

**Department of Labor Employee Benefits Security Administration**

**Interpretive Bulletin 95-1**

**Consultation Paper – ERISA Advisory Council**

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**1. Introduction**

Section 321 of the SECURE 2.0 Act of 2022,<sup>1</sup> entitled “Review of Pension Risk Transfer Interpretive Bulletin,” directs the Secretary of Labor to (1) review Interpretive Bulletin (IB) 95-1 (29 C.F.R. 2509.95-1) (relating to the fiduciary standards under the Employee Retirement Income Security Act of 1974 (ERISA) when selecting an annuity provider for a defined benefit pension plan) and consult with the Advisory Council on Employee Welfare and Pension Benefit Plans (ERISA Advisory Council or Council), to determine whether amendments to IB 95-1 are warranted; and (2) report to Congress on the findings of such review and consultation, including an assessment of any risk to participants.

The Employee Benefits Security Administration (EBSA) of the Department of Labor is currently in the process of conducting the review required by SECURE 2.0 section 321. This consultation paper is prepared for purposes of the required consultation with the ERISA Advisory Council.

**2. Background**

**2.1 Pension Risk Transfers**

Defined benefit pension plans promise participants a specific monthly benefit at retirement. Employers sponsoring or contributing to the plans are generally responsible for making contributions so that the plans can pay promised benefits. Thus, with respect to these plans, such employers bear investment and other risks related to ensuring sufficient funding.<sup>2</sup>

Plan sponsors of defined benefit plans have a number of options to consider when faced with risks to sufficient funding. One option is a total buy-out, in which the plan sponsor terminates the plan and transfers all of the benefit obligations to an insurer through purchase of an annuity contract. Another option is a “lift-out,” or “partial buy-out.” In this scenario, the sponsor amends the plan to “lift out” a certain participant population, and the plan purchases an annuity from an insurance company to satisfy benefit payments to the participants affected. These types of pension risk transfer transactions (referred to in this paper as PRT annuity

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<sup>1</sup> Consolidated Appropriations Act, 2023, Division T, Pub. L. 117-328 (2022).

<sup>2</sup> U.S. Dep’t of Labor, What You Should Know About Your Retirement Plan (2021), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/publications/what-you-should-know-about-your-retirement-plan#chapter-1>; Timothy Geddes et al., Pension Risk Transfer, Evaluating Impact and Barriers for De-Risking Strategies, Society of Actuaries 7 (June 2021), <https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/>.

purchases) transfer liability for payments from the plan to the insurance company issuing the annuity. The Department's regulation at 29 C.F.R. 2510.3-3(d)(2)(ii) recognizes that so long as certain minimum standards are satisfied with respect to the annuity and annuity provider, the affected individuals are no longer participants covered under the plan.<sup>3</sup>

Plan sponsors may decide to engage in PRT annuity purchase transactions for a variety of reasons, discussed below. The Department considers the decision to terminate a defined benefit pension plan (or to amend it to lift out a participant population) a settlor function that is not subject to ERISA's fiduciary standards. However, implementation of the decision to terminate, including the selection of an annuity provider in connection with a benefit distribution, is a fiduciary act governed by the fiduciary standards of ERISA.<sup>4</sup>

PRT annuity purchase transactions have occurred throughout ERISA's history and concerns about the claims-paying ability of insurance companies offering annuity contracts and the fiduciary decision-making with respect to these transactions date at least to the early 1990s.<sup>5</sup> At the time, some insurance companies were heavily invested in high-risk bonds sometimes called "junk bonds," and one such insurance company, the Executive Life Insurance Company, was taken over by California regulators and 44,000 retirees were impacted.<sup>6</sup> At a 1993 Congressional hearing, the Department reported that it had opened over 1,000 investigations, conducted 85 onsite investigations, and filed nine lawsuits related to annuities purchases.<sup>7</sup>

In addition to its enforcement actions, the Department also considered regulatory and guidance options. In 1991, the Department and the Pension Benefit Guaranty Corporation (PBGC) issued advanced notices of proposed rulemaking to consider regulatory action relating to the purchase of annuity contracts.<sup>8</sup> The Department's notice solicited comment on whether, in addition to and independent of ERISA's fiduciary standards, the minimum standards for annuity providers in 29 C.F.R. 2510.3-3(d)(2)(ii) should be revised. In 1995, the Department issued IB 95-1, which solely concerned ERISA's fiduciary standards, and the Department announced that

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<sup>3</sup> ERISA also includes a statutory definition of a participant at section 3(7). 29 U.S.C. § 1002(7). That definition provides that the term "participant" means "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit." In a 1988 Information Letter, the Department stated that the statutory definition is applicable whenever the term "participant" is used in the statutory provisions of title I of ERISA, including ERISA section 502, which provides standing to bring legal action. Letter from Helene A. Benson, U.S. Dep't of Labor, to Charles R. Reyher (Aug. 19, 1988). As discussed below, Congress amended ERISA in 1994 to clarify that pension annuitants who were formerly plan participants impacted by a PRT annuity purchase also have standing.

<sup>4</sup> 29 C.F.R. § 2509.95-1; Interpretive Bulletin 95-1, 60 FR 12328 (Mar. 6, 1995); Information Letter from Dennis M. Kass to John N. Erlenborn (Mar. 13, 1986).

<sup>5</sup> See U.S. General Accounting Office, *Private Pensions: Protections for Retirees' Insurance Annuities Can Be Strengthened* (1993), [www.gao.gov/assets/hrd-93-29.pdf](http://www.gao.gov/assets/hrd-93-29.pdf).

<sup>6</sup> *Id.*

<sup>7</sup> Recent Court Decisions Affecting ERISA and Executive Life Annuities, Hearing on S. 1312 Before the Subcomm. On Labor of the Sen. Comm. On Labor and Human Resources, 103d Cong. (1993) (statement of Olena Berg, Assistant Secretary, Pension and Welfare Benefits Administration, U.S. Dep't of Labor).

<sup>8</sup> Annuitization of Participants and Beneficiaries Covered Under Employee Pension Plans, 56 FR 28,638 (June 21, 1991); Selection of Annuity Providers for Terminating Pension Plans, 56 FR 28,642 (June 21, 1991).

it would not take further regulatory action to amend the minimum standards under 29 C.F.R. 2510.3-3(d)(2)(ii).<sup>9</sup>

## 2.2 IB 95-1's Guidance on ERISA section 404

IB 95-1 provides guidance on fiduciary duties under ERISA section 404. Pursuant to ERISA section 404(a)(1), fiduciaries must discharge their duties with respect to the plan solely in the interest of the participants and beneficiaries. Section 404(a)(1)(A) states that the fiduciary must act for the exclusive purpose of providing benefits to the participants and beneficiaries and defraying reasonable plan administration expenses. In addition, section 404(a)(1)(B) requires a fiduciary to act with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use.

The IB provides that to satisfy their fiduciary obligations, plan fiduciaries must take steps calculated to obtain the safest annuity available unless, under the circumstances, it would be in the interest of the participants and beneficiaries to do otherwise. IB 95-1 also provides that fiduciaries must conduct an objective, thorough, and analytical search for purposes of identifying and selecting providers from which to purchase annuities and emphasizes that reliance solely on ratings provided by insurance rating services would not be sufficient to meet the standard.

The IB sets forth the following six factors that fiduciaries should consider, among other things, in evaluating an annuity provider's claims paying ability and creditworthiness:

1. The quality and diversification of the annuity provider's investment portfolio.
2. The size of the insurer relative to the proposed contract.
3. The level of the insurer's capital and surplus.
4. The lines of business of the annuity provider and other indications of an insurer's exposure to liability.
5. The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts.
6. The availability of additional protection through state guaranty associations and the extent of their guarantees.

IB 95-1 also provides that unless plan fiduciaries possess the necessary expertise to evaluate such factors, they would need to obtain the advice of a qualified, independent expert. It further provides that a fiduciary may conclude, after conducting an appropriate search, that more than one annuity provider is able to offer the safest annuity available.

The IB recognizes that there may be situations where it may be in the interest of participants and beneficiaries to purchase other than the safest available annuity, such as when an annuity is only marginally safer, but disproportionately more expensive than competing annuities, and the participants and beneficiaries are likely to bear a significant portion of that

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<sup>9</sup> Preamble to IB 95-1, 60 FR at 12,329.

increased cost, or where the safest available annuity provider is unable to demonstrate the ability to administer the payment of benefits. However, the IB notes that increased costs or other considerations can never justify putting the benefits of participants and beneficiaries at risk by purchasing an unsafe annuity.

With respect to reversions, the IB makes clear that a fiduciary's decision to purchase more risky, lower-priced annuities to maximize a reversion of excess assets paid to the plan sponsor would violate the fiduciary's duty to act solely in the interest of the plan participants and beneficiaries. The IB cautions that fiduciaries should take special care in reversion cases where the fiduciaries' interest in the sponsoring employer could create the potential for a prohibited transaction in violation of ERISA §406(b)(1). Fiduciaries with such a conflict of interest will need to obtain and follow independent expert advice calculated to identify insurers with the highest claims-paying ability willing to write the business.

In addition to and independent of the IB, the Department's regulation at 29 C.F.R. 2510.3-3(d)(2)(ii) provides that an individual is not a "participant covered under the plan" if (1) the individual's entire benefit rights are fully guaranteed by an insurance company, insurance service, or insurance organization licensed to do business in a State, and are legally enforceable by the sole choice of the individual against the insurance company, insurance service, or insurance organization; and (2) a contract, policy, or certificate describing the benefits to which the individual is entitled under the plan has been issued to the individual. If, however, a plan purchases an annuity contract from an insurer which does not satisfy the prescribed standards in this regulation, the participant would continue to be covered under the plan and the plan would continue to be liable for the payment of any benefits to which the participant is entitled under the terms of the plan in the event of the annuity provider's default.

### 2.3 Annuity Purchases for Defined Contribution Plan Participants

Defined contribution plans are structured to provide retirement benefits based on the value of participants' individual account balances.<sup>10</sup> The Department took the position in 2002 that the general fiduciary principles set forth in IB 95-1 applied to both defined benefit plans and defined contribution plans.<sup>11</sup>

During 2005, the ERISA Advisory Council created the Working Group on Retirement Distributions & Options to study, in part, the nature of the distribution options available to participants of defined contribution plans. In November 2005, after public hearings and testimony, the ERISA Advisory Council issued the *Report of the Working Group on Retirement Distributions and Options*, concluding that many defined contribution plan distributions tend to be paid out in lump sums that "expose retirees to a wide range of risks including the possibility of outliving assets, investment losses, and inflation risk." The ERISA Advisory Council

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<sup>10</sup> U.S. Dep't of Labor, What You Should Know About Your Retirement Plan (2021), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/publications/what-you-should-know-about-your-retirement-plan#chapter-1>.

<sup>11</sup> U.S. Dep't of Labor Advisory Opinion 2002-14A (Dec. 18, 2002), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2002-14a>.

recommended in that report that the Department revise IB 95-1 to facilitate the availability of annuity options in defined contribution plans.<sup>12</sup>

Thereafter, in the Pension Protection Act of 2006, Congress directed the Department to clarify that the selection of an annuity contract as an optional form of distribution from a defined contribution individual account plan is not subject to the safest available annuity standard under IB 95-1 but is subject to all otherwise applicable fiduciary standards.<sup>13</sup> The Department published a final rule on October 7, 2008, amending IB 95-1 to apply only to the selection of annuity providers for the purpose of benefit distributions from a defined benefit plan.<sup>14</sup> On that same day, the Department issued a regulatory safe harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.<sup>15</sup>

More recently, in 2019, Congress amended ERISA to add a new fiduciary safe harbor in section 404(e) for a defined contribution plan fiduciary's selection of an insurer to provide a "guaranteed retirement income contract" – including an annuity contract that provides guaranteed benefit payments for the remaining life of the participant or joint lives of the participant and the participant's designated beneficiary.<sup>16</sup> Fiduciaries who satisfy the safe harbor's conditions will not be liable under ERISA section 404(a)(1)(B) (the statutory prudence requirement) for any losses to a participant or beneficiary due to the insurer's inability to satisfy its contractual financial obligations. The safe harbor generally requires fiduciaries to engage in an objective, thorough, and analytical review of potential insurers, and to consider both the insurers' financial capabilities to satisfy their contractual obligations and the costs of the annuities relative to their benefits, product features, and associated administrative services. Under the safe harbor, a fiduciary is explicitly not required to select the lowest cost annuity. To determine an insurer's financial capability, the fiduciary may rely on written representations from the insurer regarding compliance with certain specified state insurance law requirements, absent awareness of any facts or changes in circumstances that would call into question such representations.

#### 2.4 ERISA Enforcement in the Context of PRT Annuity Purchase Transactions

ERISA section 502 provides for civil enforcement of ERISA protections by specific parties, including for the redress of wrongful denial of plan benefits and prohibited transactions, as well as for other fiduciary breaches. Among other provisions, ERISA section 502(a)(3) provides that a civil action may be brought "by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to

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<sup>12</sup> ERISA Advisory Council, U.S. Dep't of Labor, Report of the Working Group on Retirement Distributions and Options (2005), [www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council/2005-retirement-distributions-and-options](http://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council/2005-retirement-distributions-and-options).

<sup>13</sup> Pension Protection Act of 2006, Pub. L. No. 109-280 § 625 (2006).

<sup>14</sup> 29 C.F.R. § 2509.95-1(a) (2008); *see* Amendment to IB 95-1, 73 FR 58,445 (Oct. 7, 2008).

<sup>15</sup> 29 C.F.R. § 404a-4; *see* Selection of Annuity Providers – Safe Harbor for Individual Account Plans, 73 FR 58,447 (Oct. 7, 2008).

<sup>16</sup> Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Further Consolidated Appropriations Act, 2020, Division O, Pub. L. No. 116-94 (2019).

enforce any provisions of this subchapter or the terms of the plan.” ERISA section 502(a)(5) provides, with certain exceptions, that a civil action may be brought “by the Secretary (A) to enjoin any act or practice which violates any provision of this subchapter, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this subchapter.”

