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# Statement of Karen Friedman
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## Before the ERISA Advisory Council

## Working Group on

## "Private-Sector Pension De-Risking and Participant Protections"

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My name is Karen Friedman and I am the executive vice president and policy director of the Pension Rights Center, a 37-year-old consumer organization that works exclusively to promote and protect the retirement rights of workers, retirees, and their families. Thank you for giving me this opportunity to testify today before the ERISA Advisory Council on the important subject of de-risking pension plans – or as some retirees have more aptly called it, "pension risk-dumping." I think it's fitting that we are discussing these issues in the same week as the 50th anniversary of the March on Washington and Martin Luther's King "I have a dream" speech on the Mall. Because what Martin Luther King stood for, as President Obama reminded us yesterday, was the fulfillment of the American dream for all people, a dream of equal rights and economic justice. Ensuring that people's pension promises are kept is a fundamental part of the American dream.

The de-risking transactions that we've seen implemented over the past year – most notably by GM, Verizon, and Ford – are part of a larger ongoing corporate trend to eliminate or shrink pension obligations in defined benefit pension plans, thereby eroding pension promises and disrupting the dream of a secure retirement. For years, workers and retirees have watched helplessly as their employers have frozen their plans, cut their benefits, or simply terminated their plans completely. De-risking is the latest strategy for employers to erase their pension liabilities from their balance sheets, either by transferring the liabilities to an insurance company or by offering lump-sum buy-outs to retirees, saddling them with the responsibility of investing their pension money in order to make it last a lifetime.

Since these particular transactions made headlines in 2012, the Pension Rights Center has heard from scores of retirees who, after being promised a guaranteed company pension for life, feel frightened, confused, and betrayed by these disturbing turn of events. They have asked for our help in understanding their rights and choices.

In GM's case, when 42,000 management retirees were given only a brief window to decide between a lump sum or an insurance annuity – perhaps the biggest financial decision of their lives – retirees were filled with justifiable anxiety, wondering how they could be forced to make such an agonizing decision at an advanced age when they thought they were all set for retirement. Similarly, 41,000 management retirees at Verizon felt the sting of betrayal when the Prudential annuity was forced upon them without any choice or consent. Their plight has been compellingly described in the National Retiree Legislative Network's recent paper, "Pension Plan De-Risking: Strengthening Fiduciary Duties to Protect Retirees." Last year we participated in a webinar for dozens of Ford retirees to discuss the importance of benefits guaranteed by the PBGC, and the pros and cons of lump sums – including the dangers of conflicted investment advice and the likelihood that most participants would not be able to replicate the monthly income provided by an annuity from the plan if they took a lump sum.

In reading the testimony submitted in June by a number of employer associations, financial institutions, and benefit consulting firms, I was struck by the matter-of-fact, clinically detached tone used to describe the justification for, and implied necessity of, these de-risking transactions. These groups claim that several factors – turbulent financial markets, low interest rates, required accelerated contributions, the impact of the FASB rules, the lower costs of lump sums – lead to the unalterable conclusion that all big employers should consider de-risking in one form or another as a way to shed their pension obligations. We have seen advertisements for seminars on

"Pension Settlement Strategies," sponsored by insurance companies and benefit consulting firms, which discuss, among other topics, how equity analysts and ratings agencies view companies with pension liabilities, how to prioritize pension risks, and the economics of de-risking.

Interestingly, the only topic that these seminars do not seem to address is the impact of these transactions on the workers and retirees for whom the pension plans were set up. Employer representatives contend that retirees get everything their plan promised them, but this is not entirely true: retirees lose the basic protections of ERISA, including timely disclosures and, more important, the security of PBGC-guaranteed lifetime income.

I will spend a few minutes discussing the concerns we have on these issues and devote the end of my testimony to discussing suggested protections for participants that could be implemented by the Department of Labor, other regulatory agencies, and, if necessary, Congress.

**The Risks of Annuity Transfers: Why Retirees are Legitimately Concerned**

The most common concern we hear from retirees in annuity transfers is, "How can this happen? I thought my pension was a promised benefit with ERISA protections. What happens now if the insurance company goes bankrupt and we no longer have PBGC protections?"

When we have posed these concerns to spokespeople from the insurance industry, they provide a range of answers that sound compelling on the surface but demand further investigation.

The industry defense runs along these lines: retirees are getting everything they were promised, and the insurance company will deliver the exact same benefits without disruption. De-risking advocates also argue that participants, in many cases, will be safer under a high-quality annuity such as Prudential's than they would be if the plan retained their liabilities. As an example, they contend that GM's financial condition is not nearly as strong as Prudential's, and, should the company plan go under, the PBGC guarantees are limited. They say that Prudential is a strong company whose principal business is to insure longevity and mitigate financial risk, that they have issued hundreds of annuity contracts in standard plan terminations, and those benefits are paid without an interruption. And, with respect to GM, Prudential has placed the assets for the GM benefit obligations into separate accounts, which are guarded by firewalls to protect the money from creditors. They further claim that, should the accounts fail, they would be backed by the general assets of the company. Finally, in the worst case scenario, if the company were to run into trouble in the future, they point to the fact that state guaranty associations would step in to cover Prudential's liabilities.

