Pension Plan 'De-Risking': Strengthening Fiduciary Duties to Protect Retirees

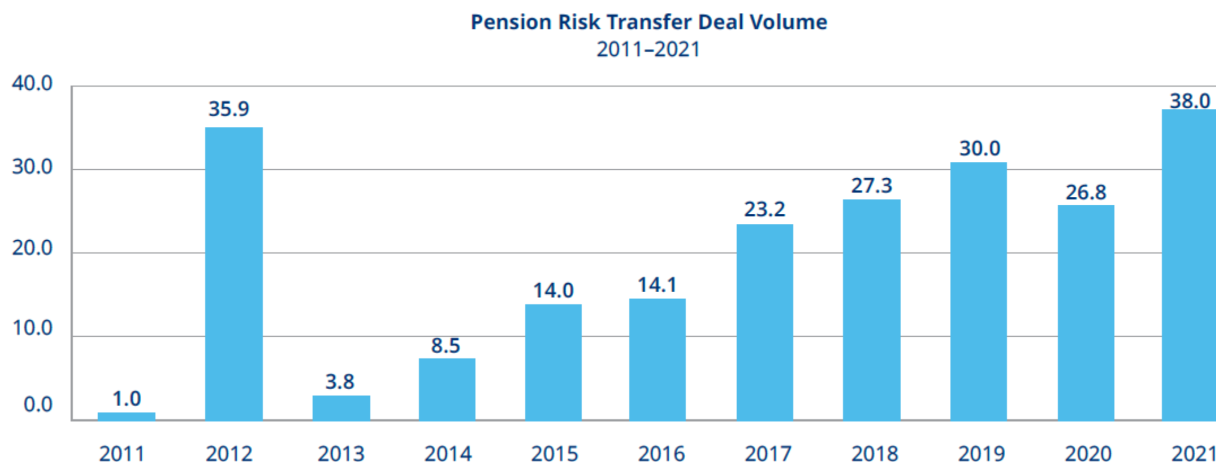
1/29/23

Introduction and Background

The steady decline in traditional defined-benefit pension plan sponsorship has taken another alarming turn for the worse as more blue chip companies move to "de-risk" their pension promises by using group annuity buyouts to transfer billions of dollars in assets and benefit liabilities to third party insurance companies. General Motors effectively established the de-risking trend a decade ago when it purchased a group annuity contract to transfer $29 billion in pension liabilities to Prudential Insurance Co.[i] GM initially offered a voluntary lump-sum buy-out to a subgroup of 44,000 of its 118,000 U.S. salaried retirees. After 13,000 accepted the offer (just under 30%), GM implemented a group annuity buy-out for the rest, removing them from the plan. Fast forward to September 2022 and we see IBM continued the trend by transferring $16 billion in pension assets to Prudential and to Metropolitan Life Insurance Co. – and with it the responsibility to pay benefits to 100,000 retirees and beneficiaries covered by the IBM Personal Pension Plan.[ii] IBM helped pushed total pension group annuity buyouts to a new record of more than $50 billion during 2022 alone.

The share of the workforce covered by defined-benefit pensions has shrunk from more than 60% to less than 15% over the past four decades. Nonetheless, retirees who had earned and vested into fixed monthly benefits believed that at least they had the security of ongoing protection against default, by the federal Pension Benefits Guaranty Corporation (PBGC), and ongoing disclosures and other fiduciary protections enforced by the U.S. Department of Labor under ERISA. That may no longer be true, particularly if the newest and most abusive "de-risking" strategies are not tempered by the fiduciary obligations proposed in this white paper.

Plan sponsors are increasingly focused on reducing their company's exposure to volatility in pension funding and its negative impacts on corporate financial statements. Defined benefit pension annuity buy-outs have exceeded $250 billion since 2012, including a record of more than $50 billion in 2022 alone, according to Buck Consultants.[iii] The number of participants impacted by pension annuity contracts seems likely to rise further. A 2022 survey of large pension fund managers by Vanguard found that 27% of pension funds surveyed said they were likely to engage in risk transfers over the following 12 months through either a partial de-risking (12%) or voluntary plan termination (15%).[iv]



Sources: Mercer Quarterly Insurer Pension Risk Transfer Sales Survey and LIMRA annual market volume reports 12/31/21

At present, a number of factors seem likely to accelerate the trend toward at least partial plan de-risking transactions that transfer a selected group of retirees and other participants to an insurance company through the purchase of a group annuity.[v] These considerations include: relatively high stock market valuations, rising interest rates and inflation (which reduce the cost of by reducing the present value of projected benefit obligations), a desire to avoid rising PBGC premium payments, and the growing demand by private equity firms to leverage pension assets for higher returns. According to MetLife's 2022 survey, 92 percent of large plan sponsors considering a pension risk transfer said that continued rising interest rates would make them more likely to move forward with de-risking plans.[vi] As the Pension Rights Center's Norman Stein stated in testimony nearly a decade ago: "If interest rates increase, as some financial analysts predict, the cost of de-risking will drop, making the practice cheaper, more appealing, and more widespread."[vii]

