Department of Labor Report to Congress on Employee Benefits Security Administration's Interpretive Bulletin 95-1

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I. Introduction

The Department of Labor's Employee Benefits Security Administration (EBSA) is issuing this report in accordance with section 321 of the SECURE 2.0 Act of 2022,[1] titled "Review of Pension Risk Transfer Interpretive Bulletin." This section directs the Department to review Interpretive Bulletin 95-1 and consult with the Advisory Council on Employee Welfare and Pension Benefit Plans (ERISA Advisory Council) to determine whether amendments to Interpretive Bulletin 95-1 are warranted. The Department must then report its findings to Congress, including an assessment of any risk to participants.

The Department issued Interpretive Bulletin 95-1 in 1995.[2] It provides guidance on the Employee Retirement Income Security Act (ERISA) fiduciary duties as applied to the selection of an annuity provider for the purpose of distributing benefits under a defined benefit pension plan. The purchase of an annuity in this context is often referred to as a "pension risk transfer," or a "de-risking" transaction.

II. Process of EBSA's Review and Consultation with the ERISA Advisory Council

EBSA's review of Interpretive Bulletin 95-1 has been broad, given that the SECURE 2.0 Act did not identify an area of focus for the required review. EBSA reviewed background materials including a previous ERISA Advisory Council report on this topic,[3] and it conducted research into historical and legal developments and current market trends.[4]

EBSA also conducted more than 40 stakeholder meetings regarding the Interpretive Bulletin as part of its review. The meeting participants included representatives of organized labor, employer groups, consumer groups, insurance companies, insurance trade associations, other regulators, consultants, academia, and other interested parties. These meetings explored individual stakeholder views on:

- how well the Interpretive Bulletin's guidance has worked;
- whether the guidance should be improved; and

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[1] Consolidated Appropriations Act, 2023, Div. T, Pub. L. No. 117-328, 136 Stat. 4459, 5378 (2022).
[2] 29 C.F.R. § 2509.95-1, 60 Fed. Reg. 12328 (Mar. 6, 1995).
[3] ERISA Advisory Council, U.S. Dep't of Labor, Private Sector Pension De-risking and Participant Protections (2013), www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf.
[4] *See* Appendix A for a selected bibliography.

- any annuity market trends or developments that they believe EBSA should consider in its review.

EBSA also conducted the required consultation with the ERISA Advisory Council, which held a public meeting on July 18, 2023, regarding the Interpretive Bulletin.[5] Before the meeting, EBSA provided background materials and a consultation paper to the ERISA Advisory Council. Other stakeholders also submitted materials to the Council. EBSA staff and other witnesses provided testimony at the public meeting and Council members then expressed a variety of views regarding possible updates to the Interpretive Bulletin.

The ERISA Advisory Council further discussed the topic at its meeting on August 29, 2023. At this meeting, council members voted to indicate support for various positions related to the Interpretive Bulletin. The council then provided EBSA with a written statement with a variety of viewpoints from the council's membership on whether and how the Interpretive Bulletin should be updated.[6]

III. Background and Relevant Trends

A. Interpretive Bulletin 95-1

Defined benefit pension plans promise participants a specific benefit (e.g., monthly payment) at retirement based upon a formula set forth in the plan. Employers involved with these plans are generally responsible for making contributions so that, between the contributions made to the plans and investment income earned by the plans, the plans can pay the promised benefits.

These plans thus present investment and other risks related to ensuring sufficient funding. Sponsors of defined benefit plans have a number of options to consider when faced with these risks.

One option is to purchase an annuity contract to transfer liability for payments from the plan to the insurance company issuing the annuity. An annuity purchase can involve a total buy-out, in which the plan sponsor terminates the plan in connection with transferring all of the benefit obligations to the insurer. Alternatively, the annuity purchase can involve a partial buy-out (sometimes referred to as a "lift-out") limited to a certain participant population.

These transactions are considered a form of pension risk transfer or de-risking, but they are not the only forms. Other methods of managing risk include restricting participation in the

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[5] *See* ERISA Advisory Council webpage, 2023 Consultation on Interpretive Bulletin 95-1, https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council.
[6] *See* Appendix B, 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 (Aug. 29, 2023).

plan, restricting benefit accruals, liability-driven investing, buy-ins in which a plan's assets are invested in an annuity that remains a plan asset, and lump sum offers to participants.

Interpretive Bulletin 95-1 was issued in 1995 amid concerns about the claims-paying ability of insurance companies offering annuity contracts and the fiduciary decision-making with respect to these transactions. At the time, the high-profile failure of the Executive Life Insurance Companies of California and New York impacted 44,000 retirees and resulted in intervention by state regulators.[7]

The Interpretive Bulletin provides that plan fiduciaries must take steps calculated to obtain the safest annuity available unless, under the circumstances, it would be in the interest of the participants and beneficiaries to do otherwise. It states that fiduciaries must conduct an objective, thorough, and analytical search for purposes of identifying and selecting providers from which to purchase annuities. The Interpretive Bulletin emphasizes that reliance solely on ratings provided by insurance rating services would not be sufficient to meet the fiduciary obligation.

The Interpretive Bulletin sets forth the following six factors that fiduciaries should consider, among other things, in evaluating an annuity provider's claims-paying ability and creditworthiness:

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 protection through state guaranty associations and the extent of their guarantees.

Interpretive Bulletin 95-1 also provides that plan fiduciaries should obtain the advice of a qualified, independent expert unless they themselves possess the necessary expertise to evaluate such factors. It further provides that a fiduciary may conclude, after conducting an appropriate search, that more than one annuity provider is able to offer the safest annuity available.

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[7] *See* Interpretive Bulletin 95-1, 60 Fed. Reg. 12328 (Mar. 6, 1995); U.S. General Accounting Office, Private Pensions: Protections for Retirees' Insurance Annuities Can Be Strengthened 2 (1993), www.gao.gov/assets/hrd-93-29.pdf.

B. Plan Sponsor Pension Risk Transfer Activity

EBSA's review indicated that plan sponsors have several reasons for engaging in pension risk transfers. Some may want to avoid or reduce the cost of maintaining the plan, the administrative responsibilities, or the impact and uncertainty that the plan's funding may have on the contributing employers' corporate balance sheets. Various factors can affect plan funding, including interest rates, market volatility, plan asset allocation, etc.

Another reason plan sponsors may consider pension risk transfer is to avoid or reduce the cost of premiums payable to the Pension Benefit Guaranty Corporation (PBGC).[8] The PBGC protects participants in single-employer defined benefit plans by paying benefits up to limits set by law if a plan is terminated and does not hold sufficient assets to pay all benefits. A lift-out pension risk transfer that involves an annuity purchase covering a participant's entire benefit under a plan eliminates the per-participant PBGC premiums for the participant.

EBSA reviewed PBGC data to evaluate how many participants are impacted by pension risk transfers and found the following:

- Approximately 32,500 single-employer defined benefit pension plans filed for standard terminations in the 2000 to 2022 period.[9]
- About eight percent of PBGC-covered single-employer plans conducted some form of partial pension risk transfer during a 2015-2022 study period.[10]
  - Almost 32 percent of the plans that engaged in a partial pension risk transfer purchased annuities for an estimated 2.2 million participants.
  - The number of plans purchasing annuities annually more than doubled over the observation period.

In 2022, defined benefit pension risk transfer annuity purchases reached an all-time high with transactions totaling $52 billion in premiums. While lift-out activity constituted around 43 percent of transactions, it represented nearly 80 percent of the total transaction value for the year.[11]

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[8] PBGC, Premium Rates: Current and Historical Information, https://www.pbgc.gov/prac/prem/premium-rates (last updated Oct. 13, 2023).
[9] PBGC, 2021 Pension Insurance Data Tables, Table S-3, https://www.pbgc.gov/prac/data-books.
[10] PBGC, Updated Analysis of Single-Employer Pension Plan Partial Risk Transfers (June 2024), https://www.pbgc.gov/sites/default/files/documents/2024-pension-risk-transfer-analysis.pdf .
[11] Aon, U.S. Pension Risk Transfer: Market Insights (Mar. 2023), https://www.aon.com/insights/reports/2023/us-pension-risk-transfer-market-insights (follow "Download Whitepaper"; complete form for access to whitepaper). Compare to 2011, when there were less than $1 billion in total premium and 194 transactions. Aon, 2021 U.S.

