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Private Sector Pension De-Risking and Participant Protections
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On behalf of its 57 affiliated unions, the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") appreciates the opportunity to testify before the 2013 ERISA Advisory Council on "Private Sector Pension De-risking and Participant Protections," an extraordinarily important and timely topic.

The AFL-CIO, together with its community affiliate, Working America, represents more than 12 million workers across the country in all sectors of our economy, including those working in manufacturing, construction, transportation, health care, education, hospitality entertainment and state and local governments. Our affiliated unions negotiate retirement benefits for millions of workers and retirees in the private sector. These benefits are provided through single employer and multiemployer plans and through both defined benefit pension plans and defined contribution plans, all of which are subject to the requirements of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

Growing Retirement Insecurity

For more than seven decades, the American labor movement has championed the provision of real retirement security to working families across all sectors of our economy. Today, working families face a growing retirement security crisis as the decades-long erosion of secure defined benefit pension plans continues and the growth of cheaper, less secure defined contribution plans persists.

Over half of American households are at risk of being unable to maintain their standard of living in retirement, up from fewer than one-in-three in 1983.[1] Two-thirds of Social Security beneficiaries who are 65 and older rely on its modest benefits for half or more of their income,[2] and the average monthly Social Security benefit of $1,262 provides an annual income just over $15,000, roughly equal to full time work at the federal minimum wage.[3] The number of workers

[1] Alicia Munnell, et al, *The National Retirement Risk Index: An Update* (Center for Retirement Research at Boston College, October 2012) available at http://crr.bc.edu/wp-content/uploads/2012/11/IB_12-20-508.pdf.

[2] Social Security Administration, *Fast Facts & Figures About Social Security, 2013* (August 2013) available at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2013/fast_facts13.pdf.

[3] *Id.*; U.S. Department of Labor, Wage and Hour Division, History of Federal Minimum Wage Rates Under the Fair Labor Standards Act, 1938 - 2009http://www.dol.gov/whd/minwage/chart.htm.

fortunate enough to have a traditional pension continues to drop as only 14 percent of private sector workers in 2011 were covered by defined benefit pension plans, compared to 38 percent in 1979.[4] In light of these grim facts, it should be no surprise that only 13 percent of workers are very confident about having sufficient money for a comfortable retirement, less than half the number who felt very confident in 2007, before the 2008 financial crisis.[5]

Defined Benefit Plan Coverage Eroding

In the three decades of declining traditional pension coverage, the recent flurry of single employer defined benefit plan "de-risking" activity is only the latest employer strategy to limit responsibility for providing meaningful retirement benefits. What is different about the current transactions is their scope and the movement of assets out of the defined benefit pension system. In our view, these transactions also signal that employers who have long supported defined benefit plans are looking to end their commitment to the retirement security of their employees.

In 1980, according to the Pension Benefit Guaranty Corporation ("PBGC"), there were 95,500 single employer defined benefit plans covering 27.5 million participants.[6] By 2011, the number of plans amounted to only 25,600, a decrease of over 70 percent. The number of participants, however, grew to 33.4 million with that growth coming in larger plans with 5,000 or more participants. But, the data also shows a major shift in the covered participant population over the thirty-year period. In 1980, almost 78 percent of insured plan participants were active participants in the covered plan while 16 percent were retired and only 6 percent were terminated vested participants. By 2010, however, active participants made up 39 percent of insured participants while the retired and terminated vested participants groups each covered about 31 percent.

Some of the decline in active participants results from the growth in frozen plans. The PBGC reports that as of 2008, 24 percent of single employer plans completely or partially froze benefit accruals and an additional 4 percent of plans were closed to new participants. By 2011, just over 40 percent of plans were frozen or closed, and these plans covered 40 percent of the active participants.[7]

Plan freezes were not the only changes affecting benefits earned by workers as design changes, including cash balance and other hybrid designs, were introduced. Between 2001 and

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4 Employee Benefit Research Institute, FAQs About Benefits—Retirement Issues, available at http://www.ebri.org/publications/benfaq/index.cfm?fa=retfaq14.

5 Ruth Helman, Nevin Adams, et al., *The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many* (Employee Benefit Research Institute, March 2013) available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-13.No384.RCS2.pdf.

6 Pension Benefit Guaranty Corporation, *PBGC Pension Data at a Glance (1975-2011)* available at http://www.pbgc.gov/documents/pension-insurance-data-tables-2011.pdf. All of the data in this paragraph come from Tables S-30, S-31 and S-32.

7 *Id.* at Tables S-36 and S-37.

2010, the number of PBGC-insured hybrid plans tripled, growing from 1,227 to 3,674 and those plans covered almost 4 in 10 participants protected by the PBGC.[8]

Affiliates of the AFL-CIO have confronted proposed freezes, benefit changes and plan terminations in bargaining and bankruptcy proceedings throughout this same 30 year period. Plans both large and small have been frozen and plan terminations have affected hundreds of thousands of workers across the economy, including steelmaking and airlines.

Despite these challenges, in our view, defined benefit pension plans remain the best means of providing meaningful secure income to workers in their retirement. They are the soundest and most cost-effective means for building and safeguarding retirement income security. They use professional asset managers, incur lower investment fees and achieve better returns. These plans provide lifetime income that cannot be outlived, and the benefits afforded disabled workers and surviving spouses provide additional protection when a worker's career unexpectedly ends.

