



2017 Annual Report of the Participant and Plan Sponsor Advocate

Pension Benefit Guaranty Corporation

December 29, 2017



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This statutorily required 2017 Annual Report discusses the activities of the Office of the PBGC Participant and Plan Sponsor Advocate (Office of the Advocate), and is submitted to the Health, Education, Labor and Pensions Committee of the Senate, the Committee on Finance of the Senate, the Committee on Education and the Workforce of the House of Representatives, and the Committee on Ways and Means of the House of Representatives. A copy of this report is concurrently submitted to the Secretary of Labor, the Director of the Corporation, and other appropriate officials.

New to this report found in the Appendix is a pension de-risking study commissioned by the Office of the Advocate at the request of plan sponsors. The study focuses on PBGC and Congressional actions that may slow pension de-risking activity, and highlights the drivers and causes of de-risking. This study found that reducing PBGC single-employer premium levels or stemming their rapid growth is likely to decrease risk transfer activity.

This report also provides the opportunity to welcome the new leadership to the PBGC Board of Directors and the PBGC Board Representatives. The Office of the Advocate is ready to assist our new leadership with their PBGC oversight responsibilities that relate to the Office of the Advocate's mission.

The role of the PBGC Participant and Plan Sponsor Advocate (Advocate) was established over five years ago in 2012 when the Employee Retirement Income Security Act of 1974 (ERISA) was amended to add section 4004, "Participant and Plan Sponsor Advocate." The PBGC Board of Directors selects the Advocate from candidates nominated by the PBGC Advisory Committee. I was appointed in December 2013 as the first Advocate. In October 2015, a reorganization created the Office of the Advocate as an independent organization within PBGC, consistent with section 4004 of ERISA, and office staff now includes an Associate Advocate and a Pathways student trainee.

The Office of the Advocate's staff supports the Advocate in fulfilling statutorily mandated duties which include, among other things, helping participants and plan sponsors resolve their disputes with PBGC, proposing changes to PBGC administrative practices, and identifying potential legislative changes that may be appropriate to address and mitigate persistent problems participants and plan sponsors encounter in their dealings with the corporation.

The arrival of new leadership also provides the Office of the Advocate the occasion to reflect upon and highlight some of the significant activities that the office was involved with since the inception of the Advocate's role at PBGC. This background information may be useful for the new leadership given their PBGC oversight responsibilities, and it may help them determine important policy issues to further strengthen and improve the agency. All of this may help shape and inform what future retirement security could look like for the American worker.

Let me begin as I always do before speaking to any group by noting that participants and plan sponsors are not calling the Office of the Advocate because they are happy with PBGC. The participants and sponsors who contact me are not representative of the large volume of routine transactions PBGC staff handles exceptionally well on an ongoing basis. Nonetheless, the issues that come to my attention are instructive as they share common themes and represent persistent and often systemic problems that sponsors and participants experience with PBGC, all of which are currently being addressed by PBGC's leadership. However, resolving some of these issues does take time and will involve transformational change at the agency.

When I first arrived at PBGC in December 2013, armed with my one page of statutory duties, my phone rang off the hook with calls from both plan sponsors and participants.

Plan sponsors voiced urgent concerns regarding PBGC's enforcement actions under ERISA section 4062(e). Section 4062(e) required an employer to provide security to PBGC when it ceased "operations" at a facility, and as a result of ceasing operations, more than 20 percent of the total number of employees who were participants in the defined benefit plan were separated from their employment. PBGC began to take an expansive view of the provisions of the statute and would pursue employers even when there was no facility closure and no employee lost their job. The agency would negotiate with employers to accelerate funding of the pension plan by requiring the employers to contribute large and disproportional amounts of money that would otherwise have been used for business investment. Many of these employers sponsored frozen defined benefit plans that met or exceeded the funding requirements and had never missed a required contribution to the plan.

As a result of PBGC's enforcement actions, some of America's most prominent companies came to my office for help. One company in the entertainment industry simply changed its corporate form and was hit with a multi-million-dollar PBGC liability under 4062(e), even though the facility never closed and employees never lost their jobs. Another well-known print and media outlet had an asset sale netting proceeds in the amount of \$70 million dollars and was initially subject to a \$170 million-dollar PBGC liability under 4062(e) even though no facility closed and no jobs were lost. In December 2014, working together, the Board, Congress, plan sponsors, and the Advocate were able to reach a legislative solution that ended years of dispute, making this "event" under 4062(e) more predictable and reasonable. Moreover, that clarity under 4062(e) best served participants, plans, plan sponsors, the PBGC itself, and the defined benefit system as a whole.

During the early years, participants and their advocates also contacted the Advocate regarding challenges when dealing with PBGC on benefit entitlement claims. Additionally, groups such as AARP and the Pension Rights Center (PRC) were passionately concerned about the pending destruction of summary plan descriptions (SPDs) covering the early years after ERISA's enactment (1975-1991). The Department of Labor (DOL) was the custodian of these documents, but the agency was no longer statutorily required to retain this historical SPD collection and was prepared to destroy it. PBGC cited cost concerns about retaining the collection, and it appeared the collection was slated for destruction. The PRC and the pension counselors who staff the Administration on Aging's (AoA's) seven regional pension counseling projects relied on this SPD collection to prove entitlement to benefits. The Office of the Advocate experienced the value of the collection when a historical SPD aided in awarding an elderly widow her surviving spouse benefit after she and her advocate had been dealing with PBGC for four years. Ultimately, the Office of the Advocate was able to save the SPD collection from destruction by directly negotiating with the National Archives for a cost-effective arrangement.

Since the inception of the Advocate's role, other plan sponsors and participants have sought assistance in resolving prolonged settlement discussions with PBGC or benefit entitlement issues that required participants to provide decades-old tax returns to show that they never received a distribution from their former plan sponsor. These cases shed light on the profound hidden costs associated with these types of interactions with the corporation. Years of protracted discussions and ongoing disputes with PBGC may cause the company and the participant to seek and retain costly advisors and legal counsel. For example, sponsors facing difficulty resolving a dispute with PBGC often find that sources of funding or investors are no longer interested in financing the business, or that the cost of borrowing increases once the lenders discover that the dispute about the pension liability is still ongoing.

However, things have changed considerably since the nascent years of the Office of the Advocate. Under the direction of the current PBGC leadership, the agency has made changes that were responsive to issues raised in the 2014, 2015, and 2016 Advocate Reports. For example, PBGC updated its premium penalty rule, providing extraordinary relief for premium payers by reducing penalty rates for all plans and waiving most of the penalty for plans that meet a standard for good compliance. This rule represents an effort by PBGC to reduce regulatory costs and makes it easier for plan sponsors to maintain traditional defined benefit plans. This relief, which was prompted by a premium penalty case brought to PBGC's attention by the Advocate, was extremely well-received by the plan sponsor community.

On the participant side, PBGC has made strides in working with the PRC and the AoA's seven pension counseling projects to remove and alleviate obstacles that make it difficult for participants to secure their benefits in a timely manner. The Advocate's 2016 Report and this 2017 Report also note improvements, particularly on the participant front, that demonstrate a more reasonable, practical, and cost-effective approach in addressing issues regarding benefit claims.

Looking forward, there are some legislative changes to the statutory duties of the Advocate worthy of consideration. Based on over four years of experience, the Office of the Advocate can best serve its statutory mission through independence and a modest increase in headcount that allows the office to hire an administrative assistant and another Associate Advocate to help with the significant increase in participant and plan sponsor demand for our services. The additional headcount can also assist the office's activities to add more quantitative studies of interest to participants and plan sponsors.

Other areas in the Advocate statute that require consideration include the expectation of confidentiality on the part of participants and plan sponsors seeking assistance from the Advocate, and the important albeit infrequent need for the Advocate staff to obtain counsel independent of PBGC. Participants and plan sponsors often remark about the credibility that the Office of the Advocate has established by assisting them in resolving their disputes with the corporation. That credibility can be reinforced by legislative changes that clarify the independence of the Office of the Advocate.

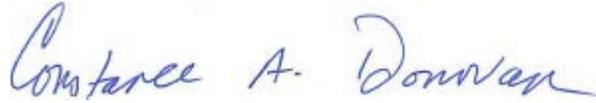
The disputes that participants and plan sponsors have with the agency discussed in this report tend to have an outcome that more or less represents a transactional "fix" or a transactional remedy. Once the Advocate gets involved with a case, a flurry of activity occurs and eventually, often sooner than later, the "fix" occurs and the dispute is resolved. However, consider what kinds of transformational change must take place to address the systemic and policy issues represented by these disputes. Unlike transactional change, transformational change does not come easily, and it requires serious reflection and discernment that includes a new way of approaching the problems that participants and sponsors bring to us for our help.

