status from an ongoing plan without satisfying fiduciary safe harbor requirements that will better protect retirees' reasonable expectations and benefit security. As described above, at Verizon 41,000 management retirees already in pay status were carved out and stripped of both PBGC guarantees and other ERISA protections without being given an option to remain in the plan (which continues to accrue and pay benefits vis-à-vis an even larger number of other participants). If necessary, Congress should also act to clarify that although ERISA intended to maintain the defined-benefit pension plans as a voluntary system, unless employers institute a standard termination and follow the statutory requirement prerequisite to settling their obligations to all participants, firms cannot terminate their obligations to selected groups within a plan without satisfying the fiduciary protections proposed below. Moreover, those participants left in the plan should end up no worse off with respect to the funded level of the plan.

The most important policy question is whether an *ongoing* pension plan that purchases group annuity contracts as part of a de-risking strategy has an obligation to retain the annuity as a plan asset. Legally, the question is unsettled. The federal District Court in *Lee et al. vs. Verizon Communications, et al.,* in its June 2013 opinion dismissing the retirees' class action against Verizon, concluded 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 (and its attendant ERISA and PBGC protections). The court stated:

> The parties dispute whether ERISA regulations expressly authorize an annuity purchase that removes a group of participants and beneficiaries from a plan without terminating the plan. The Transferee Class [the 41,000 retirees] does not point to any regulation that prohibits it, and the court has found none. **But neither does the authority on which Verizon relies expressly authorize an annuity purchase in these circumstances**.[56]

The District Court observes that Verizon relies primarily on language in EBSA Interpretive Bulletin 95-1, which in 1995 established fiduciary guidelines for the selection of an annuity provider and states that "annuities may be purchased for participants and beneficiaries in connection with the termination of a plan, **or in the case of an ongoing plan, annuities might be purchased *for participants who are retiring or separating from service*** with accrued vested benefits."[57] However, the settlement of claims for individuals at the time they separate from employment is a far cry from the massive transfer of retirees already in pay status, some for 20 years or more, to a third-party financial institution. These individuals were already long retired and separated from service – and Verizon's maneuver was indistinguishable from a transaction terminating a plan, except for the fact that the company selectively stripped only certain retirees of their benefit security. After noting this language, the District Court concluded: "Although this description of available circumstances [for annuity buy-outs] does not purport to limit when an annuity purchase can be made, neither does it expressly authorize what Verizon has done here."[58]

From a fiduciary perspective, DOL should clarify that requiring plans to retain the annuity contract as a plan asset would clearly be in the best interest of retirees, who then lose neither their federal PBGC insurance protection nor other ERISA protections (including disclosure, minimum funding thresholds and insulation of the benefit from potential creditors). The plan itself would have somewhat higher costs going forward, since it would continue to pay PBGC premiums and administer monthly payments, but this would be offset (and if Verizon's $1 billion premium to Prudential is a fair measure, more than offset) by saving the premium that the insurance company charges over the projected benefit liability on an ERISA and accounting basis.

Plan sponsors and industry lobbyists maintain that even when annuity buy-outs are imposed upon a subgroup of retirees in a plan – and there is no standard termination – that this is purely a "settlor function" for which the plan sponsor has complete discretion and no fiduciary duty to consider the interests of retirees or other plan participants.[59] It is true that the Supreme Court's 2007 decision in *Beck v. Pace Int'l Union*[60] gave plan sponsors far more discretion to make financial decisions about funding or terminating a plan, for example, by creating a distinction between a firm's "settlor functions" as plan sponsor and its fiduciary duties when implementing those decisions. However, as discussed above, even if this is true, it is clear from the structure and detail in ERISA Section 4041 that Congress did not intend to permit plan sponsors to unilaterally settle and sever their obligations to individual retirees outside the context of a plan termination. The standard termination process in Section 4041 would be effectively nullified if a plan sponsor could incrementally jettison 99.9% of its plan participants without going through the process that Congress set up to substitute for the fact that, by definition, in a standard termination the plan sponsor is acting in its "settlor" role and not "solely in the interest of participants and beneficiaries for the exclusive purpose of providing benefits" as it is otherwise required to do under ERISA Section 404(a)'s fundamental fiduciary duty mandate.

