

Putting Annuities Back Into Qualified Plans

*Society of Actuaries Symposium
“Managing Retirement Assets”*

Pamela Perun

pamela@planetnow.com

April 1, 2004

Why don't people buy annuities?

- One plausible reason:
 - Most people prepare for retirement through qualified plans.
 - Few qualified plans offer annuities, unless required by law.

Why don't qualified plans offer annuities?

- ERISA lawyers and other benefits professionals advise employers to avoid annuities if they can.
- **Why?**
 - The law doesn't require it – in most defined contribution plans.
 - Annuities add an administrative burden. Annuities from a defined benefit plan may be paid from the plan. Annuities for a defined contribution plan must be bought.
 - But the real reason is ...

FIDUCIARY LIABILITY

- **Buying an annuity for a plan participant is a fiduciary decision.**
- **The DOL says a plan must purchase “the safest available annuity.”**

To satisfy the DOL

- The plan must:
 - Perform an “objective, thorough analytical search” for the annuity.
 - Evaluate the provider’s credit-worthiness and ability to pay claims.
 - Review the financials of the provider.
 - Analyze whether the provider and the annuity product are covered by state guarantees, and the extent of those guarantees, in terms of amounts (e.g., percentage limits on guarantees) and individuals covered (e.g., residents or non-residents of a state). ERISA Reg. § 2509.95.

But when things go wrong, the employer pays.

- In the early 1990s, the failures of several large insurance companies tested the private pension system.
- In the end, catastrophe was averted largely because employers stepped in.
- To avoid fiduciary liability, they paid the plan and the DOL.

What employers learned about annuities.

- **Satisfying the DOL standard for buying annuities is difficult, expensive and time-consuming.**
 - Rating systems are not a fail-safe.
 - There is no certainty.
 - Exposure to fiduciary liability is open-ended.
- **State guarantee funds are not an adequate solution.**
 - Protection is uneven. From state to state, the rules and the coverage changes.
 - It's expensive to pay lawyers to figure out the system.
 - Plan participants can be treated very differently, depending on their state of residence and the size of their annuity.

How to put annuities back into qualified plans?

- **Require all plans to offer annuities.**
 - Unlikely to happen.
 - The law is moving in the opposite direction.
 - Proposed regulations will allow employers who offer annuities now to ditch them.
- **Reduce the fiduciary liability of employers.**
 - Unlikely to happen.
 - This would require a BIG change in ERISA.
 - Providers of other financial products would demand equal treatment.
- **But a more practical solution has recently been proposed.**

A federal regulatory system for life insurers

- The ACLI has proposed an optional federal charter program for life insurers modeled on the current national banking system.
- The National Insurer and the National Insurer Solvency Act would:
 - Create an Office of National Insurers in the Treasury Department.
 - Enable insurers to opt-in to federal regulation.
 - Establish one regulator and one set of regulations for federally-chartered insurers.
 - Promote financial stability through more stringent accounting principles and investment standards.
 - Maintain strong risk-based capital requirements and valuation standards.

The benefits for qualified plans

- **Benefits of a federal system.**
 - The law would promote uniform, consistent laws and protections nationwide.
 - Standard products would be available nationwide.
 - Uniform sales, marketing and licensing practices would apply.
- **A federal system could go a long way towards easing the fiduciary burden of employers.**
 - Federal standardization and regulation would minimize the fiduciary burden of annuity purchases.
 - A federal system would reduce employers' fiduciary exposure.

One caveat

- The ACLI proposal includes standards and procedures for insolvent insurers.
- The ACLI proposal does NOT create a federal guaranty association.
 - It requires chartered insurers to participate in “qualified” state guaranty associations.
 - It sets qualification standards for the states.
- **Is this enough?**
 - An open question.
 - Large employers, operating in many states, may still find this unsatisfactory.

In conclusion

- In order to make people more receptive to annuities, they must be a standard feature of qualified plans.
- In order to put annuities back into qualified plans, the fiduciary liability and administrative hassle of purchasing annuities must be minimized.
- The ACLI proposal is very promising but could use some special provisions for qualified plans.