This involves a change in mindset on how we approach our work with participants and plan sponsors. To guide that kind of transformational change, it might be constructive to consider a set of operating principles as follows:

- Participants and plan sponsors have the right to quality service, including prompt, courteous, and professional exchanges between PBGC and the participant or plan sponsor;
- Participants and plan sponsors have the right to be informed of PBGC's reasoning and concerns about the participant's claim or the plan sponsor's business transaction or problem;
- Plan sponsors have the right to pay no more than necessary into the plan to satisfy the plan sponsor's funding obligations under the Internal Revenue Code and ERISA, except in unusual circumstances;
- Participants have the right to receive their benefit without requiring the participant to provide decades-old tax returns in the absence of PBGC-required documentation;
- Participants and plan sponsors have the right to be heard and challenge PBGC's assumptions through substantive discussion and meaningful discourse; and
- Participants and plan sponsors have the right to finality and the prompt resolution of their case.

Respectfully, I submit for your consideration the 2017 PBGC Participant and Plan Sponsor Advocate Annual Report in accordance with my reporting duties under ERISA section 4004.

Sincerely,

A handwritten signature in blue ink that reads "Constance A. Donovan". The signature is written in a cursive style with a large initial 'C'.

Constance A. Donovan
PBGC Participant and Plan Sponsor Advocate
December 29, 2017

cc: Camille M. Castro, Esq.
Associate PBGC Participant and Plan Sponsor Advocate

Statutory Authorization¹

DUTIES

The Participant and Plan Sponsor Advocate shall—

- (1) Act as a liaison between the corporation, sponsors of defined benefit pension plans insured by the corporation, and participants in pension plans trusted by the corporation;
- (2) Advocate for the full attainment of the rights of participants in plans trusted by the corporation;
- (3) Assist pension plan sponsors and participants in resolving disputes with the corporation;
- (4) Identify areas in which participants and plan sponsors have persistent problems in dealings with the corporation;
- (5) To the extent possible, propose changes in the administrative practices of the corporation to mitigate problems;
- (6) Identify potential legislative changes which may be appropriate to mitigate problems; and
- (7) Refer instances of fraud, waste, and abuse, and violations of law to the Office of the Inspector General of the corporation.

ANNUAL REPORT

- (1) In general—Not later than December 31 of each calendar year, the Participant and Plan Sponsor Advocate shall report to the Health, Education, Labor, and Pensions Committee of the Senate, the Committee on Finance of the Senate, the Committee on Education and the Workforce of the House of Representatives, and the Committee on Ways and Means of the House of Representatives on the activities of the Office of the Participant and Plan Sponsor Advocate during the fiscal year ending during such calendar year.
- (2) Content—Each report submitted under paragraph (1) shall--
 - (a) Summarize the assistance requests received from participants and plan sponsors and describe the activities, and evaluate the effectiveness, of the Participant and Plan Sponsor Advocate during the preceding year;
 - (b) Identify significant problems the Participant and Plan Sponsor Advocate has identified;
 - (c) Include specific legislative and regulatory changes to address the problems; and
 - (d) Identify any actions taken to correct problems identified in any previous report.
- (3) Concurrent Submission—The Participant and Plan Sponsor Advocate shall submit a copy of each report to the Secretary of Labor, the Director of the corporation, and any other appropriate official at the same time such report is submitted to the committees of Congress under paragraph (1).

¹ See ERISA § 4004 (29 U.S.C. § 1304).

PARTICIPANT ISSUES

Participants that contact the Office of the Advocate for assistance in their dealings with the corporation generally struggle for many months, if not years, seeking a benefit that they believe is owed to them. Since the Advocate issued the first inaugural Annual Report in December 2014, many of the issues identified in that report still linger in some form, although substantive progress has been made by PBGC's Office of Benefits Administration (OBA) which manages plans trusted by PBGC. What is striking about OBA's progress is a willingness to look at participant claims differently, challenging the conventional thinking and years of institutional practice that have guided the corporation's interactions with participants seeking a benefit.

Most of my career was in business working for a global company. The "customer is always right" mantra was the mindset throughout this organization, imbued in its employees, particularly when we approached a customer complaint, dispute, or dissatisfaction with a product or a service. We examined the problem from the customer's perspective and found ways to resolve the issue because the competitive consequences of non-resolution were clear. Although PBGC faces virtually no competition, that customer-focused approach has been adopted by several individuals in OBA when approaching participant claims and disputes that require judgment, discretion, and sound reasoning.

With this in mind, the cases that follow highlight the continued need for PBGC to put its "customers" first, whether plan sponsors or participants, and adopt a mindset that those we serve may just be right and have justifiable complaints that we need to satisfy and promptly resolve. The need for a change in mindset when approaching participant claims or disputes will become increasingly evident in the following case studies detailing participant encounters with the large stove-piped departments within PBGC that do not necessarily communicate with each other.

There are also challenges facing participants seeking lost benefits in situations where years of mergers, asset sales, and abandoned plans make a single stock answer not workable, and maybe even harmful. These case studies highlight corresponding administrative issues, such as the importance of retaining records that address employee benefit entitlements, especially when required by regulation, that can have poignant consequences for participants who seek entitlement to a benefit many years later. You will also read about PBGC's efforts to address these issues through PBGC's Office of the General Counsel (OGC) initiatives, for which the Office of the Advocate is grateful.

Stove-Piped Departments within PBGC Hinder Participants Seeking Benefit Entitlements

The Office of the Advocate often receives inquiries from participants involved in what should be straightforward administrative issues and questions that quickly became complicated when the participants are forced to navigate through different departments for assistance and resolution. Participants and their advisors often report a lack of cohesion within the agency among its departments and an uncertainty about the process for working with PBGC on a benefit entitlement claim.

The Office of the Advocate received a request for assistance from the New England Pension Counseling Project regarding a participant searching for a summary plan description (SPD) for her former plan. The participant initially applied to PBGC for a benefit as PBGC had trustee her former employer's pension plan. PBGC denied the participant's claim, stating she was not eligible for a pension benefit under the terms of the plan. The participant's counsel contacted PBGC to request a copy of the plan's SPD to verify the denial's reasoning. PBGC advised the participant's counsel to submit a Freedom of Information Act (FOIA) request to obtain the document.

While PBGC did not have a copy of the SPD that covered the participant's service as part of its trusteeship records, the Office of the Advocate obtained the relevant SPD through a routine request to PBGC's historical SPD repository.² After reviewing the relevant SPD and the participant's case file, PBGC reversed its initial decision and determined that the participant did meet the requirements to participate in the plan and earn a vested benefit. This case also prompted a larger discussion regarding identifying which documents require a FOIA or Privacy Act request, and those documents that can be released to participants and their advisors with an informal request.

Recommendation: The process for handling a participant's request for his or her own information as well as other documents requires further examination with an eye toward alleviating the burden on participants trying to collect documents relevant to their claims. Participants and their advisors all too frequently are told to submit a FOIA request to receive plan documentation or a Privacy Act request to obtain information about themselves.

The information gathering part of a claim can be time-consuming and lengthy. It would be more efficient to provide certain documents, such as SPDs, to participants without a formal FOIA request. Although it may be convenient for one department to shift the participant to the FOIA department, and then for the FOIA department to send the participant a standard form letter on how to make a FOIA request, there needs to be some modicum of "customer etiquette" in looking at entitlement claims and thinking about what is actually being requested rather than simply defaulting to FOIA. As a result of these types of cases, OGC is reviewing its current regulations to assess, within the context of the law, what new procedures could be adopted to make this process more transparent to the participant.

Participant Seeking Entitlement to a Benefit Faces Hurdles Working Across Multiple PBGC Departments Compounded by Plan Sponsor Mergers, Acquisitions, Asset Sales, and Abandoned Plans

A variation on the apparent lack of coordination among and between PBGC departments that contributes to participants' confusion in their encounters with the agency also arises in the

² PBGC is the custodian of SPDs filed with the Department of Labor from 1975 to 1991. These SPDs contain valuable historical information that can prove entitlement to a benefit. The Pension Rights Center fought hard to retain these historical documents despite initial cost-based refusals by PBGC. The Advocate was able to reduce these costs dramatically by direct negotiations with the National Archives. See, 2014 Advocate Annual Report. These SPDs, which have now conferred thousands of dollars of benefit entitlements, are available upon request by completing a form and submitting it to PBGC. See <https://www.pbgc.gov/about/pg/other/requesting-a-summary-plan-description>.

context of plan mergers, asset sales, and abandoned plans where the sponsor has abandoned its responsibilities to the plan.

The Office of the Advocate received a request for assistance from the Mid-America Pension Rights Project (MAPRP) regarding an 86-year-old participant's search for her pension benefit. The participant's counsel initially contacted PBGC after finding what the participant believed was her name on PBGC's Unclaimed Pension List. As part of its research, PBGC requested that the participant complete an authorization form allowing it to obtain earnings data from the Social Security Administration (SSA).³

PBGC subsequently sent the participant a letter stating that the listing on the Unclaimed Pension List did not match the participant's Social Security number. PBGC's letter referenced employment information obtained from the participant's SSA Earnings Statement, and recommended that the participant contact an ongoing plan which may be responsible for the benefit. The ongoing plan to which the participant was referred was insured by PBGC, but the plan was established long after the participant worked for the plan sponsor, so that referral made no sense and added time to the participant's search. When the participant's counsel contacted the agency to request a copy of the participant's SSA Earnings Statement obtained by PBGC, she was advised to file a FOIA request.

