

**TESTIMONY OF BRENDAN S. MAHER
ERISA ADVISORY COUNCIL
UNITED STATES DEPARTMENT OF LABOR
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My name is Brendan S. Maher. I am a law professor and the Robert D. Paul Scholar at the University of Connecticut School of Law, where, as a member of the University's Insurance Law Center, I teach and conduct research in the field of employee benefits and ERISA. I am also the co-founder of a law firm, Stris & Maher LLP, that is frequently invited to participate in high-profile ERISA cases before the United States Supreme Court and the federal circuit courts of appeal. To date I have almost exclusively represented plan participants, beneficiaries, and insureds. I offer my testimony here today in a personal capacity, and not as a representative of either the University of Connecticut or Stris & Maher LLP.

Thank you for inviting me to testify before the ERISA Advisory Council on the question of pension de-risking.

In advance of my testimony, I reviewed carefully the testimony submitted to this Council on June 5, 2013. That testimony was offered by seven persons, Robert Newman of Covington & Burling LLP, Steve Keating of Penbridge Advisors, Evan Inglis of the Vanguard Group, Craig Rosenthal of Mercer Consulting on behalf of the American Benefits Council, John Ferreira of Morgan Lewis & Bockius LLP, Jack Cohen of the Association of BelTel Retirees, and Ilana Boivie of the Communications Workers of America. In my testimony or in my response to your questions I may refer to their testimony.

After some preliminary observations I would like to address two important things: remedies for beneficiaries in improper de-risking transactions, and a larger problem with relying upon voluntary employer schemes to provide retirement security.

Introduction

The phenomenon called "pension de-risking" is fundamentally quite simple, although the details can be less so. An employer made a pension promise long ago. Afterward, it determines that its current strategy for keeping the pension promise is too costly or too afflicted with uncertainty. So the company considers a number of alternate strategies to handle its pension obligation.

Some strategies are internal, meaning that the pension obligation is retained within the company and its plan. One example of an internal approach is "hedging" against interest rate changes; another example is "liability driven investing," in which an effort is made to match the characteristics of the investment assets underlying the pension promise with payout obligations to pensioners. Other solutions are external, meaning that the pension obligation is offloaded to another party. External de-risking solutions include plan termination, lump-sum buyouts, and annuity buy-outs. The first two are obvious,

and offload risk to retirees. The third is where the plan purchases a group annuity from an insurance company and transfers the pension payment obligation to said insurance company. When people think of pension de-risking, they tend to think of external solutions like lump-sum and annuity buy-outs. But internal solutions can reduce pension risk as well, with perhaps less risk to participants.

Importantly, the temptation to de-risk—particularly to externally de-risk—is higher than ever, for several reasons. First, much of the current labor force came of age in a world of 401(k) plans; the defined benefit pension was by the 1990s already thought of by Generation X and Millennials as something offered to their parents and grandparents, not them. Thus, employers face little pressure from their younger cohort of workers to make or keep the traditional defined benefit pension promise, which older employees understood as (1) the company pays your pension and (2) if it can't, the federal government pays it.

This change in employee attitudes, as well as the general decline in the influence of organized labor, means the pressure exerted by employees on employers to ensure that pension promises are robust has diminished relative to the 1970s and 1980s. Of heightened importance, then, are the economic forces pushing companies away from defined benefit plans—whether by not offering them at all or via the expedient of external de-risking strategies that essentially shed the pension obligation from the company. For example, the growth of plan obligations relative to company size, as well as low interest rates, are among the economic forces that make carrying a pension obligation costly and uncertain. Because the labor benefit of attracting and keeping modern workers can be achieved by offering a defined contribution plan (or no retirement benefits at all), defined benefit plans pose little upside and substantial risk. Where feasible, companies will seek to flee.

Thus, more pension de-risking is sure to come. And that means that more litigation over pension de-risking activities—which has already occurred—is equally certain. To my everlasting disappointment, I cannot predict the winner of the Super Bowl or the World Cup. At the same time, I can—with metaphysical certainty—predict that de-risking litigation is just beginning.

