Pension Risk Transfers

NOLHGA℠

Disclaimer: This paper is for informational purposes only and should not be relied upon for financial or legal advice or used to endorse or induce the sale of any insurance product.

Executive Summary

A pension risk transfer (PRT) is a transaction in which a company with a defined benefit pension plan (i.e., a retirement plan that generally offers a specified monthly benefit in retirement) seeks to settle some (or all) of its future financial obligations to pay retirement benefits. The company often (but not always) does this by purchasing a group annuity from an insurance company to pay the pension benefits it owes to current and former employees. When a defined benefit pension obligation is transferred to a group annuity, the safeguards and consumer protections for affected individuals shift from the federal pension regulatory system to the state insurance regulatory system. This change in regulatory oversight has been the subject of much debate, as the two systems employ different methods of protection.

The purpose of this white paper is to provide basic information on PRTs and the financial protections that exist for individuals who receive their "pension payments" through a group annuity contract with an insurance company.[1] In addition to providing general information on what PRTs are and how they are regulated, this paper discusses (1) the legal and regulatory protections in place to ensure the financial soundness of insurers and prevent companies from getting into financial trouble, and (2) how the insurance company's obligations would be paid in the unlikely event those protections ultimately don't prevent an insurer from failing. The PRT transactions that are the focus of this paper are those in which the pension plan sponsor (i.e., the company responsible for paying the retirement benefits) transfers an obligation to pay future retirement benefits to an insurance company by purchasing a single-premium group annuity contract (i.e., pays a lump sum to an insurance company up front in exchange for the insurance company taking responsibility for the pension payments)—often referred to as a "buyout."

The main points of this paper can generally be summarized as follows:

- Hundreds of PRT buyouts happen each year. Every transaction is unique and will have specific terms that are individually negotiated pursuant to applicable law.
- PRT transactions are regulated by both state and federal laws. The U.S. Department of Labor has a responsibility to regulate private pension plans under the Employee Retirement Income Security Act of 1974 (ERISA), and this extends to the selection of an insurer in a PRT transaction. Department of Labor guidance

1 This paper is not intended to draw value judgements or conclusions between federal and state regulation or the Pension Benefit Guaranty Corporation (PBGC) and state guaranty associations. Since consumers rely on a pension plan or an insurance company to make ongoing payments, both systems have established financial standards and regulatory bodies to protect the solvency of the pension plan or the insurer. The pension system is primarily regulated at the federal level by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA places the ultimate funding responsibility on a pension plan's sponsoring employer, but ERISA does not give pension regulators direct control over the financial condition of the sponsoring employer. ERISA employs a variety of mechanisms to encourage sound funding of pension plans. However, the federal system differs from state insurance regulation, in which insurance regulators have direct supervision over insurance companies and continually monitor them for financial soundness (also known as solvency). Because the two regulatory systems employ different methods of protections that have different features and oversight authorities, it is difficult to compare the two protection regimes on an "apples-to-apples" basis. A chart outlining some of the differing provisions of each system is included as an Appendix to this paper.

on PRT transactions considers a number of factors, including the financial soundness of the insurance company and the availability of guaranty association protection.
- After a PRT buyout transaction occurs, the state insurance regulatory system provides consumer protections to PRT annuitants in two important ways: first, by protecting against the failure of insurers; and second, by providing protection to PRT annuitants in the rare circumstances when an insurer fails. Of note, no insurer with PRT annuity obligations has failed since the 1990s.
- Every state, along with the District of Columbia and Puerto Rico, has a nonprofit insurance guaranty association (GA) to protect its residents if an insurance company fails. These associations "step into the shoes" of a failed insurer to continue paying claims pursuant to state law. If a life insurance company with PRT annuities were to fail, the state GAs would provide protection to the PRT annuitants up to certain limits under state law. These annuitants can also recover amounts owed to them beyond the GA limits directly from the estate of a failed insurer.
- Although no direct comparison of the federal and state systems of regulation is made in this paper, other reviews have shown that the pension system and the insurance system both provide strong protections.

Overview of Buyout Pension Risk Transfers

Pension buy-outs with single-premium group annuities are the most common way to settle pension plan liabilities in the United States and are the focus of this white paper.[2] Under the annuity contract, the insurer assumes the future financial responsibility for payment of retirement benefits in exchange for an upfront premium payment from the plan sponsor.