With respect to purchases of fixed-income annuity contracts, the NRLN urges the Department of Labor to amend and extend its policy relating to the fiduciary standards under ERISA for selecting an annuity provider, as set forth in Interpretive Bulletin 95-1.[61] The Interpretive Bulletin (IB) provides guidance on the fiduciary duty governing the selection of an annuity provider to which the plan sponsor is transferring liability for benefits. It states, in part:

> In discharging their obligations under section 404(a)(1), 29 U.S.C. 1104(a)(1), to act solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to the participants and beneficiaries as well as defraying reasonable expenses of administering the plan, fiduciaries choosing an annuity provider for the purpose of making a benefit distribution must take steps calculated to obtain the safest annuity available, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise.[62]

The DOL's Employee Benefits Security Administration (EBSA) should release a new Interpretive Bulletin that updates IB 95-1 and provides that **<u>if a qualified defined-benefit plan is not terminated pursuant to ERISA Section 4041, the plan has a fiduciary duty to continue to hold the annuity contracts as a plan asset.</u>** This allows the plan sponsor to choose to pursue an incremental de-risking strategy – the acquisition of group annuity contracts (whether irrevocable or not) – but through a "buy-in" that ensures retirees do not lose their PBGC or other ERISA protections. Absent the approval of a standard termination by the PBGC under Section 4041, this simply requires the plan sponsor to acknowledge it is wearing two hats when making decisions about an ongoing plan.

<u>Alternatively, the plan sponsor should be able choose to permanently transfer its liability for individual retirees to a qualified annuity provider</u>, as if the plan were terminated, <u>but only if it complies with one of the following safe harbor requirements</u>:

(1) **The plan seeks and 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.
<u>or</u>

(2) **The plan can purchase reinsurance** from a separate and highly-rated insurer to guarantee 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 funds. The protections afforded by state guaranty associations fall far short of PBGC maximum coverage

levels and vary widely from state to state. The selection of the reinsurance carrier should be subject to the same fiduciary criteria already established since 1995 in the safe annuity rule adopted in DOL/EBSA's Interpretive Bulletin 95-1

The Treasury Department and IRS should simultaneously provide guidance that the distribution of a group annuity contract is an alternative form of benefit distribution and requires participant consent if the reinsurance safe harbor is not met.

As part of either safe harbor above, two additional protections should be required:

- First, **the selection of the annuity provider and the prudence of the annuity contract should be reviewed and approved by the Department of Labor** based on the criteria in the safe annuity rule adopted in DOL/EBSA's Interpretive Bulletin 95-1 noted above. This would effectively be in lieu of the compliance review by PBGC in the context of annuity contracts purchased in a standard termination under ERISA Section 4041.
- 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).

A substantial notice period (90 days or more), full disclosure (at least as comprehensive as PBGC Form 500), and a substantive review by either EBSA or PBGC is no less appropriate for a selective buy-out as it is in the context of a standard termination. As explained above, when a plan sponsor purchases annuity contracts to settle its liabilities as part of a standard termination – after which the pension plan shuts down – ERISA Section 4041 requires a detailed notice, review and approval process that gives the PBGC authority to void the transaction if it is determined to be non-compliant with ERISA. Verizon, by contrast, was able to end-run this process – and transfer 41,000 retirees to Prudential without triggering even the modest review and other protections required by Section 4041. Retirees received considerably less than 60 days' notice before the transaction with Prudential was declared final – which may even have occurred sooner except for the retirees' federal district court complaint seeking an injunction.

If the agencies do not act quickly to strengthen the fiduciary protections pertaining to group annuity buyouts, Congress should at a minimum require plan sponsors to maintain back-up insurance, either from the PBGC or a highly-rated reinsurance carrier. Ideally, plan sponsors should have a choice between purchasing reinsurance from a highly-rated commercial carrier, or continuing to pay a reduced flat rate PBGC premium that is discounted to reflect the lower risk exposure associated with group annuity contracts purchased from a highly-rated insurance company. By pooling the reinsurance risk, plan sponsors can very cost-effectively mitigate what is essentially an uninsurable and catastrophic risk to each individual retiree.