This impetus to reduce the risk and volatility associated with pension liabilities can be positive or negative for plan participants, depending on the strategy a plan adopts. De-risking strategies take one of two forms. First, companies can retain the assets and liabilities in the plan, but change the investment mix to better insulate the company from market movements and even the longevity risk that retirees will live longer than expected. This is often called Liability Driven Investment (LDI) and typically means shifting a far greater proportion of assets into fixed-income securities, most often long-term bonds. LDI strategies also include the purchase of fixed annuity contracts from insurance companies (guaranteed investment contracts, or GICs). Under this more traditional **"annuity buy-in"** approach, fixed annuity contracts are held as plan assets and do not diminish protections for retirees or other participants.[viii]

A more recent and very different approach to de-risking is the **annuity buy-out.** These strategies transfer a portion of the assets and liabilities of an ongoing plan to a third party (typically an insurance company), or directly onto retirees in pay status through a voluntary lump sum buy-out. Plans frequently offer a lump sum distribution option to deferred vested participants (who are not yet eligible to commence monthly benefits) or, last year at GM and Ford, to retirees in pay status. By contrast, "[i]n a transaction involving the distribution of annuity certificates (also known as an 'annuity buy-out'), the plan purchases a group annuity contract from an insurance company and distributes certificates that enable the participants to enforce their rights to benefits directly against the insurance company. After an individual's pension benefits are settled, the individual ceases to be a participant in the plan, ERISA ceases to govern the benefit, and the PBGC no longer insures the benefit."[ix]

Share of DB Pension Annuity Transactions by Type

	2019	2020	2021
Buy-in	6%	7%	10%
Plan-termination buyout	41%	33%	15%
Retiree-only buyout	53%	60%	75%

Source: Mercer Quarterly Insurer Pension Risk Transfer Sales Survey for 12/31/19, 12/31/20 and 12/31/21

As the chart above demonstrates, partial annuity buy-outs that transfer subgroups of a plan's participants to insurance companies now represent by far the largest share of pension plan group annuity transactions. An early example was Verizon's unprecedented transfer of $7.5 billion in pension obligations for 41,000 management retirees to Prudential without complying with the notice and other rules governing voluntary (standard) plan terminations under ERISA.[x] In Verizon's case, the 41,000 management retirees were carved out from among more than 91,000 participants and stripped of both PBGC guarantees and other ERISA protections without being given an option to remain in the plan (which continues to pay benefits to other retirees). Verison simply declared that the retirees were no longer plan participants. Verizon's rationale is that the group annuity contract settled its obligations in full, just as if the plan had complied with the statutory notice, disclosure and PBGC review process that apply to voluntary terminations under ERISA Section 4041.

It's important to realize that de-risking transactions of this magnitude are a recent development. Historically, large companies with skilled, full-time workforces found defined-benefit pensions to be an economical way to encourage retention and manage retirement incentives. However, a number of factors have combined in recent years to give employers an incentive to reduce the overall risk and financial statement volatility associated with the accumulated pension liabilities earned by both current and retired workers over decades. As the American Benefits Council testified before the ERISA Advisory Council's June 2013 hearing on de-risking, for decades defined-benefit pension plans "were viewed as long-term liabilities of the plan sponsor ... based on long-term expected investment returns . . . [and] accounting rules [that] took a long-term view toward pension liabilities and required contributions."[xi] Unfortunately, a series of legislative and regulatory changes, along with increased volatility and historically low interest rates during the decade before 2022, have put plan sponsors under increasing short-term pressure to adopt strategies that "de-risk" the plans from a quarter-to-quarter financial perspective.

Since 2006 the regulatory environment has become extremely hostile to both the accounting and funding of defined-benefit pension plans. Most significantly, in 2007 new pension accounting rules issued by the Financial Accounting Standards Board (FAS 158) required plan sponsors to measure assets and liabilities on a mark-to-market basis and report any shortfall on their balance sheet as part of annual SEC disclosures to shareholders. This came on top of an

earlier FASB rule from the late 1980s that required companies to include a projection of pension costs (on a gain or loss basis) in their annual income statement, thereby increasing increasing the pressure on executives to reduce exposure to pension liability.

Exacerbating this, the Pension Protection Act of 2006 (PPA) phased in accelerated contribution requirements generally requiring plans that dropped even temporarily below 90% funding to amortize the underfunding over seven years and to calculate liabilities using a fairly conservative high-grade corporate bond yield curve.[xii] Although Congress repeatedly passed temporary contribution relief measures, the general impact has been to leave companies with less flexibility to avoid the cash flow squeeze of higher pension contributions. A final factor cited by industry is increases in PBGC premiums, which were increased roughly 20% as part of the MAP-21 legislation that gave plan sponsors temporary funding relief in the summer of 2012.