PRT has been a common strategy for companies seeking to manage their pension risk liabilities for decades, though the market has grown in recent years. According to LIMRA, there are 21 insurance companies that offer group annuity contracts to corporate pension plans through PRT buyouts.[3] In 2022, there were 562 buyout transactions impacting 628,144 pension plan participants. In 2023, there were 763 buyout transactions impacting 587,372 pension plan participants. In the first half of 2024 there were 327 buyout transactions impacting 291,675 pension plan participants.

2 In some cases, PRTs may also include a lump-sum buy-out widow where individual lump sum payments are offered as an option to plan participants in lieu of future retirement income. Purchasing longevity reinsurance or in-plan annuitization are also risk transfer strategies employed by pension plans, though these options are not common in the U.S.

3 In 2023, the 21 insurance companies that provided group annuity contracts for U.S. corporate pension plans included AIG, American National, Athene, Equitable, Guardian, John Hancock, Legal & General America, Lincoln Financial Group, MassMutual, MetLife, Minnesota Life, Mutual of America, Nationwide, New York Life, Pacific Life, Principal, Prudential, Reliance Standard, Symetra, Transamerica and Voya. See, LIMRA's U.S. Group Annuity Risk Transfer Sales Survey: https://www.limra.com/.

The graphic on the right shows the total market size for single-premium annuity PRT buy-out transactions since 2012, which is when LIMRA started collecting the data according to their website.

Plan sponsors engage in PRT buy-outs for a number of reasons, but in general, PRTs are used to reduce long-term financial uncertainty and risk related to retirees living longer than anticipated (i.e., longevity risk) or investment portfolios not performing as anticipated (i.e., interest rate or investment risk). PRTs accomplish this risk transfer by moving the risk to the insurance company and leveraging the expertise of the insurance industry in its core business of matching assets to liabilities to deliver long-term annuity benefits. PRTs also routinely shift record keeping, servicing, and other administrative functions to the insurer.

Quick Facts on Insurer Investing Practices to Support PRT Annuities

- Life insurance and annuity products, including future payments promised in PRT annuity contracts, are funded from (1) the premium payment the pension plan provides to the insurer to issue the group annuity contract and (2) investment income.
- Premium amounts are calculated considering the anticipated eventual cost of the promised payments, factoring in: (1) projected investment earnings; (2) operation and administration costs; and (3) the maintenance of appropriate surplus funds to provide a cushion against unanticipated adverse developments.
- To earn appropriate investment income on the premium payment, insurers generally pursue a strategy to match the investment maturity times and amounts to the anticipated payments to consumers (i.e., asset and liability matching).
- Insurers with liabilities expected to extend over decades—such as lifetime income payments under PRT annuities—have a market incentive to invest conservatively. They generally have investment portfolios composed of highly rated long-term bonds, commercial mortgage loans, and other investments with similar characteristics.
- Several rating agencies routinely assess insurance companies for financial strength and provide publicly available information on those assessments.
- Life insurers are required to diversify their investments according to specified rules (e.g., limits on investments in equities) laid out in state laws. Regulators confirm compliance with these rules at least annually.
- In recent years, insurance companies have started investing more in illiquid and complex structured finance instruments and private equity. These investments are subject to the same rules and oversight by insurance regulators described above.

Each PRT transaction is unique and will have specific terms that are individually negotiated between the plan sponsor and the insurance company. However, plan sponsors are required to structure a PRT so that the insurer provides matching plan options and benefit levels, with no reduction in benefits. As such, there are some basic components that are usually included in (or required for) a PRT to be executed. For example, in many PRT transactions, assets transferred to insurers can be held in a separate investment account, which seeks to insulate the funds held from risks related to other operations of an insurance company.[4]

4 As part of a PRT, pension plans can arrange for the creation of a fully funded "separate account." The separate account is owned by the insurer, but by state statute, the insurer cannot use the separate account assets for any purpose other than to pay the liabilities for which the separate account was established. For benefits supported by a separate account, the technique effectively grants a security interest to back the contractually agreed upon benefits held in the account. The insurer remains fully liable for all the annuity benefits it has guaranteed regardless of whether the separate account is sufficiently funded to cover the annuity benefits promised under the contract. If at any point the value of the assets held in the separate account is not at least equal to the insurer's liability for the annuity obligations backed by the separate account, the insurer is required to establish and hold a reserve in its general account for the deficit. This means if the separate account is fully funded to support the related annuity contracts, the insurer's insolvency should not trigger payments by the GAs. If the separate account assets were ever to fall below the applicable annuity benefit liabilities, the annuitants would be protected by GAs, and their claims in excess of separate account assets and GA coverage levels would be a claim against the insurer's general account and would share, to the extent of the separate account shortfall, the same priority claim as other policy-level claimants to the insurer's general account assets.

