AMERICAN BENEFITS COUNCIL

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Filed via e-mail

State Rep. Tommy Thompson (KY)
Chair, Financial Services and Investment Products Division
National Conference of Insurance Legislators

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Member, Financial Services and Investment Products Division
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ATTENTION: Concerns about NCOIL's Proposed Pension De-Risking Model Act

Dear Sirs:

The American Benefits Council ("Council") is writing on behalf of pension plan sponsors across the country to express significant concerns with the proposed Pension De-Risking Model Act (the "Model Act" or "proposal") that is under consideration by the National Conference of Insurance Legislators ("NCOIL"). ***As discussed in more detail below, the Model Act, if adopted by any state, would temporarily severely undermine the voluntary nature of our pension plan system and force employers to remain in untenable, economically volatile situations; ultimately, however, the Model Act would be rendered void by the Employee Retirement Income Security Act's*** **("ERISA")** ***broad preemption provision.***

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans that cover more than 100 million Americans.

As drafted, the Model Act would apply to all de-risking transactions involving the purchase of annuities – both the so-called "de-risking" activities that employers use to partially discharge their ERISA plan liabilities, and full terminations where an ERISA plan's liabilities are completely discharged. In this letter, we refer collectively to both forms of de-risking as Liability Payments.

Very generally, in all Liability Payment transactions, the proposal would require additional mandatory disclosures, state regulatory approval of the transaction, opportunities for plan participants to opt out of the transaction, the right for participants to request a lump sum option at regular intervals, supplemental protection equal to the Pension Benefit Guaranty Corporation's ("PBGC") coverage for plans, and other protections similar to those that ERISA, the federal law governing pension and welfare benefit plans, requires with respect to plans.

SUMMARY OF CONCERNS

The Council and its plan sponsor members are highly supportive of efforts to assist employees in achieving financial security in retirement through access to retirement savings opportunities, financial education and planning assistance, and requirements that employees be kept informed of changes to their plans and the rules that impact those plans. In this regard, we appreciate NCOIL's focus on ensuring that individuals have the ability to have a secure retirement in our voluntary system. But as explained in more detail below, the Council has the following significant concerns with NCOIL's proposed Pension De-Risking Model Act.

- The Model Act would severely undermine and interfere with the voluntary nature of the private pension system.

- By preventing employers from exercising their choice to engage in Liability Payment transactions, the proposal would, until preempted as discussed below, lock employers into financially volatile situations that likely will be very disruptive – and potentially disastrous – to businesses and their current and former employees.

- The major provisions of the Model Act, including the requirement to obtain a state commissioner's or superintendent's approval of any Liability Payment transaction and a participant's right to opt out of the transaction, would be preempted by ERISA's well-established authority giving employers the right to decide whether to terminate a plan in whole or in part.

- Most of the other provisions of the Model Act, such as the right to lump sums at regular intervals, would be so burdensome and cost-prohibitive that they would also be preempted by ERISA for effectively preventing employers from terminating a plan in whole or in part.

- The entire Model Act relates solely to ERISA plans and does not apply to any annuity contract that is unrelated to an ERISA plan. Thus, the Model Act runs counter to ERISA's preemption provision, which has the primary purpose of ensuring uniform retirement standards throughout the United States, and would not be saved by ERISA's insurance savings clause.

1. Background

The private pension system is voluntary. A fundamental tenet of the United States' private pension system is that employer-sponsored pension plans are voluntary. Each employer may decide whether to sponsor a pension plan for its employees; no law mandates that employers do so. Congress has deliberately protected the voluntary nature of the private pension system. In this regard, ERISA does not require employers to offer pension plans. When Congress enacted ERISA, it simply provided that *if an employer chooses to offer a plan*, then the plan will be subject to ERISA's requirements.

Just as Congress has ensured that employers have a choice in whether to offer a pension plan, employers have a choice in deciding whether to continue to maintain a plan, either in full or in part.[1] Nothing in ERISA restricts an employer's ability to discharge a plan's liabilities and cease offering such plan.