C. Private Equity Involvement in the Life Insurance Industry

There has been a documented increase in private equity involvement in the life insurance industry in recent years.[12] Private equity involvement includes private equity firms buying insurance companies or interests in them, as well as private equity firms entering into investment management agreements to manage insurance company investments.[13]

According to the National Association of Insurance Commissioners (NAIC), private equity-owned insurance companies held $534 billion in cash and invested assets in 2022. $509 billion of these assets were held by life insurance companies, accounting for 9.6 percent of the life insurance industry's total asset holdings.[14] Another report in 2022 noted that "[a]ll 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."[15]

In March 2022, U.S. Senator Sherrod Brown wrote to both the NAIC and the Federal Insurance Office (FIO) of the Department of the Treasury expressing concern about alternative asset managers such as private equity firms being involved in pension risk transfer transactions. Senator Brown asked both NAIC and FIO to evaluate concerns regarding risks to policyholders as well as the broader economy associated with private equity-controlled insurers.[16]

The Department of the Treasury's response described a shift in the business model of private equity firms, as follows:

Pension Risk Transfer Annuity Settlement Market Update 3 (Mar. 2021), https://insights-north-america.aon.com/pension-risk-management/aon-us-pension-risk-transfer-annuity-settlement-market-update-whitepaper.

[12] *See e.g.,* Eileen Appelbaum, Beware of Private Equity Gobbling Up Life Insurance and Annuity Companies, Ctr. For Econ. And Pol'y Res. (Jan. 2022), https://cepr.net/wp-content/uploads/2022/01/2022-01-PE-and-Life-Insurance-Appelbaum.pdf; Matt Wirz & Leslie Scism, Private Equity Taps Insurers' Cash to Speed Up Growth, Wall Street Journal (Jan. 31, 2023, 5:30 AM), https://www.wsj.com/articles/private-equity-taps-insurers-cash-to-speed-up-growth-11675128742.

[13] *Id.*

[14] These numbers were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on Private Equity (PE)-Owned U.S. Insurers' Investments. The calculations provided are exclusive to life insurance. The reports can be found here: https://content.naic.org/capital-markets-bureau.

[15] Ramnath Balasubramanian et al., Why Private Equity Sees Life and Annuities Companies as an Enticing Form of Permanent Capital, McKinsey & Company (Feb. 2, 2022), 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.

[16] Letter from The Honorable Sherrod Brown, U.S. Sen. to Steven Seitz, Director, Federal Insurance Office and Dean L. Cameron, President, Nat'l Assoc. of Ins. Comm'rs (Mar. 16, 2022), www.banking.senate.gov/imo/media/doc/brown_letter_on_insurance_031622.pdf.

> Previously, the focus of private equity was largely on buy-outs. Now, some private equity firms are increasingly pivoting their business objective to the private credit market and to raising more "permanent" capital to support this business. To that end, some private equity firms have increased their access to books of annuities and life insurance through purchases of insurers. With their steady cash flows, annuity and life insurers can provide private equity firms an opportunity to scale the growth of private credit strategies, to obtain a reliable long-term source of capital, and/or to have an in-house customer that provides a consistent stream of fees.[17]

The Treasury Department's response identified issues for further consideration, including:

> 1. Whether a potential misalignment may exist between the shorter-term objectives/strategy of the alternative asset manager investment model and the long-term commitment necessary for fulfilling annuity/life insurance policyholder interests.
>
> 2. Whether policyholder interests are sufficiently protected from the effects of potential conflicts of interest within private equity organizational structures (such as management/investment fees; operating strategies that result in highly levered balanced sheets; use of third-party asset managers; and sourcing from affiliated origination platforms).
>
> 3. Whether inadequate levels of transparency regarding the risks inherent in the highlighted investment strategies may contribute to insufficient requirements for reserving of liabilities and capital held for unexpected losses, potentially exposing the state guaranty system in the extreme case of insurer failure and potential contagion risk. The involvement of private equity firms could also complicate any future resolutions in case of such failures. Relatedly … in the case of pension risk transfer transactions, further examination regarding trade-offs from the loss of PBGC backing may be warranted.

[17] Letter from Jonathan Davidson, Assistant Sec'y for Legisl. Affairs, U.S. Dep't of the Treasury, to The Honorable Sherrod Brown, U.S. Sen. (June 29, 2022) (citing Sebastien Canderle, "Permanent Capital: The Holy Grail of Private Markets," *CFA Institute Enterprising Investor*, June 1, 2021, https://blogs.cfainstitute.org/investor/2021/06/01/permanent-capital-the-holy-grail-of-private-markets/), www.banking.senate.gov/imo/media/doc/fio_85.pdf.

4. Whether there are implications for the safety and soundness of insurer obligations in view of the offshore domicile of affiliated and unaffiliated reinsurers involved in the private equity-owned insurance business, which in some instances have resulted in large capital releases following insurers executing affiliated reinsurance transactions. This type of activity suggests that these deals could be motivated by regulatory arbitrage opportunities (such as allowing reduced reserves to back policyholder obligations).

The Treasury Department stated that it is monitoring developments and particularly focusing on liquidity, credit risk and capital adequacy, offshore reinsurance, and conflicts of interest.

In its response to Senator Brown, the NAIC reported taking steps as early as 2013 related to the increased private equity involvement in the life insurance industry. It also described 13 recommendations currently being worked on by the NAIC Macroprudential Working Group that are intended to "identify where existing disclosures, policies, control and affiliation requirements, and other procedures should be modified or new ones created, to address any gaps based on the increase in the number of [private equity] owners of insurers, the role of asset managers in insurance, and the increase of private investments in insurers' portfolios, among other reasons."[18]

IV. Issues Identified in EBSA's Review

At EBSA's stakeholder meetings, attendees expressed a range of opinions as to whether changes to the Interpretive Bulletin are warranted. On one end, some said that the Interpretive Bulletin identifies the appropriate considerations for plan fiduciaries and has worked well over time, and therefore, no changes are warranted. On the other end, some stakeholders asserted that significant changes to the Interpretive Bulletin are needed to protect annuitants' interests.

Some stakeholders who wanted EBSA to retain the existing Interpretive Bulletin without change said that state insurance regulators will provide effective oversight of insurance company solvency issues, including any that private equity involvement may pose. Relatedly, some attendees said that plan fiduciaries are not likely to have the experience or expertise to evaluate some of the complex practices that insurers engage in.

Stakeholders also argued that an annuity purchase is an important tool for plan sponsors and may be preferable to a lump sum offering in maintaining participants' retirement security.

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[18] Letter from Dean L. Cameron et al., Nat'l Assoc. of Ins. Comm'rs, to The Honorable Sherrod Brown, U.S. Sen. (May 31, 2022), www.banking.senate.gov/imo/media/doc/naic_may2.pdf.

They warned EBSA against placing restrictions on annuity purchases in the pension risk transfer context. A stakeholder also cautioned EBSA against placing increased emphasis on independent fiduciaries or consultants due to the extra cost that would impose on plan sponsors.

The stakeholders who believed significant changes are necessary were often concerned by the trend of private equity involvement in the life insurance industry. Some believed the Interpretive Bulletin should be amended to focus plan fiduciaries' attention on risks related to the life insurance company's ownership structure and the extent to which the insurer relies upon non-traditional and potentially riskier investments and liabilities as well as offshore and/or captive reinsurance, among other things.

Some attendees suggested more targeted changes to the Interpretive Bulletin. One frequent suggestion was that the Interpretive Bulletin should be revised to note that the life insurance company's administrative capabilities should be considered. Another common suggestion was to eliminate state guaranty association protections as a fiduciary consideration.

Other stakeholders wanted EBSA to use the Interpretive Bulletin's guidance to address the continuation of certain rights provided by ERISA to the people who are no longer participants covered under the ERISA plan because of the pension risk transfer annuity purchase.

Some meetings also included discussion of whether any revisions to the Interpretive Bulletin should include guidance to help plan fiduciaries evaluate material considerations, such as benchmarks or rankings. While some stakeholders thought additional guidance to assist plan fiduciaries would be helpful, others stated that each transaction is different and that EBSA should allow plan fiduciaries to determine how each factor should figure into the overall analysis. Several stakeholders said the Interpretive Bulletin should continue to be "principles-based" rather than more specific, so as not to become outdated or to allow parties to work around the specific provisions while evading the spirit of them.

