Penbridge™ ADVISORS

Written Testimony of

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Hearing on

Private Sector Pension De-Risking and Participant Protections

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EXECUTIVE SUMMARY

Many corporate plan sponsors have come to the conclusion that de-risking their defined benefit (DB) pension plan is the optimal solution for their company. Many factors have contributed to this shift in pension management policy. The outcome has been a substantial increase in de-risking activities ranging from lump sum offers to annuity purchases where a portion or all of a plan's liabilities are transferred to an insurance company.

RECENT TRENDS

The Pension Benefit Guaranty Corporation (PBGC) now covers fewer than 30,000 DB plans. Additionally as of 2012, roughly a third of DB plans are fully hard-frozen. 2012 was the biggest year ever in the U.S. single premium group annuity (SPGA) market with sales totaling $36 billion. This included the two largest group annuity deals on record ~ General Motors and Verizon. Historically SPGA transaction volume has been less than $3 billion annually for the last 20 years, and slightly less than $1 billion in recent years before 2012.[1] There was also a large uptick in 2012 of lump sum activity due mainly to a new calculation method, allowed under the Pension Protection Act of 2006 (PPA), being fully phased in and effective from the beginning of a plan's 2012 plan year.

PENSION DE-RISKING ALTERNATIVES

Many companies feel the strain of their pension obligations, especially as interest rates have reached record lows, dramatically increasing their liabilities. This in turn affects company earnings, stock price, credit ratings, and even the ability to focus on the core business. As a result, plan sponsors are going beyond the approaches they have traditionally used to address pension risk, mainly plan design changes and adoption of liability driven investment strategies to better match assets and liabilities, to an expanded array of pension de-risking solutions including:

- **Lump Sum Offer** to terminated participants not yet in pay status, retired or terminated participants in pay status and active employees[2]
- **Annuity Distribution Without Plan Termination** to all terminated participants, or only those terminated participants in pay status (Verizon)
- **Spinoff Termination** to all terminated/retired participants, or only those terminated/retired participants in pay status (GM, after lump sum offer)
- **Full Plan Termination** to all terminated and active participants

From the plan sponsor perspective, settlement accounting is a key consideration in the evaluation of any risk transfer transaction. Certain actions could trigger a settlement, which could require unrecognized actuarial gains or losses to be recognized in earnings under U.S. GAAP. Two common examples of a settlement include 1) a lump sum where participants are paid a distribution either through one-time offering or aggregate payments during the year, or 2) an annuity buy-out where an insurance company unconditionally takes on obligation to provide benefits to a specified group of participants.

[1] Source: LIMRA.
[2] Active employees are permitted only if offered in context of termination of entire plan.

In the situation where a plan sponsor decides not to terminate the entire plan, issues surface that need to be well understood. One such issue is the difference in protections afforded to plan participants whose benefit payment obligation has been transferred to an insurance company versus participants that remain in the plan sponsored by the company. The difference arises from the fact that participants remaining in the sponsored plan receive coverage from the PBGC in the event of a corporate insolvency, whereas regulation and enforcement occurs at the State Department of Insurance level once a plan has been transferred to an insurance company.

PLAN SPONSOR REQUIREMENTS AND LIMITATIONS – LUMP SUMS OFFERS AND ANNUITY PURCHASES

The decision to amend a plan to offer lump sums is a settlor decision. The decision is not governed by ERISA's fiduciary obligations and is not subject to fiduciary review. Once the settlor decision is made, however, the plan fiduciary must administer the lump sum offer pursuant to ERISA's fiduciary duties, and in compliance with numerous provisions of ERISA and the Internal Revenue Code designed to ensure protection of participants, beneficiaries, and the plan as a whole.

As with lump sums, the decision to amend a plan to distribute benefits as annuity contracts is a settlor decision, not governed by ERISA's fiduciary obligations and not subject to fiduciary review. The selection of the annuity provider, however, is a fiduciary decision. In selecting the annuity provider, the fiduciary is governed by ERISA's fiduciary duties of prudence, care and undivided loyalty to the plan's participants and beneficiaries, and the specific requirements of the Labor Department's Information Bulletin 95-1.