Distribution of assets in a voluntary termination: Section 4041(b)(3)(A) of ERISA states that one of two methods must be used for the final distribution of plan assets in connection with a voluntary termination. A plan administrator must either (1) purchase "irrevocable commitments" (*i.e.*, annuities) from an insurer to provide all benefit liabilities under the plan, or (2) fully provide all benefit liabilities in another way (*e.g.*, lump sum offering) that is permitted by the plan terms and any applicable regulations. Irrespective of whether a voluntary termination is involved, the plan qualification rules in sections 401(a)(11) and 417 of the Internal Revenue Code of 1986, as amended, ("Code") require defined benefit plans to offer a qualified joint and survivor annuity ("QJSA") option. Moreover, ERISA's protections preclude plan sponsors from requiring participants to take a lump sum benefit, other than for amounts not to exceed $5,000. ***Thus, if employers cannot purchase annuity contracts to discharge plan liabilities with respect to employees who do not elect a lump sum, employers have no way to terminate a plan under applicable federal law.***

2. The Model Act's opt-out and approval requirements would severely undermine the voluntary nature of the pension system.

The Model Act would require that any "pension de-risking or stripping transactions that divest retirees of ERISA protections" be approved by the commissioner or superintendent of any state where more than 25 percent of impacted retirees reside prior to implementation. The Model Act further requires that retirees subject to a Liability Payment transaction be given the opportunity to opt out of the transaction. Those who choose to opt out must be given "other

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[1] In a typical non-distress situation, employers are free to choose whether and when (subject to certain notice requirements) to terminate a plan. In a distress termination situation, different rules apply, and in some cases the PBGC may terminate a pension plan even if the employer has not chosen to do so. The comments contained in this letter relate to voluntary, or non-distress termination situations.

options" by the annuity provider, where at least one option consists of an upfront lump sum. These provisions would thoroughly undermine the voluntary nature of the pension system by effectively prohibiting employers from voluntarily terminating a plan.

As described above, a defining characteristic of our pension system is that employers have the right to choose ***both*** whether to offer and whether to continue maintaining a plan. ***By requiring that all Liability Payment transactions be approved by the state commissioner or superintendent, the Model Act would give to one individual the right to overrule an employer's decision to terminate a plan in whole or in part***. If the commissioner or superintendent denies approval of a Liability Payment transaction, the employer would be prohibited from terminating its plan for the reasons set forth above. Without the required approval by every state in which more than 25 percent of impacted retirees reside prior to implementation, the employer must continue maintaining the plan. Thus, a single commissioner or superintendent could effectively prevent a Liability Payment transaction, thereby impacting individuals in a number of other states.

While the provision requiring commissioner-level approval is alarming on its own, the proposal goes even further by requiring that participants be given an opportunity to opt out of the Liability Payment transaction. This means that under the Model Act, not only may the commissioner or superintendent deny the employer its choice to terminate, but even where the commissioner or superintendent approves the transaction, ***a single participant could still deny an employer the ability to terminate its plan***. As stated above, participants generally cannot be forced to take a lump sum of their benefits. Moreover, despite the Model Act's requirement that the annuity provider give alternative options (including a lump sum payout) to those who opt out of the Liability Payment transaction, the proposal does not require that those participants accept an alternative option. As a result, a participant who exercises his right to opt out of the annuity and who also refuses to take a lump sum would effectively force the employer to maintain its plan – even if only for one participant.

For the reasons set forth above, the Model Act directly conflicts with a fundamental tenet of ERISA, *i.e.*, that the federally governed private pension system remain voluntary.

3. Interfering with employers' ability to terminate a pension plan in whole or in part – or to enter into a Liability Payment transaction – could lock employers into untenable, economically volatile situations.

Plan sponsors take their role in offering retirement plans to their employees very seriously. Pension plans are not offered on a whim; whether out of a concern to help employees save for retirement, and/or as part of a benefits package geared at attracting and retaining employees, the decision to offer a pension plan is not made lightly.

Because of the impact that taking away a pension plan can have on employees' retirement plans and employee morale, the decision to terminate a pension plan in whole or in part is also taken very seriously. Often, the full or partial termination of a defined benefit pension plan is accompanied by the introduction or enhancement of a defined contribution plan as part of an employer's broader benefits strategy, which may include providing more portable benefits. In that context, an employer does not terminate its pension plan unless the very significant cost of doing so to both its employees and business is outweighed by some other even more significant cost that the employer would incur by continuing to maintain the plan. By forcing employers in some cases to maintain their pension plans, the Model Act could compel companies to continue maintaining plans beyond that point at which an employer has determined that the reasons to continue a plan are outweighed by some very substantial costs in doing so.

For a variety of reasons that we briefly explain below, some employers have been giving more consideration to Liability Payment options. To better understand employers' motivations in considering these Liability Payment strategies, it is important to understand how the legislative, regulatory, and economic environments for pension plans have made sponsorship increasingly difficult over the past few decades. Therefore, we would encourage states to exercise great care in considering whether to attempt to further regulate these transactions.

