PENSION RIGHTS CENTER

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Statement of Norman Stein

On Behalf of the Pension Rights Center

Before the ERISA Advisory Council

On the Subject of

29 Fed. Reg. 2509.95-1 and Risks to Participants of Pension-Risk Transfers

Submitted on July 10, 2023

This statement is submitted on behalf of the Pension Rights Center. Founded in 1976, the Pension Rights Center is a national nonprofit, nonpartisan consumer organization committed to protecting and promoting the retirement income security of workers, retirees, and their families. For the past 47 years, the Center has helped individuals receive and retain the retirement benefits they have earned, educated them about their rights, and worked to improve the nation's retirement programs. In addition, with support from the Administration for Community Living, PRC provides direct services to more than 2,000 individuals annually, as well as serving as the technical advisor for six regional pension counseling and information projects covering 30 states, which provide hands-on help to individuals with retirement income problems. PRC's work helping individuals informs our policy work and helps us to identify systemic problems in the private pension system, including issues that affect workers and retirees in pension risk transfers.

The recently enacted Secure 2.0, a potpourri of amendments to ERISA, includes a provision that directs the Department of Labor to review its guidance relating to the fiduciary standards applicable to ERISA fiduciaries in their selection of annuity provider for a defined benefit plan, to consult with the ERISA Advisory Council on those issues, and to determine whether amendments to the guidance are warranted.[1] The review and consultation are to include "an assessment of any risks to participants.[2]"

The two principal situations in which defined benefit plan fiduciaries select annuity providers subject to the DOL guidance are (1) standard plan terminations, in which the plan transfers plan liabilities to an insurer in anticipation of the end of the plan's continuing legal existence; and (2) limited risk transfers, often referred to as de-risking transactions, in which a plan transfers the liabilities of a subgroup of participants but retains liabilities for other participants. In both situations, the plan contends that it has no further responsibilities for the transferred benefit liabilities[3] and the insurer argues that its responsibilities are found solely in the annuity's contractual language, state law and state insurance regulation.[4]

Over the last fifteen or so years, we and the counseling projects have been contacted by thousands of workers, retirees, and beneficiaries who have been concerned by these benefit transfers from ERISA-regulated defined benefit plans to state-law-governed insurance companies. Their concerns cross many issues, from risk of benefit non-payment to the reliability and business practices of unfamiliar new providers, from the nature of state insurance regulation to the loss of ERISA rights. Our own analysis has indicated that these concerns are justified and that the issues they raise require far more independent study and evaluation than they have received to date. And the pace of change in the industry—both in aggressive new entrants in the

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[1] SECURE 2.0, Section 321, (1).
[2] Id. at (2)
[3] See 29 C.F.R. § 2510.3-3(d)(2)(ii)(1)-(2).
[4] See MetLife fights DOL subpoena over missing participants, at https://www.mercer.com/insights/law-and-policy/metlife-fights-dol-subpoena-over-missing-participants/

pension risk transfer business and in the increased frequency of transactions—make this an issue of pressing urgency. The Pension Rights Center thus commends the Advisory Council for inviting these comments from the public and for holding an all-day public hearing on the issue.

We want to make an initial additional point, which we believe both a plan sponsor and a plan fiduciary should consider, even if the law does not mandate its consideration, which is the distress and emotional upheaval that participants experience during a risk transfer. They watch as their earned benefits under a retirement plan are being transferred to a commercial insurer. The plan and administrative apparatus with which they are familiar and the generous PBGC guarantees that they understand and on which they have relied for decades, disappear in favor of a new entity that they did not choose and an arcane system of state regulation and state insurance guarantee associations that they do not understand.

Our further comments proceed as follows: first, a brief ERISA history of liability transfers from pension plans to private insurance companies; second, a discussion of the long lag time between the movement of liabilities from plan to insurer and the conclusion of the transaction in the actual real world, which is not until the death of the last annuity payment to the last surviving beneficiary or participant; third, a standard for evaluating annuity providers that we believe better captures the risks of liability transfer to participants than the standard the Department adopted in 1995; and fourth, some specific recommendations for ideas that might be included in a revision of IB 95-1, including actions that fiduciaries should ordinarily undertake when selecting an annuity provider.

