601 Pennsylvania Avenue, N.W., Suite 900
South Building, Washington D.C. 20004
Phone (800) 398-3044
Fax (540) 439-9570
Email: info@ProtectSeniors.Org
www.ProtectSeniors.Org

Paul Miller, *Executive Director*
C. William Jones, *Chairman of Board*
Jim Casey, *President*
Eileen Lawrence, *Secretary/Treasurer*

# PENSION DE-RISKING: The Retirees' Perspective
# GRAY PAPER

**Prepared by Edward S. Stone, Esq.**
**Special Counsel to ProtectSeniors.org**

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EDWARD STONE LAW

Edward Stone Law P.C.
175 West Putnam Avenue, 2nd Floor • Greenwich, CT 06830
Tel (203) 504-8425 • Fax (203) 348-8477
Email: eddie@edwardstonelaw.com

## Pension De-Risking Defined

Pension de-risking is ***any kind of action taken by a defined benefit plan (DBP) sponsor to reduce a plan sponsor's exposure to its pension liabilities***.

Examples of pension de-risking include:

- **Annuity "buy-ins"** where the plan sponsor purchases one or more annuity contracts to cover pension obligations with the plan sponsor remaining as the owner of the annuity contracts. The pension liabilities remain on the plan sponsor's books, but the investment decisions and asset-liability matching become the responsibility of the annuity provider.

- **Annuity "buy-outs"** where the plan sponsor transfers all of its pension liabilities to an insurance company or other annuity provider by purchasing a group annuity contract and terminating the DBP.

- **Annuity "lift-outs"** where the plan sponsor selects some retirees to be removed from the DBP and transfers its pension liabilities for those specific retirees to an insurance company or other annuity provider. The annuity purchase does not result in a termination of the DBP.

  Despite the inherently discriminatory nature of annuity lift-outs, legal challenges to this method of pension de-risking have not yet been successful.

- **Freezing pension benefits** to some or all of the plan participants.

- Changing the **pension investment strategy** to reduce asset-liability mismatch.

- Offering **lump sum** buyouts to some or all of the plan participants.[1]

Of particular concern to retirees is pension de-risking via an annuity buy-out or lift-out. With this type of pension de-risking, retirees lose all of the uniform protections intended by Congress under ERISA and their rights become subject to non-uniform state laws.

[1] Lump sum de-risking was essentially curtailed by the Internal Revenue Service in July, 2015, but some lump sum offers were "grandfathered" and will still take place.

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## Pension De-Risking Trends

For the last 25 years the number of workers covered by DBPs has been steadily declining. In 1985, eighty-nine (89) Fortune 100 companies offered a traditional defined benefit pension plan. By 2012, just eleven (11) of those companies offered a traditional DBP.[2] As of 2013, just 18% of private sector workers were covered by DBPs. Pensions are costly for employers and most companies have scaled back or eliminated their pension plans in recent years.[3] Most troubling for retirees is the statistic recently reported by Prudential: 50% of financial executives surveyed said they "will seriously consider transferring their defined benefit plan risk to a third-party insurer over the next two years."[4]

In July 2015 the Internal Revenue Service (IRS) announced new regulations limiting a company's ability to de-risk its pension liabilities by making lump sum distributions to defined benefit plan participants in pay status.[5] Taking away this de-risking option from DBP sponsors will result in more pension de-risking transfers via annuity buy-outs and lift-outs.

While de-risking reduces the volatility associated with pension obligations and funding requirements, it also strips retirees of their federally mandated protections under ERISA and dumps them into a non-uniform system of state laws.

Recent pension de-risking legislation passed in Connecticut, Public Act No. 15-167, replaces the creditor protections lost to retirees in annuity buy-outs and lift-outs. Recognizing that retirees needed to protect their hard earned pensions, this ground breaking legislation was unanimously approved by the legislature and swiftly signed into law by Governor Dannel P. Malloy. While the Connecticut protections are a step in the right direction, more reforms are needed at the state level to restore what Congress intended for retirees when ERISA was signed into law in 1974.