Federal Regulation of Pension Risk Transfers

The U.S. Department of Labor (DOL) has a responsibility to regulate private pension plans under the Employee Retirement Income Security Act of 1974 (ERISA), and this regulatory authority extends to the selection of an insurance company for a PRT transaction. Under ERISA, plan sponsors are required to structure a PRT so that the insurer provides matching plan options and benefit levels, with no reduction in benefits. Once the transaction is completed, regulatory oversight shifts to the state insurance regulatory system.

In general, to terminate a pension plan in the standard course of business, the sponsoring employer must obtain actuarial certifications and provide special reports to employees and regulators. In implementing a PRT transaction, pension plan fiduciaries must comply with the prudence, loyalty, and other statutory duties that ERISA demands of fiduciaries—by violating those duties, fiduciaries may incur a range of statutory sanctions, including personal liability.

In 1995, in response to some insurance company failures, the DOL issued Interpretive Bulletin (IB) 95-1 to provide guidance on the fiduciary duties required under ERISA in the selection of an annuity provider (the insurance company) in a PRT transaction.[i] IB 95-1 enumerates several factors that plan sponsors (or the company they hire to evaluate insurers) should take into consideration in evaluating an annuity provider's claims-paying ability and creditworthiness. These include:

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 insurer and other indications of its exposure to liability.
5. The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts.
6. The availability of additional protections through state guaranty associations and the extent of their guarantees.

Subsection (d) of IB 95-1 also permits fiduciaries to consider "the ability to administer the payment of benefits."

Most recently, the SECURE 2.0 Act of 2022 directed the DOL to determine whether amendments to IB 95-1 are warranted. The DOL issued a report in June 2024 stating that the principles-based approach used in IB 95-1 continues to be applicable today; the report did not suggest any immediate changes to IB 95-1. However, the DOL noted that, "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."[ii] While the report did not set a timeline for further study, the report found that further study is likely warranted as it relates to issues such as insurers' ownership structures; exposure to risky assets and non-traditional liabilities; and use of affiliated and offshore reinsurance.

State Regulatory System for Insurer Solvency Protection

Protecting individuals—including those who have their pension payments annuitized through a PRT transaction—from the risk that an insurer may default on its financial obligations (i.e., become insolvent) is the key tenet underpinning the state insurance regulatory system. This protection is delivered through a comprehensive and interconnected set of laws and regulations that has served insurance consumers well for decades and can be expected to do so under any reasonably foreseeable circumstances in the future.

Historical experience demonstrates that state regulatory mechanisms have been quite effective in safeguarding insurer solvency. Since the inception of most state guaranty associations in the 1980s, the frequency of multi-state insurer insolvencies has been quite low—only about

The Role of the NAIC

The National Association of Insurance Commissioners (NAIC) is a national organization of the insurance regulators of all U.S. states and territories. The NAIC provides expertise, data, accreditation, and analysis for states to effectively regulate the industry and protect consumers. It is a key part of the state insurance regulatory system. Working together through the NAIC, state insurance regulators have an array of financial and other supervisory processes that constrain insurer risk taking, as well as a robust process for administering the receivership of the few insurers that do occasionally fail.

45 annuity writers have been the subject of liquidation proceedings over this period. Moreover, most of these companies have been relatively small writers of business, and except for a failure in the 1990s, none have included PRT annuities.

Solvency Regulation

All states have laws aimed at making sure insurance companies remain solvent. These laws require insurers to comply with conservative accounting practices and reserving methodologies, as well as robust capital standards. Every state also has a law that sets parameters over how an insurer can invest the funds it holds. State laws further regulate transactions between insurers and their affiliates and subsidiaries, as well as certain third-party transactions and reinsurance transactions. Over the years, state regulators, through the NAIC, have adopted various tools and practices for detecting insurer financial problems to permit early intervention and remediation of those problems before they result in losses to policyholders, as further outlined below.[iii]

Capital & Reserving Requirements

In general, each life insurer must submit quarterly and annual financial statements to its domestic insurance regulator (the insurance department in the state where the company is based); these statements are available to regulators in every state in which the insurer is licensed. Regulators review those financial statements using a variety of tools and metrics to make sure the insurer is complying with financial requirements and to identify potential financial and solvency issues.

One of the primary tools used by regulators is risk-based capital (RBC). RBC is a calculation, usually expressed as a percentage, that measures the amount of total adjusted capital a company holds against the minimum acceptable level of capital necessary for an insurer to support its business. For instance, if Company X has a 200% RBC ratio, that means it holds twice the required RBC level—which could trigger action by insurance regulators (see below).

