Manage Subscription

Financial Accounting
Aug. 10, 2023, 2:12 PM

If You Buy Pension Risk Transfers, Don't Buy a Pig in a Poke

Analysis

While pension risk transfer purchases are more popular than ever, fiduciaries need to make sure not to transfer phantom participants who may present real problems later, advises Michael Schloss of The Wagner Law Group.

Bloomberg Law News 2023-08-10T15:39:43224840915-04:00

If You Buy Pension Risk Transfers, Don't Buy a Pig in a Poke

2023-08-10T14:12:19000-04:00

Congress, last year, directed the Department of Labor's Employee Benefits Security Administration (the "Department") to review its position on fiduciary responsibilities connected to pension risk transfers under the SECURE 2.0 Act—Division T of the Consolidated Appropriations Act, 2023—at Section 321. Last month, the Department issued a "Consultation Paper on Interpretive Bulletin 95-1" as part of its discussions with the ERISA Advisory Council (and the public) regarding those responsibilities. According to the Department, last year, pension risk transfer purchases reached an all-time high with nearly $52 billion in transactions, owing to recent market conditions favorably impacting the affordability of de-risking activities in terms of both plan funding and transaction cost, as well as rising interest rates that have made annuity purchase transactions less expensive.

Stakeholders have raised concerns that the insurance industry is pursuing increasingly riskier investment strategies in the aggregate, including increased investing in asset-backed securities such as collateralized loan obligations (including the riskier tranches) and that private credit may overexpose insurers to investment and liquidity risk that could lead to solvency issues for policyholders. It is a volatile situation that a fiduciary may find clashes with obligations around retirement security for plan participants and beneficiaries.

When I was hired by the Department in 1991, the Executive Life Insurance Company's failure drove a substantial amount of my agency's efforts and my work as an enforcement attorney. According to the Department, when Executive Life failed, 44,000 retirees were impacted. As noted in the Department's Consultation Paper, "At a 1993 Congressional hearing, the Department reported that it had opened over 1,000 investigations, conducted 85 onsite investigations, and filed nine lawsuits related to annuities purchases." Much of the Department's and Congressional regulatory activities followed on the heels of EBSA's enforcement efforts and broader concerns following Executive Life's failure. As evidenced by Congress's mandate in SECURE 2.0, those worries are with us today—*deja vu* all over again.

In addition to making sure that annuities purchased with pension funds are fundamentally safe and secure, additional practical considerations for fiduciaries engaging in pension risk transfers arise. These practical considerations focus on making sure a plan ultimately purchases the right annuities for all covered participants, does not buy annuities it does not need and does not overpay for those annuities.

The historical idiom "pig in a poke" describes how a buyer has bought a "poke" (sack) without looking inside and later finds that the seller misrepresented the true nature or value of the purchased item. No less idiomatically, pension risk transfer buyers need to be aware of what they are actually getting, in large part by making sure that plan participants both truly exist and that they actually receive the annuity benefits due them.

In particular, three types of "problem" participants can be relevant to the inquiry, as follows.

Problem Participants

One (or More) Participants Is Missing. There are two types of missing participants. The first are those who are already missing when annuities are purchased. These participants can create unique problems because, in addition to making it harder for fiduciaries to meet their obligation to act *exclusively for the purpose of providing benefits*, their missing status also can impact other obligations in connection with terminating a plan. One of those duties is to see to it that purchased annuities actually are "issued to the individual" as required under the Employee Retirement Income Security Act of 1974 ("ERISA"), at 29 C.F.R. §2510.3-3(d)(2)(ii)(A)(2). Providing benefits and delivering annuity documents is hard to do if you can't find the participant to whom they are supposed to go.

Second are those participants who go missing after the annuities were purchased. It appears as though this issue can be a significant one in practice—for example, as stated in a 2019 consent order, the New York State Department of Financial Services found that Metlife Insurance had lost more than 13,500 pension annuitants over a 17-year period and failed to make an adequate attempt to account for them, and the company had to pay $19.75 million in civil penalties to the State of New York. The Securities and Exchange Commission fined Metlife an additional $10 million in connection with Metlife's failure to keep accurate books and records.

