ACLI
Financial Security for Life

James Szostek
Vice President & Deputy, Retirement Security

Howard Bard
Vice President & Chief Counsel, Employee Benefits

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Hon. Lisa M. Gomez
Assistant Secretary, Employee Benefits Security Administration

Christine Donahue
Executive Secretary, ERISA Advisory Council

US Department of Labor
200 Constitution Ave NW
Washington, DC 20210

Subject: SECURE 2.0 Review of Interpretive Bulleting 95-1

Greetings:

On behalf of the American Council of Life Insurers (ACLI), we share with you our views of Section 2509.95-1 of title 29, Code of Federal Regulations ("Interpretive Bulletin 95-1" or "Bulletin"), relating to the fiduciary standards under the Employee Retirement Income Security Act of 1974 ("ERISA") when selecting an annuity provider for the transfer of pension plan benefit obligations (a.k.a. pension risk transfer transactions). Section 321 of Division T - The SECURE 2.0 Act of 2022 directs the Secretary of Labor to review and, in consultation with the Advisory Council on Employee Welfare and Pension Benefit Plans, determine whether amendments are warranted to this Bulletin. The Secretary is directed to report to Congress the findings of such review including an assessment of any risks to participants.

Given the complexity of the issues, the intersection between these issues and the required fiduciary evaluation of insurer solvency and capital requirements, and the significant impact on plans and plan sponsors that may result from any amendments, should the Department conclude that changes to Interpretive Bulletin 95-1 are warranted, we ask that such changes be proposed under a notice and comment process that affords all stakeholders an opportunity to review and comment on such changes.

American Council of Life Insurers | 101 Constitution Ave, NW, Suite 700 | Washington, DC 20001-2133
(202) 624-2378 t | jimszostek@acli.com
(202) 624-2028 t | howardbard@acli.com

The American Council of Life Insurers ("ACLI") is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

Interpretive Bulletin 95-1 was issued in response to concerns about the security of the pension benefits promised to participants and beneficiaries under annuity contracts purchased on their behalf; and specifically, questions raised by the failures of Executive Life of California and Executive Life of New York. As the DOL and ERISA Advisory Council explore this area, it is important to note that much has changed with respect to the regulation of life insurers. Since the implementation of enhanced reserving and other solvency rules in the mid-1990s, rules that continue to evolve, we are not aware of any retirement plan participants whose annuity benefits were reduced due to an insurer insolvency.

To assist the ERISA Advisory Council in its consultation with EBSA, we summarize the key elements of life insurer solvency regulation and oversight beyond the fiduciary evaluation discussed in the Bulletin. In addition, we provide an overview of the guaranty associations that help support the continuation of benefits in the event of an insurer insolvency. We also highlight how ERISA's spousal and creditor protections continue following a pension risk transfer transaction.

I. Key Elements of Life Insurer Solvency Regulation

Across the United States, life/annuity insurance companies are subject to robust and extensive state regulation and oversight to ensure that insurers can fulfill their long-term promises to customers. State insurance regulators use a variety of tools and confidential disclosures to supervise solvency issues and assess risks for both the insurer and from the broader holding company, when an insurer is part of a group.[1] This system has proved highly effective: since the 2008 financial crisis, ***no insurance company has failed to make a life annuity payment to a plan participant following a pension risk transfer.*** [2] That track record is a function of the robust reserving and capital standards applied to insurers.

While insurers are regulated by the states, the financial regulation of U.S. life/annuity insurers is remarkably consistent in all 50 states and the District of Columbia. Insurer solvency regulation in every state must meet or exceed the strong baseline requirements described in model laws and regulations developed by the National Association of Insurance Commissioners ("NAIC"). Much of the consistency is due to NAIC accreditation program. Accreditation is a process that certifies that a state meets or exceeds the baseline financial solvency oversight standards, in addition to other key criteria. All 50 states and the District of Columbia are NAIC accredited. Moreover, the state-based system is not static. As described in more detail below, state regulators continue to regularly review and update financial and consumer protection requirements for annuity providers.

Baseline standards and oversight include, but are not limited to, requirements regarding the establishment and adequacy of reserves,[3] the valuation of assets and liabilities, RBC requirements, surplus rules, enterprise risk management, assessments of group capital, presale approval of insurance contracts (with actuarial justification), and restrictions on issuing dividends to holding companies.