Put differently, RBC measures the minimum acceptable level of capital necessary for a specific insurer to support its business in view of its size and risk profile. The higher the risk of an insurer's obligations, the higher the amount of capital the insurer must maintain. The purpose of RBC is to identify weakly capitalized companies. Calculating and monitoring a company's RBC gives regulators an early warning sign if a company is in trouble.

Under the RBC system, regulators have legal authority to take preventive and corrective measures when a company's RBC hits certain levels. If the ratio is at or above 200%, no regulatory intervention is required, but a regulator can act if the ratio is between 200% and 300% and has been trending downward. Below 200%, interventions range from requiring the company to submit an action plan to remedy the situation to a regulatory takeover of the management of the company. If the ratio is below 70%, a regulator is obligated to take over management of the company.[iv] By providing a floor to trigger regulatory intervention, RBC plays a vital role in solvency regulation.

Above and beyond RBC measurements, two other recent enhancements to the NAIC's Insurance Holding Company System Regulatory Model Act help regulators assess capital adequacy and liquidity.[5] At the group level, for insurers that are part of a group of companies, capital is assessed through what is called the Group Capital Calculation (GCC).[v] The GCC is intended to provide information to regulators to help assess risks, such as potential risks to policyholders emanating from outside any insurance companies in the group. Insurers that meet a certain threshold must also undergo liquidity stress testing on an annual basis.

In addition to capital requirements, insurance companies must hold appropriate levels of assets to meet their expected obligations (i.e., reserves). Since 2017, the minimum reserve requirements for an insurer have generally been determined through what is called Principles-Based Reserving (PBR).[vi] Prior to PBR, static formulas and assumptions were used to determine reserve amounts. However, this rules-based approach sometimes left an insurer with excessive reserves for certain insurance products and inadequate reserves for others. Under PBR, insurers are required to hold the higher of (a) reserves using prescribed factors or (b) reserves that consider a wide range of future economic conditions using insurer experience factors, such as mortality, policyholder behavior, and expenses.

Corporate Governance, Enterprise Risk Management & Group Supervision

Regulators have several tools at their disposal to ensure that appropriate corporate governance and enterprise risk management (ERM) are practiced by the insurers they oversee. Every state has corporate governance laws and regulations that insurers must follow, and on an ongoing basis, regulators can review an insurer's corporate governance and ERM practices during regular on-site financial examinations.

A key tool in the ERM regulatory umbrella is called the Own Risk Solvency Assessment (ORSA).[vii] ORSA has two primary goals: (1) to foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes, and reports on its material and relevant risk identified by the insurer, using techniques that are appropriate to support risk and capital decisions; and (2) to provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view of the regulator.

ORSA requires insurers to analyze all reasonably foreseeable and relevant material risks (underwriting, credit, market, operational, liquidity risks, etc.) that could have an impact on an insurer's ability to meet its policyholder obligations. Through ORSA, insurers are required to articulate judgments about risk management and the adequacy of their capital position with the goal of encouraging management to anticipate potential capital needs and take proactive steps to reduce solvency risks.

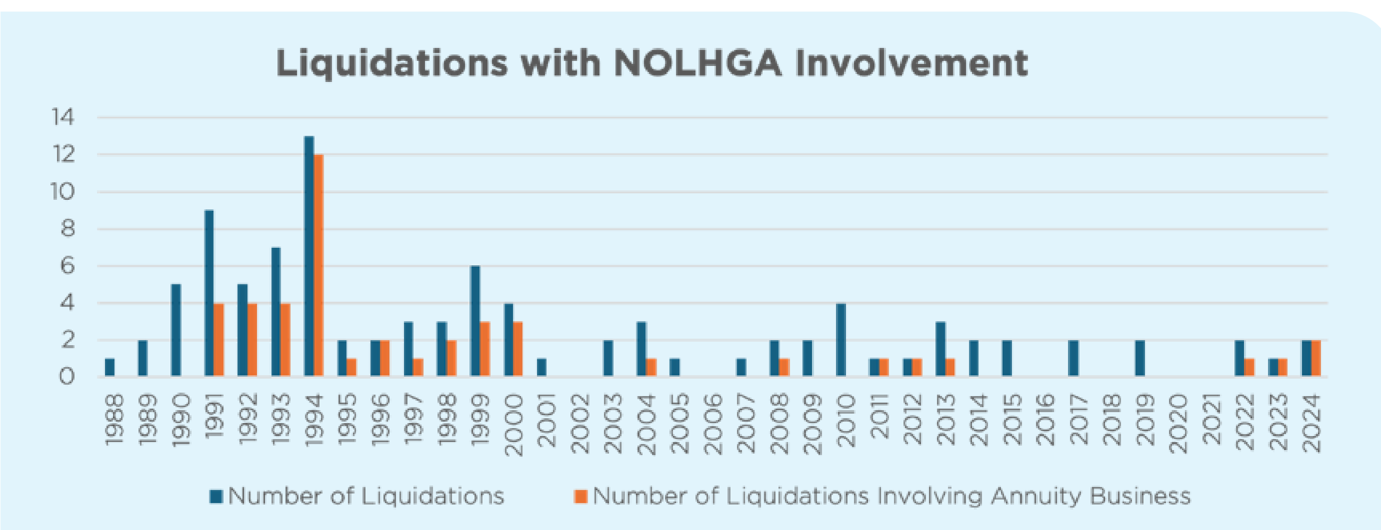
5 Liquidity is a measure of how quickly and easily an insurer's assets can be converted to cash.