De-Risking and its Discontents: The Harms to Plan Participants

When a plan sponsor purchases and distributes an annuity contract – and thereby transfers the liability for future benefit payments – the contract itself is not a plan asset. Whether the plan terminates or whether it continues after transferring a subgroup of participants to the insurance company, PBBC's guaranty and most protections of ERISA no longer apply.[xiii] In essence, the company strips plan participants and beneficiaries of a number of important ERISA protections that include: PBGC guarantees that insure a retiree's monthly benefit payments for life (up to a maximum $11,205 per month for 2023); fiduciary duties to avoid future loss or diminution of the benefits; the sale or transfer of the underlying assets to more risky or foreign entities; insulation of the retiree from claims of creditors in certain states; and regular disclosures concerning the financial health of the annuity provider. These problems apply to the purchase and distribution of annuity contracts in the context of both standard terminations and partial de-risking transactions (or spin-off terminations) by an ongoing plan.

Congress specifically acknowledged these potential harms to retirees in the SECURE 2.0 Act of 2022. That legislation, enacted and signed by President Biden in December 2022, included a provision imposing extensive disclosure and reporting requirements on plan sponsors that offer plan participants the *voluntary* option to take a lump sum payout rather than a monthly annuity payment for life. As Congress recognized, a voluntary offer of a lump sum in lieu of remaining a plan participant entails a loss of protections under ERISA – even for an older worker who has

earned a future pension benefit, but who is not yet receiving or dependent upon monthly payments. The SECURE 2.0 Act states:

> ''(E) The potential ramifications of accepting the lump sum, including longevity risks, loss of protections guaranteed by the Pension Benefit Guaranty Corporation (with an explanation of the monthly benefit amount that would be protected by the Pension Benefit Guaranty Corporation if the plan is terminated with insufficient assets to pay benefits), loss of protection from creditors, loss of spousal protections, and other protections under this Act that would be lost.[xiv]

Of course, when retirees are terminated as plan participants and sold off to an insurance company as part of an annuity buy-out, the downsides and risks identified in the SECURE 2.0 Act become mandatory, not voluntary. Plan sponsors have no incentive to negotiate specific, ERISA-like protections in the group annuity contracts that replace the package of benefits, PBGC insurance and ERISA protections that plan participants vested into and often have relied on for many years after retirement. This is especially true in a partial buy-out, since it could increase costs to the plan sponsor for retirees and others who will no longer be plan participants. The harms from a mandatory de-risking include the following:

1. ***Only a portion of private annuity payments are fully guaranteed***

The first and by far most significant harm is the loss of federal PBGC insurance that guarantees the payment of a monthly benefit for life (up to the statutory maximum). The PBGC takes the position that its guarantees do not apply once a plan distributes an annuity contract to a participant. If an insurance company fails or is otherwise unable to make good on the annuity payments, the retiree's benefits are backed solely by state guaranty associations (SGAs). The maximum coverage of state guaranty associations vary widely by state of residence; most states guarantee up to $250,000 per person per lifetime, although limits range from $100,000 (e.g., New Jersey) to $500,000 (Connecticut).[xv] By comparison, the PBGC insures against far greater losses for the typical retiree, primarily because it continues making the monthly benefit payment. For example, at age 70 the maximum benefit guaranteed by PBGC (single retiree) is $11,200 per month in 2023 – which amounts to $134,460 in just one year.

This enormous loss of reinsurance protection particularly harms older workers and younger retirees (e.g., those 65 – 75) who need to support themselves and/or their spouse for many more years. Stephen Keating, a pension consultant and co-founder of Penbridge Advisors, LLC, has

estimated that the present value of the benefits guaranteed by the PBGC ranges from 50% to 700% more than the widely varying level of protection provided by state insurance guaranty funds.

> [T]he PBGC's maximum guarantee in 2013 for a life annuity with no survivor benefits of $57,477 yearly at age 65 equates to $763,672 on a present value basis. This compares to the baseline guaranty association protection of $250,000.[xvi]

Moreover, state guaranty funds are not pre-funded. When an insurer's remaining assets are insufficient to meet its obligations, the SGAs must rely on a fee assessed on other insurers in the state who write the same type of insurance to cover the shortfall.[xvii] Since neither state nor federal governments stand behind what are essentially voluntary insurance industry guaranty funds, if there was ever a systemic failure that caused multiple companies to fail, it is not clear that even the lower guaranty limits protections would hold up.

There are also concerns about the capacity of even top-rated insurance companies to absorb tens of billions (and possibly hundreds of billions) of dollars in additional benefit obligations from pension plans. The recent economic downturn demonstrated that even the largest and most established financial institutions are no longer "too big to fail." Annuity providers once considered too big to fail have included Executive Life, AIG, Equitable Life Assurance Society (Equitable Life) and Lehman Brothers – all of which ended in bankruptcy. In addition, the smaller annuity providers are not under any special scrutiny by the Federal Reserve as "systematically important financial institutions" and are therefore not subject to stricter capital requirements and other safeguards.

