Statement of the 2023 Advisory Council on Employee Welfare and Pension Benefit Plans to the U.S. Department of Labor Regarding Interpretive Bulletin 95-1

This statement from the 2023 Advisory Council on Employee Welfare and Pension Benefit Plans (Council or EAC) provides further points of view of the Council on whether and how Interpretive Bulletin 95-1 (IB 95-1) should be updated by the U.S. Department of Labor (DOL or the Department). These views of the Council are in addition to perspectives shared orally with the Department by the Council at the EAC's July 18, 2023, meeting. The Council's views were formulated in response to DOL's request that the Council do so in order that DOL could fulfill its obligations under the SECURE 2.0 Act of 2022. Sec. 321 of that law directs DOL to "review [IB 95-1] and consult with the Advisory Council on Employee Welfare and Pension Benefit Plans…to determine whether amendments to [it] are warranted" and "report to Congress on the findings of such review and consultation, including an assessment of any risk to participants" not later than Dec. 29, 2023.[1]

IB 95-1 requires fiduciaries to evaluate the insurer's claims paying ability and creditworthiness. In IB 95-1, DOL states that in completing this evaluation a fiduciary must consider: 1)The quality and diversification of the annuity provider's investment portfolio; 2) the size of the insurer relative to the proposed contract; 3) the level of the insurer's capital and surplus; 4) the lines of business of the annuity provider and other indications of an insurer's exposure to liability; 5) the structure of the annuity contract and guarantees supporting the annuities such as the use of separate accounts; 6) the availability of additional protections through state guaranty associations and the extent of their guarantees. Subsection (d) of IB 95-1 also requires fiduciaries to consider "the ability to administer the payment of benefits."

DOL further states that unless the fiduciary possesses the necessary expertise to evaluate the above factors, fiduciaries would need to obtain the advice of a qualified, independent expert. The DOL also addresses the consideration of cost and cautions against conflicts of interest.

Recommendations and Discussion Related to Making No Changes

Six members of the Council recommend DOL make no changes to IB 95-1.

IB 95-1, issued on March 6, 1995, in the wake of the failure of Executive Life Insurance Companies of California and New York, provides guidance to pension plans considering the purchase of annuities "to transfer liability for benefits purchased under the plan to [an] annuity provider." IB 95-1 emphasizes the fiduciary responsibility owed to plan participants in the selection of the "safest annuity available" and makes it clear that "[c]ost consideration may not … justify the purchase of an unsafe annuity;" nor is it appropriate to rely solely on insurance rating services. Instead, IB 95-1 enumerates a number of factors to be taken into consideration in evaluating an annuity provider's claims-paying ability and creditworthiness.

Despite the passage of nearly 30 years, IB 95-1's guidance has stood the test of time. IB 95-1's success has been proven by the absence of a single default or failure of any annuity since its issuance. Despite massive changes that have occurred in the world of finance since IB 95-1's issuance, the factors to be considered in the selection of annuity providers remain relevant and continue to mandate a high level of due diligence yet offer plan sponsors flexibility in selecting an appropriate annuity provider.

[1] SECURE 2.0 Act of 2022, Pub. L. No. 117-328, § 321, 136 Stat. 5275, 5356.

IB 95-1 identifies a number of factors that must be taken into consideration in selecting an annuity provider consistent with the fiduciary obligations enumerated in ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1). The factors listed in IB 95-1 are not exhaustive, nor would they necessarily afford a safe harbor to employers who choose an annuity provider that subsequently defaults on its payment obligations if a fiduciary breach has nonetheless occurred.

SECURE 2.0 required DOL to review IB 95-1 to determine whether updates are needed. During this review the below concerns were raised by interested parties. However, as outlined below, these concerns already appear to be adequately addressed by IB 95-1 and the state Department of Insurance (DOI) regulatory framework. What follows is additional detail around how these concerns are addressed by existing law or guidance.

1. Ownership Structure. Interested parties have expressed concern that the ownership structure of insurance companies, engaging in Pension Risk Transfer (PRT) transactions, is not being properly considered. However, this is already accounted for by the requirement in IB 95-1 that requires the fiduciary to consider the insurer's lines of business and other liability exposure generally.

   In addition, the current insurance regulatory framework accounts for and manages the risk related to ownership structure and affiliated entities. Annuity insurance entities are not permitted to share assets with entities that are not in the annuity business and that it may be affiliated with. In fact, any arrangements involving the exchange of services between an entity providing annuity coverage and an affiliate must be approved by the domiciliary DOI.