The following discussion further details the issues that stakeholders raised:

A. Ownership Structure

In addition to concerns about certain specific life insurer practices that are discussed in later sections, some stakeholders identified overarching issues related to a life insurance company's ownership. These stakeholders had a global concern that private equity-owned insurers may not intend to be in the insurance business for the long term and, by definition, annuities are long-term commitments. These stakeholders questioned whether private equity firms would have policyholders' interests at the forefront.

Several stakeholders raised a related point that the distinction between mutual insurance companies (which essentially are owned only by policyholders) and publicly traded insurance

companies (which are owned by investors such as stockholders) is important for plan fiduciaries to understand and consider when selecting an annuity provider. In the 1990s, U.S. life insurers started demutualizing (becoming stock companies or mutual holding companies) to gain access to capital markets, incentivizing changes to investment practices and organizational structure.[19] In the view of at least some stakeholders, mutual insurance companies are managed to support policyholders while publicly traded companies must consider investors' interests, which can sometimes lead to activity that favors investors over policyholders. However, other stakeholders asserted that publicly traded insurance companies are safer for annuity holders based on their access to capital.

Another issue within the broad category of ownership structure concerns holding company structures that have multiple lines of insurance and non-insurance businesses inside the structure. Some stakeholders stressed that fiduciaries must ensure they are aware of the available capital and surplus of the insurer writing the annuity, as presented in the insurer's annual sworn statement to insurance regulators. They stressed this because the insurer is the entity that is legally obligated to pay the annuity and a policyholder has a cause of action only against the insurer and not any affiliates of the insurer. These stakeholders suggested that referencing capital held by the insurer's affiliates might mislead fiduciaries as to the financial health of the insurer.

Other stakeholders indicated more generally that the Interpretive Bulletin should emphasize the importance of transparency regarding the insurance company's parent. Stakeholders who want parent or group capital included as a factor in the Interpretive Bulletin noted that these holdings can alleviate an insurer's need to sell assets for reduced value to cover unexpected costs and prevent a liquidity crisis. One stakeholder said that a parent entity's financial support of an insurer's operations may take different forms that may or may not be formalized or reduced to contract.

Stakeholders also focused on specific business dealings between insurance companies and their affiliated entities, with the main concern being potential misalignment and conflicts of interest. Some stakeholders indicated that business relationships between an insurance company and affiliated entities can be important considerations for a fiduciary, especially if the management of these parties is not sufficiently independent to ensure that dealings are at arm's length. As one example, stakeholders expressed concern about the danger that the insurance

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[19] Barbara Remmers, Life Insurer Demutualization in the Current Era+, 22 J. of Ins. Reg. 1 (2003); Lal Chugh & Joseph W. Meador, Demutualization in the Life Insurance Industry: A Study of Effectiveness, 27 Rev. of Bus. 10-17 (Working Paper No. 1014, 2006), https://scholarworks.umb.edu/cgi/viewcontent.cgi?article=1006&context=financialforum_pubs.

company's assets would be invested in investment funds managed by affiliates and subject to high fees.

In its letter to Senator Brown, the NAIC discussed how state insurance regulators focus on risks at the level of the individual insurer as well as the group. The NAIC noted that only insurers can sell or administer policies, and therefore, risk-based capital requirements are enforced at the insurer level. However, states collect financial disclosures at the group level to allow them to monitor the group's access to insurer assets, including as part of services agreements. The NAIC explained that larger insurers must file an "Own Risk and Solvency Assessment" which reports on all risks posed to an insurance group. The NAIC has also introduced a Group Capital Calculation, which it says can give regulators insight into capital allocation throughout the group.[20]

B. Increase in Non-Traditional/Risky Investments

Several stakeholders drew EBSA's attention to what they described as the rise in risky investment strategies in the insurance industry. They said that industry's increasing investment in asset-backed securities, such as collateralized loan obligations (including the riskier tranches) and private credit possibly overexposes insurers to investment and liquidity risk that could lead to solvency issues to the potential detriment of annuitants. One stakeholder cited literature calculating that insurers' collateralized loan obligation exposures are comparable to their holdings of nonprime residential mortgage-backed securities just before the 2008 financial crisis.[21] Other types of risky assets that stakeholders mentioned were subordinated debt and stock of affiliated companies.

Many of these stakeholders asserted that private equity-backed insurers have a greater tendency towards high-risk investment strategies,[22] but others said that this is an industry-wide phenomenon of pursuing greater yield in a low-interest rate environment, and is not necessarily attributable to private equity affiliation. One stakeholder asserted that "If an insurer is quoting a significantly lower price than others, it is critical to understand the drivers for that lower price

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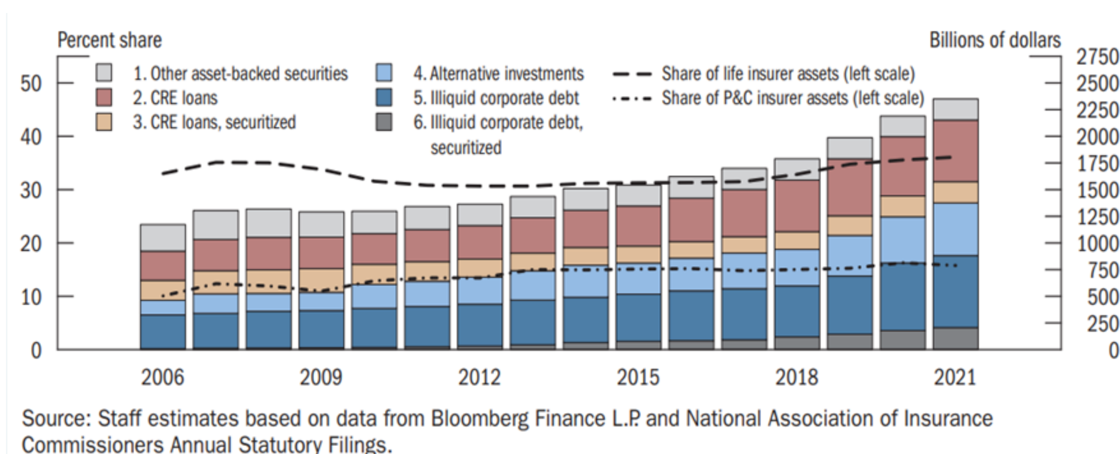
[20] Letter from Dean L. Cameron et al., Nat'l Assoc. of Ins. Comm'rs, to The Honorable Sherrod Brown, U.S. Sen. (May 31, 2022), www.banking.senate.gov/imo/media/doc/naic_may2.pdf.
[21] See Nathan Foley-Fisher et al., Are US Life Insurers the New Shadow Banks? (Apr. 20, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534847.
[22] For example, one stakeholder cited to literature finding that "PE-backed insurance firms take on greater asset risk by moving out of highly rated corporate bonds and into poorly rated private-label asset-backed securities (ABS), increasing their holdings of private-label ABS by two-thirds the industry average." Divya Kirti & Natasha Sarin, What Private Equity Does Differently: Evidence from Life Insurance, U of Penn., Inst. for L. & Econ. Res. 2-3 (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538443.

and whether those drivers add material risk"; the stakeholder stated that this is usually connected to risks in the investment portfolio and the sufficiency of capital holdings.[23]

Figure 1 is taken from the May 2023 Federal Reserve Financial Stability Report, which illustrates the Federal Reserve's observed trends of life insurers shifting their investment activities to riskier assets.[24] The report specifically highlights the increase in asset illiquidity, combined with the slow increase in the liquidity of liabilities, as a potential threat to the life insurance and annuity industry's health as the mismatch may result in assets being sold at an otherwise less favorable price to service unanticipated liability demands.[25]

Figure 1, Life Insurers Held More Risky, Illiquid Assets on Their Balance Sheets



Source: Staff estimates based on data from Bloomberg Finance L.P. and National Association of Insurance Commissioners Annual Statutory Filings.

Differences in approaches to investing are most apparent with respect to investments in bonds. Twenty-nine percent of the investments in bonds at private equity-owned life insurance firms are composed of asset-backed securities, compared to 10.6 percent at non-private equity-owned life insurance companies. Corporate bonds make up only 50.3 percent of the bond portfolios at private equity-owned life insurance firms, compared to 64.1 percent of the bond portfolios at non-private equity-owned life insurance companies.