Of course, this risk would be mitigated if the PBGC itself provided back-up insurance coverage for pension annuitants. But this is not an option under longstanding PBGC interpretations of its statutory authority. The PBGC at one time took the position that it would provide guarantees if an insurance company issuing termination annuities later failed (this was also prior to the widespread establishment of state insurance guaranty associations). The PBGC later retracted this position by issuing an opinion letter in 1991 which "concluded that the statute does not authorize PBGC to guarantee benefits distributed in the form of irrevocable annuity contracts from insurance companies." The PBGC's Opinion Letter 91-1 went on to explain its reasoning: "Nowhere in the statute is PBGC authorized to pay benefits upon the occurrence of any other event, such as the failure of an insurance company." Note, however, that in the context

of partial de-risking, if the ongoing plan was required to retain the annuity contract as an asset and to continue to pay a possibly reduced premium to the PBGC – what is known as a "buy-in" strategy for de-risking – then retirees and other participants would retain their more protective federal PBGC insurance.

2. ***Annuity contracts can be sold or transferred to a more risky or foreign company***

Second, since the annuity contracts are no longer held by a qualified pension plan, retirees and other participants lose the disclosures, minimum funding and fiduciary duty protections required under ERISA. For example, unless the pension plan happens to negotiate special protections (which would likely raise its costs), there would be nothing except possibly state insurance regulations in certain states (but not in others) that would prevent the annuity provider from selling or transferring the annuities to a less secure insurance company anywhere in the world.[xviii]

A particularly worrisome trend related to de-risking is the increasing role of private equity firms (hedge funds) in the life insurance and annuity sector. As the *Wall Street Journal* reported in October 2022, de-risking transactions have become "a major growth channel for private equity-linked insurers, enabling them to amass large pools of money. . . . Now, buyout firms back a significant number of insurers and manage many Americans' life insurance policies and annuities."[xix] A September 2022 report from A.M. Best, a credit-ratings firm specializing in insurance, reported that insurers backed by private-equity firms now manage about $850 billion in U.S. life insurance and annuity assets, or 10% of the market.[xx] In late 2021, more than two dozen investment firms owned or controlled 50 U.S. life-insurance companies out of just over 400, according to Best's data.[xxi]

One alarming example: Athene Holdings Ltd., an insurance company that "has been the biggest player in these pension acquisitions the past several years," went public in 2016 and became part of hedge fund giant Apollo Global Management Inc.[xxii] In 2021 alone, Athene completed five de-risking transactions totaling $10.10 billion in obligations transferred.[xxiii]

At a Senate Banking Committee hearing last September, Chairman Sherrod Brown (D., Ohio) asked if surging private equity investment and even control of insurance companies acquiring pension assets is endangering plan participants who have lost PBGC protection. "We know that workers end up worse off when Wall Street private-equity firms get involved," he

stated. Sen. Brown and and Sen. Elizabeth Warren (D., Mass.) expressed concern “that private equity-backed insurers take more risk than their independent counterparts, potentially imperiling workers’ benefits.”[xxiv]

Indeed, that’s the lure of the life insurance sector: Pension assets are sold to high-rated insurance companies on the assumption they will be conservatively invested to better safeguard the ability to pay monthly benefits to retirees decades in the future. But private equity groups will pay a premium to be freed from those constraints, thereby generating a higher return on investment by taking greater risks. Once again, only a group annuity contract that expressly prohibits the sale or transfer of the underlying assets to an entity that is not also a highly-rated insurance company – and with reinsurance – can protect participants during years and even decades after they lose their ERISA protections.

3. *Annuity providers can potentially change the form of benefit, amount or impose fees*

As noted above, plan sponsors have no incentive to negotiate ERISA-like protections for group annuity contracts that cover retirees and other participants who will no longer be plan participants. For example, absent contractual protections, an annuity provider can potentially impose fees on annuitants that effectively reduce benefits, or change the payment amount to correct a miscalculation of the benefit transferred to the annuity provider. Perhaps more harmful to retirement security would be a decision by the annuity provider to offer or require a change in the form of benefit, most likely by paying out a lump sum and terminating the monthly annuity stream. Although a plan participant or DOL could bring a civil action against the plan sponsor or the insurance company under ERISA Section 502(a)(9), it’s not clear that the standing created in this subsection extends beyond the “purchase of an insurance contract or insurance annuity” to protect against changes in the form or timing of benefits, as ERISA does.

Years after a participant has been offloaded to an insurance company – and often after the insurance company has been changed ownership – there is virtually no recourse under federal law since ERISA no longer applies, annuity providers are regulated at the state level (with widely varying consumer protections in place), and the plan sponsor no longer has obligations to the participant. The only way to preserve the protections associated with vested pension benefits under ERISA is to clarify a fiduciary duty to incorporate them into the group annuity contract.

