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Testimony of the American Council of Life Insurers before the Insurance & Real Estate Committee
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House Bill 6772 – An Act Requiring Disclosures Upon the Purchase of an Annuity to Fund Pension Benefits and Extending Creditor Protection to Amounts Payable to a Participant of or Beneficiary Under such Annuity

Senator Crisco, Representative Megna and members of the Insurance and Real Estate Committee, the American Council of Life Insurers (ACLI) appreciates the opportunity to offer the following comments in opposition to Section 1 of House Bill 6772 – An Act Requiring Disclosures Upon the Purchase of an Annuity to Fund Pension Benefits and Extending Creditor Protection to Amounts Payable to a Participant of or Beneficiary Under such Annuity. Section 1 of the proposed legislation will detrimentally restrict the transfer of pension plan risks and raise the costs of these beneficial transactions potentially harming Connecticut consumers.

As described in the attached "ACLI Pension De-Risking: Overview", pension de-risking typically involves the transfer of a pension risk from an employer sponsored plan into an annuity. These transactions generally involve a group of plan participants who are no longer accruing pension benefits because they have retired or have left the company. The administration of pension plans can be challenging for employers. Annuities enable plan sponsors to manage plan funding volatility. With annuities, payments are made to retirees for life regardless of the health of the employer's business. These transfers can be "win wins" for employers, employees and retirees.

The life insurers offering the annuities are subject to a robust, modern regulatory regime that holds them to their commitments through uniform rules for the establishment of reserves, the valuation of assets and liabilities, and the satisfaction of risk-based capital and other requirements. Life insurers are required to hold assets well in excess of liabilities. And the state insurance regulators conduct routine reviews of the financial strength of each insurer and its ability to meet its commitments.

Section 1 of proposed HB 6772 would require pension risk transfer transactions to be subject to onerous and unnecessary disclosures. Plan participants already receive many notices from both the employer and the insurer which are tailored to the particular transaction. Current benefit communications required of plan sponsors are regulated by the U.S. Department of Labor which has jurisdiction over requisite notices.

ACLI supports Section 2 of the proposed legislation which would protect these annuity contracts from garnishment by creditors. This would bring state law in line with ERISA plan protections. In addition, Section 522 of the U.S. Bankruptcy Code includes a provision that a direct transfer of retirement funds, such as that from a pension to an annuity, will not cease to qualify for protection from creditors and garnishment (11 U.S.C. Section 522(b)(4)(C)).

Thank you for your consideration of our position in **opposition** to Section 1 of House Bill 6772. Please contact John Larkin at (860) 508-9924 or Kate Kiernan at (202) 624-2463 with any questions.

The American Council of Life Insurers (ACLI) is a national trade association with approximately 300 member companies operating in the United States and abroad. 221 member companies serve Connecticut consumers. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums in Connecticut. Learn more at www.acli.com.

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Pension De-Risking: Overview

Pension de-risking is the term given to a transaction in which a sponsor of a defined benefit pension plan lessens the risks it faces in connection with sponsoring a plan.* These risks include ensuring it can continue to fund and manage the plan on behalf of its participants.

De-risking can be done in many ways. It typically involves plan participants who are no longer earning pension benefits, either because they have retired or left the company. Some employers choose to offer to "buy out" these participants with lump sum payments. The lump sum represents the accumulated value of their pension benefits. At the same time, some employers choose to purchase annuities, a life insurance product that provides a steady stream of income for life, from life insurance companies to fulfill the benefit owed under the plan. Often, employers will combine these strategies by offering a lump sum to participants before the annuities are purchased. In either case, the result is that -- following the transaction -- the plan has fewer remaining participants.

Some people refer to these transactions as "risk transfer," because the risk does not actually disappear, it just shifts from the pension plan to other parties. When a participant opts to receive a lump sum buy-out, risk shifts from the employer to the participant. The risks assumed by plan participants come in connection with managing money over a retirement that can last many years. Meanwhile, life insurers assume the risks associated with fulfilling the obligations to provide lifetime payments through annuities to plan participants that do not elect a lump sum payment from their pension plan.