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[23] James Walton, Private Equity and Alternative Asset Managers in the U.S. Pension Risk Transfer Market, Agilis (Dec. 5, 2022), https://agilis.llc/private-equity-and-alternative-asset-managers-in-the-us-pension-risk-transfer-market/.

[24] Board of Governors of the Federal Reserve System, Financial Stability Report, p. 57, (May 2023), https://www.federalreserve.gov/publications/files/financial-stability-report-20230508.pdf.

[25] *Id*. ("Over the past decade, the liquidity of life insurers' assets steadily declined, and the liquidity of their liabilities slowly increased, potentially making it more difficult for life insurers to meet a sudden rise in withdrawals and other claims.").

As detailed in Table 1, private equity-owned life insurance firms also hold a smaller proportion of U.S. government bonds, municipal bonds, bank loans, and agency-backed residential mortgage-backed securities, while holding a larger proportion of private label residential and commercial mortgage-backed securities.[26]

Table 1: Bond Mix of Private Equity and Non-Private Equity-Owned U.S. Life Insurance Firms (2022)

Bond Type	Private-Equity Owned	Non Private-Equity Owned	Point Difference
ABS and Other Structured Securities	29.0%	10.6%	18.5%
Agency-backed CMBS	0.3%	1.2%	-0.9%
Agency-backed RMBS	1.5%	3.3%	-1.8%
Bank Loans	1.7%	2.7%	-1.1%
Corporate Bonds	50.3%	64.1%	-13.8%
ETF-SVO Identified Funds	0.0%	0.1%	-0.1%
Foreign Government	0.8%	1.4%	-0.6%
Hybrid Securities	0.0%	0.0%	0.0%
Municipal Bonds	4.6%	6.1%	-1.6%
Private-label CMBS	6.2%	4.3%	1.9%
Private-label RMBS	3.9%	2.0%	1.9%
US Government	1.8%	4.1%	-2.2%
Total	100.0%	100.0%	
Source: NAIC. EBSA Calculations			

Irrespective of these trends, several stakeholders said that the first factor in Interpretive Bulletin 95-1—“the quality and diversification of the annuity provider’s investment portfolio”—is already sufficient to make fiduciaries aware that they need to evaluate an insurer’s investment practices. Some insurer stakeholders said the asset mix diversity of their portfolios provided greater protection to policyholders, venturing that the 2008 financial crisis had a greater negative

[26] These numbers and Table 1 were calculated by the Department from NAIC data provided in the NAIC Capital Markets Report on Private Equity (PE)-Owned U.S. Insurers’ Investments. The calculations provided are exclusive to life insurance. The reports can be found here: https://content.naic.org/capital-markets-bureau.

impact on investors who were too reliant on a limited mix of assets (e.g., a high concentration of highly rated corporate bonds). One stakeholder argued that concern about the risk of asset-backed securities is due to misconceptions that do not recognize regulatory changes implemented in the Dodd-Frank Act and other laws enacted after the 2008 financial crisis.

Several stakeholders also said state regulators are keenly aware of investment trends across the insurance sector, including trends with respect to collateralized loan obligations, and the regulators closely scrutinize investments and investment portfolios. They also said asset portfolio quality is a measure under applicable risk-based capital standards, resulting in increased capital charges to reflect increased asset risk. In this regard, they noted that the NAIC is considering changes to its model risk-based capital standards to address concerns with collateralized loan obligations.[27]

C. Non-Traditional Liabilities

Stakeholders who expressed concern about "non-traditional" liabilities did not provide a uniform definition of "non-traditional," but a common theme was that these liabilities are not structured around mortality and morbidity risk.[28] These stakeholders said these liabilities can have a significant effect on an insurance company's cash flows and risk profile that plan fiduciaries should understand, particularly the possibility that the non-traditional liabilities may result in a "run" on an insurance company's assets.

Some stakeholders associated "non-traditional" liabilities with specific types of insurance company activities that obligate the company to counterparties, who may exercise their rights to payment at unexpected times. Examples raised by stakeholders included funding agreements, funding agreement-backed securities, Federal Home Loan Bank advances, repurchase agreements, and securities loans.

Many stakeholders were particularly concerned by trends in funding agreement-backed securities, which are securities that are backed by a funding agreement issued by a life insurer. While funding agreement-backed securities have existed for decades, their use rapidly accelerated through the early 2000s before dropping around the time of the 2008 global financial crisis. Recently, the aggregate outstanding value of funding agreement-backed securities grew to

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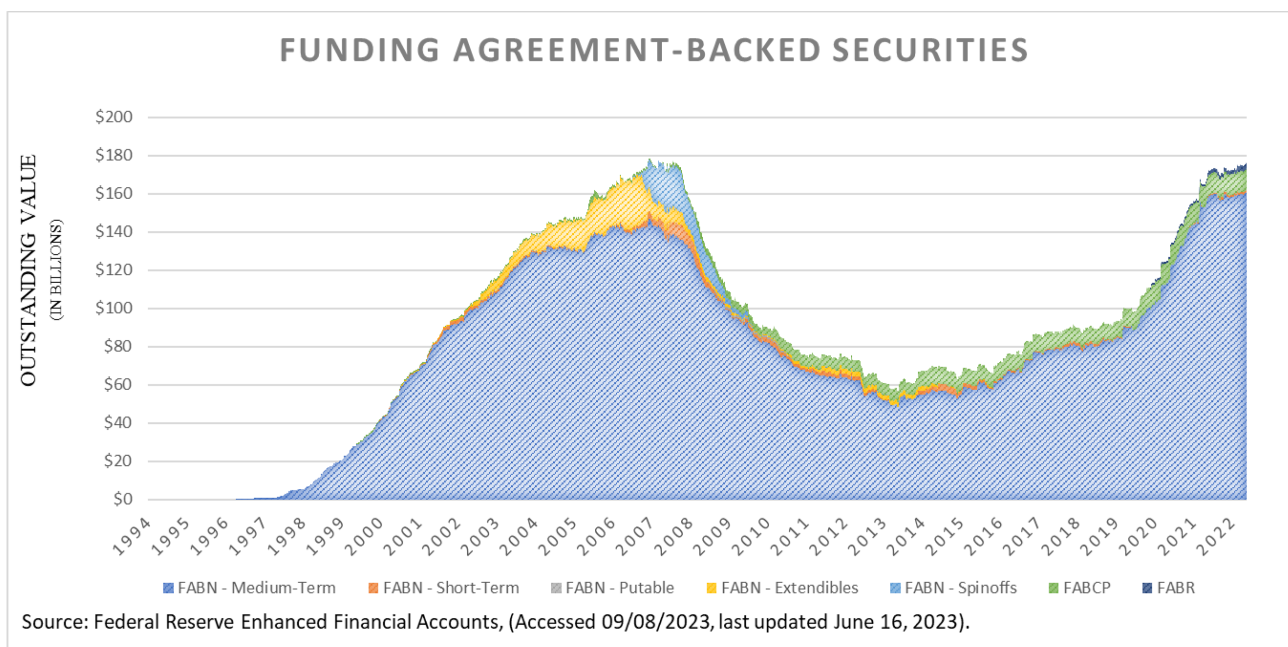
[27] *See* Risk-Based Capital Investment Risk and Evaluation (E) Working Group, https://content.naic.org/cmte_e_rbcire.htm.

[28] *Cf.* Nathan Foley-Fisher et al., FEDS Notes, Assessing the size of the risks posed by life insurers' nontraditional liabilities, Bd. of Governors of the Fed. Reserve Sys. (May 21, 2019) ("In contrast to life insurers' traditional liabilities that make payments conditional on the health of the holder, nontraditional liabilities have neither mortality nor morbidity contingencies."), https://www.federalreserve.gov/econres/notes/feds-notes/assessing-the-size-of-the-risks-posed-by-life-insurers-nontraditional-liabilities-20190521.html.

nearly $180 billion outstanding, returning to their highest levels recorded. As a percentage of the insurance industry's aggregate liabilities, the amount represents approximately 2 percent, as compared to 3.6 percent prior to the global financial crisis; but in each case, still higher than the years immediately following Interpretive Bulletin 95-1's publication. According to stakeholders, the risk of a "run" on an insurance company's assets that may be associated with these type of non-traditional liabilities is important because it may diminish a company's ability to pay annuitants.

Figure 2: Funding Agreement-Backed Securities Outstanding Value



Source: Federal Reserve Enhanced Financial Accounts, (Accessed 09/08/2023, last updated June 16, 2023).