The Risks of De-Risking

Given the critical importance of defined benefit pension plans to workers' ultimate retirement security, the AFL-CIO and its affiliates do not believe that the new "de-risking" trend is in the best interests of plan participants. For workers and retirees, these transactions—the offering of lump sums or group annuity purchases—result in more, not less, risk.[9]

Lump Sum Offers

While lump sum offers to terminated vested participants are nothing new, the announcements by Ford Motor Company and General Motors Company that these offers would be made to retirees receiving pension benefits introduced something new and different. Indeed, until these offers became public, it was generally assumed such offers were not permitted under the law absent a plan termination.[10]

If lump sum offers to retirees in pay status are to be permitted, and there are sound policy reasons for prohibiting them, then, at a minimum, full and complete disclosures must be provided. These disclosures should go beyond any technical requirements of the notices already mandated by the Internal Revenue Code and clearly explain the advantages and disadvantages of selecting a lump sum. For example, while electing a lump sum payment may provide the retiree with more control over the assets, there is also the additional responsibility and risk of making

8 *Id.* at Tables S-34 and S-35.

9 We recognize that the "de-risking" of defined benefit plans covers a continuum of activities from changing investment allocation to plan termination. This statement addresses only those activities that lead to assets and benefit obligations leaving the plan.

10 *See, e.g,* Statement of Evan Inglis, FSA, DFA, Principal & Chief Actuary at The Vanguard Group (ERISA Advisory Council, June 5, 2013); Buck Consultants, *Evaluating Retiree Cash-out Windows* (August 27, 2012) available at http://www.buckconsultants.com/portals/0/publications/fyi/2012/fyi-2012-0827c-Evaluating-Retiree-Cash-out-Windows.pdf.

investment decisions or selecting an investment advisor or manager and incurring additional costs. Other factors to be taken into account include other income available to the retiree and spouse, the health of the individuals and their financial needs. Overall, it is a complex decision and an unfamiliar one to most retirees. While checklists of questions to consider or worksheets might be helpful, before developing such tools, the Department should test any draft documents to ensure they are appropriately designed and understandable.

In addition to appropriate disclosures, adequate time for considering any offer of a lump sum payment must be provided. For example, the General Motors retirees were given an extraordinarily short period of time to make an significant decision, one they had little warning about until it arrived in the mail.

Group Annuity Purchases

For participants whose plan benefits are provided through an insurance company annuity, the transfer of the plan obligations leads to the loss of PBGC protection and potentially other ERISA protections as well, including its anti-alienation provisions.

With the insurance company solely responsible for providing benefits, retirees and their beneficiaries will rely on it and any protections afforded by state guaranty associations. The association guarantees are generally more limited than those provided by the PBGC under Title IV of ERISA. Moreover, guarantees vary from state to state so in the event of insurance company failure, participants with identical benefits and demographic characteristics may receive very different amounts while their PBGC-guaranteed benefit would have been the same.

Plan Funding

The participants who remain in the plan following a “de-risking” transaction, whether it is the offering of lump sums or the purchase of a group annuity contract, are also potentially impacted. While the benefit restriction requirements in ERISA Section 206(g) and Internal Revenue Code Section 436 prevent any risk transfer transactions resulting in an adjusted funding target attainment percentage (“funded percentage”) below 80 percent, these transactions are likely to lead to lower plan funding level. Depending upon future economic conditions, investment returns and contributions, the plan funding level could fall, triggering one or more of the statutory benefit restrictions and limiting the future benefits payable to the remaining participants.

The benefit restrictions, added by the Pension Protection Act of 2006, prohibit benefit improvements if the plan’s funded percentage falls below 80 percent. If the funded percentage drops to less than 60 percent, benefit accruals cease and any shutdown or other unpredictable contingent event benefit may not be paid. Other restrictions apply to accelerated benefit distributions, such as lump sum payments, if the funding level falls below either 80 or 60 percent.[11]

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[11] If the plan’s funding level is less than 60 percent, no lump sum payments or annuity purchases can be made and if it is at least 60 but less than 80 percent, then the amounts payable are limited to the lesser of 50 percent of the full value of pension benefit or the present value of the participant’s maximum PBGC guaranteed benefit.

Our concern about the potential impact on the benefits earned by and payable to continuing participants led to the suggestion in our comments that PBGC modify its proposed rule on reportable events to include risk transfer transactions as transfers of benefit liabilities subject to reporting.[12] PBGC's rationale for excluding these transactions was that the benefit restrictions in ERISA Section 206(g) and Code Section 436 limited both lump sums and annuity purchases, so significantly underfunded plans were unable to make those kinds of payments. In addition, any payments made satisfied the plan's benefit obligations, so "there [would be] no concern about a transferee plan's financial health."[13] But, as we noted previously, the lower funding level of the plan after any transaction poses a potential threat to the benefits of the remaining participants. Moreover, requiring reporting would provide PBGC and DOL with better information about these transactions as well as policymakers considering whether legislation governing "de-risking" activities is warranted.

Another way to address the concern about the potential harm resulting from a lower funding level would be to require plans engaging in de-risking transactions to maintain a higher funded percentage to lessen the threat to remaining participants.

Conclusion

While de-risking transactions may benefit the employers who sponsor plans by reducing their exposure to the markets and their financial and administrative responsibilities related to maintaining a defined benefit pension plan, these transactions are not reducing the risk for workers, retirees or the defined benefit pension system. The rationales proffered as justifications for these transactions are virtually the same reasons employers and consultants cited over the years for changing plan designs, freezing benefits and offering retirement savings plans, like 401(k) plans, to replace traditional pension benefits. And, in each of these situations, the ultimate result was reduced benefits for workers.

Setting appropriate rules for de-risking transactions may provide some limited protection to participants, but it will not address the underlying threat to workers' retirement income security. Doing that will require more including sensible funding and accounting rules that support and encourage defined benefit pension plans.

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[12] The proposed rule, issued by the PBGC on April 3, 2013 is available at http://www.gpo.gov/fdsys/pkg/FR-2013-04-03/pdf/2013-07664.pdf.

[13] 78 Fed. Reg. at 20050.