The ability to offer lump sums and distribute benefits as annuity contracts is constrained if plan funding falls below certain threshold levels.

UNIQUE SETTLOR / FIDUCIARY ISSUES INVOLVED IN MAKING "RISK TRANSFER" DECISIONS

In my experience, the rules governing decision-making by employees who wear "two hats" – a settlor hat and a fiduciary hat – work very well. Plan sponsors have a very clear idea of whether they are seeking advice in their settlor or fiduciary capacity, and act appropriately as such.

INTRODUCTION

Thank you for the invitation to appear before the U.S. Department of Labor's Advisory Council on Employee Welfare and Pension Benefits Plans.

I am honored to have the opportunity to speak to you today on the topic **'Private Sector Pension De-Risking and Participant Protections'.**[3] My testimony will address the following four areas:

- Recent Trends
- Pension De-risking Alternatives
- Plan Sponsor Requirements and Limitations – Lumps Sum Offers and Annuity Purchases
- Unique Settlor / Fiduciary Issues Involved in Making "Risk Transfer" Decisions

For the purpose of my testimony, I will refer to de-risking and pension risk transfer interchangeably. In doing so, I am referring to the process of contractually transferring a defined benefit (DB) plan's liabilities from a corporate plan sponsor to a participant via a lump sum offer, to an insurance company through an annuity purchase, or a combination of the two. In all cases, the goal is to eliminate or to reduce balance sheet risk, longevity risk, investment risk, interest rate risk, and/or other risks borne by a plan sponsor.

[3] The questions are listed in Appendix A.

RECENT TRENDS

Over the course of my career, I have watched the ongoing shift from DB plans to defined contribution (DC) plans. In more recent years, plan sponsors increasingly have made the decision to close their DB plan to new entrants or to freeze the plan entirely. The Pension Benefit Guaranty Corporation (PBGC) website publishes figures on the number of private-sector pension plans that it insures for individual employers, including hard-frozen pension plans. At year-end 2011, the most recent data available, there were 25,607 plans, down from a peak of 112,208 in 1985. At the same time, the number of hard frozen plans has increased steadily to 8,156 plans at year-end 2011, which amounts to 32% of all remaining DB plans.[4]

From a pension risk management standpoint, 2012 was a watershed year for corporate DB plans. We saw a record number of plans offer participants lump sums; and for the first time on record, lump sums were offered to in-payment retirees. We also witnessed annuity purchases of unprecedented size with the General Motors and Verizon transactions (together approximately $33.6 billion) as well as an active group annuity market overall with 200+ transactions, in all totaling $36 billion.

This increased demand is the result of many factors, including:

- Accounting and regulatory changes increasing funded ratio and contribution volatility
- Sponsors adopting more conservative risk/return approaches in the management of plan assets
- The Pension Protection Act of 2006 (PPA) pushing plans towards full funding and allowing for relatively less expensive lump sums
- Increasing PBGC premiums raising the cost to maintain a plan
- Size of pension obligations distracting plan sponsors' attention from core business
- Hard- or soft-frozen plans are no longer a part of core HR objectives
- Plan obligations being viewed as corporate finance rather than a separate investment issue

The combination of PPA minimum funding requirements, recognition of the on-going costs incurred to maintain a DB plan and the completion in 2012 of the phase-in for less expensive lump sum calculations has lowered the incremental financial hurdle to annuity buy-out, albeit the Moving Ahead for Progress in the 21st Century Act (MAP-21) has provided temporary funding relief to plan sponsors. With respect to lump sum cash-outs, effective from the beginning of a plan's 2012 plan year, corporate bond yields were fully phased in as the basis for minimum lump-sum calculations. In practice, this meant pension liabilities could be settled at approximately the same rates used to measure them on a corporate accounting basis.

As an indicator of pension de-risking activity, Figure 1 shows data from Towers Watson on the firm's terminated vested lump sum experience in 2012.