Why some employers are considering Liability Payment strategies: When many of today's plans were put into place, they were viewed as long-term liabilities of the plan sponsor. As such, funding requirements were based on long-term expected investment returns. Similarly, the accounting rules governing plans also took a long-term view toward pension liabilities and required contributions.

In the late-1980s, two important developments increased the potential financial consequences of these liabilities. First, tax law changes introduced accelerated contribution requirements for plans that were less than 90% (or in some cases, 80%) funded, based on liabilities tied to generally conservative Treasury bond yields. At about the same time, the Financial Accounting Standards Board ("FASB") mandated that companies reporting under U.S. generally accepted accounting principles ("GAAP") include pension costs on their income statements and include information related to the assets and liabilities of their plans in their financial statement footnotes. Those costs, particularly the liability measures, were based primarily on high quality corporate bond yields, which became a key consideration in terms of pension plan risk management.

During the 2000s, significant changes were made to both the minimum funding requirements and the GAAP accounting rules that increased pension costs and the volatility of funding obligations. In particular, the Pension Protection Act ("PPA") in 2006 applied an accelerated and volatile funding regime to all plans that were less than 100% funded by requiring, for example, that any funding shortfalls be funded over seven-year amortization periods starting in 2008. On the accounting side, FAS 158 required most sponsors to reflect the mark-to-market values of pension plan assets and liabilities directly on their balance sheets starting at year-end 2006. Changes were also made to PBGC premium calculations, which generally resulted in higher premiums.

Since then, historically low interest rates (driven largely by Federal Reserve monetary policy), volatile equity values, the deepest economic recession since the Great Depression, and an uneven economic recovery have lowered funding ratios and caused sharply higher contributions for many employers at a time when they can least afford it.

In addition to the risks associated with the assets and liabilities, increasing plan administrative costs and complexities are also concerns. At the same time, PBGC premiums are continuing to rise, and the recent Administration budget proposal would hike PBGC premiums far beyond the large increases that recently took effect as part of the Moving Ahead for Progress in the 21st Century Act (MAP-21) and the Bipartisan Budget Act of 2013.

Consequences of denying employers the ability to terminate plans in whole or in part: As a result of the above developments, the choice to engage in a Liability Payment transaction has unfortunately become for some employers very much a choice about individual business survival and job creation and retention in general. The ability that Congress granted employers to make these difficult decisions is critical for employers who find themselves facing these decisions due to economic and regulatory conditions beyond their control. It is also critical that employers deciding whether to begin *offering* a plan can be confident that the choice to terminate a plan in whole or in part will be available in the event that they, too, encounter difficult circumstances. But instead of allowing employers to make this decision, the Model Act could force employers to remain in a potentially very volatile situation rather than allowing them to make the decisions that are necessary to better ensure that the business survives challenging times. ***By potentially preventing Liability Payment transactions, the Model Act could result in employees being more likely to face layoffs, job losses, or reductions in pay and other benefits.*** These consequences are far greater and more immediate than the very remote risk that a highly rated insurer qualified to engage in Liability Payment transactions would reduce benefit payments due to a future catastrophic failure.

4. **Because of its ability to prevent employers from voluntarily terminating a pension plan, the Model Act would be preempted by ERISA.**

Even though the Model Act would violate the fundamental premise of the voluntary retirement system and could force employers to remain in potentially dangerous financial situations, these disturbing outcomes would ultimately be halted because the proposal would be preempted by ERISA. Section 514(a) of ERISA provides generally that ERISA's provisions "shall supersede any and all State laws insofar as they may now or hereafter *relate to* any employee benefit plan" (emphasis added). The Supreme Court has labeled this preemption provision as "expansive." *Aetna Health Inc. v. Davila*, 542 U.S. 200, 208 (2004). More specifically, the Court has provided that "state laws which make 'reference to' ERISA plans are laws that 'relate to' those plans." *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 829 (1988). Here, it is evident that the Model Act "relate[s] to" employee benefit plans because it is specifically targeted at "provid[ing] protections to retirees whose pension benefits are transferred." As such, the proposal would be preempted unless an exception to ERISA's general preemption provision applies. As discussed below, no such exception applies.

