Consumer Federation of America

Testimony to the Advisory Council on Employee Welfare and Pension Benefit Plans (ERISA Advisory Council)
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Thank you for the opportunity to provide written testimony to the ERISA Advisory Council. My name is Micah Hauptman and I am the director of investor protection at the Consumer Federation of America (CFA). CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

The Department of Labor (Department) has been tasked under Section 321 of the SECURE Act 2.0 with reviewing its longstanding guidance, Interpretive Bulletin 95-1, which relates to the fiduciary standards under ERISA that apply to the selection of an annuity provider by a defined benefit pension plan. This review is timely given the increasing prevalence of pension risk transfers and the significant changes that have occurred recently in insurance markets that are likely to increase risks to the retirement security of workers and retirees.

Summary

In recent years, many of the largest companies in the United States have transferred their pension obligations to insurance companies. When companies transfer their pension obligations to insurance companies in the form of annuities, they shift risks onto insurance companies. If insurance companies do not carefully control for this, then those risks and any resulting harms could be shifted to workers and retirees.

Indeed, insurance companies' business models are evolving in ways that may increase risks for workers and retirees. For example, private equity firms have become increasingly involved in insurance markets, introducing added risks, complexity, and opacity to insurers' businesses. These risks may undermine insurance companies' claims paying abilities, potentially jeopardizing the financial security of workers and retirees. Among other things, private equity's involvement in insurance markets has resulted in:

- Insurance companies' investing in and being exposed to more complex, opaque, and risky assets and strategies, which may expose those insurance companies to significant losses; and
- Insurance companies' involvement in offshore reinsurance schemes, which can hide risks and limit their ability to sufficiently backstop against losses.

In addition, credit ratings of insurance companies may not provide accurate or reliable measures of the likelihood of default and the ability to pay claims if default occurs.

Importantly, defined benefit pensions are plan obligations that are protected under ERISA and guaranteed by the Pension Benefit Guaranty Corporation (PBGC), which insures private sector defined benefit pension plans. However, once a pension transfer takes place, workers and retirees are no longer protected under ERISA and their pensions are no longer guaranteed by the PBGC. Instead, workers and retirees who receive annuities from insurance companies are subject to the terms of the annuity contract, weaker consumer protections under state-based insurance laws (which vary from state to state), and are only provided state-based guarantees that are unlikely to provide the same benefits as federal law (these guarantees also vary from state to state). Thus, the workers and retirees whose pensions are transferred to annuities are at risk of losing valuable benefits if the insurance company providing the annuities were to fail.

Given the heightened risks to workers and retirees, the Department should ensure that plan fiduciaries are adhering to their fiduciary duties and that any pension risk transfer arrangements do not leave workers or retirees worse off than they would be if they stayed in the defined benefit pension plan.

I. Recent changes in insurance market practices have increased risks for insurance companies and the workers and retirees whose pensions are transferred to them.

In recent years, many of the largest companies in the United States have transferred their pension obligations to insurance companies.[1] It's likely that this trend will continue as companies seek to shed their pension liabilities.[2] When companies transfer their pension obligations to insurance companies in the form of annuities, they also shift risks, including, longevity risk, interest rate risk, investment risk, and credit risk. If insurance companies do not carefully control those risks, those risks and any resulting harms could be shifted to workers and retirees.