[4] Source: PBGC 2011 Pension Insurance Data Tables. 2011 figures are most recent available estimates based upon PBGC internal calculations.

Figure 1

2012 Bulk Lump Sum Experience	
Number of Terminated Vested Windows Executed	79
Number of Participants Solicited	399,000+
Average Voluntary Acceptance Rate	62%
Total Lump Sums Paid	$6 billion
Total Participant Calls	330,000+

Source: Towers Watson

Furthermore, Figure 2 shows data from LIMRA on U.S. group annuity risk transfer sales in calendar year 2012 and first quarter 2013.

Figure 2

U.S. Group Annuity Risk Transfer Sales		
	Sales (millions)	Number of Transactions
Calendar Year 2012	$35,981	231
First Quarter 2013	$273	56

Source: LIMRA U.S. Group Annuity Risk Transfer Surveys

Before the two jumbo annuity purchase deals in 2012, the largest deal in the DB annuity buy-out industry on record was just over $1 billion. Historically, the annuity market for DB plans has been almost entirely driven by small to medium size plans. Even in 2012, 98% of contracts sold were for transactions under $250 million with a great many under $10 million. 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. This will likely continue to be the case.

One of the key factors that may motivate a corporate plan sponsor to offer lump sums or purchase annuities is whether the size of the pension plan is considered large relative to the size of the company's market capitalization. Large plans can expose a company's balance sheet and cash flows to movements in interest rates and capital markets. Seventeen companies had underfunding in excess of $1 billion and projected plan benefit obligations (PBO) equal to or greater than 70% of their total market capitalization as of fiscal year-end 2011.[5]

In the case of annuity buy-outs, the advantages to the plan and plan sponsor in transferring risk may include the ability to lower their risk profile, improve their competitive position, remove uncertainty around pension expense, produce more consistent financial results, focus on their core business, and take comfort that a highly creditworthy company is taking responsibility for making future payments to

[5] "Moody's Investors Service Special Comment, Pension Terminations: No Free Lunch," Moody's Investors Service, 2012.

transferred participants. Disadvantages often associated with annuity buy-outs include the loss of liquidity or increase in leverage associated with purchase costs and the negative impact on earnings due to settlement accounting.

With respect to lumps sums, they are generally viewed by plan sponsors as a cost effective method of reducing their benefit liabilities, especially when it comes to terminated vested obligations. However, lump sums effectively transfer plan risks (investment and longevity) to the individual participant, who must rely upon the proceeds for their retirement security.

PENSION DE-RISKING ALTERNATIVES

No two plans have the same circumstances, and, therefore, there is no one-size-fits-all solution. In fact, there are a wide range of solutions to consider. The actions taken by plan sponsors will ultimately depend on their own circumstances. Key considerations include the importance of the pension plan to the company's benefit strategy, the size of the pension plan relative to the size of the company, the willingness to accept volatility in financial results, views on the future direction of the economy, and the company's overall risk appetite. In practice, plan sponsors carefully consider both short-term and long-term impacts to their company such as impact on earnings, stock price, credit ratings, etc. as well as the impact on how employees might feel about a lump sum offer, an annuity transaction, or a replacement plan.

Figure 3 shows the different risk transfer alternatives available to plan sponsors and the participant groups to which each strategy could apply.

Figure 3

Strategy	Participant Groups
Lump Sum Offer	Terminated participants not yet in pay status – "deferred vesteds" and/or Terminated participants in pay status (GM, Ford) Active employees only with termination of entire plan
Annuity buy-out without plan termination	All terminated participants, or Only those terminated participants in pay status (Verizon)
Spin-off into new separate plan, annuity buyout with termination of new plan	All terminated/retired participants, or Only those terminated/retired participants in pay status (GM, after lump sum offer)
Annuity buyout with plan termination	All terminated and active participants (200+ transactions in 2012)

Key considerations for plan sponsors when deciding on risk transfer strategy are as follows:

Lump Sum

- Reduction in PBO without paying insurance premium
- One-time GAAP earnings impact
- Actives can only be transferred under a plan termination