1. A Brief History of Defined Benefit Liability Transfers Under ERISA.

Private retirement plans have long held contracts issued by insurance companies and since ERISA those contracts are typically categorized as plan assets.[5] The topic currently being considered by the Advisory Council deals with a different issue: a plan transfers benefit liabilities to an insurer to extinguish the plan's future obligations to participants.[6] The issue initially arose in 1974 when ERISA created standards for terminating a plan with assets sufficient to pay "basic benefits," essentially most vested benefits up to PBGC guarantee levels. The statute required that a terminated plan pay its basic benefits but did not specify a procedure for doing so.

Prior to ERISA, terminating plans had a variety of options to meet their benefit obligations, including establishing a wasting trust or similar fund with a third party, paying participants cash equal to their pro-rata share of benefits, or purchasing annuity contracts from insurance companies to pay future benefits.[7] After ERISA's passage, the PBGC required terminating plans to purchase annuity contracts, although a plan could offer a participant an option to take the benefit in lump sum form on plan termination if the plan included, or was amended to include, such an option. Interestingly, the PBGC initially took the position that its benefit guarantees would apply to these annuity contracts, a position that it reversed in 1990. ERISA was later amended to require specifically that terminating plans transfer their benefit obligations to insurers (unless pursuant to the plan, a participant elects a lump sum commutation of the benefit).[8]

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[5] See Dan M. McGill, Fundamental of Private Pension Plans (1955), Chapter 3.
[6] See note 3, supra.
[7] See McGill, supra note 5, at 121
[8] ERISA § 4021(b)(3).

In the last decade or so, ongoing pension plans also began transferring some (but not all) benefit obligations to insurance companies (generally for a group of deferred vested participants, participants with frozen benefits, or participants and beneficiaries in pay status).[9] Courts have generally held that such transfers, if accompanied by distribution of the contract, policy, or certificate to the individual, end the individual's participation in the pension plan and transfer the plan obligations to the insurance company.[10] These transactions are often referred to as pension risk transfers or de-risking transactions and in the ten years from 2012 through 2022, private pension plans engaged in 4,487 such transactions, with an aggregate cash flow of over $272.6 billion from ERISA-governed pension plans to private insurance companies.[11] Given that interest rates are currently at a 20-year high, which reduces the cost of pension risk transfers, we expect to see this trend continue if not accelerate. Indeed, 2022 marked a new peak in such transfers, with over $50 billion transferred out of plans.

Courts have held that a decision to terminate a plan, or to amend a plan to authorize it to engage in a pension risk transfer, is a settlor/business. The actual steps taken to execute hat decision, however, including the selection of the annuity provider and the negotiation of the contract with the annuity provider, are fiduciary decisions.

The Department issued Interpretative Bulletin 95-1 to provide guidance on the evaluative framework and considerations that a fiduciary should bring to the process of selecting an annuity provider. Interpretative Bulletin 95-1 instructed fiduciaries who are evaluating annuity providers to conduct an objective, thorough, and analytical search and provided a non-inclusive list of six factors that a fiduciary should consider. The bulletin further cautioned that a commercial rating

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[9] See https://www.aon.com/insights/reports/2023/us-pension-risk-transfer-market-insights).
[10] See, e.g., *Lee v. Verizon,* 837 F.3d 523 (2016).
[11] See note 9, supra.

of the insurer alone was not a sufficient basis for the fiduciary to select an annuity provider, and indicated the few situations in which a fiduciary could select a less expensive annuity over a "marginally safer" annuity. The IB also cautioned that the plan fiduciary could not justify the selection of a lower priced annuity on a determination that the plan lacked sufficient assets to purchase the safest available annuity. A plan without the resources to purchase the safest available annuity could not, then, transfer its liabilities to a less safe annuity provider.