2. Assets. Increase in non-traditional/risky investments by insurers. Again, this is regulated by the relevant DOIs and is covered by items 1 and 3 in the current IB 95-1. Consideration number 3 in the existing IB, requires an evaluation of the level of the insurer's capital and surplus. This capital and surplus is directly impacted by the investments held by writing insurance companies. Insurance company capital and surplus is calculated taking into consideration their liabilities and assets (including investments). If an investment is particularly risky, the insurer may be limited in their ability to invest there, because the charge of that investment to their capital may outweigh any potential return. Therefore, when a fiduciary looks at the capital and surplus of an insurance company, they can be certain that the amount of capital and surplus already takes into consideration the riskiness of investments that insurer is holding. Further, consideration number 1 requires fiduciaries to consider the quality and diversification of the insurer's investments, which clearly covers the riskiness of those investments.

3. Liabilities. Existence of non-traditional liabilities. Same comment as above. All of this is considered when determining the insurers capitalization and surplus levels. Consideration number 4 also directly requires review of an insurer's liabilities.

4. Reinsurance. Reinsurance is a risk management tool used by insurers to spread risk and manage capital. Reinsurance transactions must meet specific regulatory conditions. An insurer's decision to reinsure an annuity that was part of a PRT does not relieve the annuity issuer of their obligation to pay certificate holders. The annuity issuer selected by the plan fiduciary remains 100% liable for all annuities payments and reinsurance does not change that obligation. An insurer's reinsurance arrangement would likely be included within an examination of its "exposure to liability" as required by IB-95. Consideration number 5 also requires review of the guarantees supporting an annuity contract which includes reinsurance guarantees.

5. Risk-Based Capital and Other Methodologies. Risk-Based Capital (RBC) is one tool used by insurance regulators to evaluate an insurer's financial solvency and whether regulatory intervention is warranted. Insurers are subject to RBC requirements that require them to maintain capital proportional to risk. RBC requirements consider the riskiness of an insurer's investments to determine capital requirements (e.g., riskier assets have higher capital charges) and determine if an insurer is holding sufficient funds to make good on their financial promises to customers. It appears that the same factors that are used to evaluate RBC are already also evaluated under IB 95-1. All of these factors are taken into account under IB 95-1, as described above.

6. Separate Accounts as a Protection. Separate accounts generally provide greater protection for certificate holders. It was unclear from witness testimony what the concern is with separate accounts. EBSA's summary states that some stakeholders said that separate accounts offered extra protection, while others questioned the protections offered by separate accounts, it is important to note that IB 95-1 already requires an evaluation of the structure of the annuity contract and guarantees supporting the annuities such as the use of separate accounts. This is very appropriately listed as a consideration under IB 95-1.

7. Administrative Capabilities and Experience. This is an inherently low risk item. Market competitiveness drives the need to provide good customer experiences and the DOI complaint framework also mitigates against this concern. Further, the Council has not received any examples of situations in which participants did not receive the pension benefits they were promised because the Insurer did not provide sufficient administrative and customer experience support. Finally, this factor is already explicitly recognized as relevant under IB 95-1.

8. Spousal Protections. To remain qualified and meet the definition of "annuity" at Code section 401(g), the contract must conform to the Code requirements under Code section 401(a). See Treas. Reg. section 1.401(a)-20, Q&A 2, which provides that qualified joint and survivor annuity (QJSA) requirements extend to payments under the annuity contract, not simply the distribution of the annuity contract. No witness provided any data or evidence to illustrate or prove that spousal protections have been an actual problem subsequent to a PRT.

9. Anti-Alienation Rules: Protections Against Creditors and Division of Benefits on Divorce. To be and remain qualified, the contract must satisfy Code section 401(g) and conform to the Code requirements under Code section 401(a). A contract issued after Dec. 31, 1962, must be non-transferrable. Thus, group annuity certificates issued to participants to provide qualified plan benefits are required to follow the plan provisions and form of benefit rules, and therefore do not permit assignment to creditors or any other party unless exempted under Code section 401(a). Additionally, distributed annuities from qualified plans are exempt under Code section 401(g). Consequently, they must receive the same treatment under the law as ERISA plan benefits, because they are treated as a section 401(a) trust under Code section 401(g). Finally, no witness provided any evidence or data to illustrate or suggest that anti-alienation issues have been an actual problem for individuals subsequent to a PRT.

10. Disclosures. Concerns about the needs for additional disclosure appear to be outside of the scope of 95-1.

11. Loss of PBGC Protections. NOHLGA's 2016 study of this topic shows that there is no material difference between the PBGC protection and SGAs. In addition, one additional point is important. The state guaranty systems are rarely triggered, so that over the past 30+ years, no one has lost a penny under a PRT annuity. At the same time, a very limited PBGC study showed $8.5 billion of participant losses. Further an assessment of this risk is already covered by consideration 6 of IB 95-1.