Buy-out

- Meaningful reduction in PBO
- Premium paid to insurer
- One-time GAAP earnings impact

Lump sum distributions and annuity buy-outs may trigger settlement accounting, which requires actuarial gains and losses to be recognized in earnings under U.S. GAAP. Due to adverse capital market experience over the past decade, most plans currently have large unrecognized actuarial losses classified as Accumulated Other Comprehensive Income/Loss. For accounting purposes, a settlement is a transaction that meets the following three criteria:

- Irrevocable action, cannot be revoked, recalled, or undone
- Relieves the employer or plan of primary responsibility for providing benefits to participants; and
- Eliminates significant risks related to the benefit obligation and assets used to effect the settlement

Settlement accounting has long been considered one of the thornier issues for plan sponsors to address as part of any risk transfer.

On a related note, a few insurers offer an annuity “buy-in” contract that transfers liability/risk to an insurance company but remains an asset of the DB pension plan. If the insurance contract remains within the plans assets, a settlement is not deemed to occur. Although prevalent in the UK, to my knowledge there has only been one buy-in transaction completed in the U.S., in May 2011. The key features of a buy-in and buy-out are as follows:

Buy-in

- A guaranteed group annuity contract held as an asset of the plan
- Preserves plan funded status while hedging liability risk
- Does not trigger settlement accounting
- Convertible to a buy-out at plan sponsor’s election

Buy-out

- A guaranteed group annuity contract that transfers benefit obligations from a plan sponsor to insurance company
- Settles a plan sponsor’s obligation
- Irrevocable – triggers settlement accounting

As can be seen, de-risking takes many forms, but the ultimate long-term de-risking action is termination of the plan by a combination of lump sum offers and transfer of remaining liabilities to an insurer by purchase of a buy-out annuity contract. Plan termination is the only method permitted by ERISA to remove the entire plan from the corporate balance sheet.

Group annuity products have historically been offered to plan sponsors via a general account vehicle. But in recent years several insurers have begun to offer guaranteed separate account products. There is an additional cost for a separate account product. The separate account must adequately compensate the general account for the risks assumed. There may also be marginal costs for portfolio management, risk and liquidity management, administration, reporting, etc. The GM and Verizon annuity purchases, for example, were purchased as separate account products.

The Advisory Council has asked witnesses to testify on the impact, if any, on the plan and the remaining participants if plan sponsors do not terminate the entire plan. The plan sponsor may be unwilling to terminate its plan for active employees, or to undertake the cost of terminating the entire plan. In this case, the plan sponsor may distribute benefits as annuity contracts without a plan termination, or initiate a spin-off termination as noted above. A spin-off termination requires division of the plan into two plans, typically one for active participants and the other for retired participants (terminated vested participants may be put in either plan). The retiree plan is terminated and plan assets are distributed by the purchase of annuity contracts. Plan sponsors may decide to improve the funded status of the remaining, actives-only plan. In the case of GM, the company contributed approximately $4 billion in cash to its salaried plan to help fund the purchase of the group annuity contract and to improve the funded status of the remaining salaried plan for active participants.[6]

When a company purchases annuities without plan termination, there is a difference in protections afforded to plan participants whose benefit payment obligation has been transferred to an insurance company versus participants that remain in the plan sponsored by the company. Whereas participants remaining in the sponsored plan receive coverage from the PBGC in the event of a corporate insolvency, regulation and enforcement occurs at the State Department of Insurance level once a plan has been transferred to an insurance company.

Similar to the PBGC, the state guaranty associations have coverage limits at the individual participant level. However, state guaranty associations calculate coverage differently than the PBGC. As a result, it is important to compare PBGC protections and State Guarantee Association protections on an apple-to-apples basis.