All of these factors add up to a narrative that should provide some comfort to retirees. However, even with such assurances, there are numerous concerns, especially in the long-term. As the financial crisis taught us, even the biggest companies – AIG, Lehman Brothers and Bear Stearns among them – are not too big to fail. And while we recognize that insurance companies are under the watchful eye of state regulators, we also have seen that insurance companies – such as Executive Life and Mutual Benefit Life Insurance Company – <u>can</u> fail nevertheless.

While Prudential and other insurance companies have provided annuities in hundreds of transactions in the past, the magnitude of acquiring the obligations of GM and Verizon should give everyone pause. According to the June 6 testimony of Stephen Keating of Penbridge Advisors, the GM and Verizon annuity purchases were "of unprecedented size," totaling $33.6 billion. Keating also says "Before the two jumbo annuity purchase deals in 2012, the largest deal in the DB annuity buy-out industry on record was just $1 billion….What's changed is that large companies, despite ultra-low interest rates, are now exploring the annuity market whereas that was unheard of five years ago."

While the likelihood of a Prudential collapse may be small, it must be noted that even this well-regarded financial institution has been cited by the Federal Reserve as a potential risk to the financial system. What happens if Prudential were to take on the pension obligations of additional big companies that want to shed their obligations? What is the tipping point for what regulators would consider too much? And, even more alarming, what happens when insurance companies that are not as financially strong as Prudential get into the market? How do we ensure that individuals are properly protected? While Prudential and other insurance companies, such as Metlife, argue they are suited best to provide annuities, are there enough long-term bonds to fulfill these obligations? What would the effects be on capital markets? These are all questions that we hope the Department of Labor and others will address, when they consider the wisdom and legality of these transactions.

Congress created the Pension Benefit Guaranty Corporation to provide insurance to employees and retirees should companies go into bankruptcy. It is unfair, especially to already-retired individuals, that they will lose this protection. The PBGC maximum benefit is nearly $57,500 a year for plans terminating this year. According to Penbridge's Keating, "the PBGC'S maximum guarantee for a life annuity with no survivor benefits of $57,477.24 yearly at age 65 equates to $763,872 on a present value basis." And because the PBGC's benefit payout structure favors retirees, in the majority of cases, current retirees would get 100 percent of their full benefits, even if their plans terminated with inadequate funding. In contrast, the most generous state guarantee funds provide for only $500,000 in value and eight states provide for only $100,000 in coverage. The median coverage is just $250,000.

There are other issues in the annuity transfer that need to be addressed. While one of the selling points of these transactions is the fact that retirees never lose benefits, we wonder what happens if GM's or Verizon's records are not correct and participants are not paid correctly? Which party will be responsible to clear up any problems? For instance, what if a divorced spouse who has a court order for a pension discovers that he or she is not being paid by the responsible insurance company, or a widow inadvertently slips through the cracks? Who then will take responsibility for correcting these mistakes – the insurance company or the company pension plan? This is unclear. The Center recently heard about a GM retiree who had been inadvertently overpaid by the company, and his benefit was reduced to account for the mistake. GM promised that the benefit would increase to the correct amount once the overpaid amount was recouped. Now the participant is concerned about his future annuity. He rightly asks, what will he do if Prudential does not increase the benefit to the right amount? To whom does he complain? Who will redress such a mistake in the future?

Under ERISA, pension benefits are protected from creditors who seek to garnish or seize these retirement benefits. But once pensions are sold to an insurance company, the protections are not so clear and it appears that whether or not these benefits can be assigned or alienated is determined by state law. An additional concern is that, once a benefit is transferred to an insurer, there is no law that would prohibit the insurance company from, at some later time, converting the remaining value of the annuity into a lump sum. If this were the case, it is not clear whether that the company would need to obtain spousal consent in the case of a joint-and-survivor annuity, and it is not clear what interest rates they would be required to use.

Besides the issues raised above, we are also concerned about Verizon's transaction, which unlike GM's, was an end-run around standard termination routine practices. Verizon retirees have concerns similar to those of other retirees in these situations, but they also believe they were unlawfully stripped of ERISA protections – including the notice, disclosure, PBGC review, and approval process mandated under the law. The specific problems facing Verizon's retirees are compellingly detailed in the NLRN report.

**Lump Sums: From Security to Insecurity**

Lump sums offer few advantages to most retirees, but many older Americans, when offered the option in de-risking scenarios, are tempted to take the large pots of money and run – either because they believe they can do a better job of investing the money, or because they are so fearful of the insurance company transfer that they are willing to take the risk. In Verizon's case, as we heard from Jack Cohen in his testimony in June and as detailed in the NLRN report, many Verizon retirees wanted the choice of taking the lump sum, since they felt they lost their voice and rights when their pensions were switched to Prudential.

But taking the lump sum can be risky business. Retirees will have to invest that money in the stock market to replicate the security of a pension, investing not just for today but to ensure that the money can last a lifetime. That isn't so easy to do. According to economist Alicia Munnell, director of the Center for Retirement Research at Boston College, almost no one can beat the market. She warns that only those with serious illnesses who believe they do not have much time left should even consider taking a lump sum. She adds, "Even those who think they have numbered days many end up living longer than they think."