Although the United States Supreme Court has regrettably struggled with this fact, the objective of ERISA was and is to protect beneficiaries. Accordingly, the animating theme behind pension de-risking regulation should be simple: if the de-risking behavior makes beneficiaries as a class worse off, it should not be allowed. If it makes them no worse off, it should. Some of the past testimony I reviewed in advance of my testimony today did not, in my view, appreciate (rather than pay lip service) to this key constraint.

That beneficiaries should not be made worse off in pension de-risking transactions should be made clear, at the absolute minimum, in the commentary preceding the issuance of any and all new regulations, and should informally be communicated, as appropriate, during meetings and conferences between the bar and agency officials.

There will be sincere differences of opinion on whether a particular class of transactions, and obviously any given individual transaction, are/is better or worse for participants. I should say I do not believe that any and all de-risking transactions are a bad deal for beneficiaries, merely on account of the loss of PBGC protections. PBGC guarantees are not unlimited, and state guarantees (whether old or new), plus state law on remedy, could be as attractive or more attractive. As Justice Scalia put it, when terminating a plan through the purchase of annuities, “[t]he assets of the plan are wholly removed from the ERISA system, and plan participants and beneficiaries must rely primarily if not exclusively on state contract remedies if they do not receive proper payments or are otherwise denied access to their funds.”¹ State contract remedies may not be so bad, all things being considered.

Remedies

What may a plaintiff do when faced with a de-risking transaction, such as an annuity buy-out, that makes him worse off? A brief detour into ERISA’s statutory scheme, as interpreted by the Supreme Court, is necessary.

Normally three claims are used by unhappy beneficiaries. Section 1132(a)(1)(B), the “benefits due” remedy, permits beneficiaries to recover for benefits due under the terms of the plan. This remedy, as members of the Advisory Council well know, comes with important limitations, namely exhaustion, *Firestone* deference, and no consequential damages beyond an attorneys’ fee award and, in some courts, interest. Exhaustion requires the claim be made pursuant to a plan’s internal procedures before a court may hear it. *Firestone* deference requires courts to defer to the interpretation of the plan administrator if the plan confers discretion on said administrator.

Section 1132(a)(2), the “fiduciary” remedy, is used to police errant fiduciaries, but is limited to cases where the fiduciary personally profits from the misuse of plan assets or where there is a loss to the plan. Section 1132(a)(3), authorizes “appropriate equitable relief,” with appropriate equitable relief corresponding to the relief that would have been available in pre-merger courts of equity. According to the Supreme Court, such relief is much narrower than modern relief, although the Court may be in the middle of accepting an expansion of the relief cognizable under 1132(a)(3).²

With respect to annuitized de-risking transactions, however, a fourth provision, 1132(a)(9), comes into play. Most ERISA people, even experts, are not familiar with 1132(a)(9). That provision, added to ERISA in 1994, provides that:

In the event that the purchase of an insurance contract or insurance annuity in connection with termination of an individual's status as a participant covered under a pension plan with respect to all or any portion of the participant's pension benefit under such plan constitutes a violation of part 4 of this title or the terms of the plan, by the Secretary, by any individual who was a participant or beneficiary at the time of the alleged violation, or by a fiduciary, to obtain appropriate relief, including the posting of security if necessary,

¹ Beck v. PACE Intern. Union 551 U.S. 96, 106 (2007).

² Cigna v. Amara, 131 S. Ct. 1866 (2011).

to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity, plus reasonable prejudgment interest on such amount.

This provision has been addressed in less than twenty federal court opinions and only a handful of reported ones, so its contours are not clear. On a first glance at the statute, one may worry whether it is facially subject to the sort of judicial narrowing that afflicted ERISA's "big three" remedies.