In addition to the fiduciary requirements above, <u>the agencies should require that following any transfer of assets to settle liabilities for a subgroup of plan participants</u> – whether by group annuity purchases or by lump sum buy-outs – <u>the on-going plan must be at least as well funded as it was prior to the transaction</u>. 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, as Verizon's $1 billion premium to Prudential demonstrates.

Finally, 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 implications and the higher cost of purchasing an individual annuity contract.** As noted above, although retirees in pay status at least have a choice to decline the lump sum and continue receiving their monthly benefit for life, many older or disabled retirees may not be in a good position to decide objectively, due to an erosion of mental capacity, for example, and could be subject to manipulation or pressures from financial advisors, relatives or others with interests not completely in alignment with the retiree. The Department of Labor should request comment and examine what additional disclosures or other enhanced fiduciary obligations, if any, should apply to lump sum offers to retirees above a certain age or, perhaps, below a minimum monthly annuity amount (on the presumption that a retiree already receiving a low monthly benefit could be more dependent on that income for basic living expenses, since Social Security provides at best a poverty level income for retirees who were middle-to-low income wage earners during most of their working years.)

CONCLUSION

A number of factors have combined in recent years to give employers an incentive to reduce the overall risk and financial statement volatility associated with the accumulated pension liabilities earned by both current and retired workers over decades. While some de-risking strategies are in the best interests of plan participants, amendments to an ongoing plan that transfer the assets and liabilities for a subgroup of already-retired participants to an insurance company (through an annuity buy-out), or directly onto plan participants (through a lump sum buy-out), need to be reexamined by the DOL and by Congress. 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 sponsor from using an annuity buy-out to involuntarily separate a subgroup of participants from an ongoing plan. The DOL needs to clarify that if the plan is not terminated pursuant to ERISA Section 4041, after review and approval by PBGC, 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. Although plans should have the option to continue these risk-transfer strategies, maintaining the PBGC insurance and other protections of ERISA suggest the establishment of safe harbors requiring either individual consent to an annuity buy-out by an ongoing plan, or at least the purchase of reinsurance equivalent to the PBGC's maximum benefit protections.

ENDNOTES

[1] Written testimony of Robert S. Newman, Covington & Burling LLP, before the ERISA Advisory Council, hearing on Private Sector Pension De-Risking and Participant Protections, June 5, 2013, at 1.
[2] *Id.* at p. 2.
[3] CFO Research Services, survey of 186 U.S. corporations' senior finance executives (Jan. 2012), cited in J.P. Morgan Asset Management, "Pension Pulse – Special Edition," Spring/Summer 2013, at p. 2.
[4] Evan Inglis, Written Testimony on behalf of the ERISA Industry Council before the ERISA Advisory Council, hearing on Private Sector Pension De-risking and Participant Protections (June 5, 2013), at p. 7.
[5] Brian Foerster, "Beyond Volatility: Are 'De-Risked' Pensions Creating All New Risks?" Invesco Investment Insights (April 30, 2012), at 2.
[6] *See* Testimony of Craig Rosenthal on behalf of the American Benefits Council, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections (June 5, 2013), at p. 1.
[7] *Id.*
[8] Melanie Zanona, "There's No Relief for Corporate Pension Plans: Funding Ratios for the Nation's 100 Largest DB Plans Fall slightly Despite a year of Healthy Contributions, Equity Gains," *Pensions & Investments*, April 29, 2013.
[9] *See* Testimony of Craig Rosenthal on behalf of the American Benefits Council, *supra* note 6, at p. 2.
[10] *Id.* at p. 4.
[11] *Id.* at p. 6 (emphasis added).
[12] *Id. See also* Towers Watson, "Pension De-Risking Through Lump Sum Offers," Viewpoints (2013)("It wasn't until the Pension Protection Act of 2006 changed the basis for calculating lump sums that the offerings became viable [de-risking] solutions for many organizations. Prior to PPA's enactment, plan sponsors often had difficulty offering lump sums, because they had to calculate them using a 30-year Treasury-rate basis, which made lump sums more expensive than funding or accounting liabilities.").
[13] Prudential, "Retirement Plan Strategies: De-risking pensions – emerging opportunity through lump sum cash-outs under the Pension Protection Act of 2006" (2011), at p. 4 (emphasis added).