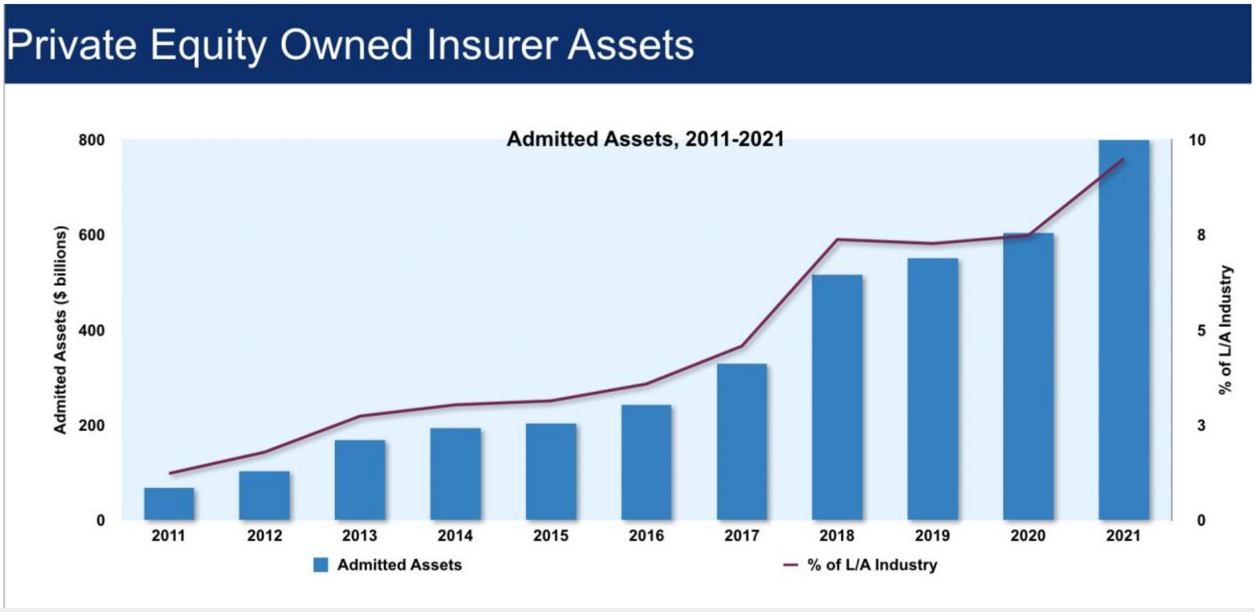
Indeed, insurance companies' business models are evolving in ways that may increase risks for insurers, and in turn, workers and retirees. Specifically, private equity firms have become increasingly involved in insurance markets, introducing new risks, complexity, and opacity to insurers' businesses -- risks that may undermine insurance companies' claims paying ability, potentially jeopardizing workers' and retirees' financial security.[3]

[1] *See* Remy Samuels, *Pension Risk Transfers Spiked in 2022 due to Higher Interest Rates, Report Shows*, PLAN SPONSOR, March 29, 2023, https://www.plansponsor.com/pension-risk-transfers-spiked-in-2022-due-to-high-interest-rates-report-shows/. *See also* Remy Samuels, *Pension Risk Transfers Continue to Skyrocket in Q1*, PLAN SPONSOR, May 25, 2023, https://www.plansponsor.com/pension-risk-transfers-continue-to-skyrocket-in-q1/.

[2] *See Id*. ("Paracer predicts that rising interest rates and escalating costs to maintain pension funds will likely drive plan sponsor interest in risk transfers in 2023.").

[3] *See* Letter from Jonathan C. Davidson, U.S. Department of the Treasury, to Senator Sherrod Brown, June 29, 2022 https://www.banking.senate.gov/imo/media/doc/fio_85.pdf ("As private markets have expanded over the last decade, far outpacing the growth of public markets, private equity firms have reshaped their business models and increased involvement in the life insurance sector.…some private equity firms have increased their access to books of annuities and life insurance through purchases of insurers."). *See also* Tim Zawacki, *Large Deals Elevate Private Equity-Linked Reinsurers in US Life, Annuity Market*, S&P GLOBAL MARKET INTELLIGENCE, May 3, 2022, https://www.spglobal.com/marketintelligence/en/newsinsights/research/large-deals-elevate-private-equity-linked-reinsurers-in-us-life-annuit.

For example, whereas private equity companies controlled only 1.2 percent of insurance industry assets in 2011, that amount has grown to roughly $800 billion or about 10 percent of the life/annuity industry assets, according to Rosemarie Mirabella of AM Best.[4]



Source: AM Best[5]

Further, according to a February 2022 report by the consulting firm McKinsey & Company, all 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. McKinsey further observed that the five largest private equity firms all now hold life insurance assets, and that 15 alternative asset managers have entered, or announced plans to enter, the insurance market.[6]

A. Insurance companies' investing in and being exposed to more complex, opaque, and riskier assets and strategies may expose those insurance companies to significant losses, which may impede their ability to pay claims to workers and retirees.

Historically, life insurance investment portfolios and strategies were largely limited to liquid, highly creditworthy fixed-income assets that were designed to match liabilities. However, as private equity has become more involved in insurance companies' businesses, insurers' investment portfolios have become increasingly exotic, with complex, opaque, risky, and difficult to value assets and strategies that may expose those insurance companies to significant

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[4] Kerry Pechter, *Private Equity in the Life/Annuity Biz*, RETIREMENT INCOME JOURNAL, April 28, 2022, https://retirementincomejournal.com/article/private-equity-in-life-annuity-biz-conferencenotes/.
[5] *See Id.*
[6] Ramnath Balasubramanian, Alex D'Amico, Rajiv Dattani, and Diego Mattone, P*rivate Equity Sees Life and Annuities as an Enticing Form of Permanent Capital*, MCKINSEY & CO., February 2, 2002, 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

losses.[7] These include assets such as private placements, private-label securities, and other structured securities, including collateralized loan obligations (CLOs) and asset-backed securities.[8]