Upon submitting a FOIA request, the participant's counsel received a response from PBGC stating that only the participant could request the information, even though the counsel had a signed and notarized letter of representation which allowed her to request and receive information on behalf of her client. The participant's counsel then requested that PBGC send the information directly to the participant. This request was also denied, as PBGC claimed that its agreement with SSA precluded the agency from releasing the records. Ultimately, the participant filed a request directly to SSA for her earnings data which PBGC facilitated obtaining given the age and ill-health of the participant. However, this entire process took months and was marked by a series of miscommunications, and incorrect information and direction to the participant and her counsel.

The Office of the Advocate supports the ongoing leadership of OGC to evaluate the circumstances of this case and the process associated with it so that better procedures can be put in place to address situations where participants are seeking a benefit from a lost or abandoned plan. Better processes will help but are not a substitute for proper research and due diligence before referring the participant and his or her advisor to yet another PBGC department or plan sponsor.

Recommendation: The above case illustrates the challenges faced by participants searching for their missing benefits. In addition to gathering documents, participants often encounter issues while searching for the correct party responsible for paying their benefits.

It can be complicated to piece together the history of a plan, particularly during significant business events such as bankruptcies, mergers, acquisitions, and other transactions affecting an

³ PBGC has an agreement with SSA which allows SSA to provide earnings information to assist the agency in the determination of an individual's eligibility for benefits from PBGC.

employer's status and that of the plan. A variety of things may happen to the plan in the event of a merger. For example, the post-merger company may become the new plan sponsor, one company may merge its plan with the other company's plan, or a post-merger company may terminate its plan.⁴ While not as frequent, the plan may become abandoned.

These events present challenges for participants searching years later for their pension benefit, particularly when records are lost over the years and the few remaining are inadequate. Many of these participants contact PBGC during their search, such as the participant described above. It is important for PBGC to trace and review a company's full history to understand the effects of these events on the plan. In addition to a careful review of the company's history, PBGC should also conduct a thorough search of its own records which may contain information relevant to a participant's claim, particularly in cases where the agency trustee the plan or supervised the plan's standard termination.

While the interagency agreement between PBGC and SSA is a useful tool for PBGC to obtain a participant's SSA earnings information as part of its analysis of a benefit claim, there should be a narrow exception in the agreement which allows releasing such information to the participant in certain situations. In this participant's situation, PBGC had the information which the participant needed to search potential successor employers, but would not release it. Because of the lessons learned from this case, OGC, to its great credit, is working with PBGC's Quality Management Department to review the interagency agreement.

A Poignant Conclusion for an 80-year-old Man Seeking a Benefit Over Thirty Years After the Plan's Termination

Another example of the hurdles that remain for participants contacting PBGC to search for their missing benefits was highlighted in the Advocate's 2016 Annual Report. The report detailed a claim by an 80-year-old potentially omitted participant (POP) searching for his benefit from a plan that underwent a standard termination in the mid-1980s.

The regrettable element in this situation is that a very elderly man was taken on an odyssey by PBGC for years while he sought to obtain what he believed was his benefit entitlement, as he had no recollection of receiving a lump sum distribution over thirty years ago. PBGC denied the participant's benefit claim based on a deficient case file in PBGC's Standard Termination Compliance Division's (STCD) possession, yet represented that its decision was reached based on a complete standard termination record.

The participant could not produce tax returns from the mid-1980s to "prove a negative" that he did not receive a lump sum distribution, so without that aged tax documentation from the participant, the agency denied the benefit even though its own documentation was inadequate.

⁴ See <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-employer-merges-with-another-company> for more information on plan mergers.

The decision also found the participant's claim to be time barred under the "doctrine of laches"⁵ based on the participant's inaction in seeking timely payment of the claim from PBGC.

A regulation in place at the time of the plan's termination required that the plan sponsor submit detailed distribution information to PBGC.⁶ However, this information was not available as part of PBGC's standard termination case file, and documentation related to PBGC's final audit of the termination seemed to indicate that the agency never received this information. While gathering information for the participant's appeal, the participant's counsel spoke with various outside parties involved in the plan's termination. Multiple parties stated that there were five copies of a binder containing the detailed distribution information required by the regulation which were distributed to PBGC, the IRS, and other parties, including the actuary at the time of the plan's termination.

Recommendation: PBGC has stated, in multiple public forums, that its audits of plans undergoing standard terminations often uncover that the plans are operated differently than their form.⁷ When this happens, participants can be omitted inadvertently and face an uphill battle when searching for their benefits years later. The lack of available records, particularly in situations where the participant terminated employment many years ago, also contributes to the issues faced by potentially omitted participants.

In this participant's situation, PBGC's case files did not contain the relevant information which could have definitively demonstrated that the plan paid the participant a lump sum. Although the regulation in effect at the time of the plan's termination required that PBGC receive this distribution information, the information was not available when PBGC reviewed this participant's case. Instead, PBGC placed the burden on the participant to produce old tax returns when the agency should have had the distribution information as part of its case file. PBGC needs to move away from requiring participants to produce decades-old tax returns, particularly when the agency should have obtained and retained certain distribution data.

Thanks to the participant's outside counsel, who ultimately located a copy of the information required under the regulation which indicated that the plan sponsor paid the participant a lump sum, we now know that the benefit denial letter reached the right conclusion.⁸ However, the denial was based on inadequate information and questionable reasoning, particularly as it related to the doctrine of laches. Citing the doctrine of laches creates a detrimental and prejudicial precedent for future potentially omitted participants. PBGC coined the term "woodwork

⁵ The doctrine of laches is "defined as neglect to assert a right or claim which, taken together with lapse of time and other circumstances causing prejudice to adverse party, operates as bar in court of equity." Black's Law Dictionary (10th Ed. 2010).

⁶ 29 CFR § 2617.23 (1985 Ed.). The regulation required the plan administrator to submit a statement to PBGC containing certain distribution information. The required information for participants or beneficiaries to whom a distribution was made included name, address, phone number, sex, date of birth, Social Security number, the amount of the benefit provided, the basis for computing the amount, the cost of providing the benefit, and the form of the benefit.

⁷ Plans qualified under section 401(a) of the Internal Revenue Code must operate the plan consistent with the plan's form (the plan documents).

⁸ PBGC's OGC also worked directly with the participant's counsel and the actuary to obtain the entire detailed participant distribution records required by regulation. This information is now part of the standard termination file.

participants” for individuals who “come out of the woodwork” after years to claim a benefit, yet appeared to hinder the ability of these participants to seek a benefit by relying on the doctrine of laches.

PBGC currently collects much less participant distribution information than was previously required under older regulations. For individuals receiving lump sum distributions as part of a plan termination, PBGC’s current Form 501 (Post-Distribution Certification for Standard Termination) requires the plan administrator to attach a copy of the cancelled check or bank statement with the individual’s name and distribution amount.⁹ Requiring submission of a more detailed participant distribution listing would be a minimal burden for plan sponsors who already should have the information available, as it is needed to calculate and pay out lump sums, and could prove useful to potentially omitted participants who seek a benefit many years after a plan’s termination.

It would also be beneficial for PBGC to reevaluate its General Records Schedule to ensure that the current record retention periods for plan records (both trustee and non-trustee plans) are adequate. While PBGC only oversees a standard termination and does not trustee the plan, the agency may be responsible for paying a benefit for a participant inadvertently omitted from the standard termination in the future. Without a long enough records retention period, the burden falls to the participant to prove his or her entitlement to a benefit. Securing these records will go a long way towards facilitating resolution of future claims from potentially omitted participants in a transparent and equitable manner.

Hopeful Expectations: PBGC Positive Strides

Despite lingering challenges faced by participants contacting the agency for assistance, there have been improvements by PBGC, particularly in OBA, with the department’s approach to benefit entitlement claims. As noted in the Advocate’s 2016 Annual Report, OBA continues to take a holistic approach to document review during its case analysis, particularly for cases involving POPs. OBA is moving away from relying solely on tax returns and placing the burden on the participant to prove an entitlement, and is instead making benefit determinations based on the exercise of sound discretion. By using sensible judgment and properly documenting the reasoning of its determination, OBA alleviates the document production burden on participants while also ensuring a complete audit trail, documenting its reasoning and analysis during its review of benefit claims.

OBA has also made positive improvements in its handling of surviving spouse benefit claims when the participant had elected a joint-and-survivor (J&S) or a certain-and-continuous (C&C) type benefit form.¹⁰ Instead of requiring the surviving spouse to fill out an additional application to start his or her surviving spouse benefit, OBA has shortened its process to immediately start

⁹ See <https://www.pbgc.gov/documents/500-instructions.pdf>.

¹⁰ A J&S annuity typically pays a participant a fixed monthly amount for life and, after the participant dies, continues payments to the participant’s spouse or other designated beneficiary for the rest of the beneficiary’s life. A C&C annuity pays benefits for a set period or for a retiree’s lifetime. If a retiree dies before the end of the period chosen, the designated beneficiary will receive the same monthly benefit for the rest of the period. See <https://www.pbgc.gov/about/pg/header/glossary>.

the surviving spouse's benefit upon notification of the participant's death instead of requiring an additional application for benefits.¹¹ This change alleviates the burden on the surviving spouse to provide PBGC with information it already has in its records at a time when the surviving spouse may have a compelling need for the income and be in the process of grieving.