In 1993, the U.S. Supreme Court decision in *Mertens v. Hewitt Associates* suggested that ERISA’s enforcement provisions in section 502(a)(3) and (5) were limited in terms of the remedies they afforded and the parties against whom suit could be brought.<sup>17</sup> These uncertainties raised concerns in Congress about ERISA enforcement, including in the context of enforcement related to PRT annuity purchases.<sup>18</sup> Less than a year and a half after the Supreme Court decided *Mertens*, Congress passed the Pension Annuitants Protection Act of 1994 which amended ERISA section 502(a) to add new paragraph (9).<sup>19</sup> The new paragraph clarifies that pension annuitants have standing to bring actions under ERISA for fiduciary breaches (including failures to follow the plan document) that occurred in connection with the selection of an annuity provider for a PRT annuity purchase, and that certain remedies are available.

### **3. EBSA’s Review of IB 95-1: Process**

SECURE 2.0 Act section 321 directs the Department to review IB 95-1, but it does not identify any particular issue of focus; accordingly, EBSA’s review has been broad. EBSA has reviewed a variety of background materials including the reports of the ERISA Advisory Council and it has conducted research into historical and legal developments and current market trends. Many of these materials have been provided to the Council as part of the required consultation.

Additionally, to date, EBSA has conducted more than 25 stakeholder meetings regarding IB 95-1, and these meetings are ongoing. The meeting participants to date have included representatives of organized labor, employer groups, consumer groups, insurance companies, insurance trade associations, other regulators, consultants, academia, and other interested parties. We intend to continue the meetings as we continue our review.

Generally, our review has involved exploration of three general questions. First, how the IB has worked in the experience of the individual stakeholder. Second, whether the individual stakeholder has suggestions on how the IB should be improved. Third, whether the individual stakeholder can identify trends or developments in the PRT annuity purchase market that should be considered by the Department as part of its review and report to Congress.

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<sup>17</sup> See 508 U.S. 248 (1993).

<sup>18</sup> See, e.g., Recent Court Decisions Affecting ERISA and Executive Life Annuities: Hearings on S. 1312 Before the Subcomm. On Labor of the Sen. Comm. On Labor and Human Resources, 103d Cong. (1993).

<sup>19</sup> Pub. L. No. 103–401 (codified as amended at 29 U.S.C. § 1132(a)(9) (1994)).

## 4. Trends Reported by Stakeholders

### 4.1 Types of De-risking Activity

The Department’s review indicates that plan sponsors with a goal of de-risking currently have a number of options to accomplish that goal. The ERISA Advisory Council 2013 report, *Private Sector Pension De-risking and Participant Protections*, summarized de-risking alternatives available to plan sponsors – both internal and external to the plan.<sup>20</sup> As the report describes, internal methods can reduce many risks to plan sponsors without disturbing the status of employees as participants in the plan.<sup>21</sup> These strategies include restricting participation or accruals, liability-driven investing, and buy-ins.<sup>22</sup> External strategies fully discharge the plan’s obligation with respect to affected participants; they include lump sum offers, and PRT annuity purchases, often referred to as complete or partial annuity buy-outs.<sup>23</sup> Other sources discuss these and other options as well.<sup>24</sup>

The following is a brief description of the major de-risking options identified in EBSA’s review; however, we note that our review focuses on the external strategy of de-risking that involves complete or partial annuity buy-outs.

- “Freezes” - *restricting participation or accruals*. Plan sponsors can limit defined benefit plan liabilities by adopting a freeze of participation (e.g., disallowing new participants) or a freeze of future benefit accruals.<sup>25</sup> Some sources have identified three types of freezes: “hard/total freezes” which involve cessation of future benefit accruals for all participants; “soft freezes” which involve closing the plan to new participants but continuing benefit accruals for current participants; and “partial freezes” which discontinue or limit benefit accruals only to some participants.<sup>26</sup>

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<sup>20</sup> ERISA Advisory Council, U.S. Dep’t of Labor, *Private Sector Pension De-risking and Participant Protections* 13-17 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

<sup>21</sup> *Id.* at 13.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> See, e.g., Timothy Geddes et al., *Pension Risk Transfer, Evaluating Impact and Barriers for De-Risking Strategies*, Society of Actuaries (2021), <https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/>; Ruilin Tian & Jeffrey Chen, *De-Risking Strategies of Defined Benefit Plans: Empirical Evidence from the United States*, Society of Actuaries (Nov. 2020), [www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf](http://www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf); American Benefits Council, *Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Show that Any Restrictions on Such Purchases Would Place Participants at Greater Risk* (Apr. 2023), [www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C](http://www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C).

<sup>25</sup> ERISA Advisory Council, U.S. Dep’t of Labor, *Private Sector Pension De-risking and Participant Protections* 8-9 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

<sup>26</sup> Ruilin Tian & Jeffrey Chen, *De-Risking Strategies of Defined Benefit Plans: Empirical Evidence from the United States*, Society of Actuaries 9 (Nov. 2020) (citing Helen Choy et al., *Does freezing a defined benefit plan affect firm risk?* 57 *J. of Acct. and Econ.* 1-21 (2014)), [www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf](http://www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf).



- *Shifting from a defined benefit plan to a defined contribution plan.* Employers have increasingly offered defined contribution plans instead of defined benefit plans.<sup>27</sup> Defined contribution plans provide retirement benefits based on the value of participants' individual account balances which are funded by participant and/or employer contributions. As opposed to a defined benefit plan, a defined contribution plan generally places much of the responsibility for funding retirement on participants.<sup>28</sup>
- *Liability-driven investing (LDI).* This is an investment strategy that may be adopted with respect to plan assets. LDI involves matching liabilities with assets in an attempt to reduce volatility and protect against risk, as opposed to a focus on maximizing returns for the plan's investments.<sup>29</sup> The Department has confirmed that a defined benefit plan fiduciary does not violate ERISA's fiduciary duties solely by implementing an investment strategy for a plan that takes into account the liability obligations of the plan and the risks associated with such liabilities and results in reduced volatility in the plan's funding requirements.<sup>30</sup>
- *Annuity buy-ins.* In a "buy-in," the plan's assets are invested in an annuity that remains an asset of the plan.<sup>31</sup> There is no change in the employees' status as participants in an ERISA-covered plan.<sup>32</sup> A buy-in transaction does not fully transfer risk, as the employer remains ultimately responsible for funding the plan sufficiently to pay benefits and administrative costs, but it can decrease funding volatility.<sup>33</sup>
- *Lump-sum offers.* Plan sponsors may offer participants a time-limited option to receive the present value of their accrued benefit in a lump-sum payment.<sup>34</sup> Defined benefit plans may

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<sup>27</sup> *Id.* at 7.

<sup>28</sup> *Id.*

<sup>29</sup> ERISA Advisory Council, U.S. Dep't of Labor, Private Sector Pension De-risking and Participant Protections 13-14 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf); Ruilin Tian & Jeffrey Chen, De-Risking Strategies of Defined Benefit Plans: Empirical Evidence from the United States, Society of Actuaries 11 (Nov. 2020), [www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf](http://www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf).

<sup>30</sup> U.S. Dep't of Labor Advisory Opinion 2006-08A (Oct. 3, 2006), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2006-08a>.

<sup>31</sup> ERISA Advisory Council, U.S. Dep't of Labor, Private Sector Pension De-risking and Participant Protections 14 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*; Ruilin Tian & Jeffrey Chen, De-Risking Strategies of Defined Benefit Plans: Empirical Evidence from the United States, Society of Actuaries 12 (Nov. 2020), [www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf](http://www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf).

<sup>34</sup> ERISA Advisory Council, U.S. Dep't of Labor, Private Sector Pension De-risking and Participant Protections 16 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf); Timothy Geddes et al., Pension Risk Transfer, Evaluating Impact and Barriers for De-Risking Strategies, Society of Actuaries 17 (2021), <https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/>; American Benefits Council, Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Shows That Any Restrictions on Such Purchases Would Place Participants at Greater Risk 7 (Apr. 2023), [www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C](http://www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C).



already include lump-sum options available to participants at termination of employment or retirement age.<sup>35</sup> Lump-sum offers for de-risking purposes may be made to a targeted group, commonly terminated vested participants.<sup>36</sup> This is an external de-risking strategy that transfers risk to the participant to determine whether the lump-sum payment or an annuity is the best choice for their financial circumstances.<sup>37</sup>

- *Total de-risking annuity purchase – often called “total buy-out.”* More common than a buy-in, a total buy-out involves the plan sponsor terminating the plan and transferring all of the benefit obligations to an insurer through purchase of an annuity contract.<sup>38</sup> The plan sponsor has no prospective obligation with respect to those benefits and the affected individuals cease to be considered participants covered under an ERISA plan.<sup>39</sup>
- *Partial de-risking annuity purchase – often called “lift-out” or “partial buy-out.”* Some plan sponsors may take a more targeted approach and engage in a “lift-out” of certain participants from the plan. The annuity purchase is then for only a portion of the plan, and the remaining participants remain covered by the plan.<sup>40</sup> Some sources indicate that there is an increase in plan sponsor interest in lift-outs as opposed to total buy-outs, at least partly due to the fact that a lift-out can be accomplished in a shorter time frame; some plan sponsors may even decide to accomplish a total buy-out through a series of lift-outs.<sup>41</sup>

#### 4.2 Increase in Prevalence and Value of PRTs

A plan sponsor may choose to (1) transfer all the pension liabilities by winding the plan down via a standard termination or (2) transfer a portion of the liabilities while the plan continues in operation, which is commonly referred to as a lift-out or partial risk transfer.

According to PBGC data, approximately 29,000 plans have filed for standard terminations between 2000 to 2020.<sup>42</sup> An October 2020 study conducted by PBGC relating to

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<sup>35</sup> ERISA Advisory Council, U.S. Dep’t of Labor, Private Sector Pension De-risking and Participant Protections 16 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

<sup>36</sup> *Id.*

<sup>37</sup> American Benefits Council, Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Shows That Any Restrictions on Such Purchases Would Place Participants at Greater Risk 7 (Apr. 2023), [www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C](http://www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C).

<sup>38</sup> Ruilin Tian & Jeffrey Chen, De-Risking Strategies of Defined Benefit Plans: Empirical Evidence from the United States, Society of Actuaries 11 (Nov. 2020), [www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf](http://www.soa.org/globalassets/assets/files/resources/research-report/2020/de-risking-strategies.pdf).

<sup>39</sup> 29 C.F.R. § 2510.3-3(d)(2)(ii).

<sup>40</sup> Timothy Geddes et al., Pension Risk Transfer: Evaluating Impact and Barriers for De-Risking Strategies, Society of Actuaries 20 (2021), <https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/>; Nat’l Retiree Legis. Network & Am. Retirees Educ. Found., Pension Plan ‘De-Risking’: Strengthening Fiduciary Duties to Protect Retirees (Jan. 2023), [https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal-Draft4-Final\\_012923\\_final.pdf](https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal-Draft4-Final_012923_final.pdf).

<sup>41</sup> MetLife, 2022 Pension Risk Transfer Poll (Oct. 2022), [www.metlife.com/retirement-and-income-solutions/insights/pension-risk-transfer-poll/](http://www.metlife.com/retirement-and-income-solutions/insights/pension-risk-transfer-poll/).

<sup>42</sup> PBGC, Pension Data Tables 2020, Table S-3, <https://www.pbgc.gov/prac/data-books>.

partial PRTs of single-employer pension plans found that 8 percent of PBGC-covered plans conducted some form of PRT during the 2015-2018 study period. Of these plans, almost 19 percent of the plans purchased annuities for an estimated 900,000 participants.<sup>43</sup> Incorporating data through plan year 2020 adds approximately 400,000 participants in just two years, bringing this estimate to 1.3 million participants having their benefits annuitized.<sup>44</sup> Also of note, the number of plans purchasing annuities more than doubled over the observation period.<sup>45</sup> In 2022, defined benefit PRT annuity purchases reached an all-time high with nearly \$52 billion in transactions. While lift-out activity constituted around 43 percent of transaction activity, it represented nearly 80 percent of the activity in terms of transaction value.<sup>46</sup>

Recent market conditions have favorably impacted the affordability of de-risking activities both in terms of plan funding and transaction cost. A recent analysis by Willis Towers Watson (WTW) of the asset allocation of Fortune 1000 defined benefit plans found the average plan in the study to have 37 percent of plan assets in equities.<sup>47</sup> The S&P 500 has increased 25 percent in value since the beginning of the COVID-19 pandemic.<sup>48</sup> This suggests that an average defined benefit plan whose equities were invested in S&P 500 stocks realized an increase in their asset value of roughly 9 percent between March 2020 and June 2023.

Moreover, rising interest rates have made annuity purchase transactions less expensive. Prevailing interest rates are indicative of the discount rates used to price annuities and higher rates result in lower present values of future benefits. In this way it becomes less expensive for plans to de-risk when interest rates are higher than it has been in the recent past with near zero rates. A change in the discount rate from 2 percent to 5 percent, which is similar to what has been experienced between 2020 and 2023, as illustrated in Figure 1, lowers the cost of an annuity by more than 15 percent. Coupled together, recent trends in both equities and interest rates have made de-risking much more affordable for plan sponsors.

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<sup>43</sup> PBGC, Analysis of Single-Employer Pension Plan Partial Risk Transfers (Oct. 2020), <https://www.pbgc.gov/sites/default/files/2020-risk-transfer-report.pdf>.

<sup>44</sup> PBGC, 2020 Pension Insurance Data Tables, Table S-59, <https://www.pbgc.gov/prac/data-books>.

