Pension Plan 'De-Risking': A Proposal to Protect Retirees and Older Workers by Adding a Statutory Safe Harbor Annuity Selection to ERISA Section 404

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The steady decline in 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. 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.

A 2022 survey of large pension fund managers by Vanguard found that 27% of pension funds surveyed said they are likely to engage in risk transfers over the following 12 months through either a partial de-risking (12%) or voluntary plan termination (15%). More worrisome is the fact that partial annuity buy-outs that transfer subgroups of a plan's participants to insurance companies – and strip participants of PBGC's guarantee and other ERISA protections – now represent by far the largest share of pension plan group annuity transactions (75% in 2021). Last September, for example, IBM continued the trend by transferring $16 billion in pension assets to Prudential and to Metropolitan Life – and with it the responsibility to pay benefits to 100,000 retirees and beneficiaries covered by the IBM Personal Pension Plan.

When a plan sponsor purchases and distributes an annuity contract – and thereby transfers the liability for future benefit payments – 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. This problem applies to the purchase and distribution of annuity contracts in the context of both standard terminations and partial de-risking transactions by an ongoing plan.

The loss of PBGC 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. 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, but most states guarantee up to $250,000 per person per lifetime. By comparison, the PBGC insures against far greater losses because it continues making the monthly benefit payment. For example, at age 70 PBGC's maximum benefit guarantee is $11,200 per month for 2023 – which amounts to $134,460 in just one year.

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

The most straightforward remedy for the potential harms of de-risking is for Congress to **add a new subsection (f) to ERISA Section 404** (29 U.S. Code § 1104) that sets forth a fiduciary "Safe Harbor for Annuity Selection" specifically for single-employer plan annuity contracts that are distributed to participants or beneficiaries, thereby terminating their PBGC and most other ERISA protections. Section

404, which describes the nature of the fiduciary duties owed to plan participants and beneficiaries, currently includes a "Safe Harbor for Annuity Selection" provision in subsection (e). However, that safe harbor applies to annuities purchased as part of an individual account plan. 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.

Any safe harbor annuity selection standard should ensure the annuity is at least as safe as a PBGC-guaranteed annuity. The annuity contract should incorporate reinsurance and other important ERISA protections. When it was adopted in 1995, DOL's Interpretive Bulletin 95-1filled an important gap by applying the principles of Section 404 to a defined benefit plan's purchase of "an annuity from an insurer as a distribution of benefits." But 25 years later, IB 95-1falls far short of protecting retirees and other 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 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).

Draft statutory language to accomplish this is just below.

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

We 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**.

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.