OBA has taken steps to assist participants with filling out their application for benefits. If the participant requests assistance, PBGC will pre-fill out the application form with information obtained from a phone call with the participant. PBGC then sends the pre-filled form to the participant for his or her signature. Since PBGC no longer has a walk-in service for participants to receive assistance with filling out forms, this phone consultation approach provides an alternative means to assisting participants.

Additionally, PBGC has initiated a regulatory action to update and improve its rules for the administrative review of agency determinations under 29 CFR Part 4003. This action is part of PBGC's ongoing regulatory planning and active retrospective review efforts to ensure that the agency provides clear and helpful guidance, minimizes burdens and maximizes benefits, and addresses ineffective and outdated rules. As part of its review, PBGC has been working with the Office of the Advocate on possible improvements. PBGC also intends to draft and eventually publish a notice of proposed rulemaking reflecting the changes, for public comment.

PBGC also published its final rule to update its Missing Participants regulation on December 22, 2017.¹² The final regulation expands PBGC's existing Missing Participants program to cover missing participants in most terminated defined contribution plans, such as 401(k) and profit sharing plans, and certain defined benefit plans that are not currently covered under the agency's existing program. The expansion of the program should increase opportunities to reunite participants and beneficiaries with their missing retirement benefits.

The Advocate previously reported on an initiative between PBGC and the Department of Labor's Employee Benefits Security Administration (EBSA) Chicago Regional office to enable the Chicago Regional office's benefit specialists to actively work with PBGC's missing participants database to reunite participants with their missing benefits. The program has continued throughout 2017 and there is an interest in expanding the program to allow additional EBSA regional offices to participate in locating missing participants. Given the success of the Chicago Regional office's work on this initiative, an expansion of the program provides immense potential for additional participants to be reunited with their missing benefits, particularly when coupled with PBGC's proposed expansion of its existing Missing Participants program.

PBGC continues to meet regularly with participant advocacy groups, furthering communications between the agency and its stakeholders, which was highlighted as a need in the Advocate's 2014 Annual Report. These meetings are a useful forum for the agency to discuss topics of concern to the participant advocacy groups, and provides an opportunity for PBGC to answer any questions about its Annual Report and Projections Report which discuss the solvency of the

¹¹ PBGC does ask the surviving spouse to verify contact information and provide tax withholding and direct deposit information, but otherwise, the process does not require an additional application for benefits by the surviving spouse.

¹² See 82 FR 60800 (Dec. 22, 2017).

single and multiemployer trust funds. The Office of the Advocate commends PBGC's Office of Policy and External Affairs for this continued and sustained effort.

MULTIEMPLOYER PENSION REFORM ACT OF 2014

The Advocate has a limited role under Multiemployer Pension Reform Act of 2014 (MPRA) during the benefit suspension application review process,¹³ and a limited consultative role during the partition and merger application process. During 2017, PBGC consulted with the Advocate regarding two plans' applications for partition. The agency ultimately approved its first partition application under MPRA, providing early financial assistance to a plan covering almost 10,000 participants. It is anticipated that this partition, coupled with a benefit suspension, should enable the plan to avoid insolvency.

These participants in troubled multiemployer plans who contact the Office of the Advocate with questions about MPRA are deeply troubled because they paid into a retirement system with the expectation of a secure retirement in their senior years. Many worked in occupations that contributed to their deteriorating health, limiting future employment options. In the eyes of these participants, laws, regulations, consultants, advisors, fiduciaries, and government agencies, which were supposed to help preserve their retirement benefits, ultimately let them down, allowing cuts to accrued benefits.

The multiemployer pension plan crisis presents a great opportunity for parties to unite in a bipartisan manner to consider options for retirement security for our American workers who labored under and contributed to a promise for a secure retirement in their senior years. America is a country of great resources and ingenuity. Surely, we can come together to provide retirement security for these American workers.

¹³ “Not later than 30 days after a determination by the Secretary of the Treasury ... that the plan is systemically important ... the Participant and Plan Sponsor Advocate ... may submit recommendations to the Secretary of the Treasury with respect to the suspension or any revisions to the suspension.” 29 U.S.C. § 1085(e)(9)(H)(v)(II).

PLAN SPONSOR ISSUES

Sponsors of varying form, including not-for-profits, small businesses, and larger companies, continued to contact the Office of the Advocate during 2017 for assistance in resolving disputes with the corporation. These sponsors had remarkably similar observations about their dealings with PBGC, noting: (1) lack of ease in doing business with PBGC; (2) lack of transparency and certainty in PBGC's actions; (3) lack of timeliness; (4) lack of substantive discussion to facilitate prompt settlement; and (5) lack of effective coordination and cohesion among various PBGC departments. While the case studies that follow describe these continued weaknesses in PBGC's ability to resolve plan sponsor issues efficiently and appropriately, you will also read about the bold and promising initiatives adopted by PBGC to address some of these weaknesses. The agency's willingness to address longstanding shortcomings raised by plan sponsors is attributable to PBGC's leadership team. It is my hope that these initiatives, which hold so much promise, will be carried out in an effective manner to fulfill such promise.

When I served as the executive director of a large public pension fund, I also encountered a lack of collaboration between departments, and little awareness of the need for inter-departmental partnerships. One department would address a narrow aspect of a customer's issue and then hand off the matter to another department, with no coordination or certainty that the "receiving department" understood the issue. There was a lack of awareness by the leadership team regarding these lapses in customer service. Addressing these deficiencies required a change in employee mindset. It required impressing on every employee that they were responsible for the handoff of a customer's issue from one department to another to ensure the issue was being addressed. Fostering a culture of social trust among and between what were once stove-piped departments created a kind of camaraderie that enhanced customer service.

PBGC's leadership can foster the kind of social trust that builds collaborative partnerships between departments that will make plan sponsors' dealings with the agency easier and more transparent, allowing the sponsors to get back to running their businesses. As you read the following case studies, think of how many of the disputes brought to the Office of the Advocate could be resolved by challenging and changing administrative practices that may need to be refreshed and updated.

A Question of Plan Coverage Much Delayed

A plan sponsor contacted the Office of the Advocate after struggling for over one year to receive a refund of premiums from the agency. PBGC had determined that the sponsor's plan was not covered under Title IV of ERISA, and pursuant to instructions in PBGC's determination letter, the sponsor's advisor submitted a written refund request for previously paid premiums. The sponsor's advisor repeatedly contacted the agency by phone and email regarding its request but was unable to resolve the issue. After the involvement of the Office of the Advocate, it was determined that the request had stalled in one department due to a lack of coordination between that department and the appropriate department to provide the sponsor's advisor with a settlement agreement to resolve the matter.

Recommendation: While different departments at PBGC may only be involved with one aspect of an issue, the plan sponsor generally views its interactions with the agency as part of one continuous process. When there is a lack of communication and coordination between departments, it is easy for a plan sponsor matter to fall through the cracks without resolution. Examples like the one detailed above suggest that the agency is still operating in silos.

In response to this plan sponsor matter, PBGC implemented a shared tracking system for premium refund requests related to coverage decisions. While this is a positive step to bring different departments together, there is still a need for a more effective coordination process between departments, as well as a party willing to take responsibility for the tracking process.

The burden cannot fall on the plan sponsor to discern where its matter lies within the agency. A more customer service focused approach is needed which will involve internal coordination and handoffs to ensure matters are addressed in a timely manner, providing for increased transparency during sponsors' interactions with the agency.

Payment of Interest on Plan Sponsor Premium Overpayments to PBGC

This case presents another issue mentioned in previous Advocate Annual Reports which has not yet been addressed by the agency. Although PBGC has the authority under the Pension Protection Act of 2006 (PPA) to pay interest on premium overpayments (on a retroactive basis back to August 17, 2006), the agency believes that it cannot act upon this authority until it issues regulatory guidance.

While PBGC did reduce the occurrence of premium overpayments by no longer requiring an estimated flat-rate premium filing for 2014 and later plan years, there are situations where premium overpayments occurred during pre-2014 plan years but no interest has been provided for the overpayments. There may also be overpayments in situations such as the PBGC coverage issue discussed above, where the sponsor paid premiums for a non-covered plan while it waited for a coverage decision from PBGC, as well as situations when the sponsor estimates its variable-rate premium filing and ultimately overpays.¹⁴

Prioritizing this long-needed regulatory guidance to pay interest on premium overpayments, including on a retroactive basis as permitted by the PPA, provides equity given that PBGC routinely collects interest on plan sponsor underpayments.

Continued Need for the Exercise of Sound Discretion

There is also a need for greater transparency in PBGC's communications with plan sponsors, particularly in cases when the sponsor asks the agency to exercise discretion and judgment permitted under PBGC regulations.

¹⁴ Other potential premium overpayment situations may include overpayments due to the standard termination exemption from the variable-rate premium and where the premium is prorated for a short year, yet the sponsor pays the full premium without knowing the length of the short year. Premium overpayments may also occur in situations where there is an inadvertent mistake that may affect the premium calculation for several plan years, resulting in premium overpayments.