PBGC

- Revenue based on premiums from employers that sponsor insured pension plans, investments and funds from pension plans taken over
- The maximum pension benefit guaranteed by PBGC is set by law and adjusted yearly. Based on the plan's termination date, with certain exceptions
- For single-employer plans ended in 2013, workers who retire at age 65 can receive up to $4,789.77 per month, or $57,477.24 per year
- For some participants, the benefits the

State Guaranty Associations

- Revenue based on assessments payable by member insurance companies and funds from insolvent carriers
- Participant protection based on a three-prong approach: State Insurance Solvency Regulation, Receivership Process Focus on Protecting Policyholders, and Guaranty Association Protection
- For annuity contracts the baseline Guaranty Association protection according to the NAIC Model Act (as updated in 2009) is $250,000 in net present value of benefits per life. (actual amount varies by

[6] "GM Announces U.S. Salaried Pension Plan Actions," General Motors press release, June 1, 2012.

employer has promised may be higher than the legal limits that the PBGC can pay

State)

- Participants with large pension benefits share pro rata with all other policy-level claimants for the portion in excess of the protected policy size limit

To make the PBGC and State Guaranty Associations protection values shown above comparable, both should be represented in the same present value terms. As such, 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[7] on a present value basis. This compares to the baseline guaranty association protection of $250,000.

But, it is still an oversimplification to compare the two systems based solely on the guarantee levels, without an analysis of the three prongs of the state-based system. The PBGC's minimum guaranteed level is also the maximum. But State Guaranty Associations do not cap what can be recovered. What annuitants would receive beyond the minimum is based on the insolvent company's liquidation ratio. This is an important distinction. Insurance companies come under progressively tighter state control as their surplus levels become lower, so liquidation ratios are often quite high. On the other hand, most pension plans considered healthy have funding levels below 100%, and PBGC control typically occurs when the deficit is already large.[8]

Furthermore, one must consider that the first line of protection for participants is the financial strength of the entity making their primary annuity payments. In most cases the creditworthiness of the "Safest Available" annuity provider will be more sound than that of the underlying DB plan sponsor that is completing the risk transfer.

PLAN SPONSOR REQUIREMENTS AND LIMITATIONS – LUMP SUMS OFFERS AND ANNUITY PURCHASES[9]

The Advisory Council has asked witnesses to testify on the current rules governing the ability of a DB plan sponsor to distribute benefits as lump sums or annuity contracts, or to terminate the plan, including but not limited to a discussion of the Department of Labor's Interpretive Bulletin 95-1.

The decision to amend a plan to offer lump sums is a settlor decision. It is not governed by ERISA's fiduciary obligations and is not subject to fiduciary review. Once the settlor decision is made, however, numerous statutory protections under ERISA and the Internal Revenue Code, as well as ERISA's fiduciary duties, ensure that the fiduciary administers the lump sum offer in a way that is protective of participants, beneficiaries, and the plan as a whole.

- Once added to the plan as a permanent feature, a lump sum option cannot be taken away (subject to protective minimum plan funding rules, discussed below.) The lump sum option is

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[7] Penbridge calculations based on 1994 Group Annuity Reserve Mortality Table, Projection Scale AA, Discount Interest Rate of 4.0%, Male Annuitant Age 65, Life Only form of annuity.

[8] Further information about PBGC benefit limits can be found at http://www.pbgc.gov, while information about state guaranty associations and specific coverage by state can be found on The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) website: http://www.nolhga.com.

[9] Kevin P. O'Brien and Rosina B Barker, of Ivins, Phillips & Barker, Washington, DC, advised with respect to this section.

considered to be so valuable that it cannot be deleted for participants not yet in pay, even if the plan is terminated and benefits are distributed as annuity contracts.

