Bloomberg BNA

Pension & Benefits Daily ™

Defined Benefit Plans

Plans Considering De-Risking Advised On Steps to Protect Participants, Themselves

As defined benefit plan de-risking continues to flourish, with sponsors either buying pension annuities or unloading their liabilities through lump-sum distributions, politicians, retirement experts and attorneys have raised questions about how to ensure that sponsors and participants come out ahead after the pension transfers have been made.

Pension plan sponsors have been de-risking their plans for decades, but the arena has been booming since 2012, when General Motors Co. led the way for other multibillion-dollar jumbo deals by offering a lump-sum distribution payment to 42,000 retirees and their beneficiaries and transferring its plan to Prudential Insurance Co. of America, with expectations that would save $26 billion in pension liabilities (6 PBD, 6/4/12).

Hundreds of companies have followed in the wake of GM's action.

According to the LIMRA Secure Retirement Institute, pension buyout sales soared to $8.5 billion in 2014, up about 120 percent from $3.8 billion in 2013 (44 PBD, 3/6/15). There were 277 pension buyout contracts in 2014, up 28 percent from 217 the previous year, the report said.

The LIMRA report said that Prudential Financial Inc. got the lion's share of the buyouts, thanks to ''jumbo'' deals by Bristol-Myers Squibb Co. and Motorola Solutions Inc. (191 PBD, 10/2/14).

Protecting Retirees. Plan sponsors and regulators can take steps to protect people's retirement savings when de-risking, said Paul Secunda, a law professor and director of Marquette University Law School's Labor and Employment Law Program.

Sponsors and the Department of Labor should consider various principles to protect retirees before, during and after a risk-shifting transaction, Secunda said in offering Bloomberg BNA a preview of a paper he and Brendan S. Maher, associate professor of law at the University of Connecticut Law School, submitted for publication.

These factors include a ''no worse-off policy,'' regulatory safe harbors, changing the ''safest available annuity'' guidance to a ''most protective'' one and severely restricting lump-sum distributions to people who have already retired.

Principle #1: No Worse-Off Policy: Employees' or retirees' benefits should be no less after a risk-shifting transaction than they were beforehand, Secunda said. The principle is based on general principles of the Employee Retirement Income Security Act and in other areas ''where the law says, if you're going to merge two plans together, you can't detrimentally impact the benefit rights the participants and beneficiaries have,'' he said.

Principle #2: Regulatory Safe Harbors: The DOL should adopt regulatory safe harbors that would incentivize plan sponsors to consider internal de-risking strategies instead of external ones. Internal strategies include liability-driven investments, or hedging different types of investment strategies that make the risk with pension funding less volatile, he said.

Principle #3: Most Protective Annuities and Lump-Sum Disclosures: Because some sponsors are intent on settling their pension obligations through external strategies, for those doing so with annuity purchases, the regulatory guidance under Interpretive Bulletin 95-1 states that fiduciaries must choose the ''safest available annuity provider,'' unless it's in the best interest of the participants to do otherwise. Later DOL guidance, under 29 C.F.R. § 2509-1, limits the bulletin to defined benefit plans.

The challenge here, Secunda said, is that the bulletin is ''much more based on the annuity itself, and its financial profile itself, or the risk it might face. So we want to be more participant-centered, as far as what we think IB 95-1 should do.''

For sponsors that choose lump-sum distributions, there should be more disclosures, Secunda said. The disclosure documents should show ''what impact a lump-sum distribution might have on an individual, given that they're going to have to invest that money on their own and make it last for a long period of time, potentially. We think there have to be actual examples in the disclosures showing what the outcomes between staying in the pension plan versus taking the lump-sum buyout'' would be, he said.

Principle #4: Lump-Sum Distribution Restrictions: Lump-sum distributions to people who have already retired should be ''severely restricted,'' Secunda said. For example, plans should also be required to get consent for a lump-sum distribution from a retiree's spouse, he said. For retirees, ''there should be some kind of showing they have an understanding—and a meaningful understanding—of the consequences of going the lump-sum route now that they're already in retirement,'' he said.