And, although it may seem counterintuitive to those well steeped in ERISA to be concerned about what happens after a plan is terminated, there is arguably a basis for fiduciaries to be concerned about participants who go missing after the plan is shut down. In particular, ERISA §502(a)(9), an essentially untested provision of the statute, provides participants with a right of action against fiduciaries who arguably breached their fiduciary duties in connection with termination activities. Could a court conclude that fiduciaries need to account for the possibility of participants going missing after plan termination? When such participants or beneficiaries are found again, could they use ERISA §502(a)(9) as a springboard against the fiduciaries for failure to fulfill their obligations? Maybe yes, maybe no.

Some early hints to answering this question may come out of a matter currently pending in the Second Circuit Court of Appeals. On July 31, 2023, in a highly unusual move, the Department of Justice filed an action asking the Court to issue a Writ of Mandamus directing the U.S. District Court for the Southern District of New York to rule on the Department's two-year-old subpoena enforcement action against Metlife. In opposing the Department's subpoena, Metlife argues that the Department's "jurisdiction over the payment of plan benefits terminates" upon the issuance of a group annuity contract (see page 57 of the addendum to DOJ's writ filing) and, therefore, the Department lacks jurisdiction to issue the subpoena. In its writ filing, Justice notes the Department's position that its investigation falls squarely within its broad investigative authority under ERISA §504 and that, because §502(a)(9) provides the Secretary with the ability to bring legal actions "to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity" (see page 4 of the writ filing) the Department's subpoena falls well within its jurisdiction. Any ruling on these actions may shed important light on litigations risks surrounding pension risk transfers.

Ghosts. It may well be axiomatic at this point to say that no plan's records are perfect. As the Supreme Court said in *Conkright v. Frommert* : "People make mistakes. Even administrators of ERISA plans." The administrator at issue in that 2010 decision, in calculating the benefits of participants who left for a time and were later rehired, used a "phantom account" method to calculate hypothetical growth for the plan (had the rehirees never left) and thus their adjusted benefits, and to avoid paying them the same benefits twice. Consolidations, mergers and changes in recordkeepers or record systems are among the many things that can lead to errant records. Many plans have active-participant listings for deceased individuals, non-existent spouses, duplicate records for the same individual and records for individuals who simply do not exist and maybe never did, etc. In a perfect world, no plan would buy annuities for these ghosts. But in the real world, annuities are bought for these ghosts all the time.

Zombies. And what about participants and beneficiaries who do exist but are not listed in plan records? These can include, for example, individuals whose records were simply lost over the years, individuals whose accounts were "conditionally forfeited" and then mistakenly deleted and spouses or other beneficiaries who are known to the human resources office, but never made their way into the plan's records. All of these people may come back growling for their pensions years later. And given that pensions are inalienable and non-forfeitable, it is unclear whether any existing statute of limitations would prevent them from mounting a successful lawsuit.

Independent Review Is in Order

Besides proper accounting for participants and beneficiaries, there are other practical issues for fiduciaries to consider—such as the fact that most plan termination audits are performed by insurance companies selling the annuities (and setting the price). Fiduciaries should carefully review in detail any audit performed by the issuer and not pay for annuities that the plan does not need. This review should include, for example, making sure the plan does not buy annuities for deceased participants or non-existent beneficiaries. Relatedly, the plan should make sure to buy the right *type* of annuity. For example, it shouldn't pay for a joint and survivor annuity for a person who has no designated beneficiary.

An independent review can go a long way in protecting a plan from overpaying for annuities it does not need and help foreclose potential legal issues that could arise. The reviewer can, among other things, (i) scrub plan records to find missing participants, get rid of ghosts and identify zombies, (ii) review actuarial or other assumptions an annuity issuer uses to price annuities; (iii) audit any "true-up" process and ensure the plan obtains all of the rebates/refunds to which it is entitled; and (iv) suggest limitations on an insurer's ability to resell purchased annuities to another provider (a resale which could both negate the efforts by the fiduciary to obtain a safe annuity and allow the issuer to receive additional profits at the participants' and plan's expense).

Practical process-related considerations such as those discussed above can play a significant role in a fiduciary's proper discharge of their duties. The Department and the courts often focus on what has come to be known as a fiduciary's "procedural prudence" under ERISA. It is not always just about the ultimate decision; it is often about how the fiduciary got there.

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.

Author Information

Michael Schloss, Of Counsel with The Wagner Law Group, specializes in employee benefits issues, is a highly sought speaker on a wide range of topics relating to Title I of ERISA and DOL activities, and has received multiple awards for his service at the DOL.

We'd love to hear your smart, original take: Write for us.

© 2023 Bloomberg Industry Group, Inc.   All Rights Reserved