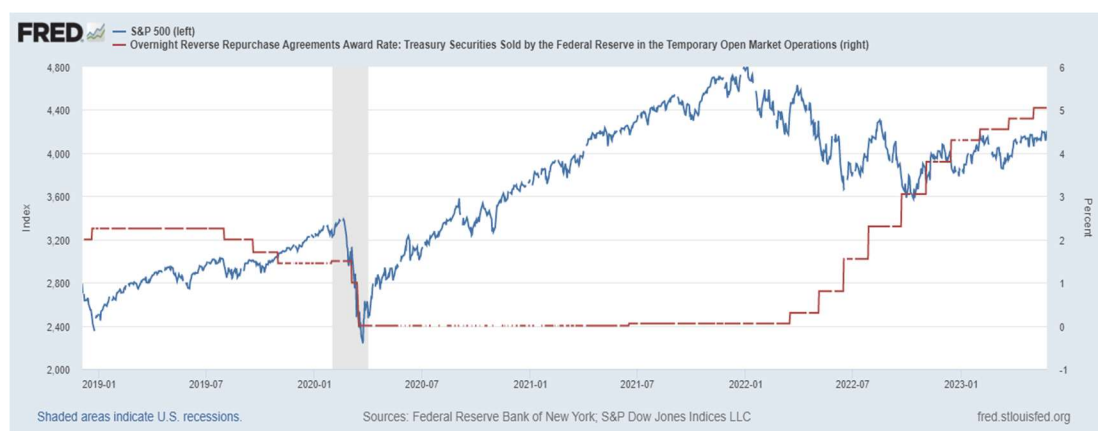
<sup>45</sup> PBGC, Analysis of Single-Employer Pension Plan Partial Risk Transfers (Oct. 2020), <https://www.pbgc.gov/sites/default/files/2020-risk-transfer-report.pdf>.

<sup>46</sup> Aon, U.S. Pension Risk Transfer: Market Insights (Mar. 2023), <https://www.aon.com/insights/reports/2023/us-pension-risk-transfer-market-insights> (follow “Download Whitepaper”; complete form for access to whitepaper). Compare to 2011, when there were less than \$1 billion in total premium and 194 transactions. Aon, 2021 U.S. Pension Risk Transfer Annuity Settlement Market Update 3 (Mar. 2021), <https://insights-north-america.aon.com/pension-risk-management/aon-us-pension-risk-transfer-annuity-settlement-market-update-whitepaper>.

<sup>47</sup> Mercedes Aguirre & Brendan McFarland, 2020 Asset Allocations in Fortune 1000 Pension Plans, Willis Towers Watson Insights (Mar. 2022), <https://www.wtwco.com/en-us/insights/2022/03/2020-asset-allocations-in-fortune-1000-pension-plans>.

<sup>48</sup> Federal Reserve Bank of St. Louis, Stock Market Indices: S&P 500, <https://fred.stlouisfed.org/series/SP500> (date range entry of Feb. 19, 2020, to June 1, 2023). Based on Feb. 19, 2020 close value of 3386.15 and June 1, 2023 close value of 4221.02.  $(4221.02 - 3386.15) / 3386.15 \approx 25\%$ .

Figure 1, Equity Gains and Interest Rate Increases Combine to Make PRTs More Affordable Than in Recent Years



### 4.3 Primary Reasons for PRT Annuity Purchases Offered by Stakeholders

A MetLife survey of defined benefit plan sponsors in 2022 identified exogenous factors driving plan sponsor interest in pension risk transfers.<sup>49</sup> The survey identified leading concerns promoting PRT transactions as rising interest rates, inflation, market volatility, and the geopolitical environment. A 2022 Aon survey of plan sponsors additionally identified pension regulation and uncertainty of compliance requirements as factors favoring de-risking options.<sup>50</sup> PBGC premiums are another factor commonly cited.<sup>51</sup> The findings of these surveys are consistent with reasons favoring PRTs offered by witnesses in the 2013 report of the ERISA Advisory Council, *Private Sector Pension De-risking and Participant Protections*.<sup>52</sup>

The following is a brief description of some of the factors identified as contributing to plan sponsor election of a PRT annuity purchase:

- *Interest rates.* Interest rates typically have an inverse relationship to the size of pension plan liabilities, as discount rates used by pension plans are linked to corporate bond

<sup>49</sup> MetLife, 2022 Pension Risk Transfer Poll (Oct. 2022), <https://www.metlife.com/retirement-and-income-solutions/insights/pension-risk-transfer-poll/>.

<sup>50</sup> Aon, Global Pension Risk Survey 2022: U.S. Findings (2022), <https://insights-north-america.aon.com/defined-benefit/aon-global-pension-risk-survey-2022-u-s-findings-report>.

<sup>51</sup> American Benefits Council, Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Show that Any Restrictions on Such Purchases Would Place Participants at Greater Risk (Apr. 2023), [www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C](http://www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C); Mass Mutual, Key Decisions for De-Risking Your Pension Plan 1 (2019), [www.massmutual.com/global/media/shared/doc/institutional/is8005\\_082819ui\\_prt%20whitepaper%20v5\\_final.pdf](http://www.massmutual.com/global/media/shared/doc/institutional/is8005_082819ui_prt%20whitepaper%20v5_final.pdf).

<sup>52</sup> ERISA Advisory Council, U.S. Dep't of Labor, *Private Sector Pension De-risking and Participant Protections* 13-17 (2013), [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

yields.<sup>53</sup> As such, rising interest rates generally contribute to shrinking plan liabilities (as well as increasing investment returns) which increases a plan's funding status.<sup>54</sup> Due to this effect, interest rate volatility can have a significant impact on the funding status of a pension plan. Changes in funding status can have a negative effect on a sponsor's balance sheets.

- *Impact of market volatility on sponsor balance sheets.* Market volatility is the measure of fluctuations to the trading value of an asset over time. Fluctuations in the value of assets held in a defined benefit plan's portfolio will impact the plan's funding status and ability to meet its obligations to participants. Such volatility impacts the plan sponsor's balance sheets.<sup>55</sup>
- *Plan funding.* Certain market conditions can be more conducive for PRTs. For instance, plan sponsors may be more willing to consider a PRT when the plan's funding status is improved as a result of high interest rates, or overperformance of the plan's equity investments when compared to plan assumptions.
- *PBGC premiums.* PBGC premium rates have increased significantly over the past fifteen years, with 2023 rates more than triple that of 2007.<sup>56</sup> This contributes to defined benefit plan operational expenses, which are ultimately borne by the plan sponsor. Avoiding the cost of the premiums is a reason plan sponsors may select a PRT annuity purchase as the method of de-risking, particularly as opposed to in-plan de-risking strategies which leave the PBGC premium obligation in place.<sup>57</sup>
- *Inflation.* Defined benefit plans typically provide benefits that are fixed in nature and do not include cost of living adjustments to offset inflation.<sup>58</sup> Due to this, during a period of high inflation, lump-sum offers may be more attractive to plan participants seeking to invest in products offering a return outpacing the inflation rate.

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<sup>53</sup> Jennifer Williams-Alvarez, With Interest Rates Rising, Companies Look to Unload Pension Liabilities, Wall Street Journal (Sept. 28, 2022, 5:30 AM), <https://www.wsj.com/articles/with-interest-rates-rising-companies-look-to-unload-pension-liabilities-11664357403>; Remy Samuels, US Pension Funded Status Continues to Improve in May, Plan Sponsor (June 18, 2023), <https://www.plansponsor.com/us-pension-funded-status-continues-to-improve-in-may/>.

<sup>54</sup> Christopher Kludy, U.S. Pension Finance Watch – May 2023, Willis Towers Watson (June 2023), <https://www.wtco.com/en-us/insights/2023/06/us-pension-finance-watch-may-2023?>

<sup>55</sup> MetLife, 2022 Pension Risk Transfer Poll (Oct. 2022), <https://www.metlife.com/retirement-and-income-solutions/insights/pension-risk-transfer-poll/>.

<sup>56</sup> PBGC, Premium Rates: Current and Historical Information, [https://www.pbgc.gov/prac/prem/premium-rates \(last updated Jan. 23, 2023\)](https://www.pbgc.gov/prac/prem/premium-rates%20(last%20updated%20Jan.%2023,%202023)).

<sup>57</sup> Mercer & Office of the PBGC Participant and Plan Sponsor Advocate, Pension De-Risking Study, Analyzing the Drivers of Pension De-Risking Activity 2 (Dec. 2017), [https://www.pbgc.gov/sites/default/files/appendix\\_i\\_-\\_de-risking\\_study.pdf](https://www.pbgc.gov/sites/default/files/appendix_i_-_de-risking_study.pdf).

<sup>58</sup> Rebecca Monroe, Considerations for DB Plan Investing in 2022, Plan Sponsor (Jan. 3, 2022), <https://www.plansponsor.com/considerations-db-plan-investing-2022/>.

#### 4.4 Increased Private Equity Involvement

Many sources document the increasing involvement of private equity in the life insurance space.<sup>59</sup> Private equity involvement includes private equity firms buying insurance companies or buying interests in them, as well as private equity firms entering into investment management agreements to manage insurance company investments. According to the National Association of Insurance Commissioners (NAIC), private equity-owned insurance companies held \$472 billion in cash and invested assets in 2021, which is the most recent year available. Just over 95 percent of these assets, which is \$450 billion in book/adjusted carrying value, comes from life insurance companies. This accounts for 8.7 percent of the life insurance industry’s assets. The share of cash and invested assets held by private equity-owned life insurance firms is up 1.4 points from the data’s start point in 2018, but down 0.9 points from its peak in 2020.<sup>60</sup> By another report in 2022, “[a]ll five of the largest private equity ... firms by assets have holdings in life insurance, representing 15 to 50 percent of their total assets under management.”<sup>61</sup> Some sources in the Department’s review indicated that the business model is not to hold life insurance companies as a short-term investment in the private equity firm’s leveraged buyout fund; rather, the private equity firm will use “the insurer’s investment portfolio over a longer time horizon to invest a portion of insurer assets in forms of private debt or securitized assets where the [private equity] firm believe they have a competitive advantage.”<sup>62</sup>

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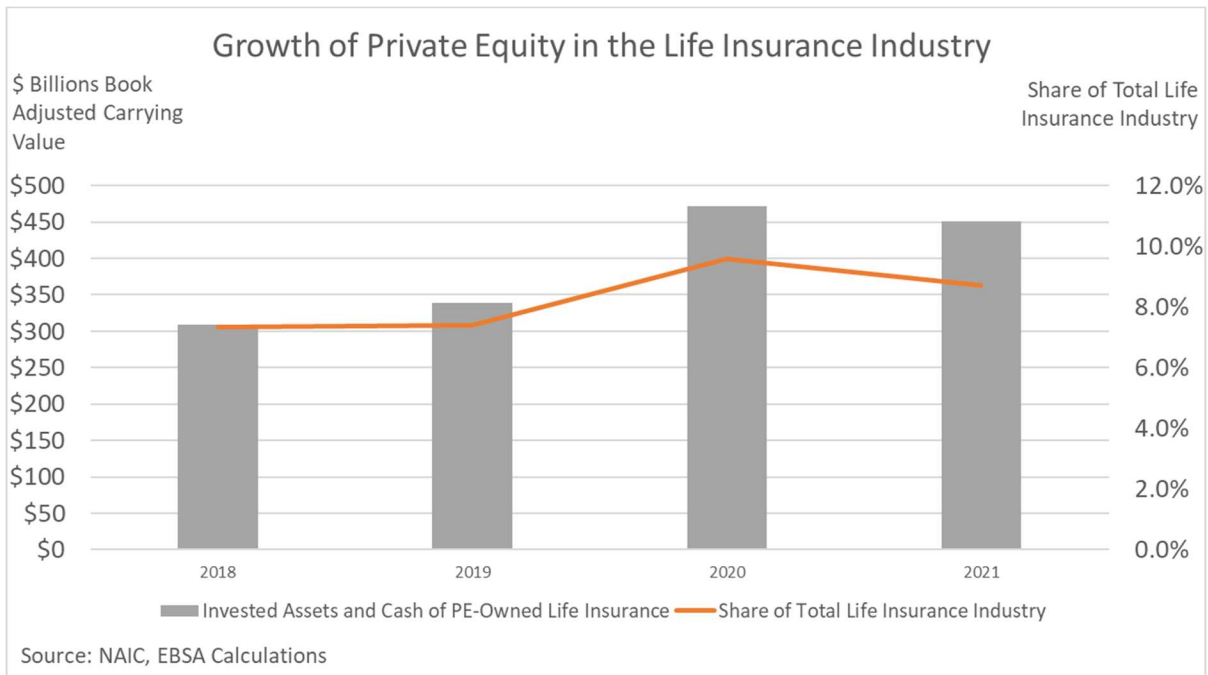
<sup>59</sup> Eileen Appelbaum, Beware of Private Equity Gobbling Up Life Insurance and Annuity Companies, Ctr. For Econ. And Pol’y Res. (Jan. 2022), <https://cepr.net/wp-content/uploads/2022/01/2022-01-PE-and-Life-Insurance-Appelbaum.pdf>; Matt Wirz & Leslie Scism, Private Equity Taps Insurers’ Cash to Speed Up Growth, Wall Street Journal (Jan. 31, 2023, 5:30 AM), <https://www.wsj.com/articles/private-equity-taps-insurers-cash-to-speed-up-growth-11675128742>.

<sup>60</sup> These numbers were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on Private Equity (PE)-Owned U.S. Insurers’ Investments. The calculations provided are exclusive to life insurance. The reports can be found here: <https://content.naic.org/capital-markets-bureau>.

<sup>61</sup> Ramnath Balasubramanian et al., Why Private Equity Sees Life and Annuities Companies as an Enticing Form of Permanent Capital, McKinsey & Company (Feb. 2, 2022), <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-private-equity-sees-life-and-annuities-as-an-enticing-form-of-permanent-capital>.

<sup>62</sup> James Walton, Private Equity and Alternative Asset Managers in the U.S. Pension Risk Transfer Market, Agilis (Dec. 5, 2022), <https://agilis.llc/private-equity-and-alternative-asset-managers-in-the-us-pension-risk-transfer-market/>.

**Figure 2: Assets Held by Private Equity-Owned Life Insurance Companies**



While private equity firms have reportedly taken an interest in life insurers for decades, some sources connect their accelerated involvement in the life insurance industry with capital scarcity and regulatory changes from the financial crisis of the late 2000s.<sup>63</sup> Sources additionally describe that assets supporting annuities arising from PRT transactions are appealing to private equity as permanent capital that can generate significant returns from investing and management fees.<sup>64</sup> As described by the Department of the Treasury, “[p]reviously, the focus of private equity was largely on buy-outs. Now, some private equity firms are increasingly pivoting their business objective to the private credit market and to raising more ‘permanent’ capital to support this business.”<sup>65</sup> The possibility of insurance company assets supporting PRT annuities being deployed in affiliated investments of the private equity firm has raised concerns about high investment management fees and conflicts of interest.<sup>66</sup> More generally, concerns have been raised regarding the potential risks being introduced by practices that some associate with private equity-owned insurers.

