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THE ASPEN INSTITUTE INITIATIVE ON FINANCIAL SECURITY
WRITTEN TESTIMONY ON
CERTAIN ISSUES RELATING TO LIFETIME INCOME OPTIONS FOR
PARTICIPANTS AND BENEFICIARIES IN RETIREMENT PLANS
BEFORE THE DEPARTMENT OF LABOR AND DEPARTMENT OF THE TREASURY

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My name is Pamela Perun, and I am the Policy Director of the Aspen Institute Initiative on Financial Security. At Aspen IFS, our focus is on the ordinary saver, those with modest to medium-size nest eggs, and our perspective on lifelong income products is intended to keep their interests in mind. I am here today to testify on the topic of a Fiduciary Safe Harbor for Selection of Lifetime Income Issuer or Product. In 2007, I published a paper on this topic titled “Putting Annuities Back in Savings Plans,” which elaborates on the comments I will make today. I will be submitting this paper for the public record along with my comments today.¹

I am an ERISA attorney, and my special interest is in keeping the private pension system a hospitable place for the small employer. It is important to remember that 90% of defined contribution plans have less than 100 participants. These plans cover about 15% of plan participants, and they represent an important constituency that we need to keep in the private pension system.

I believe that we are not asking the right question here. The question is really not how can we get a better fiduciary liability safe harbor for employers. The relevant question is what happens when something goes wrong in a lifetime income product. There is no fiduciary liability until something goes wrong. So we should be asking: when something goes wrong what should be the extent of the protection available to participants, both inside and outside a plan, and who should provide such protection.

Current ERISA regulations make the employer a potential final backstop for participant protection. The rationale for this stems from a change in the law in the Pension Annuity Protection Act of 1993. In the early 1990s, a number of insurance companies failed, including the Executive Life Insurance Company of California. This put into jeopardy the benefit payments to former plan participants in terminated defined benefit plans whose pension obligations had been transferred to insurance companies. Subsequent investigations revealed that a number of defined benefit plan sponsors had chosen very low bids from Executive

Life and other companies to pay promised plan benefits rather than those of higher-rated companies. Choosing a low bidder enabled these sponsors to increase the amount of plan assets they would re-capture after annuities had been purchased to pay plan participants. Two court cases, *Mertens v. Hewitt Associates* and *Kayes v. Pacific Lumber*, seemed to block former plan participants from either suing their employer for putting their own interests ahead of plan participants or receiving monetary damages to make their pension promise whole. The legislative history of the Pension Annuity Protection Act reveals that Congress merely intended to reaffirm the original intent of ERISA to provide such remedies, and its primary concern was with defined benefit plans.

But since then, in reaction to the abuses observed in the Executive Life case and others, regulatory guidance has morphed the fiduciary duties of employers with respect to distribution annuities in ways that this legislation never contemplated or intended. And, I believe, that guidance fails to distinguish between the risks posed to participants in a defined benefit plan versus a defined contribution plan. In a defined contribution plan, there is no such thing as a reversion so there is no need to protect against this conflict of interest between employers and employees. In a defined contribution plan, there is no promise of a guaranteed accrued plan benefit that purchased annuities must provide. In a defined contribution plan, the accrued benefit of a participant is merely the dollar amount in the account at a particular point in time. And how a participant chooses to invest that account balance in an investment product is primarily that participant's business.

Merely providing a softer safe harbor will not encourage many more employers to offer lifetime income products. Frankly, ERISA lawyers like myself will continue to advise our clients not to include them in their defined contribution plans because of the expense and potential long tail of fiduciary risk involved. So I urge you as regulators to go back to basics and think through what makes sense from an ERISA perspective in a defined contribution, NOT a defined benefit, plan context. What are the risks, who should bear them, and should protection differ depending on the type of investment product available in a defined contribution plan. We don't need a softer safe harbor, we need a reasonable process that enables employers to choose good lifetime income products without fear of long-term liability and enables participants to purchase the investment product that meets their needs.

When something does go wrong, the first step should be to look for protection, not to employers, but to the state guaranty associations standing behind these products. I understand that the Government Accountability Office is analyzing and evaluating the current strength of these funds, and I look forward to that report. I would like to point out, however, the private pension system had its first extensive experience with these funds in the early 1990s as part of the Executive Life crisis. I had just started to practice law at that time and the firm where I worked, as well as many other large firms, worked on behalf of employers – primarily large employers - with these funds to obtain redress, not just for annuitants but for participants in GICs and other investment products.

I think it's fair to say that this was an expensive, time-consuming and not wholly-satisfactory experience. Seeking redress for participants required a lot of individual fact-finding as well as preparing complicated regulatory filings. Large employers have the resources and the will to pursue these avenues for relief when necessary but it is not likely that small employers will. We also learned that there were significant gaps and differences in coverage across states that led to uneven outcomes.

1. Perun, Pamela J., "Putting Annuities Back in Savings Plans," Chapter 8 in T. Ghilarducci and C. Weller, eds., *Employee Pensions: Policies, Problems, and Possibilities*, Champaign, IL: Labor and Employment Relations Association, 2007.

This seems to me to be unacceptable for a private pension system that is governed by federal law and that provides the same protections to participants, no matter where they live or work. If we are going to continue to rely on a state-based backup for lifetime income products, we need to call for changes at the state level, whether it's uniform contracts, higher guarantee amounts, or special status under state insurance codes for qualified plan investors. Many have called for federal regulation and guarantees instead, and that is something to be considered, although that would require the federal government to have a much larger role in regulating the insurance industry than it has ever had.

My final point is that as we move forward we have to be mindful to balance the costs and benefits of new regulations under ERISA to secure the promise of lifelong income products. Every regulation that requires the plan sponsor to hire an expert, every new requirement for additional participant education and disclosure, every increase in state or federal protection will have its cost. A defined contribution plan has no unallocated pool of funds to pick up these expenses. In a defined contribution plan context, it is participants who will pay these costs, whether or not they themselves invest in such products, and these are dollars that will not be available to build retirement income.



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