4. *A partial annuity buy-out can leave the ongoing plan dangerously underfunded*

In a partial plan buy-out, the retirees and others transferred to the annuity provider are often not the only participants adversely impacted. Plan participants who are *not* transferred out of the plan are likely to find that the plan is less securely funded. Absent a large infusion of cash into the plan, "to the extent that the plan was at all underfunded before the liability transfer, it will become even more underfunded simply as a result of the transaction."[xxv] For example, 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 benefit costs – it reported a funding ratio of 68.5% at year-end – down from 78.8% at year-end 2011.[xxvi]

A plan with such a reduced funding level puts the remaining participants at greater risk of a distress termination should the company file for bankruptcy. It can also impact worker benefit accruals and payout options. In testimony to the ERISA Advisory Council, the Communications Workers of America (CWA) noted that a partial buy-out that significantly reduces plan funding for remaining participants can be "especially problematic because current rules [enacted as part of the Pension Protection Act of 2006] require that if a plan is less than 80% funded, certain benefit restrictions must go into effect. . . . Under 60% funding, the plan must freeze benefit accruals, and all lump sum payouts are prohibited."[xxvii]

5. *Annuity buyouts undermine PBGC and the DB pension system as a whole*

A related negative impact of partial de-risking transactions, such as those at IBM and Verizon described above, is the undermining of PBGC's financial position and of the DB pension system as a whole. Because plan sponsors typically need to be fairly well-funded *and/or* contribute additional corporate resources to avoid a substantial decline in the funded level for remaining participants, partial annuity buy-outs at large, financially strong companies are a form of "reverse selection" that deprive the agency of premium revenue from companies that are unlikely to go bankrupt and dump their obligations on the agency. Going forward, if de-risking transactions becomes more widespread among well-funded large company plans, such as Verizon and IBM, the growing loss of premium income threatens to undermine the solvency of PBGC and further accelerate the decline of the pension system as a whole.

Needed Legislative Changes to ERISA's Safe Harbor Annuity Selection Requirements

Because of the adverse impact on retirees described just above, Congress should ensure that plan sponsors cannot selectively terminate retirees in pay status from an ongoing plan without satisfying fiduciary safe harbor requirements that protect retirees' reasonable expectations and benefit security. Just as ERISA absolutely protects retirees against a reduction in the amount of their monthly benefit payment, Congress should ensure that retirees and other participants cannot lose basic ERISA protections – **most importantly reinsurance** – when a plan sponsor uses an annuity buy-out to transfer the liability for future benefit payments to an annuity provider.

Specifically, legislative amendments to ERISA Section 404 should require single employer plan fiduciaries to negotiate annuity contract provisions that reasonably replicate ERISA protections in the event of the insolvency of the primary annuity provider. Foremost among these protections is reinsuring the monthly benefit itself, which is not adequately protected by state guaranty associations and remains very much at risk when a retiree is stripped of his or her PBGC insurance. Section 404(e) currently includes a Safe Harbor Annuity Selection provision, but it applies only to defined contribution plans.

The parallel fiduciary guidance that applies to the selection of annuity providers by defined benefit pension plans is an interpretive bulletin adopted by the Department of Labor in 1995 and codified in the title 29 of the Code of Federal Regulations, section 2509.95-1.[xxviii] Interpretive Bulletin 95-1 is grounded in ERISA's Section 404 and applies "when a pension plan purchases an annuity from an insurer as a distribution of benefits," such "that the plan's liability for such benefits is transferred to the annuity provider."[xxix] Its legal premise is that even if a plan sponsor's decision to amend a plan to provide for de-risking may be a settlor function, the selection of an annuity contract is a fiduciary activity.[xxx] Because "the fiduciary's negotiation with the insurer over the annuity's features and contractual provisions are implementation decisions," subject to fiduciary standards, it "is within the Department of Labor's authority to issue guidance both on how to select an insurer and on the contractual provisions that a fiduciary must ensure are included in the annuity contracts that the fiduciary negotiates on behalf of the plan."[xxxi]

The Bulletin provides generally that a defined benefit plan fiduciary must select the safest available annuity. The Bulletin, echoing Section 404(e), requires that the fiduciary conduct an "objective, thorough and analytical search" for an appropriate annuity provider and "evaluate a

number of factors relating to a potential annuity provider's claims paying ability and creditworthiness." The Bulletin also notes that a fiduciary may not purchase an annuity that is less safe than the safest annuity available simply because there are not available funds to purchase the safest annuity."[xxxii]

When it was adopted in 1995, Interpretive Bulletin 95-1filled an important gap in ERISA by applying the principles of Section 404's fiduciary duties to a defined benefit plan's purchase of "an annuity from an insurer as a distribution of benefits." Back in 1995 and for years thereafter, the main relevance of IB 95-1 was voluntary plan terminations. The Bulletin does not even address selecting an annuity as part of a de-risking transaction, since partial plan terminations was not on anyone's radar screen. The statutory context and policy considerations are not the same. For example, as Professor Stein testified before the ERISA Advisory Committee a decade ago: "[O]ne option a fiduciary has in a de-risking transaction but not in a plan termination is to purchase the annuity but not distribute it to participants unless the fiduciary concludes that distribution of the annuity contract will not subject the participant to additional risk. Moreover, standards for evaluating annuity safety have evolved since 1995."[xxxiii]