<sup>63</sup> Divya Kirti & Natasha Sarin, What Private Equity Does Differently: Evidence from Life Insurance, U of Penn., Inst. for L. & Econ. Res. 10 (2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3538443](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538443).

<sup>64</sup> *Id.* at 8; Ramnath Balasubramanian et al., Why Private Equity Sees Life and Annuities Companies as an Enticing Form of Permanent Capital, McKinsey & Company (Feb. 2, 2022), <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-private-equity-sees-life-and-annuities-as-an-enticing-form-of-permanent-capital>.

<sup>65</sup> Letter from Jonathan Davidson, Assistant Sec’y for Legisl. Affairs, U.S. Dep’t of the Treasury, to The Honorable Sherrod Brown, U.S. Sen. (June 29, 2022), [www.banking.senate.gov/imo/media/doc/fio\\_85.pdf](http://www.banking.senate.gov/imo/media/doc/fio_85.pdf).

<sup>66</sup> Eileen Appelbaum, Beware of Private Equity Gobbling Up Life Insurance and Annuity Companies, Ctr. For Econ. And Pol’y Res. (Jan. 2022), <https://cepr.net/wp-content/uploads/2022/01/2022-01-PE-and-Life-Insurance-Appelbaum.pdf>.



In March 2022, U.S. Senator Sherrod Brown wrote to both the NAIC and the Federal Insurance Office (FIO) of the Department of the Treasury expressing concern about the involvement of alternative asset managers such as private equity firms in PRT transactions and asking for an evaluation of concerns regarding risks to policyholders as well as the broader economy associated with private equity-controlled insurers.<sup>67</sup> In its response, the NAIC reports taking steps in 2013 related to the increased private equity involvement in the insurance industry. It also described a list of 13 recommendations currently being worked on by the NAIC Macroprudential Working Group, intended to “identify where existing disclosures, policies, control and affiliation requirements, and other procedures should be modified or new ones created, to address any gaps based on the increase in the number of [private equity] owners of insurers, the role of asset managers in insurance, and the increase of private investments in insurers’ portfolios, among other reasons.”<sup>68</sup> The Department of the Treasury’s response also identified issues for further consideration related to private equity involvement in the insurance market consistent with the NAIC’s work, and stated that it is monitoring developments and particularly focusing on liquidity, credit risk and capital adequacy, offshore reinsurance and conflicts of interest.<sup>69</sup> Senator Brown subsequently held a hearing in September 2022 on Current Issues in Insurance in which witnesses Kathleen Birrane, Maryland’s Insurance Commissioner, and Steven Seitz, director of FIO, testified on a number of issues including private equity involvement in the life insurance market.<sup>70</sup>

## **5. Executive Summary: Range of Stakeholder Responses to Whether IB 95-1 Should be Amended**

The Department has conducted stakeholder meetings seeking viewpoints from individual attendees, and stakeholders expressed a range of opinions as to whether changes to the IB are warranted. On one end of the range, stakeholders took the position that the IB identifies the appropriate considerations for plan fiduciaries and has worked well over time, and therefore, no changes are warranted. This position was often premised on the view that state insurance regulators will provide effective oversight of insurance company solvency issues. Relatedly, some stakeholders indicated that plan fiduciaries are not likely to have experience or expertise to evaluate some of the complex practices engaged in by insurers. One stakeholder emphasized that a PRT annuity purchase transaction is an important tool for plan sponsors and presents an alternative to a lump sum offering that may contribute to participants’ retirement security. The stakeholder warned the Department against placing restrictions on annuity purchases. Another

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<sup>67</sup> Letter from The Honorable Sherrod Brown, U.S. Sen. to Steven Seitz, Director, Federal Insurance Office and Dean L. Cameron, President, Nat’l Assoc. of Ins. Comm’rs (Mar. 16, 2022), [www.banking.senate.gov/imo/media/doc/brown\\_letter\\_on\\_insurance\\_031622.pdf](http://www.banking.senate.gov/imo/media/doc/brown_letter_on_insurance_031622.pdf).

<sup>68</sup> Letter from Dean L. Cameron et al., Nat’l Assoc. of Ins. Comm’rs, to The Honorable Sherrod Brown, U.S. Sen. (May 31, 2022), [www.banking.senate.gov/imo/media/doc/naic\\_may2.pdf](http://www.banking.senate.gov/imo/media/doc/naic_may2.pdf).

<sup>69</sup> Letter from Jonathan Davidson, Assistant Sec’y for Legisl. Affairs, U.S. Dep’t of the Treasury, to The Honorable Sherrod Brown, U.S. Sen. (June 29, 2022), [www.banking.senate.gov/imo/media/doc/fio\\_85.pdf](http://www.banking.senate.gov/imo/media/doc/fio_85.pdf).

<sup>70</sup> See *Current Issues in Insurance: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 117th Cong. (2022), [www.banking.senate.gov/hearings/current-issues-in-insurance](http://www.banking.senate.gov/hearings/current-issues-in-insurance).



stakeholder cautioned the Department against placing increased emphasis on independent fiduciaries or consultants due to the extra cost that would impose on plan sponsors.

On the other end of the range, stakeholders asserted that significant changes to the IB are needed to protect the interests of annuitants. Often the concerns of these stakeholders stemmed from the trend of private equity involvement in the insurance and annuity market. Some stakeholders believed the IB should be amended to focus the attention of plan fiduciaries on risks related to the ownership structure of the annuity provider and the extent to which the annuity provider relies upon non-traditional investments and liabilities as well as reinsurance, among other things. Other stakeholders believed that the Department should address, through the IB, the continuation of certain rights provided by ERISA to the individuals who cease to be participants covered under the ERISA plan because of the PRT annuity purchase transaction. Two stakeholders put forth a proposal for Congress to act in this space and provide a new statutory safe harbor in ERISA section 404, similar to the provision for defined contribution plans in section 404(e).

In between those two views, other stakeholders suggested some more targeted changes to the IB. One frequent suggestion was that the IB should be revised to identify the annuity provider's administrative capabilities as a consideration. Another common suggestion was the elimination of state guaranty associations as a consideration. Several stakeholders requested that the Department add a statement to the IB that fiduciaries are not required to select the lowest cost annuity that could fit within the safest available annuity standard.<sup>71</sup>

Some stakeholder meetings included discussion of whether any revisions to the IB should include guidance to assist plan fiduciaries in evaluating the considerations, such as benchmarks or rankings. While some stakeholders thought additional guidance to assist plan fiduciaries would be helpful, others asserted that each transaction is different so the Department should allow plan fiduciaries to determine how each consideration should figure into the overall analysis. A few stakeholders expressed a preference that the IB should continue to be "principles based" so as not to become outdated or to allow for workarounds.

## **6. Specific Issues Raised by Stakeholders**

### ***6.1 Ownership Structure***

Stakeholders frequently mentioned concerns regarding private equity-owned or controlled insurance companies in the PRT annuity purchase marketplace. Their global concern is that private equity-owned insurers may not intend to be in the insurance business for the long term and by definition annuities are long-term commitments. Risky investment strategies, capital arbitrage, offshore operations, and rate of growth in the annuity market were mentioned by these

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<sup>71</sup> In this regard, several stakeholders noted a statistic reported by Aon that, in lift-out transactions in 2022, plan sponsors chose the lowest cost annuity 78 percent of the time. Aon, U.S. Pension Risk Transfer: Market Insights (Mar. 2023), <https://www.aon.com/insights/reports/2023/us-pension-risk-transfer-market-insights> (follow "Download Whitepaper"; complete form for access to whitepaper).

stakeholders as specific concerns.<sup>72</sup> Except for the rate of growth, which is discussed in detail in Section 4 of this paper, each of these specific concerns is discussed in detail below without distinguishing between business models or ownership structures. An agnostic discussion is important because other stakeholders asserted that practices generally attributed to or associated with private equity-owned insurance companies may be present with any type of insurance ownership structure even if the degree and prevalence of the practices are greater in the case of private equity-owned insurance structures.

Several stakeholders are of the view that the distinction between mutual insurance companies (which essentially are owned only by policyholders) and for-profit insurance companies (which are owned by investors such as stockholders) is important for plan fiduciaries to understand and take into account when making annuity provider selections. According to literature, U.S. life insurers started demutualizing in the 1990s into stock firms and mutual holding companies to gain access to capital markets, incentivizing changes to investment practices and organizational structure.<sup>73</sup> In the view of at least some stakeholders, mutual insurance companies are managed in a manner to support policyholders while for-profit companies must take into account the interests of investors, which can sometimes lead to activity that favors investors over policyholders. These stakeholders did not suggest a presumption in favor of mutual insurance companies, but they are of the view that fiduciaries should give appropriate consideration to this distinction.

Another issue concerns holding company structures with multiple lines of insurance and non-insurance businesses inside the structure, and the question is whether the fiduciary selecting an annuity provider under the IB 95-1 **standard should limit their review of available capital and surplus to the direct holdings of the insurer, or if this review should extend to the parent holding company and other affiliates. One stakeholder expressed the view that a plan fiduciary's evaluation of an annuity provider's financial strength must focus on the provider itself, as presented in the annual sworn statement, since that insurer is the entity that is legally obligated to pay the annuity and a policyholder has a cause of action only against the insurer and not any affiliates of the insurer. The stakeholder expressed a related concern that referencing capital held by affiliates of the insurer might mislead fiduciaries as to the financial health of the insurer.** Other stakeholders indicated more generally that transparency and focus with respect to the insurance company's parent should be emphasized in the IB. Stakeholder proponents for inclusion of parent or group capital noted that these holdings can alleviate an insurer's need to sell assets for reduced value to cover unexpected costs and prevent a liquidity crisis. One

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<sup>72</sup> See, e.g., Divya Kirti & Natasha Sarin, What Private Equity Does Differently: Evidence from Life Insurance, U of Penn., Inst. for L. & Econ. Res. 10 (2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3538443](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538443). See also Nathan Foley-Fisher et al., Are US Life Insurers the New Shadow Banks? (April 20, 2023), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3534847](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534847).

<sup>73</sup> Barbara Remmers, Life Insurer Demutualization in the Current Era+, 22 J. of Ins. Reg. 1 (2003); Lal Chugh & Joseph W. Meador, Demutualization in the Life Insurance Industry: A Study of Effectiveness, 27 Rev. of Bus. 10-17 (Working Paper No. 1014, 2006), [https://scholarworks.umb.edu/cgi/viewcontent.cgi?article=1006&context=financialforum\\_pubs](https://scholarworks.umb.edu/cgi/viewcontent.cgi?article=1006&context=financialforum_pubs).

stakeholder described that financial support of an insurer's operations by a parent entity may take different forms which may or may not be formalized or reduced to contract.

Stakeholders also focused on specific business dealings between insurance companies and their affiliated entities, with the main concern being potential misalignment and conflicts of interest. Some stakeholders indicated that business relationships between an insurance company and affiliated entities can be important considerations for a fiduciary, especially if the management of these parties is not sufficiently independent to ensure that dealings are at arm's length. They explained that without sufficient safeguards in place for transactions with affiliated entities, there is a risk that an insurance company's assets can be used to pursue the interests of the affiliated entity to the potential detriment of the insurance company. For example, some stakeholders expressed concern whether private equity firms that acquire insurance companies are committed to the provision of insurance and annuities for the long term, or whether the firms intend to prioritize investment earnings in the short term to the detriment of annuitants' interests. As another example, stakeholders expressed concern that the assets of the insurance company would be invested in investment funds managed by affiliates and subject to high fees.

In its letter to Senator Brown, the NAIC discusses how state insurance regulators focus on risks at the level of the individual insurer as well as the group. The NAIC notes that only insurers can sell or administer policies, therefore risk-based capital requirements are enforced at the insurer level. However, the states collect financial disclosures at the group level to allow them to monitor the group's access to insurer assets, including as part of services agreements. The NAIC explains that larger insurers must file an "Own Risk and Solvency Assessment" (ORSA) which reports on all risks posed to an insurance group. The NAIC has also introduced a Group Capital Calculation which it says can give regulators insight into capital allocation throughout the group.<sup>74</sup>

In light of the foregoing, stakeholders suggested that the Department consider whether the IB would be improved by adding a more specific factor or factors relating to ownership structure. This could include considerations discussed above, such as whether the insurance company is a mutual or for-profit business and whether the insurance company uses a complicated holding structure or not, including offshore components that may be subject to regulatory schemes that differ from U.S. domestic requirements. Such a factor or factors could also focus on the types of the businesses inside the holding company and whether the other lines of business are related to insurance, on the one hand, or asset gathering on the other hand. A related suggestion was to add to the IB a provision focusing on the insurance companies' track record of asset management and ability to fund the long-term commitment of annuities, as opposed to short-term strategies mismatched with the duration of annuity liabilities.<sup>75</sup>

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<sup>74</sup> Letter from Dean L. Cameron et al., Nat'l Assoc. of Ins. Comm'rs, to The Honorable Sherrod Brown, U.S. Sen. (May 31, 2022), [www.banking.senate.gov/imo/media/doc/naic\\_may2.pdf](http://www.banking.senate.gov/imo/media/doc/naic_may2.pdf).

<sup>75</sup> A stakeholder also provided the Department with a list of questions that fiduciaries could pose to insurers to evaluate the long term versus short term nature of their strategies. The questions covered topics such as the primary mission and core competence of the insurer; the focus of the insurer's compensation/incentive structure; the use of modified coinsurance and offshore/affiliated reinsurers; dividends payments to the insurer's parent company in recent years; and others.