**ProtectSeniors.org** supports state legislation that will provide:

- Full protection of all annuity benefits from creditor's claims;
- Limitations on future transfers of the group annuity contract by requiring that any subsequent transfers be approved by a state insurance department;
- Disclosures to retirees upon the transfer that (1) the retiree is no longer protected by ERISA and the PBGC, and (2) a statement regarding the amount and availability of applicable guaranty association coverage; and
- Mandatory annual disclosures regarding the health of the assets securing their annuity payments.

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[2] See Towers Watson Insider, October 2012 by Brendan McFarland.
[3] See Private Pension Plan Bulletin Historical Tables and Graphs, U.S. Department of Labor Employee Benefits Security Administration, June 2013.
[4] http://pensionrisk.prudential.com/pdfs/clear-path.pdf.
[5] Internal Revenue Service Notice 2015-49.

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## Losses to Retirees in Pension De-Risking
## Annuity Buy-outs and Annuity Lift-Outs

Once a company purchases a group annuity contract and removes a group of retirees from its pension plan, there are no more federal protections available to those retirees. Group annuity contracts, like most insurance products and the "business of insurance" in general, is governed under state law.

When corporations choose to de-risk via annuity buy-outs or lift-outs, retirees no longer have the uniform protections previously provided under ERISA and the Pension Benefit Guaranty Corporation (PBGC).

Retirees lose:

- Uniform protection from creditors and bankruptcy trustees;
- ERISA's fiduciary duty standards;
- Mandated annual financial disclosures;
- Minimum funding thresholds;
- Ready access to the federal courts; and
- PBGC coverage.

Since 2012 Verizon, General Motors, Kimberly-Clark, Lincoln Electric Company, and West Pharmaceutical Services, Inc. have all moved retirees out of their DBPs and into group annuity contracts.

It is estimated that over $250 billion in U.S., U.K., and Canadian pension liabilities have been transferred to insurers and reinsurers since 2007.[6]

[6] Amy Kessler, Senior V.P. Prudential, speaking at the Eleventh International Longevity Risk and Capital Markets Solution Conference in Lyon, France on September 9, 2015 http://news.prudential.com/article_display.cfm?article_id=7262.

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## Why is Pension de-Risking a concern for Retirees?

1. **Thousands of retirees have already been affected** by pension de-risking annuity transfers. As part of its pension de-risking plan General Motors purchased a group annuity for approximately 110,000 salaried retirees.[7] In December, 2012 Verizon offloaded its obligations to 41,000 retirees to Prudential via the purchase of a group annuity contract. Kimberly-Clark, Lincoln Electric, J.C. Penney, and West Pharmaceuticals followed suit in 2015.

2. **For the next 30 to 50 years, there will be hundreds of thousands of retirees entitled to receive payments under pension plans**. With life expectancies on the rise and increased pressure to show bottom line profits, more companies will be looking for ways to reduce or eliminate their future pension obligations.[8] As a pension benefits expert from Towers Watson told BNA Pension & Benefits Reporter, "The trend towards de-risking by defined benefit plan sponsors is fundamentally a question of when, not if."[9]

3. **Pension de-risking may hurt retirees remaining in a DBP plan after an annuity "lift-out"**. Plan sponsors pay a premium to divest themselves of pension obligations in a pension de-risking transaction. While accurate figures are difficult to ascertain, Verizon is purported to have paid between $8 billion and $8.6 billion to offload $7.5 billion of pension obligations to Prudential.[10] Paying a hefty premium to settle some obligations potentially leaves the remaining plan participants with an underfunded pension plan.[11]

   Thus far legal challenges to this type of discriminatory pension de-risking have failed. In *Lee v. Verizon Communs., Inc.*, 2015 U.S. App. LEXIS 14588 (5th Cir. Tex. Aug. 17, 2015) a three judge panel rejected the plaintiffs' challenges to Verizon's decision to de-risk its pension obligations by removing over 41,000 retirees from the DBP and purchasing a group annuity contract to cover their pension payments. Plaintiffs' have filed a petition for rehearing asking the court to re-visit its decision and preserving their right to appeal.