A key question that commonly arises in de-risking arrangements is whether plan participants lose consumer protections when their employers turn to life insurers to fulfill their obligations. The answer to that question is "no."

An annuity purchased in a de-risking transaction retains the spousal protections from the plan and the protections from creditors. Instead of being insured by the Pension Benefit Guaranty Corporation (PBGC), participants receive the coverage under the state insurance system. Josh Gotbaum, former PBGC director, which insures private-sector defined benefit pension plans, has said that the state insurance system, with states' insurance guaranty association coverages, is at least as good as PBGC coverage, and that policy-makers should not be concerned about de-risking when it involves a private insurance company. He made those comments in testimony before the U.S. Department of Labor's ERISA Advisory Council on August 29, 2013.

Annuities, whether paid from the plan or from a private insurer, should be encouraged, because they provide more protection to the participants than lump sum payments.

**De-risking can also refer to various "in-plan" strategies, including various investment strategies that the employer can use to manage pension risk within the plan. For our purposes, we are not referring to in-plan de-risking strategies.*

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ERISA Protections for Annuitants in Pension De-risking Transactions

Today, more plan sponsors are choosing to transfer pension plan risk through de-risking transactions. These transactions typically involve either transferring risk to the plan participant through lump sum distributions or transferring risk to an insurance company in the form of a distributed annuity, a life insurance product that provides guaranteed income for life.

This paper describes the important protections under the Employee Retirement Income Security Act of 1974 (ERISA) that apply when an employer purchases annuities to secure benefits in connection with a pension de-risking transaction. In short, annuitants in these transactions not only benefit from the continued receipt of lifetime income, but also from continued spousal and creditor protections carried over from their ERISA-covered plan.

ERISA ENSURES PLANS AND PARTICIPANTS ARE PROTECTED

Plan officials responsible for implementing de-risking transactions are governed by ERISA's fiduciary standards, described by courts as the "highest known to the law." These standards not only require that plan fiduciaries act prudently in carrying out their responsibilities, but that they act solely in the interest of the plan's participants and beneficiaries. In satisfying these standards, plan fiduciaries must, in compliance with Department of Labor's (DOL) guidance in Interpretive Bulletin 95-1, take steps calculated to obtain the safest available annuity, as well as to ensure that the annuity contract fulfills all other applicable requirements of ERISA and the Internal Revenue Code (the Code).

Congress intentionally framed ERISA to permit fiduciaries to satisfy their duties by distributing benefits through the purchase of a private annuity. Annuity contracts represent the only exception to the ERISA trust requirements for plans because they are accepted as an ERISA trust equivalent. Moreover, the DOL has recognized since 1975 that once a plan has fulfilled its obligations and secured benefits through an annuity, the ERISA fiduciary and other requirements are generally no longer relevant, as ERISA was designed to protect participants from employer actions and ensure that they receive their promised benefits. However, the benefits of ERISA coverage are not "lost" in a de-risking transaction.

Significantly, when a pension obligation is assumed by an insurer, that obligation is a guarantee that the participant will be provided the same annuity benefit determined by the plan's fiduciaries to be due the participant under the terms of the plan. These annuities are considered distributed annuities under Code section 401(g). The Code and Treasury regulations require that the annuity be nontransferable. The annuity cannot be surrendered to the insurance company or sold. There are concerns, however, about third-party companies attempting to "buy" annuity payments by offering lump-sum amounts or "advances" in exchange for receiving all or part of their annuity income stream. The marketing of such "advances," however, is not limited to holders of annuity contracts, but extends to recipients of payments from defined benefit plans as well. See the recent GAO report on pension factoring.