The extensive use of complex, risky, and opaque assets has the potential to increase a variety of risks for the insurance companies holding such assets. According to the U.S. Treasury Department, "The increased use of complex investment strategies has led to the greater prominence of illiquid and volatile assets on insurers' books. This could contribute to potential market liquidity concerns, valuation challenges, uncertain levels of credit risk, and potential concentration risk, which could intensify under situations of economic uncertainty or dislocation."[9] Similarly, according to National Association of Insurance Commissioners (NAIC), relevant considerations for PE-owned insurers include, "The material increases in privately structured securities (both by affiliated and non-affiliated asset managers), which introduce other sources of risk or increase traditional credit risk, such as complexity risk and illiquidity risk, and involve a lack of transparency."[10]

These risks could threaten insurance companies' solvency and liquidity, potentially undermining these firms' ability to pay claims to workers and retirees.

B. Insurance companies' involvement in offshore reinsurance schemes may hide risk and fail to provide sufficient backstops against losses.

In addition, insurance companies are increasingly using offshore reinsurance schemes, often through Bermuda, ostensibly for the purpose of reducing capital and liquidity requirements for the assets they hold in their portfolios.[11] Reinsurance assets under management in Bermuda have grown from $300 billion to $700 billion in the past three years, according to an actuary at a global insurance broker and consulting firm who was interviewed by Kerry Pechter at *Retirement Income Journal*.[12] This practice is effectively a game of regulatory accounting arbitrage that allow insurers to expand their involvement in the pension risk transfer market and hold riskier

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[7] Kris Devasabai, *Private equity's insurance innovation needs a risk check*, RISK.NET, March 17, 2022, https://www.risk.net/our-take/7939371/private-equitys-insurance-innovation-needs-a-risk-check?_hsenc=p2ANqtz-9w_GYZJl42cFgl3a3DdoobjwKkhThe5LVtatZBP_vMBw3VjM8uoDVVbXJotlK5i0SmMJolShE_r1-8MmlsgyZy2kiIe3TjqGBv4TSwEKNux5cyE6tq86oICl25eS2CE9d0olfY&_hsmi=207119927 ("These firms are following a path blazed by Apollo, which has turned Athene, the insurance platform it established in 2009, into a profit engine for its credit business. Apollo's big idea was to allocate a larger share of fixed income investments to higher-yielding asset-backed securities (ABS), and away from corporate bonds, which account for the bulk of traditional insurers' assets. Athene had 20% of its portfolio in ABS as of June 2021, with more than half of this in collateralised loan obligations (CLOs). The average insurer allocates 7% to ABS, with 2.6% in CLOs.").

[8] For example, life insurance industry alternative assets grew from $161 billion in 2016 to $238 billion in 2021, while asset-backed securities and other structured securitization assets grew to $393 billion in 2021. Investments by insurers in private equity funds increased from $58.7 billion in 2016 to $117.4 billion in 2021. *See* Letter from Jonathan C. Davidson, U.S. Department of the Treasury, to Senator Sherrod Brown, June 29, 2022 https://www.banking.senate.gov/imo/media/doc/fio_85.pdf (internal citations omitted).

[9] *Id*.

[10] National Association of Insurance Commissioners, *Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers*, https://content.naic.org/sites/default/files/call_materials/Materials_2.pdf

[11] Kerry Pechter, *Bermuda's Role in a Changing Annuity Industry*, RETIREMENT INCOME JOURNAL, September 10, 2021, https://retirementincomejournal.com/article/bermudas-role-in-a-changing-annuity-industry/

[12] *Id*.

assets than they otherwise would be permitted to hold, but it may come at the cost of increasing solvency and liquidity risk for the insurers engaging in such practices.

Specifically, Bermuda's financial regulators use Generally Accepted Accounting Principles (GAAP). Under GAAP, estimates of annuity liabilities—what insurers owe to policyholders or contract owners—can be lower than under Statutory Accounting Principles (SAP), which insurers must follow when preparing financial statements for regulators in the US.[13]

According to Tom Gober, a forensic accountant who studies and evaluates the assets backing insurance policies and contracts, "A life insurer knows that if it can reinsure annuity business under Generally Accepted Accounting Principles in Bermuda, for example, instead of Statutory Accounting Principles (SAP) in Iowa or New York, it will enjoy certain advantages. Its required reserves for new liabilities might be smaller, penalties for holding risky assets might be lower, and the recognition of certain large expenses (such as commissions) might be spread over many years instead of in the current year actually paid."[14]

