



EDWARD STONE LAW

PENSION RISK TRANSFERS: WHAT RETIREES NEED TO KNOW

Presentation to the U.S. Department of Labor
ERISA Advisory Council
Washington, DC
May 27-29, 2015

EDWARD STONE LAW



Edward Stone has practiced law and represented individuals, associations, entrepreneurs and growth stage companies in various capacities in the specialty finance and insurance industries for more than twenty five years.

Mr. Stone is special counsel to the Association of BellTel Retirees and ProtectSeniors.org. Together with the associations, Mr. Stone has worked to educate lawmakers across the country on the need for legislation to protect retirees in pension de-risking transactions.

Mr. Stone worked to secure passage of a “best practices” resolution by the National Conference of Insurance Legislators in November of 2014 designed to offer guidance to state legislators on issues relating to pension de-risking, and helped draft legislation currently pending in Connecticut and New York to address retiree concerns in pension de-risking transactions. Mr. Stone is also a frequent speaker and panelist at continuing education seminars lecturing on a variety of topics and he is an expert on issues related to multi-state life insurance company insolvencies.

Mr. Stone holds a B.A. from Clark University and a J.D. from Benjamin N. Cardozo School of Law, Yeshiva University, and is admitted to practice in Connecticut and New York.

Email address: Eddie@EdwardStoneLaw.com

175 West Putnam Avenue, 2nd Floor, Greenwich, CT 06830 305 Broadway, Suite 1001, New York, NY 10007
Tel: (203) 504-8425 Fax: (203) 348-8477 Email: eddie@edwardstonelaw.com

WHAT ARE PENSION RISK TRANSFERS? (a/k/a Pension De-Risking)

Any action taken by a plan sponsor
to reduce its pension liabilities

Examples:

- Freezing pension benefits to some or all plan participants
- Changing investment strategy to reduce asset liability mismatch
- Offering lump sums buyouts
- Annuity “buy-ins”:
 - Plan sponsor purchases annuity contract(s) to cover pension obligations with sponsor remaining as owner of the contracts
 - Pension liabilities remain on plan sponsor’s books - investment decisions and asset liability matching responsibility of the annuity provider
- Annuity “buy outs”:
 - Plan sponsor transfers its pension liabilities to an insurance company or other annuity provider by purchasing, **at a premium**, a group annuity contract
- Annuity “lift outs”:
 - In December 2012 Verizon removed 41,000 management retirees from the defined benefit plan – there was no plan termination

RETIREES IN RISK TRANSFER TRANSACTIONS ARE NOT PROTECTED BY ERISA

- “Buy-Ins” – Plan still exists and ERISA still applies
- “Buy-Outs” – ERISA no longer applies
- Annuity “Lift-Out” – ERISA no longer applies
- ERISA only applies fiduciary standard to the initial choice of annuity provider
 - SETTLOR DECISION TO AMEND OR TERMINATE A PLAN
 - MOST DEFINITELY **NOT** A FIDUCIARY DECISION
- McCarran-Ferguson relegates the business of insurance to the several states

WHAT DO RETIREES LOSE IN A PENSION RISK TRANSFER TRANSACTION?

- Retirees lose:
 - ERISA's fiduciary duty standards
 - Mandated annual financial disclosures
 - Minimum funding thresholds
 - Uniform protection from creditors and bankruptcy trustees
 - Ready access to the federal courts, and
 - PBGC coverage

KEY CONSIDERATIONS

ANNUITY RISK TRANSFERS

- Financial strength and claims-paying ability of the annuity provider
 - Not only on transfer date but over time
 - SIFI's and "too big to fail" considerations
 - Concentration Risk is a big concern
 - Asset/liability mix
 - Longevity expertise and experience
 - Life Insurance Companies should be well suited to manage long duration assets/liabilities
- Transaction structure
 - Separate vs. General account
 - Multiple Obligor (e.g. Kimberly Clark)
- Transparency of Annuity Provider
 - reporting
 - reserve relief deals
 - Shadow insurance
- Where do you live?
 - State laws are not uniform
 - Protection from creditors, Guaranty Association coverage limits, regulatory oversight of annuity providers varies from state to state