The Department, when it issued the notice, indicated that it had considered also revising minimum standards for an annuity provider, but ultimately "determined that no regulatory action should be taken *at this tim*e to amend the minimum standards (for an annuity)."[12]

The Department initially took the position that IB 95-1 applied to a fiduciary selection of an annuity on behalf of either a defined benefit or an individual account plan. Congress, though, in the Pension Protection Act of 2006, directed the Department to amend its regulations to clarify that the safest available annuity requirement does not apply to the selection of an annuity provider in an individual account plan. The Department complied with the PPA and retitled IB 95-1 to limit its principles to the selection of an annuity for a defined benefit plan.

2. A Brief Note About Time: From A Plan's Transfer of Liabilities to an Insurer until the Death of the Last Surviving Beneficiary.

When a plan transfers liabilities to an insurer in a pension risk transfer or a complete plan termination, it is making a one-time decision that will have consequence for retirees, workers, and their beneficiaries for an extended period, almost certainly exceeding half a century.[13] This is the landscape that a fiduciary should survey when choosing an annuity provider and

[12] Interpretative Bulletins Relating to the Employee Retirement Income Security Act of 1974, Action on Interpretative Bulletin No. 95-1 (Feb. 28, 1995), at page 4.
[13] The last veteran with a Civil War pension lived until 1956 and the last pension beneficiary of a Civil War veteran lived until 2008.

negotiating the terms of the annuity contract and that government policymakers should consider when they craft a regulatory framework to guide the fiduciary and protect the plan's participants and beneficiaries.

This insight is consequential. First, it means that fiduciaries should try to anticipate possible future changes in insurance company practices, in investment markets, in insurance company boardrooms, and in insurance regulation and its increasing globalization. Dependence on a company's individual history of good stewardship or prudent investing and competent administration is not a sufficient basis for selecting an insurer. Rather, the fiduciary should anticipate the possibility of change and negotiate contractual provisions that protect against risks that today may seem slight or remote. And regulators must craft policies that help focus the fiduciary's attention on these factors.

Regulators should also be aware that ERISA's civil remedies to address fiduciary violations that fail to consider future risks may not be satisfactory. First, there are limitations period issues: a civil action that today seems premature because future problems seem too speculative may be too late when future problems do materialize because of ERISA's statute of limitations. In some cases, in fact, the fiduciary may no longer be in existence. Moreover, the amount of potential liability would likely swamp the financial capacity of most fiduciaries. Finally, it is far better for everyone to have a fiduciary system that protects participants in the first instance as opposed to a civil liability system that attempts to compensate participants after an injury occurs. And that means creating a system that creates strong contractual protections against contingent future risks.

3. The Standard for Selecting an Annuity Provider

In IB 95-1, the Department indicated that the fiduciary "must take steps calculated to obtain the *safest annuity* available" (emphasis added) unless it is clearly in the interest of participants and beneficiaries to do otherwise. While we believe that the safest available annuity is a necessary component of a protective standard, we also believe it is not sufficient. Part of an ERISA fiduciary's duty in removing a plan's future responsibilities to ensure a participant's benefit should include replicating as much of ERISA's protective scheme as possible. This should require (i) some form of additional long-term assurance that a participant's benefit will be paid up to ERISA guarantee levels even in the event of an insurer's insolvency, without missed benefit payments; and (ii) negotiation with the annuity contractor for contractual provisions designed to replicate ERISA's rights and protections that might otherwise by sacrificed on the transfer of the plan's liabilities to an annuity provider.

4. Protecting Participants and Replicating ERISA Protections

A. Benefit Guarantees.

If an ERISA-regulated defined benefit plan lacks the assets to satisfy its benefit obligations, the participants have two protections: first, the employer may have future contribution obligations to the plan, even though the plan at the moment is underfunded; second, if the plan terminates, the Pension Benefit Guarantee Corporation will take over the plan and ensure the payment of benefits at least up to its benefit guarantees.[14]

[14] The PBGC asset allocation provisions, however, can result in payments in excess of the guarantees for participants who were or could have been in pay status at least three years before the date of plan termination. See ERISA § 4044(a)(3).