The primary exception to ERISA's broad preemption provision is the insurance savings clause. Section 514(b)(2)(A) states that "nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities." For a state law to be saved by the insurance savings clause, the law (1) "must be specifically directed toward entities engaged in insurance," and (2) "must substantially affect the risk pooling arrangement between the insurer and the insured." *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 342 (2003). The savings clause is in turn limited by the "deemer clause" in section 514(b)(2)(B), which says that an employee benefit plan may not be deemed to be an insurance company or insurer for purposes of the insurance savings clause. The Supreme Court has described the operation of the deemer clause as "reliev[ing] plans from state laws 'purporting to regulate insurance.'" *FMC Corp. v. Holliday*, 498 U.S. 52, 61 (1990).

In some cases, a state law is saved from preemption because it legitimately regulates the terms or benefits of insurance contracts, or administrative practices that are unique to the insurance industry. As discussed below, because the Model Act does not relate to insurance generally, but only relates to insurance products issued in connection with an ERISA plan, the entire Act would be preempted. But even if that flaw were addressed, ***the most significant provisions of the Model Act, such as the commissioner or superintendent approval and opt-out requirements, while masked as insurance provisions, would in actuality directly override the key provisions in ERISA that permit voluntary plan terminations in whole or in part***. These provisions "purporting to regulate insurance" clearly regulate plans, not insurance, and would plainly be preempted by ERISA.

The Supreme Court has previously ruled state laws to be preempted where the state law clearly interfered with employers' rights under ERISA. In *Alessi v. Raybestos-Manhattan, Inc.*, a state legislature attempted to eliminate a method for calculating pension benefits by prohibiting pension benefits from being offset by state workers' compensation benefits. 451 U.S. 504 (1981). Because ERISA permits such integration of pension funds with other public income maintenance moneys for benefit calculation purposes, the Court found the state law to be "an impermissible intrusion on the federal regulatory scheme." *Id.* at 524-25. Very similar to the state law interference in *Alessi* with a method for calculating benefits found to be permitted by ERISA, the interference by the NCOIL Model Act's commissioner or superintendent approval and opt-out provisions with the method of plan terminations provided for in ERISA would also be preempted as an "impermissible intrusion."

A state law that regulates retirement plans cannot escape preemption simply by doing so through the regulation of insurers that serve fundamental and irreplaceable roles under ERISA. For example, a state law could theoretically prohibit any insurance company from issuing an annuity contract to terminate a plan unless the plan met certain standards, such as providing specified minimum benefits or covering all employees of the employer. Such a law would clearly not be regulating insurance; it would be regulating plans and there is no doubt that the law would be preempted by ERISA. Similarly in this case, the Model Act is regulating plans, not insurance, when it denies the employer the right to terminate the plan in whole or in part without the approval of a state's commissioner or superintendent and all participants.

5. Most of the other provisions in the Model Act would be so burdensome that they would be preempted for effectively preventing employers from terminating a plan in whole or in part.

The provisions for state commissioner or superintendent approval and an opt-out option described above would directly eliminate an employer's right to terminate a plan in whole or in part, and thus would be preempted. Most of the Model Act's other provisions would prohibit plan terminations indirectly, and thus would also be prohibited. This is the case because the Model Act would make plan terminations and other Liability Payment transactions so expensive that such transactions would be effectively prohibited. For example, the cost of an annuity contract that makes lump sums available at regular intervals and is reinsured in the manner described in the Model Act would itself be prohibitive.[2]

[2] The Model Act's rules regarding how to value a benefit for purposes of determining a lump sum distribution are inconsistent with explicit Code and ERISA rules, and thus would clearly be preempted. In fact, if not preempted, the Model Act's rules in this regard could actually result in severely adverse tax consequences for participants by disqualifying the plan under the Code.

6. **The entire Model Act relates solely to ERISA plans and thus triggers ERISA's preemption provision without invoking the insurance savings clause.**

There is an additional reason that the Model Act would be fully preempted. As provided above, the Supreme Court in *Miller* stated that for a state law to be saved by the insurance savings clause, the law (1) "must be specifically directed toward entities engaged in insurance," *and* (2) "must substantially affect the risk pooling arrangement between the insurer and the insured." As explained below, because the Model Act in its entirety fails to meet the first prong of the savings clause test, the savings clause will not save the Model Act's provisions.

