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Hearing on
PENSION DE-RISKING AND FIDUCIARY STANDARDS FOR DISTRIBUTED ANNUITIES

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Introduction

My name is Michael Calabrese, Senior Policy Advisor to the National Retiree Legislative Network, also known as the NRLN. The NRLN is a non-partisan, grassroots coalition established in 2003 that serves as a federation of more than 25 retiree associations and individual members who retired from roughly 300 different U.S. corporations and public entities, representing roughly 2 million older and retired Americans in all 50 states. The NRLN thanks the ERISA Advisory Council for this opportunity to testify, on behalf of plan participants, about the threat that pension de-risking poses to retiree income security and the need for stronger fiduciary protections with respect to distributed annuity contracts.

Year after year, NRLN's annual survey of our retiree members tells us that threats to their income security from a plan termination or removal from their pension plan is their number one fear, especially in light of the increasing trend toward pension de-risking. In our most recent survey, 87 percent of respondents agreed that more protections are needed.

Retirees and older workers earned and vested into fixed monthly benefits believing they had the security of ongoing protection by the Pension Benefits Guaranty Corporation (PBGC), as well as ongoing disclosures and other fiduciary protections enforced by the U.S. Department of Labor under ERISA. The income security represented by a vested pension benefit amounts to more than just the nominal monthly payment. Throughout their working lives, retirees believed that the guaranteed monthly income they earned, however modest, had the additional value of PBGC and ERISA protections. That may no longer be true, particularly if the newest and most abusive "de-risking" strategies are not tempered by the fiduciary obligations the NRLN proposes in our recent white paper (attached to this statement). The DOL and Congress should not wait for the next 'black swan' financial crisis to update the fiduciary standard for annuity contracts.

Defined benefit pension annuity buy-outs have exceeded $250 billion since 2012, including a record $50 billion in 2022 alone, according to Buck Consultants. More worrisome is the fact that partial annuity “lift-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 such pension group annuity transactions (75% in 2021).

Because the cost of de-risking transactions declines as interest rates increase, observers predict that the number of partial de-risking transactions is likely to increase. We are already seeing that happen at scale. In early May, for example, the retiree associations at AT&T were informed that the company had agreed to transfer 96,000 plan participants and $7.7 billion in assets from the AT&T pension plan to two annuity providers affiliated with Athene, a subsidiary of Apollo Asset Management. Similarly, last September, IBM transferred $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.

The Risks of De-Risking

When a plan sponsor purchases and distributes an annuity contract, participants and beneficiaries often lose a number of important ERISA protections. These include: PBGC guarantees that insure a retiree’s monthly benefit payments for life (up to a maximum $11,205 per month for 2023); insulation of the retiree from creditors; flexibility in dividing the annuitized benefit in cases of divorce; notices of declines in funding status; and critical fiduciary protections which, for example, would protect participants against the insurer’s subsequent transfer of the liabilities to a poorly funded insurer or a foreign-regulated entity. These problems apply to the purchase and distribution of annuity contracts in the context of both standard terminations and partial risk transfers by an ongoing plan.

The loss of PBGC reinsurance poses unacceptable risks for older workers and younger retirees in particular (e.g., those 65 – 75) who need to support themselves and/or their spouse for many more years. If an insurance company becomes 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 varies widely by state, but can be far less (cumulatively) than PBGC guarantees.

For example, for a participant who begins benefits at age 70, the PBGC guarantees up to $11,205 per month for 2023 – which amounts to $134,400 every year. In contrast, SGA guarantees are framed in terms of a maximum annuity contract value, which in some states is as low as $100,000 per person/per lifetime.[1] For a 70-year old with a worthless annuity contract,

[1] The maximum coverage of state guaranty associations varies 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)

the monthly guaranteed benefit in such a state would be less than $8,000 a year. Even the more typical $250,000 SGA maximum guarantee would be less than $20,000 a year. While we acknowledge that there are scenarios where some retirees might recover more with a SGA as the only backstop, by and large the NRLN believes that PBGC's protections are superior and that further reinsurance is necessary to avoid an effective cutback in the risk-adjusted value of benefits.

Congress specifically acknowledged these potential harms to retirees in the SECURE 2.0 Act of 2022 in 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. 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.[2]

Absent an explicit fiduciary standard, plan sponsors have little if any incentive to negotiate ERISA-like protections for group annuity contracts that cover retirees and other participants who will no longer be plan participants. Years after a participant has been offloaded to an insurance company – and often after the insurance company has 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.

A particularly worrisome trend is the increasing role of private equity firms (hedge funds) in the life insurance and annuity sector.[3] 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

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to $500,000 (Connecticut). *See, e.g.*, Annuity Advantage, State Life and Health Guaranty Associations, 50 state list, available at https://www.annuityadvantage.com/resources/state-guaranty-associations/.