Private equity owned insurers that hold risker, more complex, and opaque assets are likely to benefit from differences in accounting treatment in other jurisdictions. According to Will Hadfield at *Risk.net*, "Private equity firms are drawn to Bermuda partly because asset-backed securities, such as collateralized loan obligations (CLOs), are treated more favorably [there] than in the US and Europe."[15] Specifically, "The Bermuda Solvency Capital Requirement (BSCR) requires insurers to hold similar levels of capital against both corporate bonds and CLOs, even though some CLO tranches have a larger downside risk than bonds with the same credit rating," according to Hadfield.[16]

The U.S. Treasury Department has raised concerns about reinsurance schemes, stating, "Regulatory incentives may help drive private equity-owned insurers to incorporate substantial reliance on offshore risk-bearing entities for certain blocks of business, potentially masking from U.S. regulators the full scope and magnitude of risk to U.S. policyholders." Further, according to the Treasury Department, the lack of transparency "may contribute to insufficient requirements

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[13] *Id*.

[14] Tom Gober, *Why Offshoring Annuity Risk is Wrong*, RETIREMENT INCOME JOURNAL, June 15, 2022, https://retirementincomejournal.com/article/why-offshoring-annuity-risk-is-wrong/

[15] Kerry Pechter, *Why Annuity Issuers Use Bermuda Reinsurance*, RETIREMENT INCOME JOURNAL, June 30, 2022, https://retirementincomejournal.com/article/13743/.

[16] *Id*. *See also* Will Hadfield, *Apollo, KKR, Ares and the Bermudan CLO Arbitrage*, RISK.NET, March 14, 2022, https://www.risk.net/investing/7938306/apollo-kkr-ares-and-the-bermudan-clo-arbitrage?atv=GD84HudRNx6BagCgkZJhZ2yyAvHr6A6HaG4WwfBSckw ("Bermuda is unique in setting similar capital charges for CLOs and corporate bonds and allowing insurers to use excess yields to reduce liabilities. Life insurers have reinsured half-a-trillion dollars on the island, most of it in the years after being recognised as equivalent with the US and EU."); Kris Devasabai, *Private equity's insurance innovation needs a risk check*, RISK.NET, March 17, 2022, https://www.risk.net/our-take/7939371/private-equitys-insurance-innovation-needs-a-risk-check?_hsenc=p2ANqtz-9w_GYZJl42cFgl3a3DdoobjwKkhThe5LVtatZBP_vMBw3VjM8uoDVVbXJotlK5i0SmMJolShE_r1-8MmlsgyZy2kiIe3TjqGBv4TSwEKNux5cyE6tq86oICl25eS2CE9d0olfY&_hsmi=207119927 ("Athene's assets are reinsured in Bermuda, where corporate bonds and CLOs with the same credit rating receive similar capital treatment. In the US, they receive the same capital treatment. But Bermuda also allows excess spread to be booked as up-front profit. This reduces an insurer's liabilities and required reserves and boosts available capital.").

for reserving of liabilities and capital held for unexpected losses…"[17] Similarly, the NAIC has raised similar concerns about "Insurers' use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency, reduce reserves, increase investment risk, and introduce complexities into the group structure."[18]

Even more concerning, there is widespread use of affiliated reinsurance schemes, which may effectively transfer risk within an insurer, without actually reducing the risk to the insurer overall.[19] According to Tom Gober, "[T]he types of reinsurance practiced by certain life/annuity companies— especially 'modified coinsurance'—are not like yesterday's arm's length reinsurance between unaffiliated, independently capitalized reinsurers. These new types of reinsurance make the balance sheets of life/annuity companies less transparent."[20] Gober asserts that, "These trends are making it harder for agents, advisers, and investors to evaluate the financial strength and the trustworthiness of the life/annuity companies whose products they use."[21] Accordingly, "[T]he fairness and reasonableness of such an arrangement is unclear when the reinsurer is in Bermuda (where disclosure is limited) and the insurer and reinsurer are within the same holding company," Gober stated.[22] "If it's an opaque, affiliated transaction, all we can see is that they're just moving money from one pocket to another," said Gober, done "for the sake of capturing Bermuda's accounting advantages."[23] He further observed that, "While I have seen many different varieties of mechanisms used in affiliated, offshore reinsurance deals, all of those variations resulted in the same outcome: they create an appearance of new, extra surplus that would certainly not be allowed in the regulated insurance company – the ceding company."[24] Gober stated that the use of affiliated reinsurance schemes function "more for financial engineering than bona fide risk transfer."[25]

To the extent offshore reinsurance schemes allow insurers to increase risks to their businesses, it could threaten insurance companies' solvency and liquidity, potentially undermining their ability to pay claims to workers and retirees.