    Additionally, some members of the Council felt PBGC has insurance programs for single-employer and multiemployer defined benefit pension plans that guarantee benefits for plan participants if their plan becomes insolvent and unable to pay benefits. The two programs differ significantly in the guaranteed level of benefits. The guaranteed level of benefits for multiemployer plans is significantly lower than PBGC's single-employer guarantee.

    Our understanding is that most participants of insolvent single-employer plans would receive 100% of their benefit under the PBGC guarantee, unless the plan has very rich benefits or heavily subsidized early retirement benefits. For multiemployer plans, generally PBGC does not guarantee 100% of the benefit unless the plan has very small benefits. Therefore, if a multiemployer plan goes insolvent and receives PBGC assistance, most participants will see a significant reduction in their benefit to the PBGC guarantee level. (Note - PBGC's special financial assistance program for financially troubled multiemployer plans under the American Rescue Plan Act generally restores any benefits that were reduced to the PBGC guarantee level after receipt of the assistance.)

    The loss of PBGC protection is certainly an important factor for plan fiduciaries to consider. However, this is a factor that plan settlors and fiduciaries may consider when deciding whether to engage in a pension risk transfer ("PRT") transaction at all. Once the decision has been made to engage in a PRT, the loss of PBGC protection is not a criterion that is relevant for the evaluation and selection of an annuity provider since PBGC protections are not applicable to annuity providers.

    IB 95-1 already directs plan fiduciaries to consider factors that do apply to annuity providers in the event of their insolvency. Specifically, Criteria 5 and 6 provide that plan fiduciaries should consider the use of separate accounts and state guaranty association protections, which provide protections for participants.

12. State Guaranty Associations. See comments above in 11 (Loss of PBGC Protections).

13. Impact of Partial Pension Risk Transfer Annuity Purchases on Residual Funding Status of Plans. The decision to do a pension risk transfer (partial or full) is a settlor decision. The effect of a particular annuity contract on all participants is already required to be taken into account under current law.

    Additionally, some members of the Council felt the purpose of IB 95-1 is to guide a plan fiduciary on the proper selection of the "safest available annuity" for the purpose of pension plan benefit distribution where the plan intends to transfer liability for benefits to the annuity provider. The impact on the plan's funded status is often a key component of the analysis by the employer when determining if they will conduct a PRT and to what extent. Any concerns regarding the impact of a PRT on a plan's funded status should be addressed when deciding if a PRT should take place.

Once an employer decides to go forward with a PRT, the impact on the funded status should not be a key consideration in the selection of the annuity provider as it could create unintended consequences. For example, if a plan is well funded, it could lead the fiduciary to consider spending more for the transaction. Conversely, if a plan is not as well funded, it may unnecessarily lead the fiduciary to focus too much on lowest cost annuities. Additionally, it is unclear how the potential impact on the funded status would be measured by the employer – would it be the funded ratio, the gap in funding on a dollar basis, or whether it affects plan administration?

The Council received examples of PRT scenarios that had a negative impact on plan funded status, and Department provided a simplified example of how the remaining participants in the plan after the PRT were worse off. Other stakeholders raised the Verizon PRT as an example. Due to how funding liabilities are determined vs the cost of annuities, an annuity purchase can reduce a plan's funded status, but whether this reduction is advisable should be part of the decision as to whether a transfer should take place, not in the selection of the annuity provider.

For the reasons stated above, IB 95-1 should not be updated to reflect the impact of a decreased funding level for remaining plan participants. If it is determined that this is a concern, it should be addressed in the decision as to whether a PRT takes place.

IB 95-1 was also drafted broadly enough to remain highly effective despite inevitable and unpredictable new influences on the annuity market, such as the entry of private equity into the annuity market, which may raise particular concerns in the selection of an annuity provider. New industry standards for selection of an annuity provider that go above and beyond the specific requirements in IB 95-1 may add an additional layer of protection to plan participants and likely further mitigate any risk that may exist as a result of the annuitization of an existing pension plan. As the saying goes, "if it ain't broke, don't fix it." Because IB 95-1 continues to serve ERISA's primary goal of protecting participants' retirement assets, there is no need to amend it.

Recommendations and Discussion Related to Ownership Structure

Council members have expressed a variety of views about whether and how the Department should update IB 95-1 to provide for the consideration of ownership structure in assessing an annuity provider's claims paying ability and creditworthiness.

Five members of the Council recommend DOL amend IB 95-1 to clarify that in selecting an annuity provider, a fiduciary should consider the ownership and control of an annuity provider.