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[1] NAIC, *State Insurance Regulation*, (2021) *available at* https://content.naic.org/sites/default/files/inline-files/topics_white_paper_hist_ins_reg.pdf.

[2] National Organization of Life Health Guaranty Associations ("NOLGHA"), *Consumer Protection Comparison, The Federal Pension System and the State Insurance System* (2016), *available at* https://www.nolhga.com/resource/code/file.cfm?ID=2559.

[3] Reserves are funds that the insurer sets aside to pay claims when they become due. There are detailed rules (*e.g.*, Valuation Manuals, Actuarial Guidelines, model laws and regulations) that determine how an insurer calculates its reserves. *See* Life and Annuity Reserve Standards Model Regulation (#820), Valuation Manual (VM) 20 and 21.

The regulation of life/annuity insurers is comprehensive and effective. Due to existing regulatory requirements and protections, annuity issuers seldom fail, and when they do, they still have substantial assets. By contrast, there is no comparable prudential regulation of defined benefit plans, and when these plans fail, shortfalls of material amounts are common. We are not aware of any plan participant that has suffered a cut in benefits after a pension risk transfer. Annuities protect retiree benefits when an employer decides to transfer the long-term risks associated with defined benefit plans (*e.g.*, interest rate risk, inflation risk, asset risk, longevity risk). Life/annuity insurers continue to play a vital role in providing for Americans' long-term financial security through the provision of annuities, including those purchased by employers in a pension risk transfer arrangement. The section below provides examples of some of the tools and prudential regulations that state regulators rely on to ensure that a life/annuity insurer can fulfill their long-term promises to American families and retirees.

1. <u>Insurance reserving and capital requirements help protect consumers from insurer insolvencies</u>

Like other sophisticated regulatory systems, the U.S. insurance regulatory system uses a risk-based capital ("RBC") system to determine the minimum amount of capital an insurer must hold. Like Basel III banking requirements, RBC incents companies to hold conservative assets instead of riskier assets by assigning higher charges to higher risk assets. Unlike other financial institutions, life insurers must maintain reserves for *every* policy or certificate issued, as well as aggregate reserves to support the overall company solvency, plus additional capital. Since the implementation of the enhanced reserving and solvency rules in the mid-1990s, ***we are not aware of any retirement plan participants whose annuity benefits were reduced due to an insurer insolvency.***

A. How RBC works

RBC sets a statutory minimum level of capital based on an insurance company's size and the level of risk associated with the insurer's financial assets and operations. Under RBC, an insurers' minimum capital requirements are proportional to its risk. RBC assesses a variety of risks including the credit risk of fixed income investments and the risk of fair-value losses from equity (and similar) investments. Other risks included in the RBC formula include asset risk, insurance/underwriting risk, interest rate risk, and business risk, and it differentiates between insurance industry sectors (life, property and casualty, and health).

RBC is calculated using Statutory Accounting Principles ("SAP") [4]. Life/annuity insurers must calculate and hold reserves using moderately adverse conditions for their outstanding liabilities including their promises to certificate holders. This approach limits the ability for companies to use overly optimistic assumptions around asset performance and key liability assumptions such as mortality (*e.g.*, for annuities, that the assumed mortality isn't too high).

While RBC is not the only tool used to evaluate financial solvency, the RBC system includes thresholds that trigger regulatory intervention and provides regulators with additional legal authority to take control of an insurance company to ensure policyholders will receive the benefits promised without relying on a guaranty association or taxpayer funds.

[4] There are many differences between U.S. GAAP and SAP. *See* PricewaterhouseCoopers, *13.5 Key differences between SAP and US GAAP (pwc.com)*, (summarizing key differences between the GAAP and SAP), *available here:* https://viewpoint.pwc.com/dt/us/en/pwc/accounting_guides/insurance-contracts/Insurance-Contracts/Ch13_statutory_accounting/13_5keydifferencesbetween.html#pwc-topic.dita_33339078-6877-4fef-ad63-7ef3d0e49431

B. *Asset-Adequacy Testing requires companies to test the adequacy of assets to fulfill obligations to policy and certificate holders.*

In addition to certificate level reserves, the insurer's appointed actuary must annually certify the adequacy of current assets to support future obligations of the company.[5] Such asset adequacy testing ("AAT"), often in the form of cash flow testing, reflects moderately adverse conditions. The sufficiency of the assets is evaluated against a variety of economic scenarios, including interest rate risk.