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[17] Letter from Jonathan C. Davidson, U.S. Department of the Treasury, to Senator Sherrod Brown, June 29, 2022 https://www.banking.senate.gov/imo/media/doc/fio_85.pdf

[18] National Association of Insurance Commissioners, *Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers*, https://content.naic.org/sites/default/files/call_materials/Materials_2.pdf

[19] Kerry Pechter, *Bermuda's Role in a Changing Annuity Industry*, RETIREMENT INCOME JOURNAL, September 10, 2021, https://retirementincomejournal.com/article/bermudas-role-in-a-changing-annuity-industry/; Tom Gober, *Why Offshoring Annuity Risk is Wrong*, RETIREMENT INCOME JOURNAL, June 15, 2022, https://retirementincomejournal.com/article/why-offshoring-annuity-risk-is-wrong/

[20] Tom Gober, *Why Offshoring Annuity Risk is Wrong*, RETIREMENT INCOME JOURNAL, June 15, 2022, https://retirementincomejournal.com/article/why-offshoring-annuity-risk-is-wrong/

[21] *Id*.

[22] Kerry Pechter, *Why Annuity Issuers Use Bermuda Reinsurance*, RETIREMENT INCOME JOURNAL, June 30, 2022, https://retirementincomejournal.com/article/13743/

[23] *Id*.

[24] Kerry Pechter, *Bermuda's Role in a Changing Annuity Industry*, RETIREMENT INCOME JOURNAL, September 10, 2021, https://retirementincomejournal.com/article/bermudas-role-in-a-changing-annuity-industry/

[25] *Id*.

C. Credit ratings of insurance companies may not provide accurate, reliable measures of insurance companies' likelihood of default and ability to pay claims given potential default.

Credit ratings purport to provide informational value about the creditworthiness of an issuer, specifically the likelihood that an issuer will default on its obligations and the potential financial loss suffered in the event of a default. Unfortunately, credit ratings are less informative than meets the eye. Time and time again, rating agencies have proven that they are unable to accurately and reliably assess the creditworthiness of an issuer.[26] Most prominently, the fundamental problems underlying credit rating agencies' business models and practices drove credit ratings' shoddy rating activities, and in turn helped to trigger the 2007-2008 financial crisis.[27] Specifically, the credit rating agencies, operating on perverse conflicts of interest, gave high credit ratings to very risky, complex, and opaque financial instruments related to subprime mortgages. When the subprime mortgage market collapsed, these instruments failed, triggering the crisis.[28]

Indeed, recent research suggests credit ratings are not accurately and reliably assessing the risk of insurers that are involved in the pension risk transfer market. Specifically, a study by NISA Investment Advisors examined the traded spreads of the bonds of various insurers to determine the market's assessment of the insurers' relative credit risk.[29] NISA found that there was a 140 basis point difference between the top-ranked insurer, New York Life Insurance Company, and Athene, at the bottom. This difference in spreads amounted to a 14 percent range in credit risk costs among nine pension risk transfer insurance providers. In comparison to actual credit ratings given to these companies, the "Market Implied Ratings" showed a large range of effective ratings – a full seven notches from AA to BBB-. According to the study's author David Eichhorn, with annual pension risk transfer transactions of approximately $40 billion, the

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[26] *See, e.g.*, Hearing before the Committee on Governmental Affairs, United States Senate, 107th Congress, Second Session, "RATING THE RATERS: ENRON AND THE CREDIT RATING AGENCIES," March 20, 2002, https://www.govinfo.gov/content/pkg/CHRG-107shrg79888/html/CHRG-107shrg79888.htm ("the credit raters continued to rate Enron as a good credit risk right up until 4 days before it declared bankruptcy."); Wall Street and the Financial Crisis: Anatomy of a Financial Collapse, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, United States Senate, April 13, 2011, https://www.levin.senate.gov/imo/media/doc/supporting/2011/PSI_WallStreetCrisis_041311.pdf.

[27] *See* Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies, By the Staff of the Office of Compliance Inspections and Examinations Division of Trading and Markets and Office of Economic Analysis, United States Securities and Exchange Commissions, July 2008, http://www.sec.gov/news/studies/2008/craexamination070808.pdf; The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Submitted by the Financial Crisis Inquiry Commission, Pursuant to Public Law 111-21, January 2011, http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf. *See also* Frank Partnoy, *What's (Still) Wrong with Credit Rating Agencies*, 92 WASH. L. REV. 1407 (2017).