4. **Additional Guaranty Association coverage or reinsurance.** State guaranty associations depend upon contributions or assessments from member insurance companies, and are most often unfunded post-solvency assessment vehicles. Additional guaranty association coverage or reinsurance is needed to address these limitations.

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[7] See http://www.mlive.com/auto/index.ssf/2012/11/gm_pensions_automaker_prudenti.html (November 2, 2012).
[8] See AON Hewitt "2013 Hot Topics in Retirement: Focusing on Financial Wellness".
[9] See 40 BPR 444 (02/26/2013) in a BNA Pension & Benefits Reporter interview with Matt Herrman of Towers Watson.
[10] See National Retiree Legislative Network report "Pension Plan "De-Risking"" Strengthening Fiduciary Duties to Protect Retirees" at: http://www.nrln.org/flyin%20whtpprs/De-risking%20White%20Paper.pdf.
[11] See BNA Pension & Benefits Reporter at 39 BPR 2389.

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## Revising ERISA to Protect Retirees in Annuity Buy-outs and Lift-Outs

While retirees are no longer protected under ERISA once a pension de-risking annuity purchase has taken place, and state legislation must step in to cover those lost protections, ERISA regulations ***can*** be revised to require DBP sponsors to meet certain requirements prior to de-risking via annuity buy-outs and lift-outs. Several organizations have urged the Department of Labor to amend its "safe annuity" rules set forth in Interpretive Bulletin 95-1 to provide protections ***prior*** to the transfer to a group annuity. **ProtectSeniors.org** has also contributed to working group sessions with the Department of Labor to discuss pension de-risking concerns and the need for additional Interpretive Bulletins.

In May, 2015 Edward Stone testified on behalf of **ProtectSeniors.org** before the U.S. Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans (ERISA Advisory Council), speaking on the need for disclosures to retirees both pre and post pension risk transfers.

Pre-transfer disclosures recommended included:

- A detailed disclosure statement that contains information regarding the loss of federal ERISA protections, including PBGC protection and the applicable state laws that will govern their future annuity payments;
- The amount, scope and conditions precedent for state guaranty association coverage in the event of an insurance company insolvency;
- The extent to which annuity payments become subject to creditor claims or avoidance actions by bankruptcy trustees;
- Disclosure related to any changes that might impact the tax treatment of retiree benefits under an annuity contract;
- Lump sum options and conditions, if any;
- Detailed information on the group annuity contract structure, including a schedule of all costs and expenses paid in connection with the transaction; and
- A copy of any fairness opinions or solvency analysis done in connection with the choice of annuity or other benefit provider.

Recommended post transfer disclosures included requiring all annuity providers to provide impacted retirees with at least the following mandatory annual disclosures:

- Funding levels of all assets relative to expected liabilities under the assumed pension benefit schedules;
- Investment performance summary by asset class;
- Investment performance detail by asset class;
- Expenses associated with any group annuity contract; and
- Material changes in actuarial assumptions, if any.

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## Understanding the Loss of PBGC Coverage

The federally run Pension Benefit Guaranty Corporation protects private sector DBPs in the event that the plan is terminated. If necessary, the PBGC would step in and cover lost pension benefits up to an annual maximum amount.

In the event of an insurance company insolvency after an annuity buy-out or lift-out, a retiree is covered, in most cases, by the state guaranty association where he or she lives, and coverage is not on an annual basis, it is per lifetime. A retiree's coverage is further limited if he/she has exposure to other life insurance or annuity products issued by the same insurance company.