SCOPE AND MAGNITUDE

- Annuity risk transfers are here to stay
- Question of “when” not “if”
- Hundreds of thousands of retirees already affected.
- Plan sponsors paying hefty premiums to divest pension obligations
- Impact of pension risk transfer on retirees remaining in the plans using “lift-out’s”
- Anti-selection at the PBGC level
 - Healthy plans de-risk.
 - Sick plans remain.
 - Fewer premiums; more liabilities.
- Systemic risk to US Pension System

LIKELIHOOD OF AN INSURANCE COMPANY INSOLVENCY

Seems remote – until it happens

- 176 life insurance company insolvencies from 1975 to 1990
- 74 multi-state life insurance company liquidations from 1987 to 2009
- 8 life insurance companies placed in liquidation from 2008 – 2011 (according to NOLHGA)
- 2 life insurance company failures have resulted in loss of benefits to annuitants, some of whom were retirees
- The aftermath of the Executive life insurance company failures

RETIREEES AND THE INSURANCE INSOLVENCY CONUNDRUM

- Insurance company insolvencies are governed by non-uniform state insurance receivership laws
 - includes: supervision, conservation, rehabilitation and liquidation
- Regulators in state regulated insolvencies take on a management role that creates a fatal conflict of interest
 - NYLB for example has a 100 year old reputation
 - ELNY rehab lasted 22 years and resulted in a “rob peter to pay paul” problem
 - California insolvencies also lack transparency
 - ELIC shortalls remain a mystery
 - Junk bond portfolio sale favored private equity over policyholders
- Scope and magnitude of recent transactions
 - Billions of dollars changing hands in risk transfer transactions
- Insolvency process in need of reform - retirees need protection from Receivers

IMPACT OF NON-UNIFORM STATE INSURANCE LAWS ON RETIREES

- State of residence now matters
- Creditor protections vary state to state
- Transferability issues
- Regulatory oversight: heavy/light – depending on state
- Guaranty Association limits vary from \$100,000 to \$500,000 per retiree per lifetime

ARE RETIREE ANNUITY PAYMENTS PROTECTED FROM CREDITORS' CLAIMS?

- Protection of annuity proceeds from creditors differs from state to state
- Some states limit the exemption to a specific monthly dollar amount
- No protection in some states
- Complete protection in others
- Retirees move!

STATE GUARANTY ASSOCIATION COVERAGE IS NOT WHAT YOU THINK IT IS

- Coverage varies from state to state (\$100k - \$500k)
- Benefits are not provided in a uniform fashion
- Coverage is generally determined by the state of residency at the time of impairment or insolvency
- State guaranty associations depend entirely upon contributions from their member life insurance companies
 - Insolvent member unlikely to contribute funds to a multi-state insolvency
 - Ability of the GA “safety net” to withstand the insolvency of a large multinational life insurance company is uncertain
- Guaranty associations are post insolvency assessment vehicles
- Neither safe nor appropriate for retirees – lifetime cap vs. annual cap
- Subrogation interpretation is discriminatory
- Lifetime limits are also discriminatory

WHAT HAPPENS IF A POLICYHOLDER MOVES?

- Typically, retiree is protected by the laws of the state he/she resides in at the time the insurance company is declared to be insolvent or impaired
- Retirees may unwittingly divest themselves of guaranty association coverage by moving *after* the transfer of their pension obligations
 - e.g., a retiree living in New York with \$500,000 of potential coverage could find himself or herself with just \$100,000 of coverage after relocating to New Hampshire

WHAT IS HAPPENING AT THE STATE LEVEL?