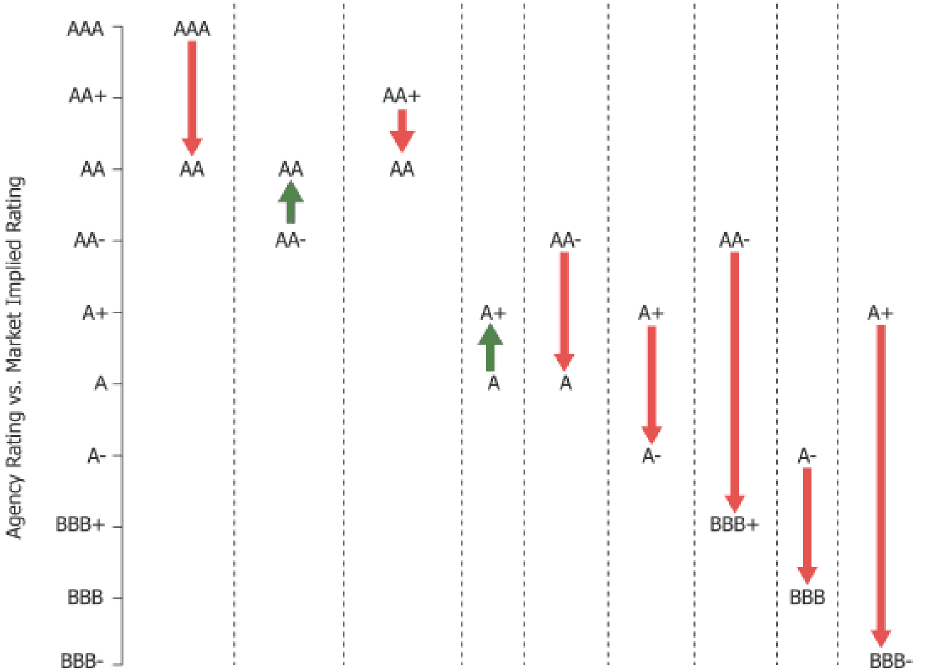
[28] Notably, insurance companies were not immune from stress during the financial crisis. While AIG failed in large part due to its issuing credit default swaps against mortgage-backed securities and collateralized debt obligations, other insurers also experienced significant stress. *See Insurance Industry Floundered in 2008*, CBSNEWS.COM, December 31, 2008, https://www.cbsnews.com/news/insurance-industry-floundered-in-2008/ ("During 2008, insurers' stocks, including Genworth, MetLife Inc. and Hartford Financial Services Group Inc., have been hit hard by concerns over the sector's mortgage exposure and the need for companies to raise capital.").

[29] David G. Eichhorn, *Pension Risk Transfers May Be Transferring Risk to Beneficiaries*, NISA.COM, October 13, 2022, https://www.nisa.com/perspectives/pension-risk-transfers-prt-may-be-transferring-risk-to-beneficiaries/

disparity puts pensioners at risk of losing as much as $5 billion per year in the form of uncompensated credit risk.

These findings have important implications for fiduciaries' consideration of insurers' credit risk, according to the study. Given the evidence that different insurers have different levels of creditworthiness, as determined by market values, it would be difficult for a plan fiduciary to conclude that all annuities meet the "safest available annuity" standard in Interpretive Bulletin 95-1. According to Eichhorn, "[B]y the market's assessment of relative credit risk, the spread between the safest and the least safe is 14%!.. [A]s we move down the list of PRT [Pension Risk Transfer] insurers (ranked by quality), we believe it gets increasingly tenuous to argue a given insurer is indeed 'safest available.'"[30]

FIGURE 1. The Market's View: There is a Very Wide Range of Provider Creditworthiness



	(A) NY Life	(B) Prudential	(C) MassMutual	(D) AIG	(E) MetLife	(F) Principal	(G) PacLife	(H) F&G	(I) Athene
Agency Rating	AAA	AA-	AA+	A	AA-	A+	AA-	A-	A+
Market Implied Rating	AA	AA	AA	A+	A	A-	BBB+	BBB	BBB-
Observed Market Spread	74	76	84	102	106	147	158	186	214

Note: In our opinion, when the DOL warned fiduciaries that they may not rely solely on ratings they were making it clear that a high rating would not be an effective safe harbor. For example, a AAA rated insurer is not appropriate when it is known to have higher credit risks. But can lower Agency ratings be ignored when the market is corroborating this assessment, or in this case, taking a dimmer view on the insurers credit quality?

Source: Bloomberg, 8/31/2022 NISA calculations.