Other stakeholders believed that non-traditional liabilities may already be adequately addressed by the fourth enumerated factor in the Interpretive Bulletin, "the lines of business of the annuity provider and other indications of an insurer's exposure to liability." They also questioned what would be considered a "non-traditional" liability for purposes of any new requirement that might be added to the Interpretive Bulletin.

In this regard, some suggested that they would not be considered to have "non-traditional" liabilities because their businesses predominantly involve writing insurance policies. One insurance company recognized that some of its liabilities could hypothetically contribute to a "run" but indicated that it conducts stress tests and takes steps to manage its liability risks.

Some also indicated that the NAIC may be examining concerns related to "non-traditional" liabilities that have been raised in connection with private equity-affiliated insurers.[29]

D. Reinsurance

The NAIC describes reinsurance as a contract between a reinsurer and an insurer, in which the insurance company—called the cedent—transfers risk to the reinsurance company, and the reinsurance company assumes all or part of the risk under one or more insurance policies issued by the cedent.[30] Stakeholders cited literature explaining that the four basic motives behind life and annuity reinsurance are risk transfer, underwriting assistance, capital management, and tax management.[31] Insurers are ultimately responsible for all liabilities they issue, even those that they cede to reinsurers.[32]

Reinsurance activity appears to have grown rapidly across the life insurance industry in recent years, rising from less than $200 billion in 1999 to $1.7 trillion in 2022. This quadrupled the share of life insurance obligations being reinsured from 6 percent to 24 percent of total obligations. [33]

Most of this growth in reinsurance activity involved either U.S. captive reinsurers or affiliated reinsurers in foreign countries. In 1999, these types of reinsurance accounted for 14 percent of life reinsurance, with the share growing to 48 percent by 2022.[34] Stakeholders indicated that use of captive reinsurance can provide capital, tax, and financial disclosure benefits without necessarily transferring assets outside of the holding company.

A significant amount of reinsurance in the life insurance industry involves off-shore reinsurers. According to ALIRT Insurance Research, of the $1.7 trillion in total reserves ceded

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[29] *See* https://content.naic.org/article/naic-announces-2023-regulatory-priorities.
[30] NAIC, Ctr. for Ins. Pol'y and Res., Reinsurance, https://content.naic.org/cipr-topics/reinsurance (last updated May 9, 2024).
[31] Ralph Koijen & Motohiro Yogo, Shadow Insurance, Nat'l Bureau of Econ. Res. 4 (Working Paper No. 19568 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2320921.
[32] John J. Pruitt, Insurance and Reinsurance in the United States: Overview (2023), https://uk.practicallaw.thomsonreuters.com/9-501-3187?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a159591. For the transferring insurer to be released from direct liability to the insured, a novation must occur, which requires the policyholder's consent. Depending on the state, such consent must be express or can be implied by conduct. Most U.S. states have detailed requirements for notices to policyholders that are necessary for consent.
[33] Michael Batty, FEDS Notes, Accounting for Reinsurance Transactions in the Financial Accounts of the United States, Bd. of Governors of the Fed. Reserve Sys. (Oct. 12, 2018), https://www.federalreserve.gov/econres/notes/feds-notes/accounting-for-reinsurance-transactions-in-the-financial-accounts-of-the-united-states-20181012.html. Additional analysis from 2017–2022 was calculated by the Department from Federal Reserve data.
[34] *Id.*

by the life insurance and annuity industry in 2021, approximately $651 billion was ceded to foreign domiciled reinsurers, with 83 percent of this amount ($539 billion) sent to Bermuda.[35]

A number of stakeholders raised concerns that life insurers are using reinsurance to move liabilities to less regulated reinsurers. They mentioned less stringent reserving requirements and accounting arbitrage as reasons for their concern. Concerns about reinsurance are reflected in the Treasury Department's letter to Senator Brown discussed above. The Department of the Treasury noted in its letter that the speed and scale of the growth of offshore and affiliated reinsurance "suggests the need for regulators and policymakers to better understand the role of offshore reinsurers and whether regulatory capital arbitrage opportunities, tax advantages, and other potential gaps that are not under the oversight of U.S. regulators are obscuring (or even amplifying) the level of risk stemming from these activities."[36]

Several stakeholders also indicated that one type of reinsurance contract—called "modified coinsurance"—is a special concern. In a "coinsurance" arrangement, the cedent transfers both assets and liabilities (reserves) to the reinsurer. However, in a modified coinsurance arrangement, the cedent transfers only liabilities and keeps the assets on its books, while paying a portion of the interest from the retained assets to the reinsurer.

Stakeholders are concerned that in modified coinsurance arrangements, insurers may have strategic reasons under applicable risk-based capital standards to hold on to riskier assets longer than optimal because the true investment risk has been ceded to the reinsurer. According to ALIRT, a total of $384 billion was ceded under modified coinsurance contracts to foreign domiciled reinsurers in 2021, with 86 percent ($333 billion) of those reserves being sent to Bermuda.[37] Kirti and Sarin found in a 2023 study that private equity-backed firms are much more likely to utilize, and are substantial drivers of, the issuance of affiliated modified coinsurance.[38]

Other stakeholders told EBSA that reinsurance is an essential tool for insurance companies to manage risks and the amount of capital they must hold to support those risks. In

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[35] ALIRT Insurance Research, U.S. Life Insurers' Bermuda Reinsurance Exposure (Oct. 18, 2022), https://rgb-prod-public-pdfs.s3.us-east-2.amazonaws.com/fiVNWhYt6dyc0E-kUV87KA9Id20.pdf. Bermuda is considered a Qualified and Reciprocal jurisdiction by the NAIC, which means that reinsurance transactions in this jurisdiction do not require collateral. This is a commonly cited reason for the popularity of Bermuda amongst foreign reinsurance transactions.
[36] Letter from Jonathan Davidson, Assistant Sec'y for Legisl. Affairs, U.S. Dep't of the Treasury, to The Honorable Sherrod Brown, U.S. Sen. 5 (June 29, 2022), www.banking.senate.gov/imo/media/doc/fio_85.pdf.
[37] ALIRT Insurance Research, U.S. Life Insurers' Bermuda Reinsurance Exposure (Oct. 18, 2022), https://rgb-prod-public-pdfs.s3.us-east-2.amazonaws.com/fiVNWhYt6dyc0E-kUV87KA9Id20.pdf.
[38] Kirti & Sarin, What Private Equity Does Differently: Evidence from Life Insurance, The Review of Financial Studies, (2023), https://doi.org/10.1093/rfs/hhad055.

addition, they asserted that offshore reinsurance entities offer tax efficiencies that attract capital and reduce the effective tax rate of the reinsurer and its holding company. While recognizing that the level of regulatory oversight of offshore reinsurance differs by jurisdiction, some stakeholders argued that Bermuda is well recognized as a credentialed international reinsurance jurisdiction.

Most stakeholders agreed that whether and the extent to which an insurer cedes liability to a reinsurer—as well as the reinsurer's jurisdictional, financial, and ownership characteristics—is or should be part of a fiduciary's analysis when selecting an insurer. A few stakeholders believe that captive and offshore reinsurers may warrant more scrutiny than unaffiliated domestic reinsurers licensed in the United States, due to the difference in regulatory requirements. Importantly, the stakeholders emphasized that any analysis of the reinsurer's financials should be done using statutory accounting principles (SAP) or both SAP and generally accepted accounting principles (GAAP), but not just GAAP.