Over the past 30+ years, RBC and asset adequacy testing has been (and continues to be) repeatedly reviewed and refined, reflecting changing conditions and increasing sophistication of modeling techniques. For the NAIC's overview of the RBC system, see https://content.naic.org/cipr-topics/risk-based-capital.

2. Financial regulation and consumer protection standards are continually evolving to protect consumers and certificate holders

None of the NAIC standards or requirements are static – the regulatory system is constantly evolving to adapt to marketplace developments. Reserves, AAT, RBC, and other parts of the solvency framework were significantly enhanced in the mid-1990s and are subject to continual review and enhancement. Recent examples of this examination and refinement include:

- **NAIC's Solvency Modernization Initiative.** The NAIC launched a Solvency Modernization Initiative ("SMI") after the great financial crisis in 2008.[6] The SMI was a critical evaluation of the United States' insurance group supervisory framework that resulted in significant enhancements to insurance group supervision in the states. It included a review of international developments regarding insurance, banking, and international accounting standards and their potential use in U.S. insurance regulation. The SMI enhanced regulatory requirements in five key solvency areas: (1) capital requirements; (2) international accounting; (3) insurance valuation; (4) reinsurance; and (5) group regulatory issues.

- **NAIC Macroprudential Initiative (2017).**[7] The Macroprudential Initiative ("MPI") was designed to identify potential regulatory enhancements in four areas, including (1) liquidity risk, (2) capital stress testing, (3) recovery and resolution, and (4) counterparty exposure and concentration. The MPI led to enhanced reporting of liquidity risks in the Annual Statements, as well as the creation of Liquidity Stress Testing Framework for large life insurance groups.[8]

- **NAIC Regulatory Considerations Applicable (but not exclusive to) Private Equity Owned Insurers (2022-2023).**[9] The Regulatory Considerations Project resulted from regulators focus on insurance company activities because of the increasing complexity of transactions and the evolving insurance marketplace. Despite its original name, regulators expressly recognized

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[5] NAIC Actuarial Opinion Memorandum Regulation (#822) (requiring asset-adequacy analysis); NAIC Standard Valuation Model Law (#820) (setting standards for the calculation of reserves, actuarial opinions and cash flow testing used in asset adequacy analysis requirements); NAIC Valuation Manual (including standards and actuarial guidance). All 50 states and DC have adopted these materials.

[6] NAIC, *NAIC Issue Brief: Solvency Modernization Initiative* (2009).

[7] NAIC Center for Insurance and Policy Research, *Macroprudential Supervision (naic.org)* (2023).

[8] *NAIC Liquidity Stress Testing Framework* (2022).

[9] NAIC Center for Insurance and Policy Research, *Macroprudential Supervision (naic.org)* (2023); NAIC List of MWG Considerations - PE Related and Other (naic.org) (2022).

that the activities discussed in the "Regulatory Considerations" should not be focused on a particular ownership type or corporate structure.

The workstreams in this review include, but are not limited to:

- Creating additional guidance on Asset-Adequacy Testing (AAT) for complex assets
- Developing more detailed RBC factors for asset-backed securities like Collateralized Loan Obligations (CLOs)
- Amending the schedules in the Annual Statement to provide additional granularity around the treatment of bonds and other investments
- Creating a new tool to make it easier for regulators review the impact of reinsurance transactions[10]

3. <u>Regulators have a wide array of tools to oversee the legal entity and insurance group to protect contract holders and policyholders from losses</u>

In addition to the standards and requirements listed above, regulators have an array of tools that are used holistically with RBC, the Group Capital Calculation ("GCC"), and financial exams and surveillance to promote insurer solvency. Examples include preemptive measures requiring notification and pre-approval from regulators and annual disclosures, exams, and assessments.

Preemptive measures built into the state insurance regulatory framework are intended to mitigate risks before they occur. Pre-emptive measures include requirements that insurers obtain pre-approval for a variety of transactions, such as the approval to issue extraordinary dividends, changes in control, or approval for large reinsurance deals.[11] Transactions between insurers and affiliates – or transactions that benefit affiliates – are subject to special scrutiny.[12] Regulators have a wide degree of latitude to deny or condition an acquisition.