A plan sponsor with two open defined benefit plans contacted the Office of the Advocate upon receiving an unfavorable determination from PBGC regarding its request for a section 4010 waiver. This plan sponsor's smaller plan had fallen below the 80-percent Funding Target Attainment Percentage (FTAP). Even though the sponsor immediately funded the plan to meet the 80-percent threshold upon becoming aware that it was under the threshold, this plan sponsor was still required to submit a costly filing to PBGC under ERISA section 4010.¹⁵

The plan sponsor's advisor requested a waiver of this filing pursuant to PBGC's 4010 regulation, which gives the agency discretion to grant a waiver of the filing requirement as well as the ability to condition any waiver. The sponsor's advisor received a short denial email from PBGC, with no explanation as to the reasoning for the denial. The sponsor's advisor subsequently contacted the Office of the Advocate for assistance regarding the agency's response.

Upon discussing the matter with the agency several times, it was clear that there had been very few cases where PBGC granted a 4010 waiver, despite the discretion available in the regulation. The few examples of granted waivers involved situations where the agency already had the information it would receive in the filing. However, at the request of the Advocate, PBGC reexamined the request and exercised its regulatory discretion to grant a conditional waiver.

Recommendation: While this matter was small compared to more complex and financially significant sponsor disputes, the outcome demonstrates that PBGC can exercise well-reasoned discretion and judgment to address sponsor requests for relief.¹⁶ The Office of the Advocate often works with smaller plan sponsors and not-for-profit organizations to help resolve their issues with the agency. These cases are often complicated and can languish without relief for the sponsor, even when the Advocate becomes involved.

A Languishing Not-For-Profit Distress Termination

A not-for-profit plan sponsor reached out to the Advocate after working with the agency for almost four years regarding the plan's distress termination. The plan sponsor had frozen its plan in the mid-2000s and determined it could no longer stay in operation while maintaining the plan. The sponsor first contacted the agency in 2012 to discuss the distress termination process and subsequently submitted its Form 600—Notice of Intent to Terminate in December 2013. As part of its review process, PBGC asked the sponsor to repeatedly submit financial information (sometimes the same financial information already requested), but then PBGC would "go dark" for months upon receiving the requested information. PBGC finally approved the distress termination in September 2016 with a March 2014 date of plan termination, but issues remained throughout 2017 regarding settling the termination liability.

The Office of the Advocate was recently brought into another protracted distress termination involving a not-for-profit organization. The matter has been pending at the agency for over three

¹⁵ ERISA section 4010 requires certain controlled groups maintaining underfunded plans to report detailed financial and actuarial information to PBGC.

¹⁶ The cost savings to this plan sponsor was small, around \$60,000, but nonetheless a major expense for this company that sponsors two open defined benefit plans.

years without resolution. At the request of PBGC, the sponsor even provided the agency with a settlement offer in May 2017, but there has been no response by PBGC to that offer. Shortly after the Advocate became involved in the case in late November 2017, PBGC finally completed the process to approve the plan termination in late December 2017. Now the negotiations will need to take place to determine the termination liability settlement, and it is hoped that PBGC will soon respond to the settlement offer submitted to PBGC in May 2017.

The delays in resolving this matter with PBGC have led to financial issues for the sponsor. The plan sponsor was denied a much-needed grant by a state agency once the state agency found out that the distress termination was still pending with PBGC. In describing the problem to its counsel, the sponsor noted in an email that “the delays in receiving a decision from PBGC is having a direct impact on the operations and cash flow of [the plan sponsor]. Inquiries from our funding sources about the status of the PBGC matter have become a regular occurrence, and further delays will significantly complicate our efforts to get the funding we need.”

These statements from the sponsor highlight the financial consequences which occur based on the way PBGC manages plan sponsor interactions. The lack of timeliness and substantive dialogue by PBGC adds to costs borne by the sponsor when attempting to resolve an issue with the agency. These costs are faced by all sponsors—not just not-for-profit organizations.

In its request for assistance from its counsel, the sponsor ended its email by stating, “Any assistance in expediting this process [with PBGC] would be greatly appreciated. This way we can put our energy and our resources back to where it belongs—providing much needed services to our most vulnerable populations.”

Recommendation: The Office of the Advocate was told months ago that PBGC was working on a more streamlined process for not-for-profits undergoing a distress termination. PBGC must act to establish that process now.

Having a streamlined process will alleviate the financial burdens associated with prolonged interactions with PBGC, which is particularly important for not-for-profit entities which often receive most of their funding from other government sources. Moreover, these interactions are further delayed by a lack of internal coordination between departments at PBGC. Time is money.

The Advocate’s 2016 Annual Report made the recommendation of developing a system for triggering a management review when cases are open for more than six months. The tracking system is one aspect, but there is no substitute for active management engagement with PBGC financial analysts and attorneys, establishing deliverables and timelines to reach resolution with the plan sponsor.

The Early Warning Program: An Area of Concern for Plan Sponsors

Another area of concern to the plan sponsor community involves the Early Warning Program (EWP). The basis for the EWP is section 4042(a)(4) of ERISA, which permits PBGC to involuntarily terminate a pension plan under certain conditions. Sponsors report that the threat of an involuntary termination of the plan is present in EWP negotiations with the agency, and, in

the view of the sponsor, may result in the sponsor making larger than necessary contributions to the pension plan at the expense of financing their business.

In May 2017, PBGC clarified its EWP guidance posted on its website. This guidance had been updated in December 2016, and many in the plan sponsor community interpreted the update as expanding the scope of the EWP. While the May 2017 update made helpful clarifications regarding the scope of the EWP and added frequently asked questions, it is still vague about situations where PBGC will intervene and request information from the plan sponsor regarding a business transaction.

Sponsors opine that there are no effective constraints on the circumstances in which a plan sponsor can be targeted under the EWP. There appear to be no limitations on what PBGC can request in exchange for not pursuing an involuntary termination of the plan during EWP negotiations, an action that could devastate a company that may already be struggling to recover from a financial setback. Additionally, sponsors are concerned that the EWP may cause a need for the sponsors to interact unnecessarily and more frequently with PBGC when the sponsors engage in certain transactions. These increased interactions often come at a great expense to the sponsor, as they may require the sponsor to obtain multiple counsel and other advisors, and even more importantly, can result in the loss of critical business opportunities.

Recommendation: These sponsor concerns illustrate the need for a substantive analysis of the EWP, a program that may have served the corporation well in its earlier years but now requires a fresh look and comprehensive review. There is a perception in the plan sponsor community that the agency is using the EWP to increase funding requirements beyond the level required pursuant to federal law, but the funding rules are not under the purview of the PBGC. Rather, these rules are set by Congress.

PBGC does not have an incentive to close EWP cases in a timely manner, and sponsors who contact the Advocate for assistance often describe cases that remain open for months and even years without resolution. Without set deadlines for PBGC to respond to the plan sponsor regarding an EWP case, many sponsors are forced to put potentially advantageous business transactions on hold as they wait for PBGC's response.

Hopeful Expectations: PBGC Positive Strides

While certain aspects of PBGC's interactions and dealings with plan sponsors continue to need improvement, the corporation has taken steps to increase transparency and engage in dialogue with sponsors.

PBGC introduced a pilot mediation project which will offer mediation to plan sponsors to facilitate resolution of negotiations in two PBGC program areas: Early Warning Program and Termination Liability Collection Program. Previous Advocate Annual Reports recommended that the agency consider Alternative Dispute Resolution (ADR), consistent with its 1999 ADR policy which recognized ADR as a means to resolve "appropriate disputes in a timely and cost-efficient manner" while providing "faster, less expensive, and more effective of resolution of

disputes that arise with ... the regulated community and others with whom the agency does business.”¹⁷

The pilot has been well-received by the plan sponsor community and has the potential to reduce the time and expense involved when negotiating with the agency. PBGC will evaluate the pilot’s success after one year. The Office of the Advocate supports this important initiative, as it will help bring finality to cases while providing a cost-effective means for dispute resolution.

PBGC has also proposed offering a voluntary pre-filing consultation for plan sponsors considering distress terminations.¹⁸ This informal consultation will provide information about the filing process and ensure the filing of a distress termination application is appropriate given the sponsor’s specific circumstances.¹⁹ The opportunity to informally consult with PBGC has the potential to be beneficial for all parties, particularly plan sponsors facing financial distress, as it may result in time and cost savings. PBGC currently offers informal consultations for plan sponsors considering applying for a partition, and this shift toward providing informal consultations for interested plan sponsors in distress termination cases is a welcome and much more customer-service-oriented change.

These are positive steps that have the potential to change the way PBGC interacts with plan sponsors. The hardworking PBGC staff in the Office of the General Counsel and the new leadership in PBGC’s Office of Negotiations and Restructuring have the full support of the Office of the Advocate as the agency implements service-oriented plan sponsor initiatives that improve sponsors’ interactions with PBGC.