During the public comment period on July 18, 2023, individuals from the public representing retirees and employee organizations voiced their concerns regarding the role of private equity firms in the pension risk transfer industry. Individuals representing insurers and employers noted that since IB 95-1 has been issued, no retiree has failed to receive their annuity payments from insurers, while others noted that there have been changes in the ownership structures of insurers in recent years. While specific viewpoints on whether changes to IB 95-1 are needed may have varied, there was some common ground between the various members of the public. Specifically, there was broad acknowledgement that insurance companies, like many other corporations, have complex ownership structures and this factor is evaluated by at least some plan fiduciaries, or their advisors, as part of a pension risk transfer transaction as part of their due diligence process – even though it is not explicitly required by IB 95-1 – in selecting the "safest annuity available." With that in mind, the Department

should consider clarifying the criteria in IB 95-1 to include the ownership and control of the annuity provider.

Four members of the Council, while supportive of formalizing the annuity provider's ownership structure as a factor, caution, however, against any guidance that disqualifies insurers solely on the basis of their ownership structure. Overly prescriptive guidance regarding an annuity provider's ownership structure (i.e., public vs. private vs. mutual) could potentially limit the options available to retirement plan fiduciaries. Greater consideration should be given to the specific types of investment strategies pursued by annuity providers and the specific ways they manage risk through reinsurance, rather than the ownership structure of the insurer in isolation. Further, an assessment of the insurer's financial strength ratings should include a review of financial strength ratings of both the parent company and the life insurance issuing company.

Two members of the Council, while agreeing that an insurer should not be disqualified solely on the basis of having any particular ownership structure and that overly prescriptive guidance regarding an annuity provider's ownership structure could potentially limit the options available to retirement plan fiduciaries, recommend DOL provide more specific guidance on aspects of ownership structure that should be considered by a fiduciary. Considerations regarding an insurer's ownership structure should include (1) whether it is a mutual or for-profit business; (2) whether it is part of a holding company structure, including one that has offshore or other components that may be subject to regulatory schemes that are not as strict as those in the vast majority of U.S. states; (3) whether there has been a shifting of liabilities into any such component (e.g., subsidiary) and the effect of that on the annuity provider's statutory surplus; and (4) any elements that increase complexity, such as captive reinsurance entities, commitments or obligations to affiliates or counterparties, or sidecar investment vehicles.

Among members of the Council who are against making any change in IB 95-1 related to the consideration of ownership structure, some share various viewpoints and concerns in response to such proposals, including those described here. Some believe considerations such as those described in the preceding paragraph could constitute picking one insurance business model over another and believe the Council should avoid making any such recommendation. With respect to the proposal made in the preceding paragraph regarding consideration of mutual and for-profit status, they note that all relevant insurers are for-profit and that the National Association of Insurance Commissioners deems stock and mutual insurance companies to be equivalent for all intents and purposes. With respect to concerns about offshore reinsurers, especially those located in Bermuda, they note that Bermuda is the leading jurisdiction for international reinsurance and one of the few jurisdictions recognized by both the European Union and the U.S. for the comprehensiveness and quality of its regulation. Further, they note that Bermuda is a tax efficient jurisdiction for raising foreign capital to support U.S. insurers. With respect to considerations of complexity, they note that complexity is a subjective concept that has nothing to do with an insurer's claims paying ability.

Recommendations and Discussion Related to Assets: Increase in Non-Traditional/Risky Investments

Five members of the Council recommend DOL amend IB 95-1 to clarify that in assessing the quality and diversification of an annuity provider's investment portfolio, fiduciaries should consider additional aspects of the insurer's portfolio related to investments in alternative assets and the insurer's ability to meet long-term commitments to annuities.

Section 404(a)(1) of ERISA, as amended, requires that a plan fiduciary discharge his or her duties with respect to the plan solely in the interest of participants and beneficiaries. Although not explicitly stated therein, IB 95-1 seems to acknowledge that when a plan engages in a PRT transaction, participants and beneficiaries lose the protections afforded to them under Section 404 of ERISA. Therefore, IB 95-1 clarified and emphasized that the selection of the "safest annuity available" is a fiduciary duty under Section 404(a)(1).

IB 95-1 was issued by the Department in the wake of the well-publicized failure of the Executive Life Insurance Companies of California and New York, whose substantial investments in high-risk bonds led to its insolvency. Consequently, it is no surprise that IB 95-1 focuses on the evaluation of an insurer's financial position. Indeed, the preamble to IB 95-1 states: "In conducting such a search, a fiduciary must evaluate a potential annuity provider's claims-paying ability and creditworthiness because the participants and beneficiaries whose entitlement to benefits will be transferred to the annuity provider have a paramount interest in the ability of the provider to make those payments." With that in mind, IB 95-1 requires a fiduciary to consider, among other factors: (1) the quality and diversification of the annuity provider's investment portfolio; (2) the level of the insurer's capital and surplus; and (3) the lines of business of the annuity provider and other indications of an insurer's exposure to liability.