Also, in too many cases, people getting these lump sums will be vulnerable to financial advisers who would not get fees if the retiree sticks with the monthly pension (the right choice for the vast majority of those to whom it is offered). Thus, it is in the adviser's financial interest to recommend taking the lump sum, even if a retiree may be better off sticking with the annuity. Particularly today, when many financial advisers are not required to put the client's interest first, we worry that too many retirees will receive questionable advice. Our concerns here would be diminished, though not eliminated, if all financial advisers giving advice in de-risking transactions were subject to the highest fiduciary standards.

From the Pension Rights Center's perspective, offering lump sums to retirees in pay status is bad policy. It violates the most reasonable interpretation of current law, and it should be prohibited in virtually all cases. We are concerned that choosing a lump sum after the individual is already in

pay status opens new windows to make potentially unwise choices. For instance, retirees who are already receiving a joint-and-survivor annuity to protect their spouses would have an opportunity to rethink that choice. What if the participant or the spouse, now in their later years, has diminished mental capacity and no longer thinks the protection is important? What if there is pressure from children who want their parents to turn the annuity into a lump sum for their own purposes? We worry that offering lump-sum options to those in pay status turns guaranteed pensions into do-it-yourself savings arrangements, totally undercutting the purpose of pensions in the first place.

Studies by the GAO, the Center for Retirement Research at Boston College, and the National Institute for Retirement Security all show that those with monthly pension payments are more secure and better able to pay for housing, healthcare, and daily necessities, particularly during economic downturns. Ilana Bovie of the Communications Workers of America cited many of these studies in her testimony before the Council in June.

**De-Risking Employees and Retirees in De-risking Arrangements**

Our bottom line is that, once retirees start receiving a pension check, companies should not be able to transfer their obligations to an insurance company unless retirees' legal and insurance protections are equivalent to those provided under ERISA. We believe it is essential that employees and retirees are de-risked in de-risking arrangements.

To that end, we strongly believe there should be a moratorium on these transactions until the Department of Labor and other agencies act to implement the following recommendations:

1) <u>Strengthen fiduciary standards for annuity selection and implementation</u>: Even though the decision to amend a plan to provide for de-risking may be a settlor function, the selection of the annuity contract is clearly a fiduciary duty. We believe the Department of Labor's interpretive bulletin on the selection of an annuity provider must be updated. The bulletin was issued in 1995, long before the wave of current de-risking activities. We believe that either the interpretive bulletin should be revised, or the Department should publish new guidance that applies to the selection of an annuity in the case of a de-risking transaction and that will strengthen protections for all retirees who have lost PBGC protection.
    a) In this regard, we believe that the plan fiduciary must not only choose the "safest available annuity," but also the most protective annuity. Our belief is that the fiduciary in these transactions must also ensure that the annuity is at least as safe as a PBGC-guaranteed annuity, which would require purchasing reinsurance to provide protection in the event of an insurance company failure to bridge the gap between the original pension amount and what the insurance company together with the applicable state guaranty association will pay. Given the insurance industry's assurances that the likelihood of such failures is remote, purchasing such reinsurance protection should not be costly.
2) <u>Require that annuity contracts include protections against garnishment and attachment by creditors or bankruptcy trustees</u>: We believe fiduciaries should be required to replicate ERISA protections to the extent possible when negotiating with an annuity provider.

Requiring contracts that include anti-alienation provisions should be a minimum requirement.

3) Prohibit the insurer from offering lump-sum conversions: Provide in de-risking annuity contracts that the insurer itself may not subsequently offer annuitants a lump-sum option.
4) Ensure participant protections in cases of benefit disputes: There must be a process for participants and beneficiaries to resolve disputes, when they believe their entire benefit is not being paid, or if they believe that their benefits have been miscalculated or have been improperly recouped. Agencies should work together to develop an efficient dispute resolution process to ensure that the individual is not tossed back and forth between the company and insurance company because it is not clear who is responsible for addressing the problem.
5) Require enhanced disclosures in insurance transfers: The DOL should require that plan sponsors give more complete disclosures about adverse consequences to the participant: vulnerability to garnishment in some states; limits of state guaranty associations (including specific information about the state guaranty associations' limits applicable to each participant); and the loss of PBGC coverage and other ERISA protections.
6) Provide protections in lump-sum buy-outs: The Pension Rights Center believes that companies should not be allowed to offer lump-sum buy-outs to participants who are already receiving their pensions. We also believe that the agencies already have the authority to prohibit such buy-outs. However, if these buy-outs continue, then, at the very least, there should be much more robust disclosure requirements to warn retirees against investment risks, tax consequences, loss of federal insurance protections, and the consequence of waiving spousal benefits. The DOL should consider holding focus groups among affected participants and issue guidance requiring the most helpful disclosures.

As I said earlier, we believe this practice should be halted until protections are in place. Thank you for giving the Pension Rights Center this opportunity to present our views on this important topic.