Examples of pre-approval requirements include:

- Form A. Section 3 and 3A of the Insurance Holding Company Systems Act describe the detailed pre-acquisition disclosures and approval required before an insurer is acquired or divested by a controlling party. Control is presumed when a person directly or indirectly holds 10% of the voting securities of another person. Commissioners have wide latitude to approve, deny, or condition approval for any acquisition or change in control. Regulators may condition and acquisition conditional on compliance with a range of short or long-term stipulations. The stipulations generally impose enhanced prudential regulatory standards and reporting requirements. Regulators are currently considering whether to impose

[10] NAIC, *Reinsurance Comparison Worksheet* (2023).

[11] The pre-dividend approval requirement is intended to protect policyholders from inappropriate payments to investors, or other distributions.

[12] Section 5 of the Insurance Holding Company Systems Act (#440) requires pre-approval for transactions between and another entity in the insurance holding company, including investments, management agreements and service contracts, guarantees, sales, loans and extensions of credit that exceed 3% of insurers surplus; direct or indirect acquisitions, reinsurance pooling agreements; reinsurance transactions exceeding 5% of the insurers' surplus.

mandatory stipulations in lieu of regulatory judgment, as well as whether to impose stipulations on past acquisitions. [13]

- Form D requires Commissioner notification and approval before certain transactions are executed, including (1) sales, purchases, exchanges, loans, extensions of credit, guarantees or investments that exceed 3% of admitted assets; (2) loans or extension of credit to a non-affiliate exceeding 3% of admitted assets; (3) certain reinsurance agreements, including those involving a transfer of assets between affiliates; (4) All management agreements, service contracts, tax allocation agreements, guarantees and all cost-sharing arrangements; (5) guarantees that exceed 0.5% of admitted assets or 10% of surplus; (6) acquisitions or investments in a person that controls the insurer or in an affiliate that combined with current holdings exceeds 2.5% of surplus.[14]

Examples of insurer disclosure requirements include:

- Form F is an annual enterprise risk report on material risks within the holding company system that could pose enterprise risk to the insurer. The report is filed by the ultimate controlling person, which may be an insurer or a holding company. [15]

- ORSA ("Own Risk Solvency Assessment") requires mid-size and large insurers and groups to assess the adequacy of its risk management, current, and prospective solvency positions under normal and severe stress scenarios. ORSAs must include all reasonably foreseeable and relevant material risks (*i.e*., underwriting, credit, market, operational, liquidity risks, etc.) that could impact an insurer's ability to meet its contract holder obligations.[16] ORSA reports provide a group wide view of risk and capital.

- Quarterly and Annual Financial Statements State insurance regulators receive quarterly and annual financial statements that give the regulator significant insight into the financial condition of the insurer. If the data reveals concerns, a "ladder of intervention" exists which requires regulators to undertake certain corrective actions, depending on the insurer's risk-based capital (RBC) results.[17]

- Corporate Governance Disclosures are filed annually by the insurer or insurance group. Filings provide a summary of the insurer/groups corporate governance, structure, policies and practices with their lead-state supervisor.[18]

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[13] *Regulatory Considerations Applicable (but not exclusive) for PE owned life insurers* (providing detailed examples of limited and long-term stipulations that may apply when a life insurer is acquired by another company).

[14] Section 5(A)(2), Insurance Holding Company Systems Act ("Holding Company Act") (#440); Form D, Holding Company Regulation Act, MO-450-22 to 24.

[15] Form F is required under the Insurance Holding Company System Model Act (#440) and the Insurance Holding Company Systems Model Regulation ("Holding Company Regulation") (#450); NAIC, *Enterprise Risk Report ("Form F") Implementation Guide (2018)*, *available at* committees_e_isftf_group_solvency_related_form_f_guide_0.pdf (naic.org)

[16] Risk Management and Own Risk and Solvency Assessment Model Act (#505)*;* Center for Insurance Policy Research, *Own Risk and Solvency Assessment (ORSA) (naic.org)/.*

[17] Interventions range from additional monitoring and a prompt corrective action plan up to takeover of the insurer. Supervisors may also declare that an insurer is in "Hazardous Financial Condition" and may intervene on the basis of that designation.

[18] Governance Disclosure Model Act (#305) and Corporate Governance Model Regulation (#306).

Examples of prudential supervisory tools:

- Financial Condition Exams assess the insurer's financial condition, its ability to fulfill obligations, and compliance with state laws and regulations.

