2013 ERISA Advisory Council
Private Sector Pension De-risking and Participant Protections

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Description:

Over the past few years, there has been an increased level of activity for single-employer defined benefit pension ("DB") plans, to either terminate the plans in their entirety, or purchase annuities or offer lump sum distributions to some or all of their plan participants. These participants can include former employees with vested deferred benefits or even retirees currently receiving pension distributions from the plan.

This activity is sometimes referred to generally as “de-risking” or “risk transfer.” One of the purposes of “risk transfer” is to reduce or eliminate the plan sponsor's risk for their current and future liabilities. However, by so doing, it also transfers the risks surrounding the current or future pension obligations to another party, which is either the participant (in the form of a lump sum), an insurance company (in the form of a distributed annuity), or both.

Commentators have proffered many reasons for this trend in “de-risking” ranging from plan sponsors’ desire to reduce volatility in their pension plans, on their balance sheets and in their funding; the revised mortality and interest rates in the Pension Protection Act and subsequent legislation providing for pension funding relief; the current interest rate environment; the desire to lower administrative costs including reduction or elimination of rising PBGC premiums; the current and future funding status of the plan; and/or considerations unique to a specific plan sponsor or industry. And they have noted, in the case of annuity purchases, the guarantees of the contract issuer as well as state guaranty fund coverage.

Other commentators have voiced concerns for participants ranging from participants’ lack of understanding about the benefits of lifetime income streams; challenges for individuals in investing effectively or in adequately addressing longevity risk; the adequacy, scope and independence of investment advice to participants as to where they should invest their distributions; the potential for adverse tax consequences for current retirees who receive a lump sum after commencing retirement distributions; absence of plan sponsor oversight and PBGC protection following distributions or annuity purchases; the capacity of insurance companies to support a substantial growth in demand for annuities; the capacity of state insurance guaranty associations to backstop insurance company guarantees; and potential impacts on employee retirement security and adequacy.

Objective and Scope:

Many plan design decisions (including a decision to offer partial or full lump sums as well as a decision to establish, maintain or terminate a plan) are generally settlor functions which do not give rise to fiduciary responsibilities in and of themselves. Nevertheless, many of the specific actions taken to implement such decisions can involve important fiduciary considerations and significantly impact plan participants

The Council's examination will focus on the following:

A. What are the reasons these plans are choosing to transfer risk? Are there common developments or factors that lead to this decision? Are the reasons more likely to be specific to the circumstances and considerations of the individual plan sponsor? What are the advantages and disadvantages to the plan and plan sponsor? What types of plans and plan sponsors, by size, industry, etc. have adopted "risk-transfer" activities? Is the incidence of plan terminations, plan distributions of annuities, and/or addition or modification of lump sum features in private sector DB plans increasing or is it likely to increase when interest rates rise and/or funding improves?

B. Employers who have adopted de-risking strategies have offered various combinations of lump sum distributions and annuities to subsets of their plan populations. Some employers have chosen to terminate the plan entirely. What are the different alternatives for plans and plan sponsors? Why do they choose these alternatives? What are the factors or criteria used for choosing these alternatives? If plan sponsors do not terminate the entire plan, what is the impact, if any, on the plan and the remaining participants?

C. What are the current requirements and limitations on the ability of a private employer DB plan sponsor to (1) add, modify or remove a lump sum (or partial lump sum) option for one or more groups of plan participants; (2) terminate the plan, or (3) distribute annuities for all or a subset of plan participants (including but not limited to the selection of the annuity provider under Interpretive Bulletin 95-1)? Should the Department of Labor consider updates or revisions to any of these rules, requirements, or limitations?

D. Are there unique issues involved in decisions on "risk-transfer" being made by plan fiduciaries who also are performing settlor functions? Is guidance needed on these issues?

E. What are the interests of plan participants, in determining whether to accept a lump sum in lieu of retaining a benefit under the plan? What are the advantages and disadvantages to plan participants? Are there patterns of acceptance or rejection of lump sum options, across specific demographics or account sizes, which may be relevant to the Department in reviewing its rules and requirements?

F. What are the current participant disclosure requirements applicable to each potential change to the plan? Do participants have sufficient information to make an informed choice? Do these requirements adequately protect the interests of plan participants? If not, should there be checklists, model disclosures, or other proposals, which would protect the interests of plan participants while recognizing the settlor functions of plan design, maintenance, and termination?