E. Risk-Based Capital and Other Methodologies

State insurance regulators use risk-based capital requirements to identify life insurance companies that are weakly capitalized and may need regulatory intervention.[39] The NAIC developed the risk-based capital requirement for life insurers and describes it as "a statutory minimum level of capital that is based on two factors: 1) an insurance company's size; and 2) the inherent riskiness of its financial assets and operations. That is, the company must hold capital in proportion to its risk."[40] The NAIC developed the *Risk-Based Capital (RBC) for Insurers Model Act* that states must adopt in substantially similar form for accreditation purposes.[41]

An insurer's risk-based capital ratio—generally described as the insurer's total adjusted capital divided by its authorized control level risk-based capital—is a metric that came up frequently in stakeholder discussions and in EBSA's research.[42] Several stakeholders suggested that an insurer's risk-based capital ratio should be specifically identified in Interpretive Bulletin

[39] *See* NAIC, Ctr. for Ins. Pol'y and Res., Risk-Based Capital, https://content.naic.org/cipr-topics/risk-based-capital (last updated Jan. 31, 2024).
[40] *Id*.
[41] NAIC, Financial Regulation Standards and Accreditation Program (Aug. 2021), https://content.naic.org/sites/default/files/inline-files/FRSA-Pamphlet-8-2021.pdf.
[42] NAIC, Ctr. for Ins. Pol'y and Res., Risk-Based Capital, https://content.naic.org/cipr-topics/risk-based-capital (last updated Jan. 31, 2024); Am. Council of Life Insurers (ACLI) Life Insurers Fact Book 2022 33 ("Risk-based capital, calculated according to an NAIC model law, is considered the minimum amount of capital an insurer needs to avoid triggering regulatory action. The [risk-based capital] ratio is total adjusted capital divided by risk-based capital, for a threshold ratio of 100 percent."), https://www.acli.com/-/media/acli/public/files/factbook/2022lifeinsurersfactbook_v2.pdf.

95-1 as a consideration for fiduciaries evaluating an insurer's claims paying ability and creditworthiness.

One stakeholder suggested that the risk-based capital ratio should be added to the Interpretive Bulletin's third factor, "the level of the insurer's capital and surplus." Some other stakeholders agreed that it would be reasonable to identify the risk-based capital ratio as one factor for fiduciary consideration, though they said EBSA should ensure it is not treated as the only factor.[43]

Other stakeholders, without disputing the relevance of risk-based capital requirements, presented downsides to identifying risk-based capital ratios in the Interpretive Bulletin. One said the risk-based capital ratio is not intended as a tool for comparing companies to one another or ranking them. According to the stakeholder, the important fact is whether an insurer's risk-based capital ratio exceeds the level at which regulatory intervention is warranted. In their view, once that threshold is met, comparing higher or lower ratios is not meaningful. The stakeholder also said insurers are not permitted to advertise their risk-based capital ratios.

Another stakeholder suggested that it may be preferable to retain the more principles-based reference to "capital and surplus," which many believe encompasses the risk-based capital ratio, thereby avoiding the Interpretive Bulletin becoming outdated if there are changes to the state regulatory framework in the future.

A few stakeholders presented other approaches to evaluate insurers' solvency and creditworthiness. One methodology is to focus on the ratio of the sum of the insurer's "higher-risk assets" and "opaque reinsurance" to surplus held (as reported on its sworn statutory annual statement). Another methodology involves review of market spreads on bonds (specifically, spreads on funding backed-agreement notes) issued by life insurance companies. The latter methodology uses the bond market's ability, and incentive, to holistically assess the insurer's creditworthiness.

F. Separate Accounts as a Protection

Group annuity contracts used in pension risk transfer annuity purchase transactions can be supported by either the insurance company's general account or by a separate account (which can be dedicated to a single employer's pension risk transfer or commingled). Separate accounts are protected from the liabilities of the insurer's general account, yet they generally benefit from

[43] The NAIC website likewise cautions that the risk-based capital calculation is a regulatory tool and is "not designed to be used as a stand-alone tool in determining financial solvency." *See* https://content.naic.org/cipr-topics/risk-based-capital.

support from the general account.[44] The fifth Interpretive Bulletin 95-1 factor currently provides that fiduciaries should consider "the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts."

In EBSA's stakeholder meetings, some stakeholders said that separate account protections are valuable due to their structure, lack of exposure to general account liabilities, and additional backing by the insurance company's general account. Several stakeholders explained that, in the event of insolvency, annuitants would have a claim on the insurer's general account after the separate account's assets are depleted.

However, a few stakeholders questioned the protections that separate accounts offer. They said the insurer's investment strategy for the separate account is the more important determinant of the risks. More than one stakeholder expressed the view that a very safe general account investment strategy is more protective than a separate account, if the separate account is invested in riskier assets. Several of these stakeholders urged EBSA to revise the fifth factor to help plan fiduciaries evaluate separate accounts.

G. Administrative Capabilities and Experience

Several stakeholders said the insurer's administrative capabilities and experience are factors that fiduciaries should, and do, consider in selecting an annuity provider.[45] Stakeholders identified several areas of inquiry related to the administrative capabilities of the entity providing the services, including the adequacy of payment systems for administering annuities, record-keeping, necessary election forms, information technology capabilities and cybersecurity practices to safeguard annuitant information, call centers and websites for annuitants to obtain information, and overall experience with pension risk transfer annuity purchase transactions of similar size and characteristics. Stakeholders said fiduciaries could ask about internal surveys the entity may have conducted regarding its administrative services, including, for example, an evaluation of response time to phone calls.

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[44] Timothy Geddes et al., Pension Risk Transfer, Evaluating Impact and Barriers for De-Risking Strategies, Society of Actuaries 26 (2021), https://www.soa.org/resources/research-reports/2021/pension-risk-transfer/; *see also* NAIC, Ctr. for Ins. Pol'y and Res., Pension Risk Transfer, https://content.naic.org/cipr-topics/pension-risk-transfer (last updated Jan. 31, 2024).

[45] Ability to administer the payment of benefits is a relevant consideration. In the Department's experience, administrative and recordkeeping failures following pension risk transfer annuity purchases can result in risks to policyholders. *See, e.g.,* Press Release, New York State Department of Financial Services, January 28, 2019 (Department of Financial Services Superintendent Vullo announcing that MetLife will pay a $19.75 million fine and provide $189 million in restitution to policy holders for failures related to pension benefit transfers), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1901282.

H. Spousal Protections

The Internal Revenue Code (Code) and ERISA include provisions designed to protect a pension plan participant's spouse with respect to the participant's plan benefits. In general, these provisions require that distributions from a defined benefit plan be made in the form of a qualified joint and survivor annuity unless the spouse waives the right to that form of benefit.[46]

The main issue raised by stakeholders regarding spousal protections following a pension risk transfer annuity purchase is whether there is any applicable law that would prohibit the annuitant from converting the annuity's remaining value into a lump sum without obtaining spousal consent. Another issue mentioned was that sometimes spouses are inadvertently omitted from coverage under an annuity contract because of incomplete records or inattention at the time of the transaction. Other stakeholders believe that the applicable Department of the Treasury regulations comprehensively address spousal protections after pension risk transfer annuity purchases.

EBSA consulted with the Internal Revenue Service (IRS) and the Department of the Treasury, which advised that Treasury Regulation § 1.401(a)-20 provides that a defined benefit plan would be disqualified if an annuity contract distributed from the plan failed to satisfy the spousal benefit protections in sections 401(a)(11) and 417 of the Code. In addition, EBSA consulted with the PBGC, which advised that spousal protections must be contained in annuity contracts purchased under section 4041 of ERISA in the case of standard plan terminations.

In the view of both the Department and the PBGC, if a participant or spouse was inadvertently omitted from an annuity contract as part of a pension risk transfer, the plan would remain liable for the payment of any benefits to which the individual is entitled under the terms of the plan.[47] Further, and more generally, the Department notes that circumstances surrounding omissions of this type may indicate fiduciary breaches by the plan administrator prior to and concurrent with the pension risk transfer, involving recordkeeping and implementing the settlor's decision to engage in a pension risk transfer. However, the Department does not believe it needs to amend the Interpretive Bulletin to clarify these principles.

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[46] *See* Code sections 401(a)(11), 417 (26 U.S.C. §§ 401(a)(11), 417) and ERISA section 205 (29 U.S.C. § 1055).

[47] *See* PBGC Advisory Opinion 91-4 (May 3, 1991) ("If a participant did not receive his or her full plan benefit, or was simply missed in the distribution of plan assets, the plan, and therefore the plan sponsor, would continue to be liable. And in the event the error remained uncorrected, the PBGC would ultimately be responsible. See ERISA § 4041(b)(4).").