- **NCOIL- National Conference of Insurance Regulators**
An organization of state legislators whose main area of public policy concern is insurance legislation and regulation. Many legislators active in NCOIL are also members of the committees responsible for insurance legislation in their respective state legislatures.
- **NEW YORK –**
 - Senator Tony Avella (Senate Bill 1092-A)
 - Assemblyman Peter Abbate (Assembly Bill 6796)
- **CONNECTICUT – Rep. Robert Megna**
 - Substitute House Bill No. 6772

THE NCOIL “BEST PRACTICES” RESOLUTION

“Best Practices Resolution” adopted by NCOIL at the November 2014 annual meeting recommended that all states:

- Raise their guaranty association limits to \$250,000 or more
- Provide protections for annuities from creditors and from any garnishment to the same extent that ERISA plans are protected
- Limit the transfer of pension de-risking liabilities from one insurer to another without appropriate state regulatory supervision
- Adopt a practice of providing clear information and key elements to those individuals impacted by pension de-risking transfers

PENDING STATE LEGISLATION

New York

- Senator Tony Avella (Senate Bill 1092-A)
- Assemblyman Peter Abbate (Assembly Bill 6796)
 - Disclosures Upon Transfer
 - Clear statement that annuities are exempt from claims of creditors
 - Statement that retirees will no longer have ERISA and PBGC protections
 - Contact info for guaranty association
 - Mandatory Annual Disclosures (1) the retiree is no longer protected by ERISA and the PBGC, and (2) a statement regarding the amount and availability of guaranty association coverage;
 - Mandatory annual disclosures
 - funding levels of assets/liabilities
 - Investment performance by asset class
 - Expenses associated with group annuity contract
 - Changes in actuarial assumptions, if any
 - Further transfers of the annuity to be approved by the Superintendent of Financial Services

Connecticut

Sponsored by Rep. Robert Megna – Chairman of the Insurance Committee

The pending legislation only addresses creditor protections

WHAT CAN THE DEPARTMENT OF LABOR DO FOR RETIREES?

- Disclosures
- Education
- Resources
- Other Considerations
 - Support the creation of an alternative backstop
 - Encourage federal oversight of multistate insolvencies

SAMPLE DISCLOSURES – prior to transfer

At least 90 days prior to any risk transfer agreement, impacted retirees should be provided with at least the following:

- A detailed disclosure statement that contains information regarding the loss of federal ERISA protections, including Pension Benefit Guaranty Corporation (“PBGC”) protection and the applicable state laws that will govern their future annuity payments;
- The amount, scope and conditions precedent for state guaranty association coverage in the event of an insurance company insolvency;
- The extent to which annuity payments become subject to creditor claims or avoidance actions by bankruptcy trustees;
- Disclosure related to any changes that might result in the tax treatment of retiree benefits under an annuity contract;
- Lump sum options and conditions, if any;
- Detailed information on the group annuity contract structure, including a schedule of all costs and expenses paid in connection with the transaction;
- A copy of any fairness opinions or solvency analysis done in connection with the choice of annuity or other benefit provider.

DISCLOSURES – post transfer

- Require that all annuity providers, or subsequent benefit providers agree to provide impacted retirees with at least the following mandatory annual disclosures
 - ✓ Funding levels of all assets relative to expected liabilities under the assumed pension benefit schedules;
 - ✓ Investment performance summary by asset class;
 - ✓ Investment performance detail by asset class;
 - ✓ Expenses associated with any group annuity contract;
 - ✓ Material changes in actuarial assumptions, if any.

EDUCATION AND RESOURCES FOR RETIREES

- Identify and disclose all options available to retirees
 - GM and Ford retirees were given lump sum options
 - Verizon retirees were not
- If lump sum options are offered, provide access to independent financial advisors with a fiduciary duty to retirees. Require disclosure of:
 - Discount rates used by the plan sponsor to calculate lump sum payouts
 - Mortality assumptions
 - Cost to purchase a replacement annuity
- Provide resources so retirees can ask questions without cost
- Encourage the creation of a federally mandated backstop guaranty association
 - Address specific needs of retirees and risks associated with periodic payment annuities
 - Support oversight by the Consumer Financial Protection Bureau or the Federal Insurance Office, or both
- Approval function pre risk transfer
- Create guidelines, accountability, standards and oversight with respect to multi-state insolvencies

CONCLUSION

175 West Putnam Avenue, 2nd Floor, Greenwich, CT 06830 305 Broadway, Suite 1001, New York, NY 10007
Tel: (203) 504-8425 Fax: (203) 348-8477 Email: eddie@edwardstonelaw.com