As the variety and complexity of investment products has continued to evolve, the Department has responded to such developments by issuing guidance to plan fiduciaries, such as Compliance Assistance Release No. 2022-01 on cryptocurrencies and the various rules on ESG investing. Accordingly, the Council recommends that the Department update its guidance in IB 95-1 to clarify that fiduciaries should consider the following:

- Generally, an insurer's ability to fund the long-term commitment of annuities, as opposed to short-term strategies mismatched with the duration of annuity liabilities.

- Whether the insurer invests in riskier and/or less liquid assets to support benefit payments, including private credit, structured credit (CLOs), asset-backed securities, private fixed income placements, subordinate debt or the stock of affiliated companies.

- Whether a higher level of reserves is appropriate for insurers with significant allocation of their investment portfolios to alternative investments that come with greater risk and/or are less liquid, compared to insurers that do not have such allocations or as great an allocation.

- The risks created by potential self-dealing or conflicts of interest when an insurer is owned by a private equity firm or at least some of the insurer's portfolio is managed by a private equity firm, such as whether insurance assets are used to shore up the finances of funds operated by the private equity firm or are at risk of exposure to related party investments.

Like the criteria currently listed in IB 95-1, the above are simply intended to be criteria that plan fiduciaries should consider when evaluating insurers; any guidance should make clear that plan fiduciaries are not prohibited from considering annuity providers that are invested in non-traditional or risky investments. Insurers should be permitted, like plan fiduciaries are permitted, to invest in alternative or riskier asset classes, provided it is prudent to do so.

Among members of the Council who are against making any change in IB 95-1 related to consideration of the quality and diversification of an annuity provider's investment portfolio, some share various viewpoints and concerns in response to such proposals, including those described here:

- It would be inappropriate to single out elements like use of affiliated asset managers because the focus should be on the quality and safety of the asset manager, regardless of whether they are affiliated with the insurer. Across the insurance industry, the use of affiliated asset management is the norm. Allianz, Ameriprise Financial, Assured Guaranty, Athene, Guardian, Mass Mutual, MetLife, Nippon Life, Prudential, Sun Life, and TIAA all use affiliated asset managers.

- It would be inappropriate for DOL to discourage the selection of annuity providers who use "non-traditional" investments. Historically, DOL has not opined on whether specific investments are prudent.

- Structured credit as a key positive example of that evolution enabling structural protections and diversification of collateral to improve portfolio and therefore participant security. IB 95-1 clearly requires fiduciaries to consider asset selection, credit quality and structural protections in its determination that the annuity provider is safe and appropriate.

- Insurers' allocation to IG Structured securities represents incremental diversification to their existing allocations in a manner that typically improves the credit profile of the insurer. Anchoring fiduciaries to a requirement that insurer portfolios remain unchanged over time would cause insurers to avoid diversifying, constrain them from reacting to market developments and improving portfolios and prevent the natural progression that investments regarded as non-traditional become traditional over time.

- Retirement plans already have exposure to all the investment types that have been identified as "non-traditional." In fact, plans may use products like investment grade collateralized loan obligations for the same reason that some insurers do, because they have provided a safer investment than similar corporate bonds.

- To the extent some asset classes may be riskier, that is already considered by insurance regulators in the rules surrounding calculation of risk-based capital requirements. Imposing a different standard or requiring plan fiduciaries to ignore the work of insurance regulators would overstep DOL's authority and would be disruptive to insurance industry operation.

- IB 95-1 has worked because it has allowed for investment selection and portfolio allocation to evolve instead of requiring the specific investment philosophies that were in place when ERISA was enacted in 1974. It has stood the test of time and will continue to do so because of, not in spite of providing fiduciaries the flexibility to consider investments in an evolving context.

- With respect to conflicts of interest and self-dealing, investment advisers are subject to substantial regulations covering fiduciary obligations and mitigation of conflicts of interest. The manager's compliance with these regulations serves to address conflicts of interest that the DOL may be concerned with in asset portfolios as they require the manager to disclose all material conflicts of interest. Ultimately such laws require the manager to always act in the best interest of its clients. In addition, where the asset management firm and insurance company are wholly owned, there is a complete alignment of interest because assets that are allocated by the asset manager to the insurer are owned by the holding company. If the asset manager selects investments that lose money for the insurer, the loss is borne by the common parent, so in these structures, alignment mitigates any perceived conflict of interest.

- NAIC's risk-based capital framework is already being updated to reflect the use of different investments and securities being used in the insurers' investment portfolios over time.

Recommendations and Discussion Related to Liabilities: Existence of Non-Traditional Liabilities

Three members of the Council recommend DOL consider amending IB 95-1 to provide that in assessing the lines of business of an annuity provider and other indications of an insurer's exposure to liability that a fiduciary consider an insurer's non-traditional liabilities and the extent to which they might pose added risk in some circumstances.