In one respect, it clearly is not. Section 1132(a)(9) uses the term "appropriate relief," not "appropriate equitable relief." The legislative history of the amendment provides that its purpose was to ensure that in litigation over de-risking annuitization violative of ERISA, "individuals who were participants and beneficiaries at the time the alleged violation of ERISA occurred may sue and recover money damages from their employers or other fiduciaries so that they can at least receive the amounts that were promised by the insurance contract or annuity, plus reasonable interest."³

I see no indication in the text of section 1132(a)(9), nor the legislative history of the amendment, that an 1132(a)(9) claim would be subject to exhaustion or *Firestone* deference. That is not surprising, because neither of those rules appear in ERISA proper; they were and are glosses breathed into life by the judiciary. Given that virtually all 1132(a)(9) claims are going to depend on a violation of ERISA, rather than the plan, it makes little sense to require that one need to exhaust some grievance procedure, or that a judge need defer to an administrator's view, on the question of whether or not an annuity de-risk violated ERISA itself. Of course, stranger things have happened.

Litigation brought by the Secretary of Labor—which is explicitly authorized by section 1132(a)(9)—faces no such hurdle. Whatever substantive standards the Department decides upon regarding permissible de-risking, it should not leave unused its civil litigation power to correct improper de-risking behavior. The potential ability of the Secretary to require an insurer providing the annuity to post security could be particularly useful.

For beneficiaries, there is an additional concern. Section 1132(a)(9) permits "appropriate relief," and does not identify those who may be targeted by the provision. Section (a)(3) similarly lacks a specified target, and also has the "appropriate" language. In *Varity v. Howe*,⁴ the Supreme Court explained that, in section 1132(a)(3), the appropriate language should be read to mean that "where Congress elsewhere provided adequate relief for a beneficiary's injury, there will likely be no need for further equitable relief, in which case such relief normally would not be 'appropriate.'"⁵ In the 1132(a)(3) setting, what some courts have interpreted *Varity* to mean is that 1132(a)(3) claims do not lie where 1132(a)(1)(B) claims do. For several reasons, I highly doubt that the *Varity* dicta would require a similar result with respect to the 1132(a)(9) remedy; but one cannot

³ H.R. Rep. 103-872, 41-43 (1994).

⁴ *Varity Corp. v. Howe*, 516 U.S. 489 (1996).

⁵ *Id.* at 515.

predict when judicial inspiration might overcome objective features of the statutory text. The fear for beneficiaries is that, despite being armed with a remedial provision explicitly designed to police annuity de-risking that makes plaintiffs worse off, they will face the same sort of judicially-created hurdles they face with other ERISA remedies.

Section 1132(a)(9) only applies to limited situations, namely the “purchase of an insurance contract or insurance annuity in connection with termination of an individual’s status as a participant covered under a pension plan.”⁶ With respect to other transactions outside that category, plaintiffs will need to rely on sections 1132(a)(1)(B), 1132(a)(2), or 1132(a)(3). Section 1132(a)(1)(B), as well as facing the *Firestone* hurdle, turns on the terms of the plan, and seems easily avoided by the expedient of plan drafting, although anti-cutback rules may make that matter not quite so straightforward as plans might hope.

Section 1132(a)(2) claims only apply if there has been a “loss to the plan” or to “recoup profits made by a fiduciary through use of assets of the plan by the fiduciary.”⁷ How those conditions could or would be satisfied in de-risking transactions is not clear. Section 1132(a)(3) claims offer “appropriate equitable relief.” There are two potential challenges here. First, the Court’s narrow definition of appropriate equitable relief, i.e., the definition offered in the *Mertens* case in 1993,⁸ may still be good law with respect to players in the de-risking process who are not fiduciaries. The *CIGNA v. Amara* decision,⁹ which signaled a new openness by the Court regarding 1132(a)(3) relief, was a case in which 1132(a)(3) claims were leveled against fiduciaries. I myself believe *Amara* is the governing standard for all 1132(a)(3) causes of action, against fiduciaries or not, but my Solomonic pretensions notwithstanding, I am not an Article III judge. Second, even assuming that *Amara* relief is applicable to all 1132(a)(3) claims, it is not clear how *Amara*-sanctioned equitable theories of recovery such as surcharge, reformation, or estoppel map onto de-risking scenarios.

The above remedies turn on either a violation of the plan or ERISA. Precisely what conduct in de-risking scenarios violates ERISA is not a question easily resolved, and I bring no stone tablet that provides the answer.