The severe restriction recommendation borrows from the Securities and Exchange Commission's ''suitability'' rule, which requires a fiduciary, before offering a lump-sum distribution to a retiree, to consider the retiree's financial condition, as well as other relevant surrounding circumstances, to determine whether that's a suitable option for certain retirees, Secunda said.

Lump-Sum Disclosures. There may be a limit on when plan sponsors are required to disclose their decisions about whether to offer lump-sum distributions, said Nancy G. Ross, a partner at Mayer Brown LLP in Chicago and a member of the American Benefits Council's Advisory Council.

She pointed to mid-1990s decisions by the U.S. courts of Appeals for the Third and Ninth circuits in which they developed the ''serious consideration test,'' which addresses an employer's obligation to disclose it is making benefit plan changes.

Under that three-element test, a proposed benefit change is under ''serious consideration'' if it (1) is a specific proposal (2) that is being discussed for purposes of implementation (3) by senior management with the authority to effect the change.

The ''serious consideration test'' may apply to lump-sum decisions because participants and beneficiaries are likely to receive higher pension lump-sum payouts after the Treasury Department adopts new mortality assumptions that the Society of Actuaries released in October, which show significantly longer life spans, Ross said (208 PBD, 10/28/14).

But because the tables haven't been adopted yet, the ''serious consideration test'' means that ''employers likely do not have to wrestle with whether they have an obligation to tell employees their lump-sum payouts may be greater if they wait,'' Ross said.

''One could argue that disclosures only come into play if the participant has a choice—are disclosures only for purpose of payout before transfer to take a lump sum,'' Ross said.

Based on ''unofficial rumblings,'' Treasury's adoption may finalize its adoption of the tables before 2016, said Sean Brennan, a partner in Mercer LLC's financial strategy group in New York.

The Government Accountability Office has also chimed in on disclosures.

Responding to a request by Rep. Sander M. Levin (D-Mich.), ranking member of the House Ways and Means Committee, the Government Accountability Office said in a January report that it had identified eight key areas that should be disclosed to plan participants who are offered lump-sum windows (39 PBD, 2/27/15).

However, in its review of 11 plans, representing about 248,000 participant offers, none of them provided information on all eight of the factors, the GAO said in the report, ''Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits'' (GAO-15-74).

Among its recommendations, the GAO said the Department of Labor should require plan sponsors to notify the DOL at the time they implement a lump-sum window offer, including the number and category of participants being extended the offer; coordinate with the Internal Revenue Service and the Pension Benefit Guaranty Corporation to clarify the guidance regarding the information sponsors should provide to participants when extending lump-sum window offers; and place the guidance on the DOL's website.

The GAO also said that Treasury should:

- review its rules governing the information contained in relative value statements to ensure these statements provide a meaningful comparison of all benefit options;
- review the applicability and appropriateness of allowing sponsors to select a ''lookback'' interest rate for use in calculating lump sums associated with a lump-sum window that can serve to advantage the interests of the sponsor; and
- establish a process and a time line for periodically updating the mortality tables used to determine minimum required lump sums.

States' Interest? The states also may be turning their attention toward annuity purchases.

The National Conference of Insurance Legislators (NCOIL), based in New York, offered a proposal called the Pension De-Risking Model Act, which the group said would provide protections to retirees whose pension benefits are transferred from pension plans protected under ERISA to substitute pension benefit providers such as insurance companies licensed and regulated under state law.

Although it isn't clear yet whether any state legislatures or regulators have taken a hard look at NCOIL's model act, ''I wouldn't be surprised to see insurance regulators taking interest,'' Ross said.

The model act has been opposed by the American Benefits Council and the American Academy of Actuaries, both of which also said in comment letters to the NCOIL that it would run afoul of ERISA.

Secunda of Marquette University said that if the states were to take interest in the model act, they would have to take it piece by piece, because some of the provisions, such as on lump-sum options for retirees, are considered settlor decisions, which are preempted by ERISA.

If any of the states were to look to the model act, ''it would certainly have to be considered provision by provision to determine whether it interferes with the management and administration of an employee benefit plan,'' Secunda said.

By Sean Forbes

To contact the reporter on this story: Sean Forbes in Washington at sforbes@bna.com

To contact the editor responsible for this story: Jo-el Meyer at jmeyer@bna.com

ISSN