[30] *Id*.

FIGURE 2. Quantifying the Economic Loss to Beneficiaries (ELB) Due to Credit Risk

Issuer	Observed Market Spread	Market Price of Bond's Risks Over Treasuries	Economic Loss to Beneficiaries (ELB) of Choosing Insurer	Market Assessment of Safest Annuity Available
(A) NY Life	74	7.4%	0.0%	
(B) Prudential	76	7.6%	0.2%	CLEAR CANDIDATES
(C) MassMutual	84	8.4%	1.0%	
(D) AIG	102	10.2%	2.8%	
(E) MetLife	106	10.6%	3.2%	POTENTIAL CANDIDATES BUT EXTRA SCRUTINY REQUIRED
(F) Principal	147	14.7%	7.3%	
(G) PacLife	158	15.8%	8.4%	
(H) F&G	186	18.6%	11.2%	QUESTIONABLE CANDIDATES: DEMANDS EXTENUATING CIRCUMSTANCES
(I) Athene	214	21.4%	14.0%	

Source: Bloomberg, NISA calculations.

To the extent insurers are engaging in activities that increase their credit risk, those risks could undermine firms' ability to pay claims to workers and retirees.

II. State insurance guarantees are unlikely to provide the same benefits as PBGC guarantees.

Defined benefit pensions are plan obligations and protected under ERISA and are guaranteed by the Pension Benefit Guaranty Corporation (PBGC), which insures private sector defined benefit pension plans. To the extent an employer defaults on its pension obligations, those losses are backstopped, up to a monthly maximum amount, by the PBGC. However, once a pension transfer takes place, workers and retirees are no longer protected under ERISA, and their pensions are no longer guaranteed by the PBGC. Instead, workers and retirees who receive annuities from insurance companies are subject to the terms of the annuity contract, weaker consumer protections under state-based insurance laws, which vary from state to state, and state-based guarantees, which can also vary from state to state. To the extent an insurer defaults on its annuity obligations, those losses are backstopped by state guaranty associations, up to a maximum total amount of value, as determined by each state. As discussed below, state guaranty associations are unlikely to provide the same level of benefits as the PBGC. As a result, workers and retirees whose pensions are transferred to annuities provided by insurance companies are at risk of losing valuable benefits if the insurance company fails.

The amount of insurance that state guaranty associations provide for annuities is limited, and in many instances likely to be lower than the amount provided for by the PBGC, although each state may vary.[31] My review of the National Organization of Life and Health Insurance Guaranty Association's (NOLHGA's) Benefit Limits - State Comparison Report found that many states offer $250,000 in present value annuity benefits. That means that a 65-year-old retiree who has earned a $50,000 per year pension—whose pension has been transferred to an insurance company and whose insurance company defaults—would hit their $250,000 limit in 5 years. In contrast, the PBGC would guaranty the retiree's full $50,000 pension for the rest of their life. In fact, the maximum amount the PBGC currently guarantees for a 65-year-old is $6,750 per month or $81,000 per year for the pensioner's life.[32] This potential difference in payments is significant.

In addition, because workers and retirees are no longer protected under ERISA after a pension is transferred to an insurance company, an insurance company could engage in practices that harm workers and retirees, leaving them without legal recourse. These could include increasing fees, decreasing benefits, changing annuity contract terms, or engaging in conflicts of interest that are not in the best interest of annuitants.

Recent research examined whether pension buyouts help or hurt workers and retirees. Specifically, the researchers compared the expected pension default losses of workers and retirees before and after pension buyouts.[33] The researchers found that "the lower protection level provided by the State Guarantee Association relative to that of the PBGC is a critical factor that explains the welfare reduction, or equivalently, larger expected pension default losses, of most retirees who become annuity holders in the buyouts."[34]

According to the authors, the study's results are consistent with the observation that state guarantee associations generally guarantee a smaller pension payoff than the PBGC. The authors show that the expected benefits of many retirees covered by annuities in a buyout are smaller than they would have been if their employers had not implemented the buyout. Specifically, the study's results "indicate that if private-sector pensions were replaced with annuities, given a state guarantee limit of $250,000, the employees covered by the group annuities would lose welfare equivalent to 11.6 percent or more due to state guarantee limits lower than those of the PBGC."[35]

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[31] *See* National Organization of Life and Health Insurance Guaranty Association's (NOLHGA's) Benefit Limits - State Comparison Report, https://www.nolhga.com/factsandfigures/main.cfm/location/lawdetail/docid/8. The fact that state guarantees vary could lead to a strange result where employees of the same company with the same pension value could receive different amounts of coverage based on the different states in which they reside.