- The lump sum must be valued using a discount rate and mortality assumptions not less favorable to the participant than those required by statute.
- No lump sum can be offered unless a life or joint life annuity is offered at the same time.
- When offering the lump sum, the fiduciary must disclose its value relative to other distribution options, and explain the consequences of failure to defer distribution of the pension benefit.
- The participant may not elect a lump sum without the consent of his/her spouse.
- To give the participant and spouse ample time to consider their decision, all materials describing the election must be supplied at least 30 days before it takes effect, and the participant must be allowed to revoke at any time right until the annuity starting date.
- In administering the lump sum option, the plan fiduciary is governed not only by these statutory valuation, disclosure and consent requirements, but also by the general fiduciary obligation to administer the option in the best interests of plan participants. All communications describing the option are subject to the general fiduciary duties of care, prudence and loyalty, including the duty not to mislead.
- If plan funding drops below 80%, lump sums are restricted, ensuring protection is not eroded for other plan participants.
- The PBGC can in some circumstances claw back lump sums after a distress termination.
- As with lump sums, the decision to amend a plan to distribute benefits as annuity contracts is a settlor decision, not governed by ERISA's fiduciary obligations and not subject to fiduciary review. The selection of the annuity provider, however, is a fiduciary decision, concerned with providing participants ample protection. In selecting the annuity provider, the fiduciary is governed by ERISA's fiduciary duties of prudence, care and undivided loyalty to the plan's participants and beneficiaries.
- These fiduciary obligations are guided by Department of Labor's Interpretive Bulletin 95-1, which requires the fiduciary to select the "safest available annuity," as determined according to numerous criteria including the following:

    - The quality and diversification of the annuity provider's investment portfolio
    - The size of the insurer relative to the proposed contract
    - The level of the insurer's capital and surplus
    - The lines of business of the annuity provider and other indications of the insurer's exposure to liability
    - The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts
    - The availability of additional protection through state guarantee associations and the extent of their guarantees

- To ensure the fiduciary's accountability to participants, Congress amended section 502 of ERISA to fill a gap in its remedial provisions. ERISA section 502(a)(9) provides that former participants can sue the fiduciary for imprudent selection of an annuity provider, even though they are no longer technically plan participants with standing to sue once their benefit has been distributed as an annuity contract.

- Congress also amended the Code and ERISA to provide that, as with lump sums, the plan sponsor's ability to distribute benefits as annuity contracts is limited if plan funding falls below 80% measured on an Adjusted Funding Target Attainment Percentage (AFTAP) basis.

ERISA's fiduciary rules, as applied by Interpretive Bulletin 95-1, provide robust protection for plan participants. The positive impact of Interpretive Bulletin 95-1 can be seen in the annuity bidding process. Typically, 3-5 carriers quote on a contract, although it may be more or fewer than that number. There appears to be a barrier to entry to the PRT market. Insurers who are not expected to meet the "safest available" standard are effectively not able to participate. Since the bulletin was issued, there have been only about 10 insurers participating in the buy-out market – with only a few new entrants and leavers. Insurers without very strong creditworthiness can't effectively compete.

In addition, Interpretive Bulletin 95-1 requires that the insurer demonstrate the ability to administer payment of benefits. Insurers' awareness of this requirement may be keeping out insurers without administrative capabilities. It has been observed that buy-outs of plans with particularly complicated administration requirements tend to attract fewer insurance bidders.

Finally, the decision to effectuate a plan termination or spinoff termination is a settlor decision, but, like the decision to offer lump sums or distribute benefits as annuity contracts, must be implemented by the plan fiduciary in accordance with its fiduciary obligations. The same kinds of protections set forth above also serve here to protect plan participants and beneficiaries.

UNIQUE SETTLOR / FIDUCIARY ISSUES INVOLVED IN MAKING "RISK TRANSFER" DECISIONS

The Advisory Council has also asked witnesses to consider whether there are unique issues involved in decisions on risk transfer being made by plan fiduciaries who are also performing settlor functions. In my experience, the rules governing decision-making by employees who wear "two hats" – a settlor hat and a fiduciary hat – work very well. When acting in his or her capacity as a plan fiduciary, every plan representative has a clear set of guidelines governing his or her decision-making. All decisions must be governed by the requirements of care, prudence and undivided loyalty to plan participants and beneficiaries. Plan sponsors have a very clear idea of whether they are seeking advice in their settlor or fiduciary capacity, and act appropriately as such.

That concludes my prepared testimony. I would be pleased to answer any questions you may have. Thank you.

Appendix A

DRAFT

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

Issue Chair: Richard Turner
Issue Vice Chair: Mary Ellen Signorille
Drafting Team: Josh Cohen, James English and Paul Secunda

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?