Today, more than 25 years later, IB 95-1falls far short of protecting retirees and other plan participants from the new wave of de-risking transactions and hedge fund acquisitions of annuity providers. A statutory update is overdue. In short, a *statutory* Safe Harbor Annuity Selection requirement for single employer plans should be added to ensure that plan fiduciaries only purchase annuity contracts that include reinsurance and the following other protections for plan participants who are, as a result, separated from the plan:

1. Reinsurance: Group annuity contracts must require the purchase of reinsurance that is sufficient to provide a replacement annuity of equal value from a third-party insurer that is independent of the annuity provider and financially capable.

2. Prohibit an insurer from offering to convert or exchange the contract for a lump sum or other change in the form of benefit.

3. Prohibit the sale or transfer of all or a portion of the annuity contracts to an entity that is not a state-licensed insurance company with an above average financial risk rating.

4. Require the annuity provider to send an annual report that confirms the reinsurance provider and the current rating and financial status of the annuity provider.

5. Prohibit the assessment of fees against the annuitant by the annuity provider.

6. Prohibit the annuity provider from reducing the benefit amount transferred from the plan to the annuity provider, including to correct a miscalculation of the benefit transferred to the annuity provider.
7. Establish a claim and appeals procedure for annuitants that conforms to the claims and appeals procedure under ERISA.
8. More generally, require that annuitants comply with regulations or other guidance adopted by the Department of Labor and designed to ensure that a participant's rights under ERISA are not reduced or impaired by the transfer of the benefit to the annuity provider.
9. Finally, plan sponsors should affirm that the transfer of benefit liabilities to the insurer does not substantially impair the funded status of the plan after the de-risking transaction (based on a standard to be promulgated by Treasury in consultation with DOL).

Proposed Legislative Amendment to ERISA Section 404: Safe Harbor Annuity Selection

The most straightforward remedy to the potential harms of de-risking is for Congress to **amend ERISA Section 404** to add a new subsection that sets forth a fiduciary "Safe Harbor for Annuity Selection" that applies specifically to single-employer plan annuity contracts that are distributed to participants or beneficiaries, thereby terminating their PBGC and other ERISA protections. Generally, ERISA Section 404 (29 U.S. Code § 1104) describes the nature of the fiduciary duties owed to plan participants and beneficiaries. At the core of ERISA's fiduciary duties is the Section 404(a) requirement to manage a plan "solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity" would use.

Section 404 currently includes a "Safe Harbor for Annuity Selection" provision in subsection (e). However, that safe harbor applies specifically to annuities purchased as part of an individual account plan (subsection 404(e)(6)). These definied contribution plan safe harbor protections focus on the selection of the annuity provider. And although the Safe Harbor in 404(e) provides important protections with respect to the financial capability of the insurer, a Safe Harbor for the selection of annuity contracts that will be distributed to defined benefit plan participants losing their PBGC and other protections under ERISA must go further.

Alternatively, Congress could direct the Secretary of Labor to update and amend its fiduciary guidance in Interpretive Bulletin 95-1 to create a more comprehensive "Safe Harbor Annuity

Selection" standard for the purchase and distribution of annuities by single-employer defined benefit plans. As the discussion in the section just above recounts in greater detail, Interpretive Bulletin 95-1 does not even address selecting an annuity as part of a de-risking transaction. Further interpreting ERISA Section 404's fiduciary duties to include an obligation to purchase annuity contracts from an insurer for the purpose of distributing benefits that incorporate reinsurance and preserves the other ERISA protections listed above would be a significant policy change that ideally should be enacted by Congress.

Most importantly, any safe harbor annuity selection standard, whether statutory or regulatory, should ensure that the annuity is at least as safe as a PBGC-guaranteed annuity. Specific provisions should ensure that the annuity contract purchased by the plan replicates the other important ERISA protections listed in the section just above. We therefore propose a clarification of fiduciary duties with respect to distributed annuities **to require that defined benefit plan fiduciaries negotiate annuity contract provisions that reasonably replicate ERISA protections** – **most importantly reinsurance** – **in the event of the insolvency of the primary annuity provider**.