- Annual Supervisory Plans are developed for each domestic insurer based on the results of recent financial exams and the quarterly and annual analysis process. The plan describes the supervisory plan for each insurer for the ensuring year. Supervisory plans include financial examiners' recommendations for enhanced oversight (*e.g.,* more frequent statutory exams, additional limited scope exams, key areas for financial analysis monitoring, etc.).

- Group Capital Calculation (GCC) assessments are conducted annually. The GCC assists regulators in understanding the financial condition of non-insurance entities in the group, how capital is distributed across an entire group, and whether and to what extent an insurer may be supporting the operations of non-insurance entities.[19] The GCC is a baseline quantitative metric that compliments the view of group-specific risks in ORSA and Form F, that may not otherwise be disclosed in legal entity filings.[20]

- Liquidity Stress Testing requires enhanced disclosure and stress testing of large life insurers to allow regulators to better assess the macroprudential impact of liquidity stress impacting multiple life insurers.[21]

- Supervisory Colleges facilitate the oversight of internationally active insurance companies at the group level. Colleges are joint meetings of interested regulators with company officials and include detailed discussions about financial data, corporate governance, and enterprise risk management functions.

4. State regulators coordinate a broad range of risk based financial surveillance tools to promote the safety and soundness of insurers

In addition to the robust tools listed above, all 50 states and D.C. contribute to and use financial surveillance and analysis tools. The NAIC offers almost 70 specific tools to assist with the solvency assessment of insurers.[22] Examples of these tools include:

- FAST is a "collection of analytical solvency tools and databases designed to provide state insurance departments with an integrated approach to reviewing the financial condition of insurers" operating in their jurisdictions.[23] FAST helps identify and analyze insurers in greatest need of regulatory attention by assessing a variety of indicators, including leverage, asset quality, liquidity and insurer operations.[24] FAST consists of a wide range of applications including: (1) a scoring system based on over 20 financial ratios;[25] (2) the

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[19] *NAIC Group Capital Calculation 2022 Instructions*, 4, *available at* https://content.naic.org/sites/default/files/inline-files/12312022%20GCC%20Instructions_revised.pdf.

[20] *Id.*

[21] Final 2021 LST Framework (naic.org).

[22] NAIC, *Technology and Products Services* (2019).

[23] *Id.*

[24] NAIC Technology Products and Services, (2019); NAIC, *The U.S. National State Based System of Insurance Regulation and the Solvency Modernization Initiative* (2013).

[25] The NAIC Scoring System uses several financial ratios to provide regulators with updated scoring reports every quarter.

Analyst Team System (ATS) which leverages statistical analysis, a scoring system, and RBC to assign review levels for insurers; (3) the RBC trend test, which evaluates RBC trends for individual insurers; and (4) loss reserve projection tools. Poor FAST results for an insurer trigger additional review by financial analysts and results are provided to states where the insurer is licensed.

- The Financial Analysis Working Group and Reinsurance Financial Analysis Working Group are groups of seasoned regulators that meet quarterly to analyze nationally significant insurers and groups that are identified as potentially "trending towards financially troubled." Any state regulator may request that FAWG or ReFAWG review an insurer licensed in their state.

  Both groups consult with the insurers domiciliary and lead-state regulator to discuss, advise and support appropriate regulatory strategies and actions. The groups also promote a multi-state approach to identifying and addressing potential solvency concerns, including industry-wide trends.

Regulators also rely on routine financial analysis, financial exams, and other tools. Regulators can use these tools to benchmark companies against peer companies to identify outliers in need of additional surveillance. The results of the information and supervisory analysis ultimately inform and guide the regulators response to the data.

5. Reinsurance is a critical component of the insurance ecosystem and does not eliminate or decrease an annuity issuer's obligation to certificate holders.

Reinsurance is an essential risk management tool used by life insurers to spread risk and manage capital. With reinsurance, a life/annuity insurer transfers some of its insurance risk to another insurer. In effect, reinsurance is insurance for insurers. By transferring and lessening its risk, a life/annuity insurer is better able to provide financial protection products to a larger array of people and groups.

The size and number of insurable risks in the United States are substantial and ever-growing, making the availability of reinsurance, including outside the U.S., essential for a functioning insurance system. That is why, if certain regulatory conditions are met (including U.S. Credit for Reinsurance and Life and Health Reinsurance Agreements laws and regulations), U.S. insurers can obtain reinsurance domestically and internationally, and why U.S. reinsurers can provide reinsurance in the U.S. and abroad.