[2] SECURE 2.0 Act of 2022, enacted as part of the FY 2023 Omnibus Budget Act (Dec. 29, 2022), at pp. 2329-2330.

[3] *See, e.g.*, 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; 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.

invested to better safeguard the ability to pay 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 state-regulated and highly-rated insurance company – and with reinsurance – can protect participants during years and even decades after they lose their ERISA protections.

Needed Changes to ERISA's Safe Harbor Annuity Selection Requirements

Because of the potential adverse impact on retirees and older workers, the Department of Labor 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, the DOL 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.

DOL has the authority to accomplish this directly, by updating the fiduciary standard in its own Interpretive Bulletin (29 CFR §2509.95–1), as well as by recommending that Congress adopt these protections. The NRLN's recent white paper (appended to this statement) proposes a legislative amendment that would add a new subsection (f) to ERISA Section 404 (29 U.S. Code § 1104) that would define a fiduciary "Safe Harbor for Annuity Selection" specifically for single-employer defined benefit plan annuity contracts that are distributed to participants or beneficiaries, thereby terminating their PBGC and most other ERISA protections.[4] Section 404(e) currently includes a Safe Harbor Annuity Selection provision, but it applies only to defined contribution plans.

Nonetheless, although a report is due to Congress, this Advisory Council should recommend that the Department update Interpretive Bulletin 95-1 to include a fiduciary standard that more explicitly sets an expectation that distributed annuity contracts will incorporate certain protections. There is no need to wait for further legislation. DOL's authority is grounded in ERISA's Section 404 and, as IB 95-1 states, 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." Its legal premise is that even if a plan sponsor's decision to

[4] 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 by an individual account plan and raises different considerations.

amend a plan to provide for de-risking may be a settlor function, the selection of an annuity provider and the negotiation of the protections in the contract are fiduciary activities. 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."[5]

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. Partial plan terminations and transferring selected participants out of an ongoing plan were not on anyone's radar screen. At a minimum, the fiduciary standard that applies to an ongoing plan should be more protective than the current IB 95-1 standard, which contemplated the purchase of annuities as an asset (an annuity "buy-in"), or as part of a plan termination. For example, as Professor Norman 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."[6]

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 potential hedge fund acquisitions of annuity providers. A fiduciary standard based on ERISA Section 404 should more explicitly 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.

While it is no doubt true that many pension group annuity contracts contain some provisions that replicate these protections (sometimes explicitly, sometimes vaguely), the 'best practices' of a few insurance companies cannot substitute for a more explicit and comprehensive fiduciary

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[5] *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, at 10 (2015), available at http://scholarship.law.unc.edu/nclr/vol93/iss2/4.

[6] Norman Stein, Statement before the ERISA Advisory Council Working Group on Private Sector Pension Derisking and Participant Protections," U.S. Dept. of Labor, at 4 (Aug. 29, 2013).

safe harbor standard. Indeed, if the plan sponsor's intent is to ensure that retirees who are "lifted out" of a qualified pension plan are no worse off, then there should be no objection to a fiduciary standard that is updated to be more explicit about the protections that should be incorporated in the annuity contract – and thereby obligating both the annuity provider and any successor.

The NRLN therefore proposes 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**. Specific provisions should ensure that the annuity contract purchased by the plan replicates the other important ERISA protections listed in the section just above.

In short, a Safe Harbor Annuity Selection standard for single employer plans should ensure that plan fiduciaries only purchase annuity contracts that include, as contractual terms, reinsurance and the following other protections for plan participants 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 individual annuity contracts for a lump sum or other change in the form of benefit.

3. Prohibit the re-sale or transfer of all or a portion of the annuity contracts to an entity that is not a state-licensed insurance company under the jurisdiction of U.S. courts that also satisfies the safest available annuity requirements of IB 95-1.

4. Require the annuity provider to send a short-form annual report that confirms the reinsurance provider and the current rating and financial status of the annuity provider.

5. Prohibit the assignment or alienation of any payment or of the present value of the annuity.

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. Require that an annuity provider accept and follow a state domestic relations order dividing the annuity in a manner that would satisfy ERISA § 206(d)(3)(B)(i).

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

9. Establish a claim and appeals procedure for annuitants that conforms to the claims and appeals procedure under ERISA.

10. 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).

Conclusion

De-risking transactions that transfer subgroups of retirees and other participants from a pension plan to an insurance company has a variety of adverse impacts, most significantly the loss of federal PBGC insurance. A statutory update to ERISA's fiduciary standard for annuity selection is overdue. We should not wait for a 'black swan' event to acknowledge that insurance companies can fail and that industry-funded guarantee funds are not a sufficient backstop. NRLN urges the Advisory Council to recommend that DOL both recommend a stronger standard to Congress, including third-party reinsurance, and also act on its own authority to update IB-95.

Appendix

NRLN White Paper:
"Pension Plan De-Risking: Strengthening Fiduciary Duties to Protect Retirees" (Jan. 2023)