The best and most expeditious way to extend these fiduciary obligations is for Congress to enact a statutory amendment that should most likely take the form of a new subsection 404(f), as follows:

Section 404(f) Safe Harbor for Annuity Selection—single-employer plan

Section 404(f) [new]

(1) In general

With respect to the selection of an insurer for a guaranteed retirement income contract that is distributed to a single employer plan participant, or group of participants, the requirements of subsection (a)(1)(B) will be deemed to be satisfied if a fiduciary—

(A) meets the requirements of subsection (e)(1) and (2);

(B) The terms of the guaranteed retirement income contract reasonably replicate ERISA participant protections such that any annuity contract that is distributed and not retained as an asset of a plan

(2) Protections included in distributed annuity contracts

With respect to the purchase of a guaranteed retirement income contracts that is distributed to a single employer plan participant, or group of participants, a fiduciary shall ensure that such contracts—

(A) **require the annuity provider to purchase a contract of reinsurance** that is sufficient to provide a replacement annuity of equal value from a third-party insurer that is independent of the annuity provider and financially capable, as provided under subsection (e)(2); and

(B) include provisions that—

i. prohibit an insurer from offering to convert or exchange the contract for a lump sum or other change in the form of benefit;

ii. prohibit the sale or transfer of all or a portion of the annuity contracts to an entity that is not a state-licensed insurance company with an above-average financial risk rating;

iii. require the annuity provider to send an annual report to annuitants that confirms the reinsurance provider and the current rating and financial status of the annuity provider and of the reinsurer;

iv. prohibits the assessment of fees against the annuitant by the annuity provider;

v. prohibits the annuity provider from reducing the benefit amount transferred from the plan to the annuity provider, including to correct a miscalculation of the benefit transferred to the annuity provider;

vi. establish a claim and appeals procedure for annuitants that conforms to the claims and appeals procedure under ERISA;

vii. comply with Department of Labor regulations or other guidance designed to ensure that a participant's rights under ERISA are not reduced or impaired by a fiduciary's purchase and distribution of a guaranteed retirement income contract to a plan participant or beneficiary.

(3) **Impact on funded status of the plan**

If the guaranteed retirement income contract is not distributed to plan participants and beneficiaries as part of a voluntary plan termination, the plan fiduciary must attest that the transfer of plan assets and liabilities to the insurer does not substantially impair the funded status of the plan, based on a standard to be promulgated by the Secretary of Labor in consultation with the Secretary of the Treasury.

(4) Definitions

For purposes of this subsection—

(A) **Insurer**

The term "insurer" means an insurance company, insurance service, or insurance organization, including affiliates of such companies.

(B) **Guaranteed retirement income contract**
The term "guaranteed retirement income contract" means an annuity contract for a fixed term, or a contract (or provision or feature thereof), which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant, or the joint lives of the participant and the participant's designated beneficiary, that is distributed to a single-employer plan participant or beneficiary.

(C) Single-employer plan
The term single-employer plan means any defined benefit plan (as defined in section 3(35) of ERISA) that is not a multiemployer plan (as defined in section 4001(a)(3) of ERISA) and that is covered by title IV of ERISA.

CONCLUSION

De-risking transactions that transfer subgroups of retirees or other plan participants from a pension plan to an insurance company has a variety of adverse impacts, most significantly the loss of federal PBGC insurance that guarantees the payment of a monthly benefit for life (up to the statutory maximum). A statutory update to ERISA's fiduciary duty standard is overdue. NRLN therefore propose a legislative amendment to Section 404 to clarify that with respect to annuities purchased and distributed by single-employer plans, **fiduciaries must incorporate annuity contract provisions that reasonably replicate ERISA protections – most importantly reinsurance – in the event of the insolvency of the primary annuity provider**.

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[i] Rob Kozlowski, "GM Paved New Road to Pension Derisking," *Pensions & Investments* (Oct. 3, 2022).
[ii] Rob Kozlowski, "IBM Offloads $16 Billion in Pension Liabilities," *Pensions & Investments* (Sept. 13, 2022), https://www.pionline.com/pension-risk-transfer/ibm-offloads-16-billion-pension-liabilities-annuity-purchases.
[iii] Buck, "U.S. Pension Risk Transfer Market Insights—December 2022" (Dec. 14, 2022), https://buck.com/update-u-s-pension-risk-transfer-market-insights-december-2022/.
[iv] Vanguard, "2022 Pension Sponsor Survey" (2022), at p. 8, https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2022/2022-pension-sponsor-survey.pdf.
[v] *See* Vanguard 2022 Pension Survey, *supra*, at 9; MetLife Retirement and Income Solutions, "2022 Pension Risk Transfer Poll" (Oct. 11, 2022), https://www.metlife.com/retirement-and-income-solutions/insights/pension-risk-transfer-poll/.