In my view, both the contours of the remedies available to plaintiffs, as well as the substantive conduct violative of ERISA, are unpredictable, and the latter is likely to be true no matter how much care the Department puts into promulgating regulations on that point. Because both remedies and substantive standards can be unreliable, perhaps the Department should err on the side of discouraging transactions that do not clearly satisfy the “are beneficiaries as well off?” test. What that may mean, in practice, is to limit via regulation as much as possible external de-risking transactions (or classes thereof), and instead encourage plans who seek to reduce pension risk to do so by pursuing internal strategies. Internal strategies are subject to fiduciary duties and thus afflicted with some uncertainty, so a “safe harbor” approach might make the most sense. For example,

⁶ 29 U.S.C. § 1132(a)(9).

⁷ 29 U.S.C. § 1109.

⁸ *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

⁹ *CIGNA v. Amara*, 131 S. Ct. 1866 (2011).

perhaps if plans looking to de-risk were to pursue “liability driven” investment approaches that satisfy to-be-created Department guidelines, the Secretary would not pursue civil litigation against them, and would oppose private plaintiffs who do so. Alternatively, the Department could urge Congress to amend ERISA to create a statutory safe-harbor for “liability driven” de-risking approaches. Of course, safe harboring could apply to more than “liability driven” approaches.

To the extent the Department wants to preserve the guaranteed nature of defined benefit plans as backed by the PBGC, safe harbors for external de-risking might be more difficult because participants live in different states and the quality of state guarantees vary. However, it is not impossible to imagine safe harbors for external de-risking transactions that rely on state guarantees of a specified strength, under metrics to be determined. To borrow an example from the health care world, the Patient Protection and Affordable Care Act envisions that the external review of health care claims will be undertaken according to a state-governed process, with one key caveat: the state process must meet certain federal minimums. Here, the Department could research state guarantee funds, and issue regulatory guidance explaining that the choice of a de-risking transaction that relies on insurers backed by state guarantors having certain undesirable characteristics are presumed by the Department to be an imprudent exercise of fiduciary discretion to implement a chosen de-risking strategy. (While the decision to terminate a plan is a settlor decision, the implementation of that decision, such as the selection an annuity insurer, is a fiduciary one.)¹⁰

Thoughts on Limits of an Employer-Based Retirement System

As Evan Inglis of Vanguard explained in an appendix to his testimony, equity returns from 1980 to 1999 were exceptional. The result of that extraordinary market period was to obscure a point too often overlooked when we attempt to chart out solutions to our nation’s retirement problems: employers and plans do not have a core competency in “investing,” nor more specifically in “investing so as to ensure pension obligations are satisfied.” Employers have a core competency related to the product or service they sell—that is why they are in business. When the market is so bountiful than anyone can earn high returns, this uncontroversial fact is often ignored. You can promise pensioners the world when you think you can earn 17.9% on your money for the foreseeable future. And experts retained by plans might lack the discipline or incentive to promote responsible projections and investment choices.

The temptation to engage in rosy assumptions (or be ignorant of the risks of overly optimistic assumptions) regarding rates of return is amplified by the desire to spend money today on more pressing business needs, simply because we are all inclined to spend today rather than save for tomorrow. Prioritizing “today” is often implicitly justified as being better for both present and future claimants on the company’s resources, i.e., “if we don’t spend money today, we won’t be around to fund anyone’s pension in the future.”

¹⁰ 29 C.F.R. § 2509.91-1(c).

Regulatory efforts to ensure balance between present and future obligations will be tolerated in good times but bitterly complained about in bad times (when setting aside money for the future is even more painful). Some of those complaints will amount to threats to leave the system entirely. And that's the problem. Retirement security is something that must be funded in good times and bad. Depending on employers to do that not only demands that they perform a socially critical role on matters outside their core competence, but it also leaves the nation's retirement system the constant subject of compromise between regulators and employers.

I realize, of course, that ERISA made this policy choice, for better or for worse, almost four decades ago. But other options—both government-based and private-based—exist outside of an employment-based system. Consideration of such approaches, while a topic for another time, is long overdue.

Thank you.