It is important to note that an annuity issuer's decision to reinsure an annuity that was part of a pension risk transfer does not relieve the annuity issuer from their obligation to pay certificate holders, regardless of the reinsurer's performance. There is no contract between the certificate holder and the reinsurer. The annuity issuer selected by the plan fiduciary remains 100% liable for all annuity payments and the use of reinsurance does not change that obligation.

6. Regulatory Intervention, Rehabilitation and Receivership

Regulators often intervene before companies even reach the first regulatory level of intervention. The states have broad powers under state law to intervene, implement corrective actions, and take over certain responsibilities of the insurer early on should problems be identified, such as when a company is deemed to be in hazardous financial condition. All 50 states and DC have adopted (1) the RBC Model Act, which provides a ladder of intervention with escalating requirements for states to intervene and take action if an insurers RBC ratio falls below a specified amount; and (2) the

Hazardous Financial Condition Model Regulation, which provides regulators with broad authority to determine that continued operation of an insurer is hazardous to policyholders and the public. While the Act enumerates standards to determine whether continued operation is hazardous, it also allows the regulator to deem continued operation hazardous based on "any…finding determined by the commissioner to be hazardous to the insurer's policyholders, creditors or general public."

There is a well-developed process in each state when an insurance company falls below its minimum capital requirements. Regulators are required to intervene and work with companies to implement corrective action plans long before a company becomes impaired or insolvent. Early intervention is intended to prevent the insolvency and liquidation of a company by guarding the assets of the insurer and in many instances, organizing the sale of some, or all, of the insurer's business to a financially stable insurer.

If an insurance company, however, becomes financially unstable, the insurance department in its home state will step in and seek to take control of the company and then attempt to improve or "rehabilitate" the company's financial status. This broad rehabilitation authority enables the state to fully protect the insurer's financial soundness and policyholders' interests. If rehabilitation fails, the department will then seek to place the insurer into liquidation.

The Ladder of Intervention

There are four levels of mandatory intervention tied to an insurers' RBC ratio and its authorized control level (ACL) of RBC. Authorized Control Levels are calculated for each insurer using the RBC formula, taking the insurers risks and assets into account.

- **Company Action Level:** The insurer has total adjusted capital greater than 200% Authorized Control Level RBC, but less than 300% ACL[26] and the total adjusted capital is trending negatively; or the insurer has total adjusted capital less than 200% Authorized Control Level.

- **Regulatory Action Level:** An insurer has total adjusted capital greater or equal to 150% ACL.

- **Authorized Control Level:** An insurer has total adjusted capital greater than 70% but less than 150% ACL.

- **Mandatory Control Level:** An insurer has total adjusted capital less than 70% of its ACL.

The RBC ratio formula is designed to determine ratios that fall between a target of 70% and 300%. And, while it is true that an insurer with an RBC of 70% still has sufficient capital to pay their existing liabilities, that level of capital is not sufficient to continue issuing new business.

The range of responses from regulators and the degree of discretion afforded to regulators decreases as the RBC ratio lowers. A range of prompt corrective actions are required at the Company Action Level and Regulatory Action Level.

Regulators are authorized to seek to place an insurer in receivership if the RBC ratio falls below 150%; however, if the RBC ratio falls below 70% and cannot be corrected in 90 days, the regulator must seek to take over the insurer. The state's receiver would then have the option of trying to rehabilitate or liquidate the insurer.

[26] 350% in some states.

It should be noted that while well-capitalized insurance companies generally hold multiples of the required RBC level, the NAIC RBC for Insurers Model Act[27] makes clear that RBC "is a regulatory tool that may indicate the need for possible corrective action, and *is not intended as a means to rank insurers generally.*" The advertising of an insurer's RBC is prohibited by law because it may be misleading for this reason.

State receiverships

There are two main types of receiverships. Rehabilitation is an attempt to restore the insurer to a healthier financial position so it can eventually continue normal business operations (some states allow for conservation before a rehabilitation is sought). Liquidation provides for the winding down and termination of an insurer and the marshalling of the estate's assets to pay the claims of policyholders and other creditors.

When a company's financial difficulties are too great to overcome, the insurance department will petition its state's receivership court to declare the company insolvent and move for liquidation. At this stage, the liquidator, usually the insurance commissioner or someone appointed by the commissioner, will attempt to maximize the company's estate assets to pay the claims of its creditors and policyholders. The liquidator may also seek to have one or more financially sound insurance companies take over or assume some or all of the insolvent insurer's "book of business" and associated policyholder obligations.