In the case of an insurance company insolvency, the state insurance regulators will attempt to rehabilitate the insurance company, perhaps transferring some assets and liabilities to other insurance companies, but if those efforts are unsuccessful, the insurance company will be liquidated. Losses of participants are covered up to limits by state guaranty associations, which are private associations comprised of insurers doing business in a state. On insurer insolvency, the insurers are assessed a charge so that participants will be made whole up to specified maximum limits, which vary from state to state. The limits are per individual, so an individual who has multiple policies from an insurer is at a disadvantage. Generally, each state covers losses incurred by residents of that state. The limits are expressed as present value amounts for annuities and the present value limit in most states is only $250,000.

The PBGC guarantees typically exceed state guaranty association limits. The PBGC program is prefunded, while the state programs are not. In addition, the PBGC is a single national program with an excellent record of avoiding temporary benefit interruptions when it takes over a plan. We believe that the substitution of the state guaranty association programs for PBGC coverage leaves pension plan participants and their families at a disadvantage and further believe that plan fiduciaries who transfer benefit obligations to insurers should be required to purchase reinsurance from another carrier (unrelated to the primary insurer) to compensate for that loss of coverage.

B. ERISA Protections.

ERISA provides important protections to employees and retirees in pension plans. And plans are subject to annual reporting requirements, and to regulatory, investigative and enforcement action by the DOL, IRS and PBGC. In addition, plans are administered by statutory fiduciaries with the duty to act solely in the interests of participants. This is not, of course, typically true in insurance contracts. Moreover, a plan sponsor will generally have more accurate and more current information about active employees and their marital status than an insurance company to which plan benefits have been transferred. We urge the Department of Labor to expand IB 95-1 to expand a fiduciary's responsibilities beyond selecting a safest available annuity to include negotiating participant protections that replicate ERISA protections. Among the provisions that should be negotiated[15]:

(i) The insurer shall provide an annual benefit statement to a participant. This can be especially important to maximize the likelihood that a former plan participant with a deferred annuity is kept aware that the insurance company is holding a deferred benefit for her.

(ii) The insurer shall provide an ERISA-compliant claims procedure to hear claims from former plan participants and shall agree that courts will use a de novo standard of review in reviewing actions of the insurer.

(iii) The insurer agrees that it shall act in accordance with the ERISA fiduciary duty of loyalty to participants and beneficiaries.

(iv) The insurer agrees to respond to inquiries from the Department of Labor concerning the insurer's efforts to locate missing annuitants.

(v) In the insurer's welcome letter to an annuitant, and in any subsequent periodic benefit statements or other communications to the participant, the insurer must indicate that a participant should keep the insurer informed of changes in his or her marital status, e-mail and physical addresses.

(vi) The insurer is expressly forbidden to offer new benefit elections or options not provided for in the plan.

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[15] We note that annuity contracts we were able to review include some but not all of these provisions.

(vii) The insurer will prohibit anticipation or alienation of benefits and provide that annuity benefits are not subject to the claims of creditors to the maximum extent permitted by law.

(viii) The insurer is required to divide pensions in accordance with state court orders, so long as those orders would have satisfied the requirements for a qualified domestic relations order, and that the insurer provide a process by which an insurer's rejection of such an order can be reviewed and appealed expeditiously.

(ix) The insurer may not transfer its obligations to another insurer or use reinsurance from an offshore entity.

C. New Entrants to the Pension Risk Transfer Markets

The last several years have seen interest from recently formed or reconfigured entities in entering the pension risk-transfer marketplace, which some observers believe may result in greater risk in their insurance reserves and a more aggressive posture with respect to insurance regulators. Some observers also believe that some insurers may have greater tolerance for risk and that this increased risk tolerance may permit them to underbid more traditional market participants. Part of an examination of IB 95-1 should include whether its criteria for evaluating an annuity provider should be revised to isolate any special risks posed by such companies.