It is my strong hope and desire for PBGC staff to develop a deep sense of personal urgency in servicing the sponsor community who comes to the agency for assistance in solving business problems. This urgency coupled with a strong commitment to social trust that fosters collaboration among and between PBGC departments holds much promise when combined with the above positive strides.

¹⁷ See 64 Fed. Reg. 17696 (Apr. 12, 1999).

¹⁸ 82 Fed. Reg. 45912 (Oct. 2, 2017).

¹⁹ Additionally, “[t]his consultation will assist PBGC and the plan sponsor in exploring whether a waiver of one or more filing obligations is appropriate, identifying potential issues preventing a distress termination of a particular plan, and may indicate that commencement of an agency-initiated termination of the pension plan is warranted.”

PENSION DE-RISKING STUDY

Background

As more plan sponsors shed their pension liabilities through de-risking activities, there are serious concerns about the viability of the voluntary defined benefit system. Plan sponsors asked the Office of the Advocate to commission a study on pension plan de-risking to analyze the underlying causes and drivers of this de-risking activity, focusing mostly on risk transfers, which have the most significant effect on the viability of the system.²⁰ The Office of the Advocate determined the most appropriate use of resources would be to focus the study on PBGC and Congressional actions that may slow de-risking activity.

Through an open procurement process, the Office of the Advocate selected Mercer as a research partner to undertake this study. The goals of the study were to identify the key causes of de-risking activity as well as potential changes that could slow the growth of de-risking activity. The Office of the Advocate is pleased to present the study's findings in the Appendix attached to this report, and anticipates further follow-up on the study results during 2018.

Notable Findings

The de-risking study found that the top factors influencing plan sponsors' propensity towards risk transfer activity are accounting and earnings volatility, balance sheet liability management, funding volatility, and PBGC premiums. Undertaking at least some degree of de-risking activity is extremely common in today's defined benefit plan environment, with over 86% of plan sponsors taking at least some steps to de-risk their pension plans.

This overall de-risking trend is undeniable. Information gathered during the study indicates that decision-makers within most organizations maintaining defined benefit plans are likely considering how they should be de-risking their plan or are already in the process of doing so. While plan sponsors do understand the value that defined benefit plans bring to an organization, these benefits in many cases are outweighed by financial volatility and the increasing costs of PBGC premiums, leading sponsors to consider de-risking activities.

Risk transfer is visibly on the rise with no signs of slowing down.

- 55% of respondents studied believe a lump-sum based risk transfer is likely or very likely in the next two years and 56% believe a retiree annuity buyout is likely or very likely.²¹

There may, however, be some incentives that could potentially slow down the pace of de-risking. The most significant PBGC-related factor driving risk transfer activity is premiums. While PBGC premiums are certainly PBGC-related, they are ultimately set by statute. Flat-rate

²⁰ De-risking activity may consist of "out-of-plan de-risking" or "risk transfer" actions such as lump sum payout offerings, full plan termination, and purchase of insurance contracts, as well as "in-plan de-risking" actions which include liability-driven investment strategies (LDI), plan design changes, and plan closure or freeze.

²¹ Mercer/CFO Publishing 2017 Pension Risk Survey, available at <https://www.mercer.com/our-thinking/wealth/adventures-in-pension-risk-management.html>.

premiums have doubled since 2012 and variable-rate premium (VRP) rates have quadrupled since 2013.

- According to Mercer consultants, 71% of plan sponsors have analyzed the present value of the cost of PBGC premiums compared to the cost of risk transfer activities, which has led to more consideration of such actions. Lowering PBGC premiums would likely have a positive effect of slowing de-risking activity, as 69% of respondents in the study indicated that a material decrease in PBGC premiums would make plan sponsors less likely to implement risk transfer actions.
- This study has found that reducing PBGC premium levels or stemming their rapid growth is likely to decrease de-risking activity, specifically risk transfer.

While not impacting a large number of plan sponsors (less than 10%), PBGC's Early Warning Program is a PBGC-related factor that appears to cause considerable difficulty for plan sponsors in the ongoing maintenance of their defined benefit plans. A number of respondents detailed experiences that required accessing difficult-to-obtain information, additional calculations, and drawn-out and contentious interactions.

Close to 40% of respondents that had PBGC Early Warning Program encounters indicated that these encounters increased the plan sponsors' desire to exit the defined benefit system.

Future Considerations

Increasing risk transfer activity has far-reaching implications for plan participants, plan sponsors, and government and regulatory bodies. These implications may pose an anti-selection problem where healthier sponsors reduce or eliminate their obligation and risk, leaving larger shares of less healthy sponsors with more poorly funded plans in the defined benefit system, which increases the overall risk and exposure to PBGC.

When considering what can be done to stem the growing risk transfer tide, levels of PBGC premiums are undeniably a key factor. This study has found that reducing PBGC premium levels or stemming their rapid growth is likely to decrease de-risking activity, specifically risk transfer.

APPENDIX

HEALTH WEALTH CAREER

PENSION DE-RISKING STUDY

ANALYZING THE DRIVERS OF PENSION
DE-RISKING ACTIVITY

DECEMBER 7, 2017

PREPARED IN PARTNERSHIP WITH THE
OFFICE OF THE PBGC PARTICIPANT
AND PLAN SPONSOR ADVOCATE

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1

OBJECTIVE AND BACKGROUND

As the environment in which pension plans live has evolved over the past decade, defined benefit pension plans are no longer just an important part of an employer's total benefits and rewards program; they are also increasingly a legacy liability with significant impact on a company's financial results. In response to this, more plan sponsors have been looking to reduce their exposure to pension risk through various de-risking strategies. Such strategies span a wide spectrum of options, including plan design, workforce management, liability-driven investments (LDI), and risk transfer.

A plan sponsor's decision to implement pension de-risking is not one made lightly, but a confluence of several factors has led to an increase in such actions, including:

- The evolution of funding and accounting rules.
- Growth of liabilities as the pension system matures, leading to an increase in plan size relative to the overall financials of sponsoring organizations.
- Volatile funded status, driven by falling interest rates and turbulent equity markets environment.
- Competitive pressures as peer companies exit the defined benefit system to move to defined contribution plans.
- The desire in some cases to exit the defined benefit space all together, which is especially true for frozen and closed plans.

These various forms of risk reduction can be more broadly defined as “out-of-plan de-risking” or “risk transfer” and “in-plan de-risking”, respectively.

Exhibit 1 – Examples of De-Risking Techniques

RISK TRANSFER (OUT-OF-PLAN DE-RISKING)	IN-PLAN DE-RISKING
Lump sum payout offerings	Liability-driven investment strategies ¹ (LDI)
Purchase of insurance contracts (buy-out)	Plan design changes such as account-based formulas or variable annuities
Full plan termination	Plan closure or freeze

A more recent stimulus for intensifying de-risking activity is the steep increases in Pension Benefit Guaranty Corporation (PBGC) premiums. These increases have served as a significant catalyst for de-risking, specifically via risk transfer activity. The increased PBGC premiums have “tilted the scales” to make risk transfer look like a more cost-effective approach compared to in-plan solutions such as LDI. Eliminating benefit obligation and participant headcount allows sponsors to capitalize on short term and ongoing savings while simultaneously reducing risk.

Increasing risk transfer activity has far-reaching implications for plan participants, plan sponsors and government and regulatory bodies. These implications include:

- An anti-selection problem whereby healthier plans eliminate their obligation and risk, leaving larger shares of poorly funded plans in the defined benefit system, increasing overall risk to the PBGC.
- A reduction in the overall size of the private defined benefit system, leading to questions about sustainability.
- Participant exposure to additional risk including longevity risk and inadequate retirement income risk – specifically in the case of lump sum risk transfer programs.

For the PBGC, this shifting landscape represents a fundamental change to the dynamics of how private pensions are insured in the US. While PBGC premiums are set by statute, the PBGC’s

¹ This includes insurance solutions (“buy-in”), which are prevalent in the UK but relatively uncommon in the US. A buy-in is an insurance contract that transfers risk for a subset of participants to the insurer. However, in contrast to a buy-out, the participants remain in the plan and the contract is held as a plan asset. Such arrangements are relatively unattractive to plan sponsors in the US because the sponsor must continue to pay PBGC premiums on covered participants.

financial projections are generally analyzed by assuming the pension landscape remains relatively stable over time, and without anticipating future risk transfer activity. The exit of plans – either in full or in part – reduces future premiums and threatens to undermine the ongoing viability of the insurance program. Even worse, it is often plans that are well funded that are more likely to fully terminate or implement risk transfer strategies, potentially leaving the PBGC to insure an increasingly unhealthy pension universe with a shrinking premium base.

Furthermore, a declining defined benefit universe threatens the very mission the PBGC was set out to accomplish. The PBGC was created by the Employee Retirement Income Security Act of 1974 with a mission of enhancing retirement security by preserving the voluntary private pension system and protecting the benefits of workers and retirees.

In light of this noticeably changing pension environment, the Office of the PBGC Participant and Plan Sponsor Advocate (OPPSA) has partnered with Mercer to conduct a study to analyze the underlying causes and drivers of pension de-risking activity, with a particular focus on factors that are related to the PBGC as well as those under Congressional jurisdiction.