Policyholders, as well as certificate holders under group contracts, are given "super priority" status over general creditors and many otherwise protected parties (*i.e.*, employee claims). Few, if any, claims are superior to policyholder claims (*i.e.*, the state's administrative costs, guaranty association costs). Life insurers' creditors seldom have extensive security interests, so policyholders' claims often have access to most of the insurer's general assets.

As a result of the rigorous risk-surveillance system and ladder of intervention requiring prompt, corrective action, the number and size of annuity carriers that have gone into liquidation is quite small, and, in general, most account policyholders have received the full amount of contractual benefits guaranteed under their contracts. Since the implementation of the enhanced reserving and solvency rules in the mid-1990s, *we are not aware of any retirement plan participants whose annuity benefits were reduced due to an insurer insolvency.*

State insurance guaranty fund associations provide a further safety net or "floor" of protection for policyholders.

II. State Guaranty Associations Support the Continuation of Benefits

When a participant's or class of participants' pension obligation is annuitized, the liability for payment of annuitized benefits is legally transferred from the plan to an insurer. Because annuity benefits are not covered by the Pension Benefit Guaranty Corporation ("PBGC"), the plan is no longer required to pay premiums to the PBGC on behalf of those participants. However, the guarantor of annuity payments is the licensed insurance company which, as we have detailed here, is subject to stringent solvency standards and ongoing oversight by state insurance regulators. In addition, all states have a

[27] Risk Based Capital for Insurers Model Act, available at https://content.naic.org/sites/default/files/inline-files/MDL-312.pdf

life and health insurance guaranty association established to provide certain statutory benefits to policyholders in the case of an insurer failure.

In the unlikely event of an insurer insolvency, each state guaranty association will provide up to the state's statutory amount of coverage to its resident policyholders, including those for annuity obligations. State coverage limits range from $100,000 to $500,000 of *the contract's present value*, though most states provide at least $250,000 of coverage. A contract's present value is the current value of the stream of payments.

In the case of a pension risk transfer, a certificate holder under a group annuity contract is treated as a separate contract for the purposes of guaranty association protections. In an insolvency, plan participants with total payment streams valued at or below the state guaranty association's coverage limit would be fully covered. Claims exceeding those limits are paid to the extent there are any remaining estate assets. As noted above, since the implementation of the enhanced reserving and solvency rules in the mid-1990s, we are not aware of any retirement plan participants whose annuity benefits were reduced due to an insurer insolvency.

While the state guaranty associations are an important piece of the annuity payment protection system, the primary protection is the strong regulation of the life insurance industry which includes stringent capital and reserve requirements. In discussions regarding pension risk transfers, many compare coverage under the guaranty associations with PBGC coverage. However, before a pensioner ever receives coverage under either entity, there must be a failure of an insurance company or a pension plan.

III. ERISA Benefit Protections Applicable to Annuities

When a pension obligation is assumed by an insurer, that obligation is a guaranty that the participant will receive the very same annuity benefit determined by the plan's fiduciaries to be due the participant under the terms of the plan. These annuities are considered distributed annuities under Code section 401(g). The Code and Treasury regulations require that the annuity be nontransferable. The annuity cannot be surrendered to the insurance company or sold.

Spousal Protections

The same ERISA spousal protection rules apply, whether the benefit is provided as a stream of payments directly from the plan or through an annuity.[28] If the participant is a retiree in pay status already receiving a monthly benefit, then the annuity purchased from the insurer must provide the same type of distribution in the same amount that the participant has already elected and is already receiving (*e.g.*, single life annuity, joint and survivor annuity, life and period certain, etc.). If the employer does not purchase an annuity that satisfies the participant's election, then the plan sponsor's liability is not extinguished.

If an annuity is purchased before the participant has made a benefit election, then the spousal consent rules would apply under the annuity – the participant would need to obtain spousal consent to elect any distribution form other than a QJSA (or a qualified optional survivor annuity ("QOSA")), just as is the case under the plan.

Creditor Protections

[28] 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.