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## 6.2 Assets: Increase in Non-Traditional / Risky Investments

Several stakeholders raised concerns about what they described as the insurance industry's increasingly riskier investment strategies in the aggregate. They said that the industry's increasing investment in asset-backed securities, such as collateralized loan obligations (CLOs) (including the riskier tranches) and private credit possibly overexposes insurers to investment and liquidity risk that could lead to solvency issues to the potential detriment of policyholders. One stakeholder cited to literature calculating that insurers' CLO exposures are comparable to their holdings of nonprime residential mortgage-backed securities just before the 2007-09 financial crisis.<sup>76</sup> Other types of risky assets specifically mentioned by the stakeholders were subordinated debt and stock of affiliated companies. Many of these stakeholders asserted that private equity-backed insurers have a greater tendency towards high-risk investment strategies,<sup>77</sup> but others said that this is an industry function of pursuing greater yield in a low-interest rate environment and is not necessarily attributable to private equity affiliation.

The following data better illustrates the investment trend behind the stakeholders' concerns.

According to the NAIC, the life insurance industry has decreased its investments in bonds as a share of assets by 4.1 points, from 72.4 percent of their investment mix in 2015 to 68.3 percent in 2022, which is the most recent data available. These proportions were primarily shifted to mortgages and Schedule BA assets, which include long term assets like private equity, hedge funds, and real estate as seen in Table 1.<sup>78</sup>

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<sup>76</sup> See Nathan Foley-Fisher et al., Are US Life Insurers the New Shadow Banks? (Apr. 20, 2023), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3534847](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534847).

<sup>77</sup> For example, one stakeholder cited to literature finding that "PE-backed insurance firms take on greater asset risk by moving out of highly rated corporate bonds and into poorly rated private-label asset-backed securities (ABS), increasing their holdings of private-label ABS by two-thirds the industry average." Divya Kirti & Natasha Sarin, What Private Equity Does Differently: Evidence from Life Insurance, U of Penn., Inst. for L. & Econ. Res. 2-3 (2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3538443](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538443).

<sup>78</sup> These numbers and Table 1 were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on the U.S. Insurance Industry's Cash and Invested Assets. The calculations provided are exclusive to life insurance. The reports can be found here: <https://content.naic.org/capital-markets-bureau>.

**Table 1: Investment Mix of U.S. Life Insurance Companies**

| Asset Type                                 | 2015-2022 |       |       |       |       |       |       |       | Point Change |
|--|-----------|-------|-------|-------|-------|-------|-------|-------|--------------|
|  | 2015      | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  |              |
| Bonds                                      | 72.4%     | 72.2% | 71.7% | 71.2% | 70.1% | 69.2% | 68.6% | 68.3% | -4.1%        |
| Mortgages                                  | 10.7%     | 11.0% | 11.5% | 12.4% | 12.6% | 12.2% | 12.4% | 13.1% | 2.4%         |
| BA & Other Long Term                       | 4.2%      | 4.0%  | 4.3%  | 4.5%  | 4.7%  | 4.8%  | 5.7%  | 6.1%  | 1.9%         |
| Common Stock                               | 3.9%      | 4.0%  | 4.0%  | 3.7%  | 3.9%  | 4.0%  | 4.3%  | 4.0%  | 0.1%         |
| Cash & Short-term Investments              | 2.7%      | 2.6%  | 2.5%  | 2.5%  | 2.7%  | 3.2%  | 2.9%  | 2.7%  | 0.0%         |
| Contract Loans                             | 3.3%      | 3.2%  | 3.1%  | 3.1%  | 2.9%  | 2.7%  | 2.5%  | 2.5%  | -0.9%        |
| Derivatives                                | 1.4%      | 1.6%  | 1.4%  | 1.3%  | 1.7%  | 2.5%  | 1.9%  | 1.8%  | 0.4%         |
| Other Receivables                          | 0.2%      | 0.3%  | 0.3%  | 0.2%  | 0.1%  | 0.3%  | 0.4%  | 0.6%  | 0.4%         |
| Real Estate                                | 0.6%      | 0.6%  | 0.6%  | 0.5%  | 0.5%  | 0.5%  | 0.4%  | 0.4%  | -0.2%        |
| Preferred Stock                            | 0.3%      | 0.2%  | 0.4%  | 0.3%  | 0.3%  | 0.3%  | 0.4%  | 0.3%  | 0.1%         |
| Securities Lending (Reinvested Collateral) | 0.3%      | 0.3%  | 0.3%  | 0.3%  | 0.4%  | 0.3%  | 0.4%  | 0.3%  | 0.0%         |

Source: NAIC. EBSA Calculations

Not only has the industry reduced its exposure to bonds, but the composition of the bond portfolio has changed. Since 2015, the life insurance industry’s investment in ABS, which include CLOs, increased by 4.4 points from 7.9 percent to 12.4 percent of the bond portfolio. ABS were the second fastest growing bond type in 2022 and have consistently been one of the industry’s fastest growing bond types since 2018, with annual growth rates between 9 and 14 percent. The fastest growing bond type was bank loans, which were small enough to not be separately accounted for in 2015, but now make up 2.6 percent of the life insurance industry’s bond portfolio. The life insurance industry as a whole also increased its investment in corporate bonds by 1.1 points. These increases were accompanied by a decreased concentration in residential mortgage-backed securities (RMBS),<sup>79</sup> U.S. government bonds, and foreign government bonds by 4.6 points, 1.7 points, and 1.5 points respectively.<sup>80</sup> These and other changes are detailed in Table 2 below.

<sup>79</sup> This includes agency backed and private label RMBS. Agency backed RMBS declined by 3.6 points, while private label RMBS declined by 1 point.

<sup>80</sup> These numbers and Table 2 were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on the U.S. Insurance Industry’s Cash and Invested Assets. The calculations provided are exclusive to life insurance. The reports can be found here: <https://content.naic.org/capital-markets-bureau>.

**Table 2: Bond Mix of U.S. Life Insurance Companies**

| Type of Bond                          | 2015-2022 |       |       |       |       |       |       |       | Point Change |
|---------------------------------------|-----------|-------|-------|-------|-------|-------|-------|-------|--------------|
|                                       | 2015      | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  |              |
| Corporate                             | 61.7%     | 61.6% | 61.9% | 61.8% | 62.2% | 63.0% | 63.4% | 62.8% | 1.1%         |
| Municipal                             | 6.5%      | 6.4%  | 6.5%  | 6.6%  | 6.3%  | 6.1%  | 6.0%  | 6.0%  | -0.5%        |
| ABS (and Other Structured Securities) | 7.9%      | 8.3%  | 8.4%  | 9.4%  | 9.8%  | 10.6% | 11.1% | 12.4% | 4.4%         |
| US Government                         | 5.6%      | 5.6%  | 5.6%  | 5.0%  | 4.6%  | 4.5%  | 4.3%  | 3.9%  | -1.7%        |
| Agency Backed RMBS                    | 6.8%      | 6.4%  | 6.1%  | 5.9%  | 5.7%  | 4.5%  | 3.7%  | 3.2%  | -3.6%        |
| Private-Label CMBS                    | 4.6%      | 4.4%  | 4.2%  | 4.4%  | 4.4%  | 4.4%  | 4.5%  | 4.5%  | -0.1%        |
| Bank Loans                            |           |       |       | 1.3%  | 1.5%  | 1.7%  | 2.1%  | 2.6%  |              |
| Private-Label RMBS                    | 3.2%      | 3.0%  | 2.7%  | 2.5%  | 2.3%  | 2.2%  | 2.1%  | 2.2%  | -1.0%        |
| Agency Backed CMBS                    | 0.9%      | 1.1%  | 1.3%  | 1.6%  | 1.7%  | 1.5%  | 1.3%  | 1.1%  | 0.2%         |
| Foreign Government                    | 2.8%      | 3.1%  | 3.2%  | 1.5%  | 1.4%  | 1.4%  | 1.5%  | 1.3%  | -1.5%        |

Source: NAIC. EBSA Calculations

Since total invested assets and cash in the life insurance industry were also growing over this time period, these proportional changes correspond to even larger changes when expressed in terms of dollars. For instance, assets invested in ABS increased 214 percent from \$204 billion to \$449 billion between 2015 and 2022.

Data specifically on CLOs is more limited but shows a similar story. From 2018 to 2021, the life insurance industry increased its holdings in CLOs from \$94 billion to \$164 billion. This doubled CLOs' share of the industry's bond portfolio from 2.7 percent to 5.5 percent. This has also led the life insurance industry to hold an increasingly large share of the CLO market. According to data from the Securities Industry and Financial Markets Association, referenced by the NAIC, there were \$856 billion in outstanding CLOs at the end of 2021. This would indicate that the U.S. life insurance industry currently holds 19.1 percent of all outstanding CLOs. This represents an increase from 2018, when the U.S. life insurance industry held 15.6 percent of the \$616 billion market.<sup>81</sup>

The change in the investment mix has been even more striking at private equity-owned insurance firms. Private equity's overall investment mix of their insurance company assets is fairly similar to the overall life insurance industry when it comes to the total mix of stocks, bonds, and major investment categories. However, the differences become more apparent when examining the bond portfolio. Of the bonds at private equity-owned life insurance firms, 27.6 percent are in ABS, compared to 9.4 percent at non-private equity-owned life insurance companies. At the same time, corporate bonds make up only 52.3 percent of the bond portfolios at private equity-owned life insurance firms, compared to 64.5 percent of the bond portfolios at non-private equity-owned life insurance companies. As detailed in Table 3, private equity-owned life insurance firms also hold a smaller proportion of U.S. government bonds, municipal bonds,

<sup>81</sup> These numbers were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on the U.S. Insurers' CLO Exposure. The calculations provided are exclusive to life insurance. The reports can be found here: <https://content.naic.org/capital-markets-bureau>.

and agency-backed commercial and residential mortgage-backed securities (CMBS and RMBS), while holding a larger proportion of private label RMBS and CMBS.<sup>82</sup>

**Table 3: Bond Mix of Private Equity and Non-Private Equity-Owned U.S. Life Insurance Firms (2021)**

| Bond Type                           | Private Equity Owned | Non Private-Equity Owned | Point Difference |
|-------------------------------------|----------------------|--------------------------|------------------|
| ABS and Other Structured Securities | 27.6%                | 9.4%                     | 18.1%            |
| Agency-backed CMBS                  | 0.5%                 | 1.4%                     | -0.9%            |
| Agency-backed RMBS                  | 1.8%                 | 3.9%                     | -2.2%            |
| Bank Loans                          | 1.5%                 | 2.1%                     | -0.6%            |
| Corporate Bonds                     | 52.3%                | 64.5%                    | -12.1%           |
| ETF-SVO Identified Funds            | 0.1%                 | 0.1%                     | 0.0%             |
| Foreign Government                  | 0.6%                 | 1.6%                     | -1.0%            |
| Hybrid Securities                   | 0.0%                 | 0.0%                     | 0.0%             |
| Municipal Bonds                     | 4.8%                 | 6.1%                     | -1.3%            |
| Private-label CMBS                  | 5.8%                 | 4.3%                     | 1.4%             |
| Private-label RMBS                  | 3.8%                 | 1.9%                     | 1.9%             |
| US Government                       | 1.3%                 | 4.6%                     | -3.4%            |
| Total                               | 100.0%               | 100.0%                   |                  |

Source: NAIC. EBSA Calculations

Other stakeholders are less concerned about the trends discussed above. Several stakeholders said that IB 95-1 already covers the quality and diversification of the investment portfolio. Some insurer stakeholders cited to the asset mix diversity of their portfolios as providing greater protection to policyholders, noting that investors too reliant on a limited mix of assets (e.g., high concentration of highly rated corporate bonds) were more negatively impacted by the 2008 financial crisis, with one stakeholder saying that concerns about the risk of ABS is due to misconceptions that do not recognize regulatory changes implemented in the Dodd-Frank Act and other laws enacted subsequent to the 2008 financial crisis. Several stakeholders said that state regulators, who are keenly aware of investment trends across the insurance sector, including CLOs, closely scrutinize investments and investment portfolios. They also said asset portfolio quality is a measure under applicable risk-based capital standards, resulting in increased capital charges to reflect increased asset risk. In this regard, they noted specifically that the NAIC is considering changes to its model risk-based capital (RBC) standards to address concerns with CLOs.<sup>83</sup> Finally, stakeholders noted that there have been no investment-related solvency losses to annuitants in PRT annuity purchase transactions, even throughout the 2008 financial crisis.

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<sup>82</sup> These numbers and Table 3 were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on Private Equity (PE)-Owned U.S. Insurers' Investments. The calculations provided are exclusive to life insurance. The reports can be found here: <https://content.naic.org/capital-markets-bureau>.

<sup>83</sup> See Risk-Based Capital Investment Risk and Evaluation (E) Working Group, [https://content.naic.org/cmt\\_e\\_rbcire.htm](https://content.naic.org/cmt_e_rbcire.htm).



### *6.3 Liabilities: Existence of Non-Traditional Liabilities*

A number of stakeholders expressed a concern that certain “non-traditional” liabilities being taken on by some insurance companies are underappreciated by plan fiduciaries. These stakeholders did not provide a uniform definition of “non-traditional” liabilities, but a common theme was that these liabilities may result in a “run” on an insurance company’s assets.<sup>84</sup> As such, in their view, these liabilities can have a significant effect on an insurance company’s cash flow and risk profile that should be understood by plan fiduciaries. Some stakeholders associated “non-traditional” liabilities with specific types of insurance company operational or investment activities that obligate the company to pay amounts to counterparties, who may exercise their rights to payment at unexpected times. Examples raised by stakeholders included funding agreement-backed securities, repurchase agreements, and securities loans.

According to stakeholders, the risk of such a “run” on an insurance company’s assets is important because it may diminish a company’s ability to pay annuitants. Stakeholders in particular cautioned that an insurance company may face challenges in meeting cash needs if it holds a significant proportion of its investments in investments with limited liquidity, or with high sensitivity to economic conditions. There were indications that even assets with highly liquid markets may not be readily available if the assets are held by an insurance company to match anticipated payment liabilities; in such a case the insurance company may not be able to sell those assets without violating its actuarial or regulatory constraints. (A discussion of stakeholder views with respect to insurance company assets and investment portfolio is contained elsewhere in this paper.)