SPOUSAL PROTECTIONS

The same spousal potection rules apply, whether the benefit is provided as a stream of payments directly from the plan or through an annuity. (See Treas. Reg. section 1.401(a)-20, Q&A 2, which provides that qualified joint and survivor annuity (QJSA) requirements extend to payments under the annuity contract, not simply the distribution of the annuity contract.) If the participant is a retiree in pay status already receiving an annuity, then the annuity provided by the private insurer must be the same type of distribution that the participant has already elected and is already receiving (e.g., single life annuity, joint and survivor annuity, life and period certain, etc.). If the employer does not purchase an annuity that satisfies the participant's election, then the plan sponsor's liability is not extinguished.

If a de-risking transaction takes place before the participant has made a benefit election, then the spousal consent rules would apply – the participant would need to obtain spousal consent to elect any distribution form other than a QJSA (or a qualified optional survivor annuity (QOSA)), just as is the case under the plan.

CREDITOR PROTECTIONS

ERISA provides strong creditor protections, and those protections do not go away merely because an annuity is purchased on behalf of an ERISA plan participant, by an ERISA plan. If a plan participant enters bankruptcy, his ERISA benefit receives special protection and is not included in the bankruptcy estate under Federal law. In 2005, changes were made to the Federal Bankruptcy Code. Section 522(b)(3)(C), or alternatively section 522(d)(12), broadly exempts retirement funds that are exempt under Code section 401. Distributed annuities from qualified plans are exempt under Code section 401(g), so they would be covered by this exemption. The Bankruptcy Code also exempts direct transfers from one retirement account to another.

Even outside of the context of bankruptcy, ERISA's broad anti-alienation provision prohibits the assignment or alienation of ERISA retirement benefits. Group annuity certificates issued to participants to provide qualified plan benefits are required to follow the plan provisions and form of benefit rules, and therefore do not permit assignment to creditors or any other party. See IRS General Counsel Memorandum 39882 (May 27, 1992) and Treas. Reg. §1.401(a)-20, Q&A-2.

ERISA DISCLOSURES

The ERISA disclosures required for defined benefit plans are designed to ensure that participants understand their rights, obligations, and entitlements under the plan in which they participate. At the time individuals cease to be participants covered under a plan—as would be the case following the distribution of all of a participant's benefits from the plan, whether by lump sum distribution or annuity—information pertaining to the plan is no longer needed by or relevant to the participant. For example, summaries of subsequent changes to the plan or changes in the plan's funding status would have no bearing on an annuitized participant's rights, obligations, or entitlements under the plan and, therefore, provide no discernible benefit to such a participant. Similarly, furnishing an annual benefit statement to an annuitized participant with respect to which a payable accrued and vested benefit determination has already been made and disclosed serves no meaningful purpose. As noted above, before a distribution can be made, the participant must receive notice of the QJSA provisions that includes an explanation of the requirement to obtain spousal consent before a non-QJSA distribution form, including a lump sum, may be elected. This must be provided before the annuity form of benefit is provided.

Complementing the many ERISA protections afforded participants in connection with de-risking transactions, insurers have dedicated significant resources to ensure that participants and retirees understand, through clear and concise disclosures, the transaction and how they are affected, the consequences of any decisions they may have to make, and their rights under the annuity contract. For insurers, the longer term satisfaction of annuitants is an imperative, and participant communications are an integral element of new case implementation.

PBGC COVERAGE

When a participant's or class of participants' pension obligation is annuitized, the plan is no longer required to pay premiums to the Pension Benefit Guaranty Corporation (PBGC) on behalf of those participants because the liability for payment of annuitized benefits has been legally transferred from the plan to an insurer. In the case of annuitized benefits, the guarantee of payment is now the obligation of a licensed insurance company that is subject to stringent solvency standards and oversight by state insurance regulators. In addition, all states manage state guaranty funds that are intended to protect promised benefits against the failure of any one insurer. Unlike the PBGC protections, which are subject to caps on promised benefits, annuitized benefits are not subject to a defined guarantee.

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