[14] Testimony of Robert S. Newman, *supra* note 1, at p. 3, citing Treasury Regulation § 1.401(a)(9)-6, Q&A-1(a).
[15] *Id.*, citing U.S. Department of the Treasury, Private Letter Rulings 201228045 and 201228051 (2012).
[16] Testimony of Evan Inglis, *supra* note 4, at p. 6.
[17] *Id.*
[18] In addition to the efficiency and purchasing power of a large group, pension funds have less adverse selection since it's assumed that the individual out looking to buy a fixed life annuity is relatively healthy and concerned they will outlive their assets. Female retirees may pay even more in the individual annuity market because of their longer life expectancy on average.
[19] Prudential, *supra* note 13, at p. 7.
[20] Russ Banham, "The Great Pension De-Risking," *CFO Magazine*, April 15, 2013.
[21] Prudential, *supra* note 13, at p. 7.
[22] *See* National Retirees Legislative Network, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms," NRLN White Paper Series (January 2013).
[23] Prudential, *supra* note 13, at p. 6.
[24] Barry B. Burr, "Corporate Pension Funded Status Not Rising Despite Contributions," *Pensions & Investments* (March 4, 2013).
[25] Testimony of Stephen A. Keating, Co-Founder & Principal, Penbridge Advisors LLC, to the ERISA Advisory Council (June 5, 2013), at p. 6.
[26] Russ Banham, "The Great Pension Derisking," *CFO Magazine* (April 15, 2013).
[27] Testimony of Jack Cohen, Association of BellTel Retirees, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections, (June 5, 2013), at p. 2.
[28] *See* Association of BellTel Retirees, "*Lee, et al. v. Verizon Communications, Inc., et al.* - Pension De-Risking and Retirees' Class Action Litigation Still Active," May 2013 Update, a*vailable at* *http://belltelretirees.org/images/stories/Update_Report_Lee_v_Verizon_043013.pdf*.
[29] *Lee, et al. v. Verizon Communications Inc., et al.*, Memorandum Opinion and Order, U.S. District Court for the No. District of Texas (Dallas Div.), Civil Action No. 3:12-CV-4834-D (June 24, 2013), at pp. 7-11.
[30] *Id.* at p. 10.
[31] *Id.* at pp. 11-12.
[32] *Id.* at p. 8, n. 9. ("The Transferee Class [retirees] does not point to any regulation that prohibits it, and the court has found none. But neither does the authority on which Verizon relies expressly authorize an annuity purchase in their circumstances.")
[33] *Id.*
[34] Written Testimony of Stephen A. Keating, Co-Founder & Principal, Penbridge Advisors LLC, before the ERISA Advisory Council, hearing on Private Sector Pension De-Risking and Participant Protections, June 5, 2013, at 10. "Penbridge calculations based on 1994 Group Annuity Reserve Mortality Table, Projection Scale AA, Discount Interest Rate of 4.0%, Male Annuitant Age 65, Life Only form of annuity." *Id.*
[35] Testimony of Ilana Bolvie, Communications Workers of America, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections, (June 5, 2013), at p. 4.
[36] ProtectSeniors.org, "New Pension De-Risking Legislation Introduced in Connecticut," *Seniors Advocate*, April 2013, at p. 4.
[37] Danielle Douglas, "Prudential enters uncharted legal realm by appealing its regulatory label," *The Washington Post* (July 3, 2013), *available at* http://www.washingtonpost.com/business/economy/does-prudential-have-a-chance-of-beating-the-systemically-important-label/2013/07/03/9f3f22f8-e3ed-11e2-80eb-3145e2994a55_print.html.
[38] *Id.*
[39] *See* Assn. of BellTel Retirees, May 2013 Litigation Update, *supra* note 9, at p. 2.
[40] Testimony of Ilana Bolvie, CWA, *supra* note 35, at p. 4.
[41] Melanie Zanona, "There's No Relief for Corporate Pension Plans," *Pensions & Investments* (April 29, 2013).
[42] *Id.*
[43] *Pensions & Benefits Reporter*, "De-Risking Focuses on Business Issues: Retirement Security a Concern, Critics Say," *Bloomberg BNA*, Nov. 6, 2012, at p. 2.
[44] Testimony of Jack Cohen, Association of BellTel Retirees, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections, (June 5, 2013), at p. 5.
[45] For an explanation of how the PBGC exaggerates its projected deficit, see National Retirees Legislative Network, "Back Door Reversions" White Paper Series (updated Jan. 2013) at www.nrln.org .
[46] Under ERISA § 4042(a)(4), the PBGC "may institute proceedings . . . to terminate a plan whenever it determines that the possible long-run loss of the corporation with respect to the plan may reasonably be expected to increase