DOL should consider amending IB 95-1 to provide that in considering an annuity provider's lines of business and other indications of an insurer's exposure to liability as part of a fiduciary's assessment of an insurer's claims paying ability and creditworthiness, a fiduciary should consider an insurer's non-traditional liabilities and the extent to which they might pose added risk in some circumstances. Since 95-1 was promulgated, experiences with nontraditional liabilities, such as funding agreement backed securities, have shown that these liabilities can in some cases carry significant liquidity risks that may threaten the financial health of insurers. Given this, it would be appropriate to explicitly call for consideration of these kinds of liabilities to ensure all fiduciaries, not just those following best practices, are aware of the need to do so.

Among members of the Council who are against making any change in IB 95-1 related to consideration of an insurer's non-traditional liabilities, some share various viewpoints and concerns in response to such proposals, including those described here:

- It would be unprecedented for a fiduciary to successfully argue that they had satisfied their responsibility where they excluded known risks from their analysis of an investment's safety. As a result, it would be foolish for DOL to place a thumb on the scale of directing fiduciaries to consider certain liabilities. Prudent fiduciaries already consider factors like credit spreads as part of considering the lines of business of the annuity provider and other indications of an insurer's exposure to liability. Calling out specific liabilities will lead to overweight of them as factors.

- Non-traditional liabilities can include a range of liabilities ranging from FABNs to long-term care insurance, variable annuities with living benefits and universal life with secondary guarantees. FABNs are a particularly low risk liability as they have a fixed-term and no longevity risk.

- Changing IB 95-1 to identify specific liabilities would convert IB 95-1 from the principles-based guidance that has worked and convert it into one where DOL would have to repeatedly overrule insurance regulators on what evolving insurance practices work best for annuitants.

Recommendations and Discussion Related to Reinsurance

Seven members of the Council recommend DOL consider amending IB 95-1 to incorporate reinsurance as a factor in evaluating an insurer's claims paying ability and creditworthiness.

Reinsurance can provide valuable additional security for promised annuities and therefore should be considered by fiduciaries. As part of that evaluation, a fiduciary should assess how the reinsurer's domicile or the relationship between the reinsurer and insurer impacts the reinsurance protections. The increasing use of offshore reinsurers and captive/affiliated reinsurers by life insurers, however, highlights the need for fiduciaries to understand any meaningful differences between reinsurers that may be standing behind an annuity provider's promises. This includes an understanding of the substance, not merely the form of the relationship with the reinsurer.

Among members of the Council who are against making any change in IB 95-1 related to incorporating reinsurance as a factor in evaluating an insurer's claims paying ability and creditworthiness, some share various viewpoints and concerns in response to such proposals, including those described here:

- Reinsurance provides insurers with broad access to capital, including from global jurisdictions. That access to capital supports the stability and safety of insurers and participants.
- IB 95-1 requires consideration of guarantees supporting annuities. Reinsurance is one such guarantee; it provides an additional layer of protection for annuitants. Fiduciaries consider reinsurance in a handful of ways, including types, collateral levels and other aspects. When a fiduciary examines reinsurance, a fiduciary frequently asks if the reinsurer is in a state or country that has been approved by the NAIC as a Reciprocal Jurisdiction or as a Qualified Jurisdiction.
- The quality of different jurisdictions for reinsurance is governed by treaties and through NAIC review, and it would be disruptive and inappropriate for DOL to interfere with those regulations.
- Requiring reinsurance or even a specific type of reinsurance would go beyond the text of the statute which expressly provides that a participant's status as a participant can be terminated through the purchase of an annuity.

Recommendations and Discussion Related to Risk-Based Capital and Other Methodologies

One member of the Council recommends DOL update 95-1 to provide for the consideration of additional factors in assessing an annuity provider's level of capital and surplus as it relates to its claims paying ability and creditworthiness.

DOL should update IB 95-1 to provide that in evaluating a potential annuity provider's level of capital and surplus, as well as its claims paying ability and creditworthiness, a fiduciary should evaluate additional issues, including the insurer's risk-based capital (RBC) ratio; how reinsurance or modified coinsurance agreements with offshore affiliates or affiliates in states that have less strict requirements than the majority of U.S. states might affect the reported ratio, especially with respect to significant allocation of their investment portfolios to alternative investments that come with greater risk; and whether the insurer is properly reserved under statutory accounting principles ("SAP").