[32] *See* Pension Benefit Guaranty Corporation, Maximum Monthly Guarantee Tables, https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee

[33] Yijia Lin, Richard D. MacMinn, and Tianxiang Shi, *Do pension buyouts help or hurt employees (retirees)?*, February 9, 2023, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4282447

[34] *Id*.

[35] *Id*.

III. The Department must ensure that plan fiduciaries that transfer pensions to insurance companies adhere to their fiduciary duties to ensure that any pension risk transfer arrangements are in the sole interest of plan participants and beneficiaries, and do not leave workers or retirees worse off than they would be if they stayed in the defined benefit pension.

Given the heightened risks to workers and retirees discussed above, the Department should ensure that plan fiduciaries adhere to their fiduciary duties to ensure that any pension risk transfer arrangements are in the sole interest of plan participants and beneficiaries and that any pension risk transfer arrangements do not leave workers or retirees worse off than they would be if they stayed in the defined benefit pension.

In 1995, the Department issued Interpretive Bulletin (IB) 95-1, which provided guidance concerning the fiduciary standards that are applicable to the selection of annuity providers for purposes of pension plan benefit distributions.[36] IB 95-1 makes clear that the selection of an annuity provider in connection with benefit distributions is a fiduciary act governed by the fiduciary standards of section 404(a)(1), including the duty to act prudently and solely in the interest of the plan's participants and beneficiaries. The IB provides generally that plan fiduciaries must select the safest annuity available. The IB also provides that fiduciaries must conduct an objective, thorough and analytical search for purposes of identifying providers from which to purchase annuities and sets forth six factors that should be considered by fiduciaries in evaluating a provider's claims paying ability and creditworthiness.[37]

While the interpretative bulletin was issued in 1995, it provides a strong framework to ensure plan fiduciaries comply with their fiduciary duties of prudence and loyalty and that workers and retirees are sufficiently protected. However, given that the insurance market has experienced significant changes in recent years and that those changes may adversely affect workers and retirees, it's important that the Department ensure that plan participants and beneficiaries are not made worse off when their pensions are transferred to an insurance annuity provider.

To the extent the Department is considering updating its framework for IB 95-1, the Department should preserve IB 95-1's requirement that fiduciaries select the safest available annuity. Moreover, fiduciaries should be required to conduct an analysis comparing different annuities and insurance companies in the market, including an analysis of market spreads, which may imply a different rating than a credit rating agency provides. To the extent spreads are markedly higher for one insurance company than another, that should provide strong evidence that the

[36] 29 CFR § 2509.95-1, Interpretive bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan, https://www.law.cornell.edu/cfr/text/29/2509.95-1 [60 FR 12329, Mar. 6, 1995, as amended at 72 FR 52006, Sept. 12, 2007; 73 FR 58447, Oct. 7, 2008].

[37] These factors that the plan sponsor should consider include: (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 its exposure to liability; (5) the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts; and (6) the availability of additional protection through state guaranty associations and the extent of those guarantees.

company with higher spreads is not the safest available annuity. This kind of analysis would ensure that fiduciaries do not rely excessively on credit ratings, which, as discussed above, are often inaccurate and unreliable.

In addition, the Department should consider requiring plan fiduciaries to purchase and maintain independent reinsurance of the pensions being transferred. There are two primary reasons for doing so. First, as discussed above, insurance companies are undertaking reinsurance schemes that may not provide sufficient backstops against losses. This is particularly the case if insurers use affiliated reinsurers, which may effectively transfer risk within the insurer without actually reducing the risk to the insurer overall. Second, also as discussed above, state guaranty associations may not provide the same level of benefits as the PBGC would if the pension benefits remained in the plan. Given these two risks associated with transferring pensions to annuities, it's entirely appropriate that plan fiduciaries provide an independent backstop against losses and that any potential gaps in pension benefits are covered.

Finally, while better disclosures for employees and workers about pension risk transfers may help inform employees and workers of their various options and associated risks, the Department should not rely exclusively or even primarily on disclosures to address these important issues. Employees and workers may not fully understand disclosures, and even if they did, they may not be able to protect themselves against the potential risks and harms associated with a pension risk transfer. Accordingly, disclosures should not displace the high level of prudence and loyalty that plan fiduciaries should undertake when selecting an annuity as part of a pension risk transfer.

Ultimately, the Department should seek to ensure that any pension risk transfer arrangements do not leave workers or retirees worse off than they would be if they stayed in the plan. Workers and retirees have earned their pensions and they depend on them to help get them through retirement. Those benefits and the protections that are afforded to workers and retirees should not be compromised.