These stakeholders believed it important for fiduciaries to consider “non-traditional” liabilities, and for the Department to consider placing greater emphasis on them in the Interpretive Bulletin. For example, several stakeholders suggested the IB should include a factor on the extent to which the insurer has high concentrations of such obligations, particularly funding-backed notes. The stakeholder explained that these obligations are particularly important because holders of these obligations stand alongside policyholders as payees of an insurer, but sometimes have additional rights that can indirectly affect policyholders’ interests. For instance, noteholders may have rights to affect the timing of payments from an insurer or have priority rights to assets of the insurer. Exercise of these rights may lead to a “run” on an insurer that could negatively impact policyholders.

Stakeholders from the insurance industry had a number of views on the issue of “non-traditional” liabilities. Some noted that the current Interpretive Bulletin may be sufficient as it includes a broad reference to an insurance company’s lines of business and other indications of its exposure to liability. They also questioned what would be considered a “non-traditional” liability for purposes of any new requirement. In this regard, some believed they would not be

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<sup>84</sup> Cf. Nathan Foley-Fisher et al., FEDS Notes, Assessing the size of the risks posed by life insurers' nontraditional liabilities, Bd. of Governors of the Fed. Reserve Sys. (May 21, 2019) (“In contrast to life insurers' traditional liabilities that make payments conditional on the health of the holder, nontraditional liabilities have neither mortality nor morbidity contingencies.”), <https://www.federalreserve.gov/econres/notes/feds-notes/assessing-the-size-of-the-risks-posed-by-life-insurers-nontraditional-liabilities-20190521.html>.

considered to have “non-traditional” liabilities because their businesses are comprised predominantly of writing insurance policies. Another insurance company recognized that some of its liabilities could hypothetically contribute to a “run,” but indicated that it conducts stress tests and takes steps to manage its liability risks. Some also indicated that, to the extent concerns related to “non-traditional” liabilities have been raised in connection with private equity-affiliated insurers, the NAIC may be examining this issue.<sup>85</sup>

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#### 6.4 Reinsurance

Many stakeholders raised the topic of reinsurance. Stakeholders described reinsurance as essentially insurance for an insurance provider. The NAIC describes it more technically as a contract between a reinsurer and an insurer, in which the insurance company—called the cedent—transfers risk to the reinsurance company, and the latter assumes all or part of one or more insurance policies issued by the cedent.<sup>86</sup> Literature cited by a number of stakeholders explains that the four basic motives of life and annuity reinsurance are risk transfer, underwriting assistance, capital management, and tax management.<sup>87</sup> Licensed insurance companies must report information about their reinsurance contracts (both ceded and assumed) on Schedule S of their annual filings. The insurers are ultimately responsible for all liabilities they issue, even those that they cede to reinsurers.<sup>88</sup>

According to the NAIC, U.S. licensed reinsurers are subject to the same state-based regulation as other licensed insurers. Thus, when an insurer cedes business to a licensed reinsurer, the cedent is permitted under regulatory accounting rules to recognize a reduction in its liabilities in the amount of ceded liabilities, without a regulatory requirement for the reinsurer to post any collateral to secure the reinsurer's payment of the reinsured liabilities.<sup>89</sup>

By contrast, reinsurers that are not licensed in the United States face a different regulatory regime. Reinsurers that are not licensed in the United States, often referred to as “alien” or offshore companies, must post 100 percent collateral to secure the transaction, unless they are a Certified Reinsurer or a Reciprocal Jurisdiction Reinsurer. An insurer that is not licensed or approved to accept reinsurance is an Unauthorized Reinsurer. Companies that are domiciled in Qualified Jurisdictions can become Certified Reinsurers after completing additional

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<sup>85</sup> See <https://content.naic.org/article/naic-announces-2023-regulatory-priorities>.

<sup>86</sup> NAIC, Ctr. for Ins. Pol’y and Res., Reinsurance, <https://content.naic.org/cipr-topics/reinsurance> (last updated June 1, 2023).

<sup>87</sup> Ralph Kojien & Motohiro Yogo, Shadow Insurance, Nat’l Bureau of Econ. Res. 4 (Working Paper No. 19568 2016), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2320921](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2320921).

<sup>88</sup> John J. Pruitt, Insurance and Reinsurance in the United States: Overview (2023), [https://uk.practicallaw.thomsonreuters.com/9-501-3187?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co\\_anchor\\_a159591](https://uk.practicallaw.thomsonreuters.com/9-501-3187?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a159591). For the transferring insurer to be released from direct liability to the insured, a novation must occur, which requires the policyholder’s consent. Depending on the state, such consent must be express or can be implied by conduct. Most U.S. states have detailed requirements for notices to policyholders that are necessary for consent.

<sup>89</sup> NAIC, Ctr. for Ins. Pol’y and Res, Reinsurance, <https://content.naic.org/cipr-topics/reinsurance> (last updated June 1, 2023).

review by the states, and this status allows the reinsurers to reduce the collateral required. Additionally, companies that have a head office or are domiciled in Reciprocal Jurisdictions can become Reciprocal Jurisdiction Reinsurers if they meet certain standards, and this status will allow these companies to not post collateral.<sup>90</sup>

In recent years, some evidence suggests that reinsurance activity has grown rapidly across the life insurance industry. According to an economist at the Board of Governors of the Federal Reserve System, in 1999, less than \$200 billion in obligations were assumed by reinsurance policies. By 2017, \$1 trillion in obligations were assumed. This nearly tripled the share of life insurance obligations being reinsured from 6 percent to 16 percent of total obligations. Most of this growth came from either captive reinsurers or affiliated reinsurers in foreign countries, which provide capital, tax, and financial disclosure benefits without transferring assets outside the company. In 1999, these types of reinsurance accounted for 14 percent of life reinsurance, which grew to 57 percent by 2017.<sup>91</sup>

The growth demonstrated in the prior paragraph continued in 2021. According to ALIRT Insurance Research (2022), the life insurance and annuity industry ceded \$1.7 trillion in total reserves in 2021. Of this amount, approximately \$651 billion was ceded to foreign domiciled reinsurers, with 83 percent of this amount (\$539 billion) sent to the Bahamas. In addition, a total of \$384 billion was ceded under modified coinsurance contracts to foreign domiciled reinsurers, with 86 percent (\$333 billion) of those reserves being sent to the Bahamas.<sup>92</sup>

A number of stakeholders raised concerns with trends in the life and annuity insurance industry regarding reinsurance. One concern is that annuity insurers are using reinsurance to move liabilities from highly regulated operating companies to less regulated and off-balance sheet reinsurers, typically affiliated (captive of the ceding insurer) and often offshore reinsurers based in Bermuda. Among other things, stakeholders mentioned less stringent reserving requirements and accounting arbitrage as underlying their concern. In its letter to Senator Brown regarding the growing role of alternative asset managers, such as private equity firms, in the U.S. insurance sector, discussed above, the Department of the Treasury noted that the speed and scale of the growth of offshore and affiliated reinsurance “suggests the need for regulators and policymakers to better understand the role of offshore reinsurers and whether regulatory capital arbitrage opportunities, tax advantages, and other potential gaps that are not under the oversight of U.S. regulators are obscuring (or even amplifying) the level of risk stemming from these activities.”<sup>93</sup>

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<sup>90</sup> *Id.*

<sup>91</sup> Michael Batty, FEDS Notes, Accounting for Reinsurance Transactions in the Financial Accounts of the United States, Bd. of Governors of the Fed. Reserve Sys. (Oct. 12, 2018), <https://www.federalreserve.gov/econres/notes/feds-notes/accounting-for-reinsurance-transactions-in-the-financial-accounts-of-the-united-states-20181012.html>.

<sup>92</sup> ALIRT Insurance Research, U.S. Life Insurers’ Bermuda Reinsurance Exposure (Oct. 18, 2022), <https://rgb-prod-public-pdfs.s3.us-east-2.amazonaws.com/fiVNWhYt6dyc0E-kUV87KA9Id20.pdf>.

<sup>93</sup> Letter from Jonathan Davidson, Assistant Sec’y for Legisl. Affairs, U.S. Dep’t of the Treasury, to The Honorable Sherrod Brown, U.S. Sen. 5 (June 29, 2022), [www.banking.senate.gov/imo/media/doc/fio\\_85.pdf](http://www.banking.senate.gov/imo/media/doc/fio_85.pdf).

Several stakeholders also indicted that there are different types of reinsurance contracts and one type in particular – called “modified coinsurance” – was identified as a concern. With regard to “coinsurance,” the cedent transfers both assets and liabilities (reserves) to the reinsurer. However, the cedent transfers only liabilities (reserves) with modified coinsurance and keeps the assets on its books. Under this type of reinsurance arrangement, stakeholders are concerned that insurers may have strategic reasons under applicable RBC standards to hold on to riskier assets longer than optimal because the true investment risk has been ceded to the reinsurer. One stakeholder submitted literature with “empirical evidence that life insurers with [modified coinsurance] are less likely than those without [modified coinsurance] to sell downgraded bonds if capital losses are much larger than the increase in regulatory capital costs.”<sup>94</sup>

Other stakeholders told the Department that there are business reasons to engage in reinsurance transactions. To begin, these stakeholders asserted that reinsurance is an essential tool for insurance companies to manage risks and the amount of capital they must hold to support those risks. In addition, they asserted that offshore reinsurance entities offer tax efficiencies that attract capital and reduce the effective tax rate of the reinsurer and its holding company. While recognizing that the level of regulatory oversight of offshore reinsurance differs by jurisdiction, stakeholders offered that Bermuda generally is recognized as a premier international reinsurance jurisdiction. In support of this assertion, these stakeholders noted that the NAIC has approved Bermuda as a Qualified Jurisdiction and most recently a Reciprocal Jurisdiction for reinsurance purposes, and that European regulators have also approved Bermuda for Solvency II equivalency.

There were suggestions from other stakeholders who believe that reinsurance should be required. These stakeholders describe the purchase of reinsurance “sufficient to provide a replacement annuity of equal value from a third-party insurer that is independent of the annuity provider and financially capable.”<sup>95</sup>

Most stakeholders agreed that whether and the extent to which an insurer cedes liability to a reinsurer, as well as the jurisdictional, financial, and ownership characteristics of the reinsurer, is or should be part of a fiduciary’s analysis when selecting an insurer. The extent to which an insurer cedes liabilities to reinsurers is reported on the insurer’s Schedule S. A few stakeholders believe that captive and offshore reinsurers may warrant more scrutiny than unaffiliated domestic reinsurers licensed in the United States, due to the potential for relaxed supervision of captives and offshore entities. Importantly, the stakeholders emphasized that a fiduciary’s analysis of the reinsurer’s financials should be done using statutory accounting principles (SAP) or both generally accepted accounting principles (GAAP) and SAP, but not just

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<sup>94</sup> Kyeonghee Kim et al., Regulatory Capital and Asset Risk Transfer 32 (Dec. 29, 2019), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4221205](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4221205). Bermuda domiciled reinsurers account for 50 percent of the total modified coinsurance market and 87 percent of the foreign domiciled modified coinsurance market. See ALIRT Insurance Research, U.S. Life Insurers’ Bermuda Reinsurance Exposure (Oct. 18, 2022), <https://rgb-prod-public-pdfs.s3.us-east-2.amazonaws.com/fiVNWhYt6dyc0E-kUV87KA9Id20.pdf>.

<sup>95</sup> Nat’l Retiree Legis. Network & Pension Rights Center, Pension Plan ‘De-Risking’: A Proposal to Protect Retirees and Older Workers by Adding a Statutory Safe Harbor Annuity Selection to ERISA Section 404 (Jan. 2023), <https://nrln.org/wp-content/uploads/2023/03/Summary-Proposal-De-risking-Legislative-Reform-Final-012923.pdf>.

**GAAP.** Consistent with this view, one insurance holding company stakeholder stated that it presents its reinsurer’s financials using both SAP and GAAP regardless of whether the offshore regulatory structure requires or permits only GAAP.

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### 6.5 Risk-based Capital and Other Methodologies

RBC requirements are used by state insurance regulators to identify life insurance companies that are weakly capitalized and for which regulatory intervention may be needed.<sup>96</sup> The NAIC developed the RBC requirement for life insurers and describes it as “a statutory minimum level of capital that is based on two factors: 1) an insurance company’s size; and 2) the inherent riskiness of its financial assets and operations. That is, **the company must hold capital in proportion to its risk.**”<sup>97</sup> The NAIC has developed the *Risk-Based Capital (RBC) for Insurers Model Act* that is necessary for states to adopt in substantially similar form for accreditation purposes.<sup>98</sup>

An insurer’s RBC ratio – generally described as the insurer’s total adjusted capital divided by its authorized control level risk-based capital – is a metric that came up frequently in stakeholder discussions and in the Department’s research for the IB 95-1 review.<sup>99</sup> According to the NAIC’s website, the states generally provide that regulatory action is not required with respect to an insurer with an RBC ratio that is at or above 200 percent; below that level, a range of interventions apply and a regulator must take over the insurer if the ratio falls below 70 percent.<sup>100</sup> The American Council of Life Insurers reports that at year end 2021, life insurer RBC ratios averaged in the mid-400s percent, and that 93.5 percent of life insurers (carrying 99.1 percent of the industry’s total assets) had ratios of 200 percent or more.<sup>101</sup> One stakeholder expressed the opinion that, for purposes of a review of insurers for PRT transactions, an RBC ratio becomes concerning at around 300 percent.

Several stakeholders suggested that an insurer’s RBC ratio should be specifically identified in IB 95-1 as a consideration for fiduciaries evaluating an insurer’s claims paying ability and creditworthiness. In terms of placement within the IB, one stakeholder suggested that the RBC ratio should be added to the existing consideration 3, “the level of the insurer’s capital

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<sup>96</sup> See NAIC, Ctr. for Ins. Pol’y and Res., Risk-Based Capital, <https://content.naic.org/cipr-topics/risk-based-capital> (last updated June 1, 2023).

<sup>97</sup> *Id.*

<sup>98</sup> NAIC, Financial Regulation Standards and Accreditation Program (Aug. 2021), <https://content.naic.org/sites/default/files/inline-files/FRSA-Pamphlet-8-2021.pdf>.