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STUDY METHODOLOGY

Findings in this report are based on material collected as part of this study, previously conducted surveys and information in various Mercer databases. The following are the key sources of information used to develop the conclusions posed in this report:

- **Results from the 2011, 2013, 2015 and 2017 Mercer / CFO Research Pension Risk Surveys** – Biennial surveys are conducted by Mercer in conjunction with CFO Research, with the most recent survey completed in 2017. Responses are collected mostly from CFOs, CEOs and Finance Directors, and encompass a wide range of plan sponsors.²
- **Information from a set of discussion topics distributed internally to Mercer consultants on various de-risking issues** – Responses were received from 154 Mercer consultants. Consultants were tasked with reflecting on the discussion topics based on their in-depth knowledge of their clients' plans, financial circumstances and past and present deliberations regarding de-risking activities. In addition to the discussion topics, information was collected on plan status, size, funded status and organization ownership structure and industry. Discussion topics included general de-risking issues as well as more specific drill-down into PBGC premiums and other PBGC programs and reporting requirements. Consultants were asked to respond to these topics based on their clients' view of these issues.³ Plan specific details were not shared externally.
- **Historical information in Mercer's databases from:**
 - › **PBGC Comprehensive Premium filings for years 2012 to 2016**
 - › **IRS Form 5500 filings for years 2011 to 2015**

² The 2017 survey was comprised of 175 plan sponsors, including publicly-traded, privately-held, and not-for-profit sponsors holding DB assets ranging from \$100 million to over \$10 billion.

³ A natural question may be why plan sponsors were not surveyed directly for this purpose. Legal counsel expressed concern that a mass survey of plan sponsors on behalf of OPPSA may violate the Paperwork Reduction Act of 1980. To address this, the approach above was used instead. We believe this approach yielded insights that were just as valuable as surveying plan sponsors directly, given that our consultants have intimate knowledge of their clients' de-risking decisions and reasons.

› **Publicly disclosed de-risking actions**

PBGC-related factors were an important element of this study. In this context, it is important to make the distinction that not all PBGC-related factors are formally regulated by the PBGC. As an example, PBGC premiums, which are a large part of the discussion in this report, are certainly PBGC-related, but are ultimately set by statute.

3

KEY FINDINGS

DE-RISKING IS ON THE RISE, ESPECIALLY RISK TRANSFERS

In today's defined benefit pension environment, it is evident that most plan sponsors have employed at least some type of de-risking strategy. The de-risking journey often starts with plan design changes such as amending plan formulas to shift risk or, more commonly, closing the plan to new entrants and/or freezing ongoing benefit accruals entirely for some or all employees. An overwhelming majority of plan sponsors have already taken this step towards de-risking, with many doing so many years ago; the result is that the current single-employer defined benefit universe covers a smaller and smaller percentage of the workforce.

Another often common step for plan sponsors has been to implement risk reduction strategies through modifying investment policy. Such tactics include dynamic investment policies that adjust the plan's asset allocation based on funded status triggers, liability-driven investment strategies and asset-liability duration-matching policies.

Either in conjunction with other de-risking activities or as standalone measures, many plan sponsors have also employed various risk transfer activities that eliminate liability and participant headcount. Most commonly these strategies include lump sum payments and purchase of "buy-out" insurance contracts.

The overall trend is undeniable. Regardless of the method used, it is clear that if an organization maintains a defined benefit pension plan, the data supports the fact that decision-makers within that organization are likely considering how they should be de-risking their plan or are already in the process of doing so.

Our responses from Mercer consultants indicated that over 86% of plan sponsors have taken at least some steps to de-risk their pension plans.

At least 80% of respondents in the 2015 and 2017 CFO surveys indicated that they were either considering a de-risking strategy or already had one in place.

While broad de-risking activity continues to increasingly permeate the defined benefit space, the nature of de-risking activity is also evolving. Growing trends for risk transfer activity vastly outstrip growth in “in-plan” de-risking solutions. This is an indication that plan sponsors are now more likely to remove obligations from their plans rather than maintain and manage liability and risk within their plans – leading to large numbers of liabilities and participants being transferred out of defined benefit pension plans.

Increase in risk transfer through lump sums⁴ based on CFO surveys



Increase in dynamic de-risking⁵ based on CFO surveys – a much more modest change



Nearly half of Mercer consultants indicated that plan sponsors had previously implemented a terminated vested lump sum offering or retiree annuity buyout.

Risk transfer is visibly on the rise with no signs of slowing down – risk transfer continues to be top-of-mind for many plan sponsors as a majority indicate that risk transfer activity is likely in the near future. Additionally, there is a commonly expressed sentiment that risk transfer transactions may increase if interest rates rise materially, as many plan sponsors would like to undertake such activity, but are either not well funded enough or perceive risk transfer as “too expensive” in today’s environment.⁶

55% of 2017 CFO survey respondents believe a lump-sum based risk transfer is likely or very likely in the next two years. 56% of 2017 CFO survey respondents believe a retiree annuity buyout is likely or very likely.

⁴ This data point refers to all lump sums, including plan amendments to incorporate permanent lump sum features for active participants.

⁵ Dynamic de-risking is an investment strategy that reduces the plan’s risk as funded status improves.

⁶ According to the discussion topics distributed to Mercer consultants as part of this study.

FINANCIAL VOLATILITY AND THE RISING LEVEL OF PBGC PREMIUMS ARE DRIVING RISK TRANSFER ACTIVITY

The discussion surrounding risk transfer activity involves a number of key drivers. Topping the list of factors influencing plan sponsors' propensity towards risk transfer activity are:⁷

- Accounting and earnings volatility
- Balance sheet liability management
- Funding volatility
- PBGC premiums

These areas continue to evolve and command the focus of decision-makers. Falling interest rates and turbulent equity markets have placed additional focus on balance sheet and earnings volatility. Similarly, funding volatility is a consistent area of concern, but in recent years, has been somewhat mitigated by several rounds of legislation offering funding relief to sponsors. Nevertheless, the notion of looming future cash contributions for underfunded plans, possibly at financially difficult times for the company, is a continuous and ominous concern for many plan sponsors.

PBGC flat rate premiums have doubled since 2012, and variable rate premium rates have quadrupled since 2013. As a result, this is an area of particular concern for sponsors, as the magnitude of increase has made this impossible to ignore. Furthermore, there are no indications of a slowing in these escalations, with premium rates in the coming years continuing to be pegged to inflation. Such increases magnify the advantage of undertaking risk transfer activity to reduce plan underfunding and participant headcount as a means of substantially decreasing the ongoing cost of maintaining a pension plan.

There is some economic justification for growing the flat rate premium with inflation each year. However, the inclusion of an inflationary increase on the variable rate premium rate – already expressed as a percentage of underfunding – makes little sense to plan sponsors. Taken to its

⁷ According to the discussion topics distributed to Mercer consultants as part of this study.

logical extreme, the variable rate premium rate will eventually exceed 100% under the current policy, resulting in a premium due that is larger than the plan's underfunded liability.⁸

69% of Mercer consultants indicated that a material decrease in PBGC premiums would make plan sponsors less likely to implement risk transfer actions.

According to Mercer consultants, 71% of plan sponsors have analyzed the present value of the cost of PBGC premiums compared to the cost of risk transfer activities, which has led to more consideration of such actions.

Beginning in 2014, the percentage of plan sponsors offering lump sums to terminated vested participants more than doubled based on analysis of IRS Form 5500 data. This coincides with the timing of PBGC variable rate premium (VRP) increases and the understanding that future flat rate and VRP increases were imminent.

THE CURRENT STRUCTURE OF PBGC PREMIUMS CREATES INCENTIVES FOR RISK TRANSFER FOR CERTAIN SPONSORS

The current structure of PBGC premiums – specifically the application of the variable rate premium (VRP) cap – creates strong (and presumably unintended) incentives for sponsors to reduce headcount. For a plan sponsor at the variable rate premium cap, 2018 premiums can be reduced by about \$600 per participant removed from the plan. And the savings continue at an increasing level for each year the plan remains at the cap. This structure – while well intentioned to limit the premiums paid by a given employer – encourages outcomes that appear contrary to the overarching goals of the PBGC.

⁸ A percentage-based premium inherently reflects inflation because the premium is expressed as a percentage of unfunded liability. Under the current structure, the percentage itself is subject to inflation adjustments. Eventually, this structure will result in a variable rate premium that exceeds 100% of the plan's underfunding.

Exhibit 2 – Example of Incentives Created by Hitting VRP Cap

PRIOR TO RETIREE BUY-OUT		AFTER RETIREE BUY-OUT	
Participant Count		Participant Count	
Active	5,000	Active	5,000
Terminated Vested	5,000	Terminated Vested	5,000
Retiree	10,000	Retiree	0
Total	20,000	Total	10,000
2018 PBGC Premium Calculation		2018 PBGC Premium Calculation	
Flat rate premium (\$74 x total participant count)	\$1,480,000	Flat rate premium (\$74 x total participant count)	\$740,000
Variable rate premium assuming cap hit (\$523 x total participant count)	\$10,460,000	Variable rate premium assuming cap hit (\$523 x total participant count)	\$5,230,000
Total premium	\$11,940,000	Total premium	\$5,970,000
		Annual savings due to risk transfer activity (all else equal)	\$5,970,000

Note: In 2018 it takes \$13,763 per capita underfunding to hit the variable rate premium cap.