Among members of the Council who are against making any change in IB 95-1 related to considering the level of capital and surplus in evaluating an insurer's claims paying ability and creditworthiness, some share various viewpoints and concerns in response to such proposals, including those described here:

- IB 95-1 already requires consideration of the level of an insurer's capital and surplus, which is heavily regulated.
- Insurance regulators set how risk-based capital ratios are calculated and incorporate reinsurance, modified coinsurance, affiliated insurance, portfolio composition, and the accounting principles that may be used. Requiring plan fiduciaries to use a different formula or ask that insurers calculate their risk-based capital using a non-NAIC approved formula would harm participants as it would minimize the ability of fiduciaries to compare the safety of annuity providers using well-developed and regularly updated formulas that have been approved by regulators myopically focused on annuity safety.
- IB 95-1 should not be amended to restate or to second-guess the rules put in place by insurance regulators. Issues of (1) how risk-based capital (RBC) ratios are calculated; (2)) the rules regarding how various types of reinsurance or modified coinsurance agreements impact the reported ratio; (3) reserving requirements for insurers who allocate to alternative investments; and (4) whether the insurer is properly reserved under statutory accounting principles ("SAP") are all fundamental issues of insurance regulation. If there are concerns about the framework of insurance regulation, those issues should be raised with insurance regulators. Adding a separate framework for insurer risk would be disruptive, likely cause fiduciary confusion and could lead to conflicting regulatory standards.

<u>**Recommendations and Discussion Related to Separate Accounts as a Protection**</u>

Council members are not providing any recommendations or discussion on this topic, other than what is described in the no changes recommendation above.

<u>**Recommendations and Discussion Related to Administrative Capabilities and Experience**</u>

A majority of eight members of the Council recommend DOL update 95-1 to expand on its existing language addressing how a fiduciary should consider an annuity provider's administrative capabilities and experience.

IB 95-1 briefly mentions the annuity provider's ability to administer the payment of benefits to the participants in the discussion of "Costs and Other Considerations." We recommend the Department expand on the current language about the annuity provider's administrative capabilities as a factor for consideration. Specifically, an assessment of the annuity provider's capacity to administer benefits effectively and efficiently should be formally included as a factor that fiduciaries consider. This could include both an assessment of what the annuity provider's administrative capabilities are and also the quality of the annuity provider's administrative capabilities relative to other annuity providers. Factors of quality that are generally considered today by independent fiduciaries and experts include the accuracy and timeliness of payments, response time answering phone calls, participant web access capabilities and any concerns about customer service or data accuracy (e.g., losing participants). It could also include an assessment of an annuity provider's cybersecurity practices.

<u>Recommendations and Discussion Related to Spousal Protections & Anti-Alienation Rules: Protections Against Creditors and Division of Benefits on Divorce</u>

Council members have expressed a variety of views about whether and how the Department should update IB 95-1 with respect to ERISA's spousal protections and anti-alienation requirements.

Five members of the Council view spousal protections and anti-alienation rules as being outside the scope of IB 95-1 and recommend DOL address these issues within the context of the existing regulations defining what an annuity contract must provide for the contract to terminate an individual's rights under the plan.[2] DOL should clarify these rules to address whether annuity contracts must include spousal protections or the anti-alienation rules to satisfy the conditions of this rule. Adding spousal protections as a factor to consider under IB 95-1 could imply that annuity contracts are not required under existing regulations to include spousal protections. Adding anti-alienation rules to IB 95-1 also raises risks insofar that it is unclear whether benefits in pay status could be subject to legal action, such as the imposition of a constructive trust by state courts. DOL also should consult with the U.S. Treasury Department regarding current Treasury rules requiring annuity contracts purchased and distributed to a participant or spouse by a plan to protect survivor rights.

Six members of the Council recommend DOL provide guidance on requirements related to spousal benefit elections by annuity providers and Domestic Relations Orders (DROs) issued after the pension risk transfer, whether as part of IB 95-1 or in separate guidance or rulemaking. Several members of the public who provided comments to the Council and EBSA's report to the Council on the IB 95-1 consultation indicate that there have been problems with annuity providers accepting DROs and deficiencies in annuity providers' dealing with spousal benefit elections. Although Treasury regulations and an opinion from the IRS General Counsel indicate that the Internal Revenue Code requires annuity providers to apply ERISA provisions pertaining to one or both of these situations, courts have repeatedly held that employee benefit plan participants and beneficiaries have no right to sue to enforce provisions of the Tax Code and, in any event, once annuities have been purchased, they have no right to sue under ERISA. DOL has not issued guidance or any regulation as to these issues.

<u>Recommendations and Discussion Related to Disclosures</u>

Seven members of the Council recommend IB 95-1 be updated to provide a model statement that plans would be required to be sent to participants and beneficiaries with relevant information prior to and at the time of transfer of obligation to pay benefits from the pension plan to a new annuity provider.

To alleviate confusion or concern of impacted participants, developing a standard model statement that would describe why the transition is occurring, clarify the protections of future benefits that participants do and don't have, describe what is staying the same vs. changing, and provide contact information for both the current plan sponsor as well as the annuity provider's customer service team. Having a model statement will ensure that all impacted participants receive similar information that has been deemed important in their transition to an annuity provider.