In regard to the first prong of the *Miller* test – whether a state law is "specifically directed toward" insurance – by its terms, the Model Act is limited to annuity contracts or other arrangements that provide benefits previously provided by an ERISA plan. Thus, the Model Act has no application to any insurance product unrelated to an ERISA plan. As drafted, the proposal is simultaneously too broad and, more importantly, too narrow to meet this first prong. First, the Model Act is too broad because it is not limited to regulating only insurance or insurance providers – it is directed toward "any insurance company *or other benefit provider* that issues a group annuity contract *or other retirement funding vehicle*" (emphasis added). In *Pilot Life Insurance Co. v. Dedeaux*, the Supreme Court found that a state law that had a primary effect on insurers but was not limited to insurers did not fall within the savings clause. 481 U.S. 41 (1987). Here, because the Model Act's provisions are similarly not limited solely to insurers or group annuity contracts, they would also fail to be protected by the savings clause because they are not "specifically directed toward" insurance.

Even if this error of being too broad is corrected, the Model Act would in another sense apply too narrowly to be saved from preemption. By attempting to narrowly regulate a subset of annuity contracts (only those connected to Liability Payment transactions), it is not possible to argue that the Model Act is "specifically directed toward" regulating insurance. If the Model Act were regulating insurance, it would apply its proposals to annuity contracts without regard to whether the annuity contracts relate to an ERISA plan.

The Third Circuit has looked to both the title of a state law and the law's introductory sentence for evidence of whether a law is "specifically directed toward entities engaged in insurance." The Court found this first prong to be satisfied where a law was entitled "actions on insurance policies," and the first sentence clearly set the scope of the law as applying broadly to all insurers. *Barber v. Unum Life Ins. Co. of Am.*, 383 F.3d 134, 142 (3d Cir. 2004). Unlike the state law at issue in *Barber*, the Model Act's title, "Pension De-Risking Model Act," is clearly not directed toward insurance but instead at pension plans. The Model Act's introductory statement of purpose, "to provide protections to retirees whose pension benefits are transferred," is very evidently directed at pension plans, not at all annuity contracts on an insurance industry-wide basis. Furthermore, several cases in which a state law was found to be "specifically directed toward" insurance were found as such where the state law applied broadly across the insurance industry. *See, e.g.*, *Barber*, 383 F.3d at 142 (describing the state law as imposing "industry-wide conditions on the insurance business"); *Am. Council of Life Insurers v. Ross*, 558 F.3d 600, 605 (6th Cir. 2009) (describing how, under the state law, "any insurer" would be required to take certain action); *Standard Ins. Co. v. Morrison*, 584 F.3d 837, 843-44 (9th Cir. 2009) (stating that "all insurers" would be required to omit a certain contract clause, and that because the state practice is "grounded in policy concerns specific to the insurance industry…[i]t is indeed directed at insurance companies").

The Supreme Court has also utilized a simple "common-sense view" of whether a law regulates insurance, stating that "a law must not just have an impact on the insurance industry, but must be specifically directed toward that industry." *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 365-66 (2002). Here, the Model Act is, in fact, by its own words, specifically directed at pension plans and not more broadly at insurance. Thus, the first prong of the *Miller* test for the savings clause is not met, and the entire Model Act would not be saved from preemption.

Because the Model Act is not, in fact, regulating insurance but is instead regulating ERISA plans due to its limited scope, the Model Act would not be saved by the insurance savings clause and thus would be preempted by ERISA.

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In conclusion, the Council cannot overstate the irreparable harm that the Model Act, if adopted by states, would create for employers and employees, by eliminating the *voluntary* nature of the private pension plan system that every employer relied on when deciding to offer and maintain a plan. Because many of the proposal's provisions could directly or effectively prevent an employer from partially or fully terminating a plan, the Model Act could force employers to remain in – or be unable to stave off – dire financial circumstances. Congress adopted ERISA's broad preemption provisions to provide for the regulation of private pension plans at the federal level and to promote uniform retirement safeguards. As drafted, the Model Act would upend these purposes of ERISA.

Any state's adoption of the Model Act will only serve to create temporary havoc for (1) employers in particular states, (2) the job security and benefits provided for their employees, and (3) the retirement system, before eventually being ruled void as preempted by ERISA. The path forward to addressing de-risking issues is to reduce the necessity for Liability Payment transactions by dealing directly with the motivations that underlie them – plan funding volatility, accounting volatility, and rising PBGC premiums. The Council and its many plan sponsor members would welcome working with NCOIL in expressing those concerns to our representatives in Washington.

We appreciate your consideration of our concerns and are available to discuss them at further length or to provide additional information or clarification as you may request.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy

cc: Susan Nolan
Candace Thorson