unreasonably if the plan is not terminated." ERISA § 4042(a)(4) is the government's primary authority to protect retirees and other plan participants in the aftermath of a corporate spin-off or other M&A transaction is the PBGC's ability to initiate an involuntary plan termination – although it is commonly referred to as the "nuclear option" because it also means that the plan is terminated and any vested but nonguaranteed benefits are permanently lost to retirees and other plan participants. *See* National Retirees Legislative Committee, "Pension Spin-Offs: Protecting Retirees from Financial Engineering and Foreign Acquisition," NRLN White Paper Series (updated Jan. 2013), at pp. 9-10).

[47] Not all vested benefits are guaranteed due to a variety of limitations. Large numbers of workers and retirees learn only after their company's plan has been turned over to the PBGC that a number of PBGC practices – some discretionary, some statutory – can leave them with monthly benefits that are permanently reduced by 30% or more. The permanent loss of vested but *non-guaranteed* benefits due to various PBGC limitations can be devastating to the individuals affected. The gaps in PBGC's coverage are substantial and impacting a higher percentage of terminated plan participants each year. *See* National Retiree Legislative Network, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reform," NRLN White Paper Series (Jan. 2013), available at www.nrln.org .

[48] *MetLife U.S. Pension Risk Behavior Index*, "Fifth Annual Study of Risk Management Attitudes and Aptitude Among Defined Benefit Pension Plan Sponsors," MetLife (June 2013), at p. 36.

[49] § 4041.23(a).

[50] § 4041.23(b)(9).

[51] § 4041.27(b).

[52] § 4041.26.

[53] § 4041(b)(2)(A)(i). This information is filed on Schedule EA-S of PBGC Form 500. (Standard Termination Notice Single-Employer Plan Termination).

[54] § 4041.31 and § 4041.31(a)(4).

[55] § 4041.31(e)(1).

[56] *Lee, et al. v. Verizon Communications Inc., et al.*, Memorandum Opinion and Order, *supra* note 29, at p. 8, n. 9.

[57] *Id.*, citing and quoting EBSA Interpretive Bulletin 95-1, C.F.R. § 2509.95-1 – "Interpretive Bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan," EBSA Final Rule, 60 Fed. Reg. 12329 (Mar. 6, 1995), amended at 72 Fed. Reg. 52006 (Sept. 12, 2007); *available at* http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&sid=6362d00e23b4c19546ad85e402ed4139&rgn=div8&view=text&node=29:9.1.3.1.1.0.10.13&idno=29. (emphasis added).

[58] *Id.*

[59] *See, e.g.*, Testimony of Robert S. Newman, *supra* note 1, at p. 2; Testimony of John G. Ferreira, Morgan, Lewis & Bockius LLP, before ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections (June 5, 2013), at p. 5.

[60] *See Beck v. PACE Int'l Union*, 551 U.S. 96 (2007).

[61] C.F.R. § 2509.95-1 – "Interpretive Bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan," EBSA Final Rule, 60 Fed. Reg. 12329, Mar. 6, 1995, amended at 72 Fed. Reg. 52006, Sept. 12, 2007; *available at* http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&sid=6362d00e23b4c19546ad85e402ed4139&rgn=div8&view=text&node=29:9.1.3.1.1.0.10.13&idno=29.

[62] *Id.*