ERISA provides strong creditor protections, and those protections do not go away merely because an annuity is purchased on behalf of an ERISA plan participant, by an ERISA plan. If a plan participant enters bankruptcy, her ERISA benefit receives special protection and is not included in the bankruptcy estate under Federal law. In 2005, changes were made to the Federal Bankruptcy Code. Section 522(b)(3)(C), or alternatively section 522(d)(12), that broadly exempts retirement funds that are exempt under Code section 401. Distributed annuities from qualified plans are exempt under Code section 401(g), so they are covered by this exemption. The Bankruptcy Code also exempts direct transfers from one retirement account to another.

Even outside of the context of bankruptcy, ERISA's broad anti-alienation provision prohibits the assignment or alienation of ERISA retirement benefits. 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.[29]

We commend to you the National Organization of Health & Life Guaranty Associations white paper entitled Pension Protection Comparison Report that outlines the differences between the pension protections offered by ERISA and the state-based system. It is available at https://www.nolhga.com/resource/code/file.cfm?ID=2559.

IV. Regulatory Process

We recommend that DOL engage in a review of IB 95-1 in a manner consistent with the Administrative Procedures Act (the "APA"). Under the APA, DOL is required to go through formal notice and comment rulemaking to amend IB 95-1. This is because IB 95-1 sets substantive obligations, and as DOL has previously recognized, notice and comment rulemaking is required to attempt to set "minimum standards for annuity providers . . . in order to ensure a reasonable likelihood that participants or beneficiaries on whose behalf annuities are purchased will receive their promised pension benefits."[30] We also recommend that DOL ensure the EAC "consultation" requirement in the statute is met by ensuring this topic receive a full review by the EAC so that the EAC can provide sufficient information and recommendations to the DOL. We also suggest EAC and DOL consult with state insurance regulators and the NAIC to better understand the strong state system of insurance regulation.

V. Conclusion

The life insurance industry is subject to robust and extensive regulation and oversight by the states to ensure that life insurers can fulfill their long-term promises to customers. These rules have been established, standardized across the states. They are actively monitored and enforced by the states to ensure that insurers have are assets in excess of the commitments they have made to ensure every annuitant receives the income they have been promised for as long as they live.

Interpretive Bulletin 95-1 has performed well and remains relevant today. As the data demonstrates, there remains little to no risk to participants under a pension risk transfer. Indeed, as noted above, since the 2008 financial crisis, and no insurance company has failed to make a life annuity payment to a plan participant following a pension risk transfer.[31] Contrast this with defined benefit plan failures, since 2008 over 1,300 plans have failed, and according to its 2002 Annual Report, in 2022

[29] See IRS General Counsel Memorandum 39882 (May 27, 1992) and Treas. Reg. §1.401(a)-20, Q&A-2.

[30] *Annuitization of Participants and Beneficiaries Covered Under Employee Pension Plans*, 56 Fed. Reg. 28,638 (June 21, 1991).

[31] NOLGHA, *Consumer Protection Comparison, The Federal Pension System and the State Insurance System* (2016) https://www.nolhga.com/resource/code/file.cfm?ID=2559

alone, the PBGC assumed responsibility for 32 single employer plans that terminated without sufficient assets to pay participants. We request that, consistent with other processes with this level of importance, the Council share its findings before making any recommendations and that the Department provide a preview of preliminary conclusions before making any final recommendations or proposed changes to IB 95-1, so that ACLI can provide constructive feedback. Given the complexity of the issues being discussed and the significant impact on plans and plan sponsors that will result from any amendments, we ask that such changes be proposed under a notice and comment process that affords all stakeholders an opportunity to review and comment.

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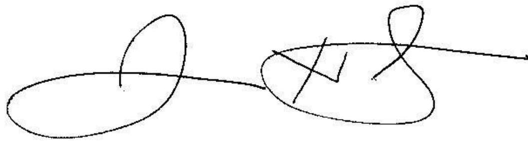
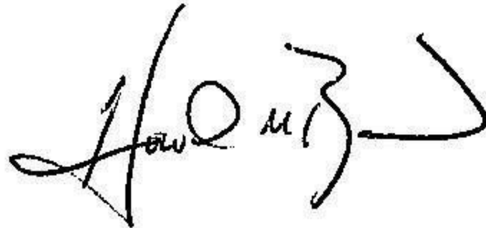
On behalf of ACLI, we appreciate the opportunity to share our views with the Council and the Department. Please let us know if you have any questions or would like to discuss these comments further.

Respectfully,





James Szostek Howard Bard