I. Anti-Alienation Rules: Protections Against Creditors and Division of Benefits on Divorce

In general, ERISA and the Code prohibit a participant or plan from assigning or alienating the participant's interest in their retirement plan.[48] These "anti-assignment and alienation" rules are intended to ensure that a participant's retirement benefits are available to provide financial support during the participant's retirement years. ERISA and the Code also contain an important exception to the general anti-alienation rules through an established framework for permitting a court-ordered division of a pension benefit upon separation or divorce, through a domestic relations order, called a Qualified Domestic Relations Order (QDRO).[49]

Some stakeholders wanted clarification that fiduciaries have a responsibility to negotiate annuity contract provisions that replicate ERISA protections, including those under ERISA and the Code's assignment and alienation provisions. They believe that once the obligation to provide pension benefits is transferred to an insurance company, the continued application of these protections is unclear and the application of anti-assignment and anti-alienation rules may be determined by state law, which can vary significantly. Stakeholders also expressed concern that, without ERISA's framework for dividing benefits on divorce, it may be difficult and costly for former spouses to obtain a court-awarded share of the annuity. Stakeholders from the insurance industry maintain that ERISA's strong creditor protections do not go away merely because an annuity is purchased on behalf of an ERISA plan participant.

In an effort to reconcile the conflicting positions, EBSA consulted the IRS and the Department of the Treasury, as the assignment and alienation provisions in ERISA and the Code are under their interpretive jurisdiction. The IRS and the Department of the Treasury confirmed that a distributed annuity contract must be nontransferable in order to satisfy section 401(g) of the Code. As support, they cited Treasury Regulation section 1.401-9(b)(1), which provides that, to satisfy the requirement to be nontransferable, the distributed annuity contract "must expressly contain the provisions that are necessary to make such . . . contract not transferable within the meaning of this paragraph." For this purpose, Treasury Regulation section 1.401-9(b)(3) provides that a contract is transferable "if the owner can sell, assign, discount, or pledge as collateral for a loan or as security for the performance of an obligation or for any other purpose his interest in the certificate or contract to any person other than the issuer thereof."

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[48] ERISA section 206(d)(1) (29 U.S.C. § 1056(d)(1)) and Code section 401(a)(13) (26 U.S.C. § 401(a)(13).
[49] ERISA section 206(d) (29 U.S.C. § 1056(d)); Code sections 401(a)(13) and 414(p) (26 U.S.C. §§ 401(a)(13), 414(p)); *see* EBSA publication, QDROs: The Division of Retirement Benefits Through Qualified Domestic Relations Orders (2020), https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/publications/qdros.pdf.

In addition, one stakeholder asserted that section 522 of the U.S. Bankruptcy Code protects annuities from creditors in bankruptcy proceedings. EBSA consulted with the U.S. Department of Justice, Office of the U.S Trustee Program (USTP), as it has interpretive jurisdiction over this section of the Bankruptcy Code. USTP confirmed that section 522 of the Bankruptcy Code conditionally protects certain retirement funds from creditors.

EBSA also consulted with the PBGC in response to one stakeholder who asserted that PBGC has previously addressed annuity providers' obligations to comply with ERISA and the Code's QDRO rules. PBGC advised that under section 4041 of ERISA, a standard termination has no effect on the ability to obtain a QDRO or on benefits received under a QDRO. PBGC also advised that under section 4041, plan administrators and annuity providers must comply with the terms of a QDRO.[50]

J. Disclosures

Stakeholders said there may be insufficient disclosure to participants about partial buy-outs (so-called "lift-outs") and their implications for participants and beneficiaries. In the case of total buy-outs in which the plan is terminated in a standard termination, ERISA contains a detailed reporting and disclosure structure.[51] However, no structure exists under ERISA for partial buy-outs when, according to these stakeholders, one should.

Stakeholders representing plan sponsors and insurers said that they dedicate significant resources to ensuring that participants and retirees understand the annuity purchase, how they are affected, and the consequences of any decision they may make with respect to their rights under the annuity contract. These stakeholders asserted that compelling business reasons, such as brand reputation and human relations, justify comprehensive and understandable disclosures. For example, advance disclosures inviting participants to review and verify the accuracy of all personal information, such as age, dates of employment, salary, and elected spousal benefit, reduce the likelihood of transition errors and post-annuity purchase recalculations.

A few stakeholders highlighted a different disclosure issue following a pension risk transfer annuity purchase. After the purchase, nothing comparable to the annual funding notice required under section 101(f) of ERISA is required to be furnished to policyholders, which may leave them uninformed as to the insurer's solvency and safety, these stakeholders said. However,

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[50] *See* 62 Fed. Reg. 60,424, 60,426 (Nov. 7, 1997); *see also* 29 C.F.R. § 4041.28(c)(1) ("The plan administrator must, in accordance with all applicable requirements under the Code and ERISA, distribute plan assets in satisfaction of all plan benefits by purchase of an irrevocable commitment from an insurer or in another permitted form.").
[51] ERISA section 4041 (29 U.S.C. § 1341); 29 C.F.R. §§ 4041.23, .24, .27, .28.

other stakeholders said that outcome is logical, because once a participant is no longer a participant under the plan, they are no longer entitled to nor would they have any practical need for the types of funding disclosures required under ERISA.

K. Loss of PBGC Protections

The PBGC protects participants in defined benefit plans by paying benefits up to limits set by law if a plan is terminated and does not hold sufficient assets to pay all benefits.[52] As a result of a pension risk transfer annuity purchase transaction, the benefits of the individuals who were formerly defined benefit plan participants become insured by state guaranty associations (SGAs) rather than the PBGC. SGAs provide coverage up to state law limits in the event the issuing insurer becomes insolvent.[53]

Several stakeholders said the removal of the PBGC guarantee is a significant loss for participants, asserting that the PBGC offers a higher level of guarantee than the SGAs. Stakeholders also expressed other concerns about SGAs, such as the fact that they are not pre-funded, raising the possibility that a systemic failure could lead to multiple insolvent insurance companies that could collapse the system. A stakeholder further asserted that the loss of PBGC protections exacts an emotional toll on plan participants and beneficiaries that plan fiduciaries should consider. A few stakeholders suggested that the Interpretive Bulletin should be revised to provide that fiduciaries engaging in a pension risk transfer annuity transaction must consider obtaining, or requiring the annuity provider to obtain, independent reinsurance of the annuity.

Another stakeholder alternatively asserted that there are more risks under the PBGC program than under annuity contracts backed by SGAs. The stakeholder cited a PBGC study of guarantee limitations set by law and regulation as applicable to 500 single-employer plans trusteed by the PBGC between 1988 and 2012. While 84 percent of the participants received 100 percent of their vested benefits, 16 percent had their benefits reduced by one or more of the

[52] *See* https://www.pbgc.gov/about/faq/pg/general-faqs-about-pbgc.
[53] Nat'l Org. of Life & Health Ins. Guaranty Associations, https://nolhga.com/.

limitations considered in the study.[54] Other sources suggest that comparing the two systems does not lead to an outright conclusion that one is superior to the other.[55]

Another view presented was that the fiduciary implementing the settlor decision does not need to consider the loss of the PBGC guarantee, because it is a direct and unavoidable consequence of the settlor decision to engage in the pension risk transfer annuity purchase transaction.

L. State Guaranty Associations

Several stakeholders raised a different issue related to SGAs. These stakeholders noted that the Interpretive Bulletin's sixth factor identifies "the availability of additional protection through state guaranty associations and the extent of their guarantees" as a factor for fiduciary consideration. However, these stakeholders questioned whether SGA guarantees are relevant when identifying a provider for the safest available annuity, and suggested it should be removed as a consideration.

These stakeholders opined that SGA coverage is not relevant when analyzing whether any particular insurer is safer or more solvent than any other competing insurer because every state (and consequently every licensed insurer doing business in the state) has some form of SGA protection. These stakeholders further suggested that the extent of SGA guarantees may be difficult to evaluate as it will usually depend on the policyholder's domiciliary state, a factor the purchasing plan fiduciary has no control over.

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[54] American Benefits Council, Annuity Purchases by Defined Benefit Plans Enhance Participant Protections: Data Shows That Any Restrictions on Such Purchases Would Place Participants at Greater Risk 2 (Apr. 2023), www.americanbenefitscouncil.org/pub/?id=176CFD9B-1866-DAAC-99FB-5894C9EF628C (citing PBGC, PBGC's Single-Employer Guarantee Outcomes (May 2019), https://www.pbgc.gov/sites/default/files/2016-single-employer-guaranty-study.pdf). The report found that 89 percent of the reductions in the value of plan benefits were concentrated in 10 plans.