[vi] Michael Katz, "Inflation and Rates Likely to Spur Pension Risk Transfers," *Plan Sponsor* (Oct. 14, 2022), https://www.plansponsor.com/inflation-rates-likely-spur-pension-risk-transfers/.
[viivii] Norman Stein, Statement before ERISA Advisory Council Working Group on Private Sector Pension Derisking and Participant Protections," U.S. Dept. of Labor (Aug. 29, 2013) ("Stein Testimony").
[viii] Written testimony of Robert S. Newman, Covington & Burling LLP, before the ERISA Advisory Council, hearing on Private Sector Pension De-Risking and Participant Protections, June 5, 2013, at 1.
[ix] *Id.* at p. 2.
[x] Rebecca Moore, "Verizon, Prudential Complete Partial Pension Plan Buyout," *Plan Sponsor* (Dec. 10, 2012), https://www.plansponsor.com/Verizon-Prudential-Complete-Partial-Pension-Buyout/.
[xi] Brian Foerster, "Beyond Volatility: Are 'De-Risked' Pensions Creating All New Risks?" Invesco Investment Insights (April 30, 2012), at 2.
[xii] *See* Testimony of Craig Rosenthal on behalf of the American Benefits Council, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections (June 5, 2013), at p. 1.
[xiii] An exception is that ERISA does allow for a cause of action by the Secretary of Labor or any participant under the plan to ensure receipt of the benefits to which the individual is entitled under the terms of the annuity contract. *See* ERISA § 502(a)(9). *See also* ACLI, "ERISA Protections for Annuitants in Pension De-risking Transactions" (2018) (noting that the annuity provided by the insurer must be the same type of distribution that the participant is already receiving, and that Treasury regulations require that qualified joint and survivor annuity (QJSA) requirements extend to payments under the annuity contract).
[xiv] SECURE 2.0 Act of 2022, enacted as part of the FY 2023 Omnibus Budget Act (Dec. 29, 2022), at pp. 2329-2330).
[xv] *See, e.g.*, Annuity Advantage, State Life and Health Guaranty Associations, 50 state list, available at https://www.annuityadvantage.com/resources/state-guaranty-associations/.
[xvi] Written Testimony of Stephen A. Keating, Co-Founder & Principal, Penbridge Advisors LLC, before the ERISA Advisory Council, hearing on Private Sector Pension De-Risking and Participant Protections, June 5, 2013, at 10. "Penbridge calculations are based on 1994 Group Annuity Reserve Mortality Table, Projection Scale AA Discount Interest Rate of 4.0%, Male Annuitant Age 65, Life Only form of annuity."
[xvii] Testimony of Ilana Bolvie, Communications Workers of America, before the ERISA Advisory Council hearing on Private Sector Pension De-Risking and Participant Protections, (June 5, 2013), at p. 4.
[xviii] *See* Assn. of BellTel Retirees, May 2013 Litigation Update, *supra* note 9, at p. 2.
[xix] Chris Cummings, "Private Equity's Pension-Plan Takeovers Face Backlash," *The Wall Street Journal* (Oct. 7, 2022), https://www.wsj.com/articles/private-equitys-pension-plan-takeovers-face-backlash-11665136802.
[xx] *Ibid*; A.M. Best, "Special Report: Private Equity Continues to Make Inroads in Life/Annuity Segment" (Sept 27, 2022) https://www3.ambest.com/ambv/sales/bwpurchase.aspx?record_code=324369&altsrc=23.
[xxi] Leslie Scism, "Who Owns Your Life Insurance Policy? It May be a Private-Equity Firm," *The Wall Street Journal* (Sept. 21, 2021), https://www.wsj.com/articles/insurance-policy-private-equity-11632236526?mod=article_inline.
[xxii] *Wall St. Journal* (Oct. 7, 2022)*, supra*.
[xxiii] Hailey Ross, "Pension Risk Transfer Scrutiny Stems from 'Misperception'—Athene Exec," *S&P Global Market Intelligence* (July 25, 2022), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/pension-risk-transfer-scrutiny-stems-from-misconception-8211-athene-exec-71266556.
[xxiv] *Ibid*.
[xxv] Testimony of Ilana Bolvie, CWA, *supra* note 35, at p. 4.
[xxvi] Melanie Zanona, "There's No Relief for Corporate Pension Plans," *Pensions & Investments* (April 29, 2013).
[xxvii] *Id.*

[xxviii] 29 C.F.R. § 2509.95-1, "Interpretive Bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan" (60 FR 12329, Mar. 6, 1995, as amended) ("IB 95-1").

[xxix] *Ibid*.

[xxx] *See* Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. Rev. 459 (2015) ("Muir & Stein"), available at http://scholarship.law.unc.edu/nclr/vol93/iss2/4. In ERISA law, the distinction between fiduciary and "settlor" decisions, particularly in relation to terminating a DB plan, dates back to a 1986 DOL information letter to the chair of the ERISA Advisory Council. The DOL letter stated that:

> "[I]n light of the voluntary nature of the private pension system governed by ERISA, . . . there is a class of discretionary activities which relate to the formation, rather than the management, of plans. These so-called 'settlor' functions include decisions relating to the establishment, termination and design of plans and are not fiduciary activities subject to Title I of ERISA. . . . Consistent with the functional analysis of fiduciary activity, . . . the fiduciary provisions of ERISA, including the prudence requirement of section 404(a)(1)(B), will apply to the choice of an insurer to issue annuities upon plan termination."

Department of Labor, Information Letter 03-13-1986 to John N. Erlenborn (March 13, 1986), available at https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/03-13-1986.

[xxxi] *Id*. at 10.

[xxxii] *See* Stein Testimony to ERISA Advisory Council, *supra*, at 11-12.

[xxxiii] *Id*. at 4.