[INSIGHT] By Peter H. Bickford

Pension Stripping and De-Risking

Pension what? Is this some form of new TSA security protocol? A new energy source? An X-rated event for old people? No, but it does involve the alchemy of converting pension obligations into annuities.

Peter H. Bickford

Advocacy groups for retirees, such as ProtectSeniors.org, have been pressing Federal and state regulators and legislators to understand what they perceive as significant adverse consequences of these transfers — which they refer to as pension stripping transactions.

Corporations, particularly large organizations with massive pension obligations, are always looking for ways to reduce or stabilize these long-term liabilities. One way that seems to be gaining favor is through the purchase of group annuities under which the pension obligations to certain employees is transferred to the annuity issuer. The most noted example is the recent transfer of more than 40,000 retired Verizon employees out of their pensions plan and into annuities under a group annuity policy issued by Prudential. Despite a hefty up-front premium payment to the annuity issuer, the benefits to a company can be significant including: no longer having to pay annual premiums to the Pension Benefits Guaranty Corporation (PBGC), removing long-term pension obligations from the balance sheet, reducing future pension related expenses, and potentially lowering borrowing costs resulting from improved credit ratings. The employees would also seem to benefit from having the assurance of an annuity from one of our leading financial institutions, The Rock! So what's the problem?

Advocacy groups for retirees, such as ProtectSeniors.org, have been pressing Federal and state regulators and legislators to understand what they perceive as significant adverse consequences of these transfers — which they refer to as pension stripping transactions. These groups are encouraging states to adopt pension de-risking legislation to help minimize these adverse consequences. The most obvious consequence is the loss of Federal insurance benefits through the PBGC, which critics say forces pensioners into a maze of state-run guaranty associations with a patchwork of inconsistent coverage and dollar limitations. The industry response to these concerns is to point to the strength of The Rock and the success of the state-sanctioned guaranty fund system in protecting policyholders of the few life insurer insolvencies that have occurred over the decades.

The substitution of an inconsistent, limited and often discriminatory state guaranty fund system for full Federal insurance coverage, however, is but one of a number of issues advanced by critics of pension stripping. For instance, critics argue that once the pension obligation is transferred to the annuity issuer, the protections of ERISA, including its fiduciary standards, are lost. Also lost are the annual financial disclosures to retirees regarding the financial performance of their pension accounts. No similar accountability rules are currently applicable to annuity issuers.

One of the more overlooked yet significant criticisms is that once their benefits are no longer protected by Federal law, retirees are subject to the inconsistent vagaries of state debtor/creditor laws that may or may not protect retirees from creditors or bankruptcy trustees. A retiree, for instance, caught short in hard financial times, may find that his annuity payments may be subject to garnishment by a creditor. Under Federal law, pension benefits are not subject to attack by creditors.

In the absence of Federal laws prohibiting or limiting pension stripping, retiree advocacy groups are asking state legislators to consider adopting pension de-risking laws requiring a level of oversight, disclosures and protections for the benefit of annuitants similar to those provided to pensions under Federal law. Pension de-risking legislation has been proposed in several states, including New York and Connecticut, and the National Conference of Insurance Legislators (NCOIL) has presented a model bill for consideration. In fact, at its most recent meeting, NCOIL hosted a presentation on the pension stripping issues among advocates for and against the proposed de-risking legislation.

Interestingly, so far this conversation has lacked any significant input from the regulators, particularly New York's normally less than shy enforcers. While equity investors in annuity issuers have been the target of DFS through the imposition of stricter standards of capitalization than other investors in the name of protecting annuitants, and while DFS recently imposed a well-publicized fine against an annuity issuer for failing to inform DFS of changes in some of its annuity products, it has been mostly silent on the pension de-risking effort.

The life insurance industry in New York has developed a well-earned respect over the decades with the regulators and legislators, and it is understandably opposed to de-risking legislation as an unnecessary burden on annuity issuers. Besides, we're not looking at a financial lightweight here. The Rock is one of the strongest financial institutions in the US, and pension de-risking is simply another example of regulatory overkill adding unnecessary expense and red tape to an already complex industry.

Wait! Have we learned nothing from the insolvency of Executive Life Insurance

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Company (ELNY)? ELNY exposed the significant shortcomings of the state guaranty fund system, and the less than stellar response of the life industry to the damage done to the neediest ELNY annuitants. The defects and inconsistencies in the system ELNY exposed have not been addressed by regulators or legislators, nor is there any meaningful indication of a willingness to do so. For example, even thought two full legislative sessions have passed since ELNY depleted the life guaranty fund in New York, the fund still has no current statutory authority to assess life companies or otherwise obtain funds to respond to a future insolvency. The lessons that we should have learned from ELNY are too fresh to be ignored.

Even accepting the imposing financial strength of Prudential and the unlikelihood of there ever being an ability to pay issue (with due deference to the passengers of the unsinkable Titanic and the creditors of indestructible Lehman Brothers), there is nothing to prevent companies from transferring their pension obligations to lesser financial stalwarts than Prudential. Once the precedent has been firmly established without controls in place, who is to say that XYZ annuity issuer will not seek a piece of the lucrative pension pie at more "competitive" rates? And who is to say that with our genius for inventing new investment products that some even riskier avenue of pension stripping may not occur?

This is a very serious issue for people who have a secure, Federally insured pension one day and wake up the next with an annuity from a company they did not choose, without having been asked or given any option to accept or reject, and protected by a flawed, inconsistent and limited safety net. At the very least this development requires serious and open discussion at all levels – a discussion that the state regulators need to join as soon as possible.[IA]

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growth, companies are seeking avenues to expand their product offerings and distribution capabilities through acquisitions. In fact, for half of respondents, one of the most important alternative growth strategies will involve the development of new distribution channels. Most respondents believe that private equity firms will play an increasingly important role in insurance dealmaking. The majority of them predict that alternative asset managers and/or private equity firms will be among the most active buyers driving M&A in the life and P&C subsectors over the next 12 months. It's already begun says savvy **Steve Nigro**, quarterback of the M&A team at **TAG Financial** in the Empire State Building. His view is that the marketplace will respond as aggressively to good news as it did to the negative news that has been afoot. Steve may have some announcements coming out in the agency force and on the carrier side very soon, he tells us.[IA]