[55] National Organization of Life and Health Insurance Guaranty Associations, Consumer Protection Comparison - The Federal Pension System and the State Insurance System 2 (May 22, 2016) ("An objective comparison of those protections—which are delivered through two different protection systems that have similar objectives but are very different in application—compels the conclusion that participants are strongly protected in both cases: the resolution and safety net mechanisms of the two systems would fully cover the vast majority of all benefit claims, and the small minority of benefit claims not fully covered would have marginally different outcomes, sometimes slightly favoring one system or the other for some individuals, depending on the specific circumstances of a particular case."), https://www.nolhga.com/resource/code/file.cfm?ID=2559; ERISA Advisory Council, U.S. Dep't of Labor, Private Sector Pension De-risking and Participant Protections 12 (2013) (stating that Josh Gotbaum, then-Director of the PBGC, indicated that "he did not think that a defined benefit plan with a PBGC guarantee was necessarily safer than an insurance company annuity backed by a state insurance guaranty association"), www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2013-private-sector-pension-derisking-and-participant-protections.pdf.

More fundamentally, some stakeholders even asserted that the Interpretive Bulletin's sixth factor may have a counterproductive effect on a fiduciary's solvency analysis. They argued that some fiduciaries may engage in a less rigorous analysis than they would if the Interpretive Bulletin did not contain the provision. They said this is because fiduciaries may take a more casual approach to selecting the insurer with the comfort of knowing that, regardless of the quality and diligence of their effort and analysis, the SGA coverage will ultimately backstop the insurer.

M. Impact of Partial Pension Risk Transfer Annuity Purchases on Residual Funding Status of Plans

As mentioned earlier, partial buy-outs involve plans transferring a portion of their liabilities while the plans continue operating. Some stakeholders discussed how a partial buy-out might impact a plan's ability to fund the liabilities that remain in the plan. While purchasing annuities from large, diversified insurers with appropriately conservative investment policies can benefit the group the annuities are being purchased for, these stakeholders believe that the transaction can leave the remaining participants worse off by removing assets underpinning their promised benefits.[56]

Other stakeholders drew EBSA's attention to an Aon finding that, in retiree lift-out transactions Aon led in 2022, plan fiduciaries chose the lowest cost annuity in 78 percent of transactions.[57] To some, this statistic suggested that the chief driver of annuity selections is cost, rather than a rigorous process aimed at choosing the safest available annuity, at least in this context.

In light of the above, stakeholders suggested there is uncertainty as to whether, and precisely how, the Interpretive Bulletin's factors apply to situations when a partial pension risk transfer annuity purchase materially reduces the plan's funding percentage. Further, some questioned whether there may be any circumstances in which a plan fiduciary might conclude under the Interpretive Bulletin or ERISA section 404 more generally that the fiduciary is unable to implement the settlor's decision to de-risk because of the negative effect the partial buy-out would have on the plan's funding status. Moreover, one stakeholder suggested that if the plan sponsor does not maintain pension funding levels of at least 80 percent, the plan sponsor may

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[56] For instance, stakeholders explained that for a plan that is less than 100 percent funded, purchasing an annuity for some participants means that those participants are expected to receive their full benefits (that is 100 cents on the dollar). Given the overall funding coverage of the plan's liabilities was less than 100 cents on the dollar, the participants for whom an annuity was not purchased will have a reduction in the plan's funding coverage of their liabilities following the partial buy-out.

[57] Aon, U.S. Pension Risk Transfer: Market Insights (Mar. 2023), https://www.aon.com/insights/reports/2023/us-pension-risk-transfer-market-insights (follow "Download Whitepaper"; complete form for access to whitepaper.

find that its ability to modify the plan in certain ways is limited.[58] Depending on the funding level, the plan sponsor may find that it must restrict the plan's ability to engage in pension risk transfer annuity purchases, the stakeholder added.

V. Findings

Based on its review of Interpretive Bulletin 95-1, including consultation with the ERISA Advisory Council, EBSA finds that Interpretive Bulletin 95-1 continues to identify broad factors that are relevant to a fiduciary's prudent and loyal evaluation of an annuity provider's claims-paying ability and creditworthiness. EBSA also finds that it is desirable for guidance in this area to remain principles-based.

At the same time, EBSA has not concluded that changes to the Interpretive Bulletin are unwarranted. Further exploration into developments in both the life insurance industry and in pension risk transfer practices is necessary to determine whether some of the Interpretive Bulletin's factors need revision or supplementation and whether additional guidance should be developed.

In this regard, EBSA's review has found that some stakeholders are very concerned about developments in the life insurance industry that may impact insurers' claims-paying ability and creditworthiness. As set forth above, some stakeholders urged EBSA to update the Interpretive Bulletin to focus fiduciaries' attention on issues such as insurers' ownership structures; exposure to risky assets and non-traditional liabilities; and use of affiliated and offshore reinsurance. While at least some industry participants view these issues as fully addressed by the existing Interpretive Bulletin, EBSA finds that further consideration should be given to whether the Interpretive Bulletin's guidance should be amended to enhance fiduciary decision-making on these issues. These issues—separately or in combination—may expose annuitants to excessive risk.

Some stakeholders attributed concerning developments in these areas to private equity firms' increased involvement in the industry. They said that private equity-affiliated insurers tend to engage in riskier practices than traditional insurers. Stakeholders were also concerned that private equity firms do not have a long track record of managing life insurance obligations and may lack a commitment to policyholder interests. However, others say the concerning practices are employed on a more widespread basis in the industry.

EBSA is not prepared at this time to propose amendments to the Interpretive Bulletin to address this area of potential risk. The issues raised by stakeholders are complex and there were

[58] *See* Code section 436 (26 U.S.C. § 436), and ERISA section 206(g) (29 U.S.C. § 1056(g)).

few, if any, areas of consensus. As just one example of this, six ERISA Advisory Council members supported no changes to the Interpretive Bulletin, while the other nine members supported different positions on different issues.

Broader public input is an important next step in determining how the Interpretive Bulletin might be amended to address this area of potential risk to participants and beneficiaries. It is important that any changes to the Interpretive Bulletin do not have unanticipated consequences, particularly as related to insurance regulation. Any such changes will be preceded by public notice and comment.

It is also appropriate to further consider the issues some stakeholders raised about disclosure following a partial buy-out as there are significant consequences to plan participants and beneficiaries of such transactions as well as significant concern regarding whether all affected participants and beneficiaries uniformly receive sufficient and timely disclosure. EBSA's further consideration of these recommendations will include coordination with the PBGC, and any next steps will involve public notice and comment.

Regarding some of the other issues stakeholders raised about specific phrasing or weighting of the Interpretive Bulletin's factors, EBSA notes that the Interpretive Bulletin does not state that the enumerated factors are the only factors for fiduciary consideration or that they must be given equal weight. EBSA agrees with stakeholders who asserted that plan fiduciaries must apply the factors based on the individual circumstances of each plan and transaction.

Further, with respect to loss of PBGC protections in connection with the selection of an annuity provider, EBSA rejects the view that the settlor's decision to engage in a pension risk transfer means that the plan's fiduciary, in implementing that decision, may be indifferent to the substitution of PBGC coverage with SGA coverage or the extent of the state guarantees.

Likewise, EBSA is not persuaded that additional guidance is needed regarding a fiduciary's duties in connection with a partial buy-out's impact on the plan's funding status. The safest available annuity standard applies equally in the context of a partial buy-out. The fiduciary implementing the buy-out has a duty of impartiality to all of the plan's participants. If the fiduciary is not able to implement a pension risk transfer without breaching its duty of prudence and loyalty to all participants, the fiduciary may be compelled to seek additional funding from the plan sponsor.[59]

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[59] *See*, *e.g.,* U.S. Dep't of Labor Field Assistance Bulletin 2002-01 (Sept. 26, 2002) ("Further, we note that the fiduciary has a duty of impartiality to all of the plan's participants, and may appropriately balance the interests of

Finally, a number of concerns stakeholders raised related to preserving ERISA rights and obligations following a pension risk transfer annuity purchase appear to be addressed in whole or in part by regulations of the Department of the Treasury or the PBGC, or by industry practice, as discussed above. EBSA will continue to monitor these issues.

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different classes of participants in evaluating a proposed refinancing, including the potentially varying interests of present and future participants."). *See also Varity Corp. v. Howe*, 516 U.S. 489, 514 (1996) ("The common law of trusts recognizes the need to preserve assets to satisfy future, as well as present, claims and requires a trustee to take impartial account of the interests of all beneficiaries."); Restatement (Third) of Trusts § 79 (2007) (discussing duty of impartiality)).