<sup>99</sup> NAIC, Ctr. for Ins. Pol’y and Res., Risk-Based Capital, <https://content.naic.org/cipr-topics/risk-based-capital> (last updated 6/1/2023); Am. Council of Life Insurers (ACLI) Life Insurers Fact Book 2022 33 (“Risk-based capital, calculated according to an NAIC model law, is considered the minimum amount of capital an insurer needs to avoid triggering regulatory action. The RBC ratio is total adjusted capital divided by risk-based capital, for a threshold ratio of 100 percent.”), [https://www.acli.com/-/media/acli/public/files/factbook/2022lifeinsurersfactbook\\_v2.pdf](https://www.acli.com/-/media/acli/public/files/factbook/2022lifeinsurersfactbook_v2.pdf).

<sup>100</sup> NAIC, Ctr. for Ins. Pol’y and Res., Risk-Based Capital (citing Martin Eling & Ines Holzmuller, An Overview and Comparison of Risk-Based Capital Standards, 26(4) J. of Ins. Reg. 31 (2008)), <https://content.naic.org/cipr-topics/risk-based-capital> (last updated 6/1/2023).

<sup>101</sup> ACLI Life Insurers Fact Book 2022 33, [https://www.acli.com/-/media/acli/public/files/factbook/2022lifeinsurersfactbook\\_v2.pdf](https://www.acli.com/-/media/acli/public/files/factbook/2022lifeinsurersfactbook_v2.pdf).



and surplus.” Some other stakeholders agreed that it would be reasonable to identify the RBC ratio as one factor for fiduciary consideration; however, they indicated the Department should take care to ensure it is not overemphasized as the only factor. These stakeholders expressed the view that an insurers’ capital and surplus position may be nuanced and the sole focus on an insurer’s RBC ratio would not provide a full picture.<sup>102</sup>

Other stakeholders, without disputing the relevance of RBC requirements, presented downsides to identifying RBC ratios in the IB. One stated that the RBC ratio is not intended as a tool for comparing companies to one another or ranking them. According to the stakeholder, the important fact is whether an insurer’s RBC ratio exceeds the level at which regulatory intervention is warranted; once that threshold is met, comparing higher or lower RBC ratios is not meaningful. The stakeholder further informed the Department that insurers are not permitted to advertise their RBC ratios. Another stakeholder suggested that it may be preferable to retain the more principles-based reference to “capital and surplus” which many believe encompasses the RBC ratio, thereby avoiding the IB becoming outdated if there are changes to the state regulatory framework in the future.

Certain perceived weaknesses and shortfalls of the RBC requirements applicable to life insurers were also mentioned by some stakeholders, for example, the different treatment of corporate bonds and securitized products such as CLOs and the fact that the RBC ratio is limited to the insurer entity and does not illustrate the strengths or weaknesses of the parent or other affiliates.<sup>103</sup> One stakeholder indicated that insurers have been known to add to their reserves at the time they are required to report their RBC ratio, and then reverse the transaction and remove the extra reserves immediately thereafter.

A few stakeholders presented other approaches for evaluating the solvency and creditworthiness of insurers. One methodology is to focus on the ratio of the sum of the insurer’s “higher-risk assets” and “opaque reinsurance” to surplus held (as reported on its sworn statutory annual statement).<sup>104</sup> Another methodology involves review of market spreads on bonds (specifically, spreads on funding backed-agreement notes) issued by annuity providers. The latter methodology uses the bond market’s ability, and incentive, to holistically assess the insurer’s creditworthiness.<sup>105</sup>

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<sup>102</sup> The NAIC website likewise cautions that the RBC calculation is a regulatory tool and is “not designed to be used as a stand-alone tool in determining financial solvency.” See <https://content.naic.org/cipr-topics/risk-based-capital>.

<sup>103</sup> The NAIC is considering changes to treatment of CLOs for purposes of risk-based capital requirements. See Risk-Based Capital Investment Risk and Evaluation (E) Working Group, [https://content.naic.org/cmt\\_e\\_rbcire.htm](https://content.naic.org/cmt_e_rbcire.htm).

<sup>104</sup> See [www.whatisthetr.com](http://www.whatisthetr.com).

<sup>105</sup> See David Eichhorn, Pension Risk Transfers (PRT) May Be Transferring Risk to Beneficiaries, NISA Investment Advisors LLC (Oct. 13, 2022), <https://www.nisa.com/perspectives/pension-risk-transfers-prt-may-be-transferring-risk-to-beneficiaries/#>. See also David Eichhorn, Liquidity Refinements to Potential Economic Loss Beneficiaries (ELB) in PRTs, NISA Investment Advisors LLC (June 16, 2023), <https://www.nisa.com/perspectives/liquidity-refinements-to-potential-economic-loss-to-beneficiaries-elb-in-prts/>.

## 6.6 Separate Accounts as a Protection

Group annuity contracts used in PRT annuity purchase transactions can be supported by either the insurance company's general account or by a separate account (which can be dedicated to a single employer's PRT or commingled).<sup>106</sup> Separate accounts are protected from the liabilities of the insurer's general account, yet they generally benefit from support from the general account.<sup>107</sup> IB 95-1 currently provides that fiduciaries should consider "the structure of the annuity contract and guarantees supporting the annuities, such as use of separate accounts."

Some of the Department's stakeholder meetings included discussion of the extent to which separate accounts provide additional protection of participants impacted by PRT annuity purchase transactions. Several stakeholders expressed the view that separate account protections are valuable due to their structure and backing by the insurance company's general account. One insurer in the PRT market told the Department that it only used separate accounts and it believed that distinguished it from its competitors, although its investment strategy for the separate accounts is the same strategy used for its general account.

A few stakeholders questioned the protections offered by separate accounts, however. They stated that the insurer's investment strategy for the separate account is the more important determinant of the risks. More than one stakeholder expressed the view that a very safe general account investment strategy is more protective than a separate account, if the separate account is invested in riskier assets. At least one stakeholder also suggested that the additional protections offered by the use of a separate account may be diminished to some extent if the separate and general account use the same investment strategy, because the investment risk of both accounts is perfectly correlated in such cases. In sum, the observations of these commenters are that the Department might consider whether to revise IB 95-1 to focus not only on whether a separate account exists but also on the characteristics of the account including the level of correlation between its risk features and those of the general account.

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## 6.7 Administrative Capabilities and Experience

Quite a few stakeholders indicated that the administrative capabilities and experience of the insurer are factors that fiduciaries should, and do, consider in selecting an annuity provider.<sup>108</sup> Stakeholders indicated that administrative services may be handled in-house or outsourced. Several stakeholders identified capabilities with respect to deferred annuities as

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<sup>106</sup> Timothy Geddes et al., Pension Risk Transfer, Evaluating Impact and Barriers for De-Risking Strategies, Society of Actuaries 26 (2021), <https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/>.

<sup>107</sup> *Id.*; see NAIC, Ctr. for Ins. Pol'y and Res., Pension Risk Transfer, <https://content.naic.org/cipr-topics/pension-risk-transfer> (last updated 4/3/2023).

<sup>108</sup> A demonstrated ability to administer the payment of benefits is a relevant consideration. In the Department's experience, administrative and recordkeeping failures following PRT annuity purchases can result in risks to policyholders. See, e.g., Press Release, New York State Department of Financial Services, January 28, 2019 (DFS Superintendent Vullo announcing that MetLife will pay a \$19.75 million fine and provide \$189 million in restitution to policy holders for failures related to pension benefit transfers), [https://www.dfs.ny.gov/reports\\_and\\_publications/press\\_releases/pr1901282](https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1901282).



being particularly challenging from an administrative standpoint. Some identified a perception that the new entrants to the annuity market may lack the administrative and operational capacities of traditional insurers to reliably meet their commitments to annuitants and provide a reasonable customer experience.

Stakeholders identified several areas of inquiry related to the administrative capabilities of the entity providing the services, including the adequacy of payments systems for administering annuities, record-keeping, necessary election forms, IT capabilities and cybersecurity practices to safeguard annuitant information, call centers and websites for annuitants to obtain information, and overall experience with PRT annuity purchase transactions of similar size and characteristics. Stakeholders said fiduciaries could inquire about internal surveys that the entity may have conducted regarding its administrative services, including, for example, an evaluation of response time to phone calls.

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### 6.8 Spousal Protections

Several stakeholders mentioned concerns regarding the possible loss of the Internal Revenue Code's (Code) spousal protections as part of or following PRT annuity purchases. The Code's qualified joint and survivor annuity (QJSA) requirements are designed to protect the participant's spouse. In general, they require that distributions from the plan be made in the form of a qualified joint and survivor annuity unless the spouse waives the right to that form of benefit.<sup>109</sup> The main issue raised by these stakeholders is whether, following a PRT annuity purchase, there is any applicable law that would prohibit the annuitant from, at some later time, converting the remaining value of the annuity into a lump sum without obtaining spousal consent.<sup>110</sup>

Other stakeholders are of the view that, despite individuals' loss of status as participants covered under ERISA plans as a result of PRT annuity purchases, the applicable Department of the Treasury regulations comprehensively address spousal protections after PRTs. These stakeholders indicated that these regulations require annuity contracts to replicate both the terms of the pension plan and the QJSA requirements, and that the parties work diligently throughout the bidding and execution phases of PRTs to ensure such protections are incorporated into annuity contracts.<sup>111</sup> These stakeholders noted that the Treasury regulations, in relevant part, state that the QJSA "requirements are applicable to any benefit payable under a plan, including a benefit payable to a participant under a contract purchased by the plan and paid by a third

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<sup>109</sup> See 26 U.S.C. 401(a)(11) and 26 U.S.C. 417.

<sup>110</sup> Statement of Karen Friedman on behalf of Pension Rights Center (Aug. 29, 2013), [2013-private-sector-pension-derisking-and-participant-protections-friedman-08-29.pdf \(dol.gov\)](https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-friedman-08-29.pdf); Statement of David Certner on behalf of AARP (Aug. 29, 2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-certner-08-29.pdf>.

<sup>111</sup> ACLI, ERISA Protections for Annuitants in Pension De-risking Transactions (Dec. 2014), <https://www.acli.com/-/media/ACLI/Files/Pension-DeRisking-Public/ERISA-Protections-for-Annuitants.ashx?la=en>.

party.”<sup>112</sup> The regulations also state that QJSA rights and benefits “may not be eliminated or reduced because the plan uses annuity contracts to provide benefits merely because (a) such contract is held by a participant or spouse instead of a plan trustee, or (b) such contracts are distributed upon plan termination.”<sup>113</sup> Finally, these stakeholders noted that the regulations provide that “the requirements of [Code] sections 401(a)(11) and 417 apply to payments under the annuity contracts, not to distributions of the contracts.”<sup>114</sup>

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### 6.9 Anti-Alienation Rules: Protections Against Creditors and Division of Benefits on Divorce

Several stakeholders mentioned concerns regarding the possible loss of protections under ERISA and the Code’s assignment and alienation provisions as part of or following PRT annuity purchases. In general, ERISA and the Code do not permit a participant or plan to assign or alienate the participant’s interest in their retirement plan to another person.<sup>115</sup> These “anti-assignment and alienation” rules are intended to ensure that a participant’s retirement benefits are available to provide financial support during the participant’s retirement years. ERISA and the Code also contain an important exception to the general anti-alienation rules through an established framework for permitting a court ordered division of a pension benefit upon divorce called a Qualified Domestic Relations Order (QDRO).<sup>116</sup>

The primary concern raised by these stakeholders is the potential loss of ERISA and Code protections from the claims of creditors who seek to garnish or seize a participant’s retirement benefits following a PRT annuity purchase. According to these stakeholders, once the obligation to provide pension benefits is transferred to an insurance company, the continued application of these protections is not so clear and it appears that whether or not these benefits can be assigned or alienated is determined by state law, which can vary significantly.<sup>117</sup>

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<sup>112</sup> Treas. Reg. 1.401(a)-20, Q&A 1 (as amended in 2006).

<sup>113</sup> Treas. Reg. 1.401(a)-20, Q&A 2 (as amended in 2006).

<sup>114</sup> ACLI, ERISA Protections for Annuitants in Pension De-risking Transactions (Dec. 2014) (citing Treas. Reg. 1.401(a)-20, Q&A 2, “the requirements of sections 401(a)(11) and 417 apply to payments under the annuity contracts, not to the distributions of the contracts.”), <https://www.acli.com/-/media/ACLI/Files/Pension-DeRisking-Public/ERISA-Protections-for-Annuitants.ashx?la=en>.

<sup>115</sup> ERISA section 206(d)(1) (29 U.S.C. § 1056(d)(1)) and Code section 401(a)(13); see EBSA publication, QDROs: The Division of Retirement Benefits Through Qualified Domestic Relations Orders (2020), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/publications/qdros.pdf>.

<sup>116</sup> ERISA section 206(d) (29 U.S.C. § 1056(d)); Code sections 401(a)(13) and 414(p).