Two members of the Council recommend IB 95-1 be updated to add to IB 95-1 that selection of the safest annuity provider includes (1) preservation of documents sufficient to demonstrate the

[2] 29 C.F.R. § 2510.3-3(d)(2)(ii)(A) (2022).

prudence of the selection and (2) making such documents available upon written request to a participant, beneficiary or annuitant, or their authorized representative.

Fiduciaries, as part of exercising prudence in their decisions, already should be preserving such documents. However, given that many de-risking transactions involve full plan terminations, that may not always be happening. Additionally, given that the annuitants are no longer participants and beneficiaries under current law, they have no right under ERISA to request and obtain documents from the plan or plan sponsor after the transfer.

Three members of the Council recommend IB 95-1 be updated to encourage plan fiduciaries to negotiate/contract with the insurance company to add standard contract holder and certificate holder disclosures upon annuity purchase and periodically after purchase.

State law disclosure requirements for annuities and notices of change regarding those annuities may be inconsistent and certain disclosures may only apply to contract holders, not certificate holders. Disclosures are not likely to be the same as ERISA's mandated disclosures for pension plans. Prior to the annuity purchase, participants were able to rely upon ERISA's mandated disclosures, and DOL enforcement. Post purchase, the annuity certificate holder's relationship becomes contractual.

A single notice to participants/certificate holders is suggested, so that any changes will be highlighted, and so that the annual notice will confirm current provisions.

- No less than 60 days prior to the purchase, issue a Summary of Benefits & Coverage (SBC) Side by Side individual illustration which identifies not only what has changed with the annuity purchase, but also what has not changed. Included should be everything the participant needs to know to claim and maintain the annuity.
- Post purchase, an updated SBC should be issued no less than 60 days in advance of the effective date of any change to the terms of the SBC.
- Where there are no changes to the SBC, the SBC should be issued no less frequently than once every 12 months.

<u>**Recommendations and Discussion Related to Loss of PBGC Protections**</u>

Council members are not providing any recommendations or discussion on this topic, other than what is described in the no changes recommendation above.

<u>**Recommendations and Discussion Related to State Guaranty Associations**</u>

Council members have expressed a variety of views about whether and how the Department should update IB 95-1's provision for the consideration of the availability of additional protection through state guaranty associations (SGAs) and the extent of their guarantees in assessing an annuity provider's claims paying ability and creditworthiness.

A majority of eight members of the Council consider the current SGA assessment to be relevant for fiduciaries and strongly oppose removing them from the guidance. The availability of additional protections protection through SGAs and the extent of the guarantees are an important factor in determining the appropriate structure of the annuity contract, such as purchasing an annuity from a single insurer or annuities from multiple insurers, and guarantees supporting the annuities, such as the use of separate accounts.

Three members of the Council recommend DOL consider enhancing IB 95-1 to include guidance that the analysis of an annuity provider start without regard to any SGA protections and recommend DOL clarify further that SGA guarantee levels relative to the benefit amounts of potential annuitants are appropriately considered when deciding whether to purchase more than one annuity for a participant from more than one annuity provider. This allows a fiduciary and their expert advisers to review each provider and solution on its merits alone. When the evaluation of a provider focuses on SGA protections, it opens a backdoor for lower creditworthy insurers to be considered "safest available" or acceptable. While SGA protections are important to participants and beneficiaries, including the analysis diverts attention from the differences among providers.

Recommendations and Discussion Related to Impact of Partial Pension Risk Transfer Annuity Purchases on Residual Funding Status of Plans

Council members are not providing any recommendations or discussion on this topic, other than what is described in the no changes recommendation above.

Recommendations and Discussion Related to More than One Annuity Provider Satisfying the Safest Available Annuity Standard

Three members of the Council recommend DOL update 95-1 to reinforce the concept that more than one annuity provider can meet the "safest available" criteria.

DOL should reinforce the concept that more than one annuity provider can meet the "safest available" criteria. When evaluating insurers, it is often the case that certain insurers will appear strongest against some of the criteria, while other insurers appear strongest against other criteria. Therefore, it is not uncommon to have a situation where two or more insurers have overall financial strength profiles that are similar enough that a fiduciary might reasonably be unable to definitively determine whether one is "safer" than the other. In that case, the fiduciary might reasonably determine both insurers meet the "safest available" criteria, in that there is not one insurer demonstrably "safer." While the "more-than-one-safest" annuity provider is generally accepted by most fiduciaries and independent experts, we encourage the Department to codify the position that there can be more than one "safest" available annuity provider in its report.

Among Council members who did not support this recommendation, some noted that this change is unnecessary because IB 95-1 already states clearly that a fiduciary may conclude "that more than one annuity provider is able to offer the safest annuity available."