State guaranty association coverage ranges from a low of $100,000 to a high of $500,000 per lifetime. New Hampshire and Puerto Rico only offer $100,000 of lifetime coverage; thirty seven states limit coverage for annuity holders to a lifetime maximum of $250,000. Eight states and one territory, including Arkansas, Florida, Georgia, North Carolina, Oklahoma, Pennsylvania, South Carolina, Wisconsin and the District of Columbia offer coverage up to a lifetime maximum of $300,000. Just four states, Connecticut, New Jersey, New York and Washington offer coverage up to a lifetime maximum of $500,000.

State guaranty associations depend entirely upon contributions from their member life insurance companies and most states impose limits on the amounts that any one guaranty association can assess its members. The ability of the state guaranty associations to withstand the insolvency of a large multinational life insurance company is completely uncertain and delays and reductions in benefit payments could result.

History has shown that insurance companies do fail, regardless of how strong they may appear. From 1975 - 1990 there were 176 life insurance company insolvencies. The National Organization of Life and Health Guaranty Associations ("NOLHGA") reports that from 1987 - 2009 it was involved in seventy-four (74) multistate life insurance company liquidations.[12] To date, at least two life insurance company failures have resulted in a loss of benefits to annuitants, some of whom were retirees.

Typically, in the event of an insurance company or annuity provider insolvency, a retiree would be protected by the laws of the state he/she resides in at the time the insurance company is declared to be insolvent or impaired. Retirees may unwittingly divest themselves of guaranty association coverage by moving *after* the transfer of their pension obligations. A retiree living in New York with $500,000 of potential coverage could find himself or herself with just $100,000 of coverage after relocating to New Hampshire.

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[12] See "NOLHGA, the Life and Health Insurance Guaranty System, and the Financial Crisis of 2008-2009" by Peter Gallanis, (June 5, 2009) at: http://www.nolhga.com/resource/file/NOLHGAandFinancialCrisis.pdf.

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## The Need for State Laws Protecting Retirees

Once a company purchases a group annuity contract and removes the retirees from its pension plan, there are no more federal protections available to those retirees. Under the McCarran-Ferguson Act, the "business of insurance" and most insurance products, including group annuity contracts are regulated under state law.

Retirees need state protections that provide the following:

1. **Uniform protections for annuity proceeds from garnishment or attachment**. Whether or not the annuity proceeds are protected from garnishment or attachment by creditors varies from state to state. Some states have seemingly unlimited exemptions and other states limit the exemption to a specific monthly dollar amount. The table on the next page shows the variations in coverage for certain states.

2. **Protections from subsequent transfers**. When a DBP sponsor decides to de-risk via an annuity buy-out or annuity lift-out, the choice of annuity provider is a fiduciary decision under ERISA and requires that the plan sponsor choose the "best available" annuity provider. However, once this initial pension risk transfer has taken place, there nothing to prevent a well-capitalized solid insurance company from transferring that group annuity contract to another, less reputable insurance company. **ProtectSeniors.org** supports state legislation that requires a subsequent transfer to be vetted and approved by a state insurance department.

3. **Mandatory disclosures as to the loss of ERISA and PBGC Coverage**. Many retirees do not understand that a pension de-risking transfer via a group annuity contract divests them of ***all*** ERISA and PBGC coverage. **ProtectSeniors.org** advocates mandatory disclosures to retirees pre-transfer that (1) the retiree is no longer protected by ERISA and the PBGC, and (2) a statement regarding the amount and availability of guaranty association coverage, post-transfer disclosures on an annual basis regarding the health of the assets securing the annuity payments.

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## State Variations in Creditor Protections for Annuity Proceeds[13]

**Arizona:** Exempts proceeds of annuities that have been held by the debtor for two years, except to satisfy a support order. AZ Rev. State Ann. §33-1126.

**California:** Benefits are exempt to the extent reasonably necessary for the support of the debtor and dependents. Modified by case law. Cal Code Civ Proc § 703.140 (b) (10) (E).