<sup>117</sup> Statement of Norman Stein before the ERISA Advisory Council (Aug. 29, 2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-stein-08-29.pdf>; Statement of William Kadereit on behalf of NRLN (Aug. 29, 2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-kadereit-08-29.pdf>; Statement of Karen Friedman on behalf of Pension Rights Center before the ERISA Advisory Council (Aug. 29, 2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-friedman-08-29.pdf>; Statement of Jane Smith on behalf of Pension Rights Center before ERISA Advisory Council (Aug. 18, 2015) (observing that in 2015 the state of Connecticut adopted a law protecting retirement plan benefits from creditors’ claims),

Stakeholders also expressed concern that without ERISA’s framework for dividing benefits on divorce, it may be difficult and costly for former spouses to obtain a court-awarded share of the annuity.<sup>118</sup> These stakeholders recommended that the Department issue guidance clarifying that fiduciaries have a responsibility to negotiate annuity contract provisions that replicate ERISA protections, including those under ERISA and the Code’s assignment and alienation provisions.<sup>119</sup>

Stakeholders from the insurance industry maintain that ERISA’s strong creditor protections do not go away merely because an annuity is purchased on behalf of an ERISA plan participant.<sup>120</sup> One stakeholder described 2005 amendments to the Federal Bankruptcy Code that now exempt from a bankruptcy estate retirement funds that are exempt under Code section 401.<sup>121</sup> According to this stakeholder, group annuities purchased with qualified plan benefits are required under the Code to replicate plan provisions including the plan’s payable form of benefit and prohibition against assignment of benefits to third parties.<sup>122</sup>

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### 6.10 Disclosures

Stakeholders raised a concern regarding a potential lack of disclosure as part of partial PRT annuity purchases, so-called lift-outs.<sup>123</sup> In the case of standard termination PRT annuity purchases, ERISA contains a detailed reporting and disclosure structure.<sup>124</sup> However, no similar reporting and disclosure regime exists under ERISA for partial PRT annuity purchases, according to these stakeholders, but one should. Other stakeholders representing plan sponsors and insurers indicated that, regardless of a legal duty, they dedicate significant resources to ensuring that participants and retirees understand the PRT annuity purchase, how they are affected, and the consequences of any decision they may make with respect to their rights under

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<https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2015-model-notices-and-disclosures-for-pension-risk-transfers-smith-08-18.pdf>; statement and presentation by Edward Stone for the ERISA Advisory Council (May 27-29, 2015), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2015-model-notices-and-disclosures-for-pension-risk-transfers-stone-05-28.pdf>.

<sup>118</sup> Statement of Norman Stein before the ERISA Advisory Council (Aug. 29, 2013),

<https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-stein-08-29.pdf>.

<sup>119</sup> *Id.*

<sup>120</sup> ACLI, ERISA Protections for Annuitants in Pension De-risking Transactions (Dec. 2014) <https://www.acli.com/-/media/ACLI/Files/Pension-DeRisking-Public/ERISA-Protections-for-Annuitants.ashx?la=en>.

<sup>121</sup> *Id.* (explaining that Bankruptcy Code sections 522(b)(3)(C) and 522(d)(12) exempt retirement funds that are exempt under Code section 401(g)).

<sup>122</sup> *Id.* (citing IRS General Counsel Memorandum 39882 (Oct. 14, 1992) and Treas. Reg. 1.401(a)-20, Q&A-2); *see* Code section 401(a)(13).

<sup>123</sup> Jane Smith statement on behalf of Pension Rights Center to ERISA Advisory Council (Aug. 18, 2015), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2015-model-notices-and-disclosures-for-pension-risk-transfers-smith-08-18.pdf>; Karen Friedman on behalf of Pension Rights Center statement to ERISA Advisory Council (Aug. 29, 2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-friedman-08-29.pdf>.

<sup>124</sup> ERISA section 4041 (29 U.S.C. § 1341); 29 CFR § 4041.23, .24, .27, .28.

the annuity contract.<sup>125</sup> These stakeholders asserted that compelling business reasons, such as brand reputation and human relations, justify comprehensive and understandable disclosures. For example, advance disclosures inviting participants to review and verify the accuracy of all personal information, such as age, dates of employment, salary, and elected spousal benefit, reduce the likelihood of transition errors and post-PRT annuity purchase recalculations.

A few stakeholders raised a different concern regarding a lack disclosure following a PRT annuity purchase. In the aftermath, nothing comparable to the annual funding notice required under section 101(f) of ERISA is required to be furnished to policyholders, which may leave them uninformed as to the solvency of the insurer, according to these stakeholders.<sup>126</sup> However, other stakeholders find this outcome entirely logical, reasoning that once a participant ceases to be a participant under the plan they are no longer entitled to nor would they have any practical need for the types of funding disclosures required under ERISA. Nevertheless, the stakeholders concerned by the lack of post-PRT annuity purchase disclosures recommended that fiduciaries should negotiate terms in the annuity contract obliging the insurer to send annual reports to annuitants on the financial status of the annuity provider and reinsurer.<sup>127</sup> These stakeholders are of the view that, without such contractual obligations, participants will only receive information required by state insurance laws, if any, regarding the financial health of the annuity provider.

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### 6.11 Loss of PBGC Protections

The PBGC protects participants in defined benefit plans by paying benefits up to limits set by law if a plan is terminated and does not hold sufficient assets to pay all benefits.<sup>128</sup> As a result of a PRT annuity purchase transaction, benefits of the individuals who were formerly defined benefit plan participants become insured by state guaranty associations (SGAs) rather than the PBGC. SGAs provide coverage up to state law limits in the event the issuing insurer becomes insolvent.<sup>129</sup>

Some stakeholders indicated that the comparison of PBGC guarantees versus SGA guarantees is a topic of concern to plan fiduciaries. One stakeholder identified the removal of the PBGC guarantee as a significant loss for participants, based on the view that the PBGC offers a

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<sup>125</sup> ACLI, ERISA Protections for Annuitants in Pension De-risking Transactions (Dec. 2014), <https://www.acli.com/-/media/ACLI/Files/Pension-DeRisking-Public/ERISA-Protections-for-Annuitants.ashx?la=en>.

<sup>126</sup> Nat'l Retiree Legis. Network & Am. Retirees Educ. Found., Pension Plan "De-Risking": Strengthening Fiduciary Duties to Protect Retirees (Jan. 2023), [https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal\\_Draft4-Final\\_012923\\_final.pdf](https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal_Draft4-Final_012923_final.pdf); Statement of William Kadereit on behalf of NRLN (2013), <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections-kadereit-08-29.pdf>.

<sup>127</sup> Nat'l Retiree Legis. Network & Am. Retirees Educ. Found., Pension Plan "De-Risking": Strengthening Fiduciary Duties to Protect Retirees (Jan. 2023), [https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal\\_Draft4-Final\\_012923\\_final.pdf](https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal_Draft4-Final_012923_final.pdf).

<sup>128</sup> See <https://www.pbgc.gov/about/faq/pg/general-faqs-about-pbgc>.

<sup>129</sup> Nat'l Org. of Life & Health Ins. Guaranty Associations, <https://nolhga.com/>.

higher level of guarantee compared with the SGAs.<sup>130</sup> This stakeholder also worried that because SGAs are not pre-funded, a systemic failure could lead to multiple insolvent insurance companies that could collapse the system. Another stakeholder alternatively asserted that there are more risks under the PBGC program. The stakeholder cited a PBGC study of guarantee limitations set by law and regulation that resulted in benefit reductions to vested participants in plans that terminated without enough assets to provide the full value of accrued benefits to all participants.<sup>131</sup> Other sources suggest that a comparison of the two regimes does not lead to an outright conclusion that one is superior to the other.<sup>132</sup>

On this topic, one stakeholder viewed the loss of the PBGC guarantee as a direct and unavoidable consequence of the settlor decision to engage in the PRT annuity purchase transaction. This stakeholder therefore believed that this issue is not a proper consideration for the fiduciary implementing the settlor decision.

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### 6.12 State Guaranty Associations

Several stakeholders raised a different issue related to SGAs. These stakeholders noted that IB 95-1 identifies “the availability of additional protection through state guaranty associations and the extent of their guarantees” as a factor for fiduciary consideration. However, these stakeholders questioned the relevancy of SGA guarantees to the identification of a provider for the safest available annuity.

These stakeholders opined that SGA coverage is not germane to an analysis of whether any particular insurer is safer or more solvent than any other competing insurer because every state (and consequently every licensed insurer doing business in the state) has some form of SGA protection. Put differently, since all licensed insurers have SGA coverage, it adds almost nothing

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<sup>130</sup> Nat’l Retiree Legis. Network & Am. Retirees Educ. Found., Pension Plan ‘De-Risking’: Strengthening Fiduciary Duties to Protect Retirees 6 (Jan. 2023), [https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal-Draft4-Final\\_012923\\_final.pdf](https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal-Draft4-Final_012923_final.pdf).

<sup>131</sup> American Benefits Council, Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Shows That Any Restrictions on Such Purchases Would Place Participants at Greater Risk 2 (Apr. 2023), [www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C](http://www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C) (citing PBGC, PBGC’s Single-Employer Guarantee Outcomes (May 2019), <https://www.pbgc.gov/sites/default/files/2016-single-employer-guaranty-study.pdf>).

<sup>132</sup> National Organization of Life and Health Insurance Guaranty Associations, Consumer Protection Comparison - The Federal Pension System and the State Insurance System 2 (May 22, 2016) (“An objective comparison of those protections—which are delivered through two different protection systems that have similar objectives but are very different in application—compels the conclusion that participants are strongly protected in both cases: the resolution and safety net mechanisms of the two systems would fully cover the vast majority of all benefit claims, and the small minority of benefit claims not fully covered would have marginally different outcomes, sometimes slightly favoring one system or the other for some individuals, depending on the specific circumstances of a particular case.”), <https://www.nolhga.com/resource/code/file.cfm?ID=2559>; ERISA Advisory Council, U.S. Dep’t of Labor, Private Sector Pension De-risking and Participant Protections 12 (2013) (stating that Josh Gotbaum, then-Director of the PBGC, indicated that “he did not think that a defined benefit plan with a PBGC guarantee was necessarily safer than an insurance company annuity backed by a state insurance guaranty association”), [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf](http://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf).

to a comparative analysis of competing issuers. These stakeholders further suggest that the extent of SGA guarantees may be difficult to evaluate as in many cases it will depend on the domiciliary state of the policyholder, a factor the purchasing plan fiduciary has no control over. More fundamentally, some stakeholders even assert that the provision in question may have a counterproductive effect on a fiduciary’s solvency analysis. They argue that some fiduciaries may engage in a less rigorous analysis because of the provision than they might perform if the IB did not contain the provision at all. This is because fiduciaries may be inclined to engage in a more casual approach to selecting the insurer with the comfort of knowing that regardless of the quality and diligence of their effort and analysis, the SGA coverage ultimately will backstop the insurer in any event. One stakeholder described that the effect of the provision is to permit a “deeper bench” of available insurers in the PRT annuity purchase marketplace than should be available under the IB. Overall, these stakeholders suggest that the Department consider removing the provision from the IB.

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### 6.13 Impact of Partial Pension Risk Transfer Annuity Purchases on Residual Funding Status of Plans

Several stakeholders raised a concern regarding the impact of a partial PRT annuity purchase on the residual funding status of the plan after the transfer. As mentioned elsewhere in this paper, partial PRT annuity purchases involve plans transferring a portion of their liabilities while the plans continue in operation. These transactions are commonly referred to as “partial PRTs” or “lift-outs.”

The specific concern raised by the stakeholders is that partial PRT annuity purchases may affect the plan’s ability to fund the liabilities that remain in the plan. While purchasing annuities from large, diversified insurers with appropriately conservative investment policies can benefit the group the annuities are being purchased for, the stakeholders are of the view that the transaction can leave the remaining participants worse off by removing assets underpinning their promised benefits.

One stakeholder pointed to the Verizon PRT as example of their concern. According to the materials submitted by this stakeholder, “although Verizon contributed \$3.7 billion to its pension plans in 2012, after closing its annuity buy-out that transferred 41,000 management retirees to Prudential – including a \$1 billion premium above projected costs – it reported a funding ratio of 68.5 [percent] at year end – down from 78.8 [percent] at year-end 2011.”<sup>133</sup>

In an effort to further illustrate this point, the Department has created the simplified hypothetical example presented in the chart below. The example presents a pre- and post-transaction funding level for a plan engaging in a partial PRT annuity purchase involving a third of the liability associated with retired participants (with no premium for simplification). The plan

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<sup>133</sup> Nat’l Retiree Legis. Network & Am. Retirees Educ. Found., Pension Plan ‘De-Risking’: Strengthening Fiduciary Duties to Protect Retirees 10 (Jan. 2023), [https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal\\_Draft4-Final\\_012923\\_final.pdf](https://nrln.org/wp-content/uploads/2023/02/NRLN-Derisking-WP-2023-Update-and-Proposal_Draft4-Final_012923_final.pdf).



funding level is moved from 85.0 percent to 81.3 percent funded by this transaction. Although the retired population that was annuitized may be viewed as better off, the participants remaining in the plan are worse off absent any action by the plan sponsor to inject funds so the plan is funded at the prior level.

| Participant Type        | Liability       | Partial Transfer Rate | Liability Removed | Post Transaction Liability | Pre Transaction Assets | Pre Transaction Funded Level | Post Transaction Assets | Post Transaction Funded Level |
|-------------------------|-----------------|-----------------------|-------------------|----------------------------|------------------------|------------------------------|-------------------------|-------------------------------|
| Active Worker           | \$ 550          | 0%                    | \$ -              | \$ 550                     |                        |                              |                         |                               |
| Separated Vested Worker | \$ 250          | 0%                    | \$ -              | \$ 250                     |                        |                              |                         |                               |
| Retired Worker          | \$ 1,200        | 33%                   | \$ 396            | \$ 804                     |                        |                              |                         |                               |
| <b>Total</b>            | <b>\$ 2,000</b> |                       | <b>\$ 396</b>     | <b>\$ 1,604</b>            | <b>\$ 1,700</b>        | <b>85.0%</b>                 | <b>\$ 1,304</b>         | <b>81.3%</b>                  |

A few stakeholders raised with the Department that there may be uncertainty as to whether, and precisely how, the specific factors in the IB apply to situations when a partial PRT annuity purchase materially reduces the funding percentage of the plan. Further, some questioned whether there may be any circumstances under which a plan fiduciary might conclude under the IB or section 404 of ERISA more generally that the fiduciary is unable to implement the settlor's decision to de-risk because of the negative affect the partial PRT annuity purchase would have on the funding status of the plan after the PRT. Moreover, one stakeholder suggested that to the extent that the plan sponsor does not maintain pension funding levels of at least 80 percent, the plan sponsor may find that its ability to modify the plan in certain ways is limited and, depending on the funding level, may find that it must restrict the ability of plans to engage in PRT annuity purchases.

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## 7. Conclusion

Section 6 of this consultation paper sets forth the main issues raised by stakeholders. The Department welcomes the Council's input on conclusions that should be drawn with respect to these issues and their impact on the guidance provided in the IB, for purposes of the Department's report to Congress as required by section 321 of Secure 2.0. In this regard, the Department also invites comments on whether there are additional issues that the Department should consider as part of its review of the IB and development of the report.