As an example, in this scenario, a plan not at the cap would only see savings of \$740,000.

For plan sponsors hitting the VRP cap, the incentive of reducing participant headcount to directly reduce PBGC premiums is abundantly clear. For a plan at the cap, the incentive to reduce headcount is so powerful that all types of risk transfer will appear attractive, particularly when focusing on participants with smaller benefits. Information collected as part of this study indicates that higher fixed premiums (whether flat rate or fixed due to the VRP cap) drive more risk transfer activity.

65% of Mercer consultants indicated that sponsors would be more likely to implement risk transfer activity if flat rate premiums were materially higher and VRPs were materially lower.

⁹ Savings may be greater than or less than \$740,000 to the extent the annuity purchase price is more or less than the PBGC vested liability of the participants covered, and depending on the plan’s funded status.

40% of Mercer consultants indicated that sponsors would be less likely to implement risk transfer activity if the cap on VRPs were removed, even if the total amount of premium paid was unchanged.

However, note that this analysis focuses solely on the impact of risk transfer activity. When evaluating the appropriateness of the VRP cap, it is critically important to also consider the broader significance of the VRP cap. For severely underfunded plans, a change in the PBGC premium structure to eliminate the VRP cap could result in debilitating levels of PBGC premiums, ultimately endangering the plan sponsor's solvency or incentivizing these plans to leave the pension system entirely. The influence of premiums on plan sponsor decisions, and the resulting long-term effects on plan participants and the defined benefit system as a whole must be considered in any decisions regarding PBGC premium structure.

OTHER PBGC-RELATED FACTORS ARE SIGNIFICANT PAIN POINTS FOR SOME, BUT GENERALLY NOT WIDE-SPREAD ENOUGH TO DRASTICALLY IMPACT RISK TRANSFER ACTIVITY LEVELS

By far, the most significant PBGC-related factor leading to risk transfer activity is premiums. Still, a number of other PBGC-related issues present significant burdens for the plan sponsors they impact. This is because PBGC premiums impact all plan sponsors to some degree, whereas other PBGC-related factors may only affect a minority of sponsors. Nonetheless, there is opportunity for the PBGC to improve plan sponsor interactions, as some of these interactions drive an increased desire for the sponsor to exit the pension system.

Other PBGC-related factors examined include:

- Penalties
- Asymmetry of interest payments (i.e. the PBGC charges interest on underpayments but does not provide interest on overpayments)
- Early Warning Program encounters
- Plan termination encounters
- Reporting requirements (e.g. 4010, Form 10)
- 4062(e) funding

Of these factors, Mercer consultants broadly indicated that PBGC penalties and reporting requirements would not impact the likelihood of implementing risk transfer activity.

While not impacting a large number of plan sponsors (less than 10% based on responses from Mercer consultants), the PBGC Early Warning Program is another PBGC-related factor that appears to cause considerable difficulty for plan sponsors in the ongoing maintenance of their defined benefit plans. A number of Mercer consultants detailed experiences that required accessing difficult-to-obtain information, additional calculations and drawn-out and contentious interactions.

Of Mercer consultants that had PBGC Early Warning Program encounters, close to 40% indicated that this increased the plan sponsor's desire to exit the defined benefit system.

THE DEFINED BENEFIT VALUE PROPOSITION IS CHANGING AND PLAN TERMINATION IS OFTEN THE END GOAL

Over the last decade or so, a very noticeable shift from defined benefit plans to defined contribution plans has occurred. The closing and/or freezing of many defined benefit plans as a first step in the de-risking journey has left behind a retirement system that is heavily weighted towards defined contribution plans. The ensuing reality for many plan sponsors is that their pension plan represents a significant amount of risk – especially for sponsors with large plans relative to the company size – but provide little benefit to the majority of the active employee population.

This common phenomenon, along with increasing competitive pressures of industry-wide movements away from defined benefit plans, has changed the way many plan sponsors evaluate risk transfer activities – participant impact is less of a concern in the decision to implement risk transfer activity because of the overwhelmingly powerful and broad changes in the outlook on defined benefit plans. These broad changes in outlook also stem from the changing preferences of employees, who have come to value defined benefit plans less over time. The result is that when it comes to decisions regarding implementing risk transfer activity, the primary areas of focus are financial impact, management consensus, data quality and public perception.¹⁰

Only 12% of Mercer consultants indicated that a decision to not implement risk transfer action was due to concern over impact on participants.

According to the 2017 CFO survey, only 28% of plan sponsors have not implemented a terminated vested lump sum offering because of participant impact concerns. Only 22% regarded participant impact concerns as the main reason for not purchasing annuities for retirees.

For many, de-risking is viewed as a journey – one that requires a number of smaller steps, but has a final destination of plan termination. As de-risking has risen to the forefront of plan sponsor

¹⁰ According to the discussion topics distributed to Mercer consultants as part of this study.

attention, so has the examination of possible future plan terminations. For closed or frozen plans moving further along their individual de-risking journeys, plan termination often seems to be an inevitable destination. Some plan sponsors who are far along this path believe not much can be done to reverse their trajectory.

The number of sponsors considering plan termination in the next ten years has increased from 47% to 59% based on the 2015 and 2017 CFO surveys.

Nevertheless, the outlook is not universally grim. While the view of pension plans may have changed for many, for companies that still maintain defined benefit plans with ongoing accruals, the value they bring to the organization is significant. Similarly, employee appreciation for a pension benefit and the ability to use the plan as a workforce management tool are important factors in the argument against plan termination.

Over 45% of Mercer consultants indicated that sponsors are not considering terminating their plans because either employees appreciate the plan or the plan is helpful for workforce management.

These findings underscore the fact that plan freezes and risk transfer are not decisions made lightly by plan sponsors. Sponsors see and understand the value of these plans – but often feel the benefits are outweighed by financial volatility and the increasing cost of PBGC premiums.

INDUSTRY, PLAN SIZE, AND FUNDED STATUS INFLUENCE LEVELS OF DE-RISKING ACTIVITY

Industry-wide trends have a clear impact on the levels of de-risking action. Organizations often seek to collect information on peer behaviors prior to implementing de-risking – commonly performing benchmarking studies to understand how benefit levels compare and inquiring about publicly announced risk transfer transactions. The result is that there are frequently strong trends within particular industries – with some industries having a greater propensity towards de-risking than others.

Mercer consultants provided information on plan sponsors within a number of different industries. The Healthcare and Auto/Industrial/Manufacturing industries had the highest percentage of sponsors taking at least some de-risking steps. Energy/Utilities and Food/Beverages/Consumer Packaged Goods similarly had fairly significant proportions of sponsors taking at least some de-

risking actions. Financial Services/Real Estate had the lowest share of sponsors taking de-risking steps.¹¹

Exhibit 3 – Percentage of Plan Sponsors De-Risking by Industry

INDUSTRY	PERCENTAGE OF SPONSORS TAKING AT LEAST SOME DE-RISKING STEPS
Auto/Industrial/Manufacturing	94%
Healthcare	92%
Energy/Utilities	82%
Food/Beverages/Consumer Packaged Goods	76%
Financial Services/Real Estate	73%

Plan size and funded status also play an important role in de-risking decisions. According to Mercer consultants, well-funded plans are more likely than poorly funded plans to undertake de-risking actions. In many cases, this is because poorly funded plans are restricted from utilizing certain types of risk transfer by statute. In other cases, underfunded plans are hoping to close the gap through investment returns prior to reducing risk.

Similarly, the size of the plan in relation to the overall size of the organization impacts the prospect of taking de-risking steps. If the plan is immaterial to the overall company size, de-risking is less of a focus. On the other hand, plans that are large relative to the overall enterprise are likely to garner more scrutiny, often leading to increased de-risking activity. Some of the earliest movers in the risk transfer space were plan sponsors with very large pension liabilities relative to their balance sheet – in some cases, the pension liability was larger than the firm’s market capitalization.

¹¹ Based on industries with at least ten Mercer respondents from the discussion topics distributed to Mercer consultants as part of this study.

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CONCLUSIONS AND FUTURE CONSIDERATIONS

Changes that have taken place in recent history have indisputably altered the defined benefit pension landscape. De-risking is at the forefront of most discussions regarding pension plans as sponsors now focus more and more on how they can manage the uncertainty that surrounds these plans. These changes originally stemmed from concerns about financial volatility, but have been noticeably accelerated by significant increases in PBGC premiums.

When considering what can be done to stem the growing de-risking tide, levels of PBGC premiums are undeniably a key factor. This study has found that reducing PBGC premium levels or stemming their rapid growth is likely to decrease de-risking activity, specifically risk transfer. A reduction in future PBGC premium levels would also likely help curb the unintended incentives created when sponsors hit the VRP cap by lowering the likelihood that the cap would be hit in the first place.

A reduction in future PBGC premiums would have a significant beneficial impact on preserving the remaining plans in the defined benefit pension universe.

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