**Connecticut:** Recent pension de-risking legislation passed in Connecticut, Public Act No. 15-167, replaces the creditor protections lost to retirees in annuity buy-outs and lift-outs. Recognizing that retirees needed to protect their hard earned pensions, this ground breaking legislation was unanimously approved in Connecticut and swiftly signed into law by Governor Dannel P. Malloy. The new law took effect October 1, 2015.

**Florida**: Exempt. FL State. Ann. § 222.14.

**Massachusetts:** Benefits of group annuities are exempt from attachment, except to satisfy a support order. MA Gen. Laws Ann. Ch. 175 § 132C.

**New Jersey**: Benefits in excess of $500 are subject to attachment. NJ Stat Ann. §17B:24-7.

**New York:** At first glance, New York law appears to exempt annuity proceeds from attachment by creditors under N.Y. Insurance Law § 3212 (d) (2), but a court "may order the annuitant to pay to a judgment creditor…a portion of such benefits that appears just and proper to the court, with due regard for the reasonable requirements of the judgment debtor and his family". As such, a retiree might find him/herself embroiled in a lawsuit where creditors are trying to garnish his/her annuity proceeds.

**Ohio**: Annuity benefits are exempt to the extent reasonably necessary for the support of beneficiary or dependents. It is possible that ORC Ann. §3923.19 (B) could be interpreted to provide that the benefits under a group annuity contract as a result of a pension de-risking transfer are fully exempt. ORC Ann. §3923.19(A).

**Pennsylvania**: Annuity payments in excess of $100 per month are subject to claims of creditors. 42 PA Cons. Stat. Ann. §8124 (c).

**Texas**: Exempt. TX Ins. Code Ann. §1108.051.

**Vermont**: Annuity benefits in excess of $350 are subject to attachment. 8 V.S.A. § 3709.

[13] Data may not be current.

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# ProtectSeniors.org Advocates State Legislation Protecting Retirees

## Pending State Legislation

In 2014, **ProtectSeniors.org** advocated for the adoption of legislation in Connecticut that offered full creditor protections to retirees in pension de-risking transfers. On October 1, 2015 Public Law 15-67 providing those creditor protections went into effect. Plans are underway to re-introduce a bill providing subsequent transfer protections and mandatory disclosures.

**ProtectSeniors.org** is working with legislators in various other states to introduce legislation that would provide protections for retirees in pension de-risking transfers. **ProtectSeniors.org** supports state legislation that will provide:

- Full protection of annuity benefits from creditor's claims;
- Limitations on future transfers of the group annuity contract by requiring that subsequent transfers are approved by the state insurance department;
- Disclosures to retirees upon the transfer that (1) the retiree is no longer protected by ERISA and the PBGC, and (2) a statement regarding the amount and availability of guaranty association coverage; and
- Mandatory post-transfer annual disclosures regarding the health of the assets securing their annuity payments.

## The NCOIL Resolution

**ProtectSeniors.org** submitted a Pension De-Risking Model Act at the National Conference of Insurance Legislators (NCOIL) Annual Meeting in November, 2013.[14]

At NCOIL's 2014 Annual Meeting, members of NCOIL, representatives from the insurance industry and advocates from **ProtectSeniors.org** came together to adopt a "Best Practices Resolution" with regard to pension de-risking transfers which recommended that all states:

- Raise their guaranty association limits to $250,000 or more;
- Clarify and close any gaps in the protection of annuity contracts from the claims of creditors;
- Provide protections for annuities from creditors and from any garnishment to the same extent that ERISA plans are protected;
- Limit the transfer of pension de-risking liabilities from one insurer to another without appropriate state regulatory supervision; and
- Adopt a practice of providing clear information and key elements to those individuals impacted by pension de-risking transfers.

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[14] NCOIL is an organization of state legislators whose main area of public policy concern is insurance legislation and regulation.

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