All large and medium-sized U.S. insurers and insurance groups are required to annually perform an ORSA and file a report with regulators. For large internationally active insurance companies, there is enhanced supervision above and beyond ORSA, including a requirement that a subset of regulators (U.S. and non-U.S. jurisdictions) form a crisis management group/supervisory college and meet regularly to discuss the company in question. And, as noted, insurers that meet certain thresholds must also undergo annual liquidity stress testing and the GCC process.

Finally, the NAIC has several working groups and task forces where regulators collaborate and discuss potential solvency issues, such as the Financial Analysis (E) Working Group—a regulator-only group that provides the means for candid discussion, early coordination, and intervention for nationally significant troubled insurers. The NAIC also has several other working groups that take public stakeholder feedback to help address concerns and make improvements to the regulatory system, such as the Financial Stability (E) Task Force, Macroprudential (E) Working Group, and Group Solvency Issues (E) Working Group, among others.

Receivership & Liquidation

The principal objective of the insurance regulatory system is to protect the financial integrity of insurers so that their promises to consumers will be fulfilled, and these efforts have been largely successful over the past 40 years. The chart below shows all life and health insurance failures that NOLHGA has been involved in since 1988, which includes any insolvency that impacts more than three states. It also shows all failures that included annuity business—of the annuity failures noted, only Executive Life Insurance Company and its subsidiary, Executive Life Insurance Company of New York, included PRT business. Considering that over 2,000 insurers are licensed to sell annuities and/or life or health insurance in the U.S., this demonstrates that failures are relatively infrequent.



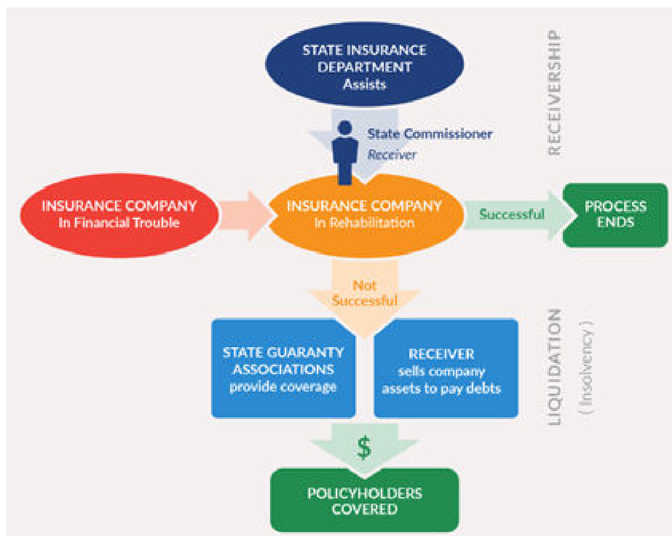
If a potential financial issue is uncovered by state insurance regulators, the state in which the insurer is domiciled has broad statutory authority to intervene. This intervention generally requires that a corrective plan be developed and implemented to remove the cause of the financial concern. If corrective actions cannot remediate the problems, the domestic regulator has the authority to seek a court-supervised receivership in which the regulator serves, under state law, as court-appointed receiver for the financially impaired insurance company.

In that capacity, the regulator assumes full control of the insolvent insurer and retains any necessary independent experts to evaluate the insurer's condition (this process is usually known as rehabilitation). The receiver determines whether the insurer's financial issues can be addressed in a way that will permit the insurer to return to business and private management, or whether the problems require that the insurer be liquidated.

If the insurer cannot be rehabilitated, the receiver petitions a state court for an order of liquidation (similar to Chapter 7 bankruptcy). When an insurance company is placed in liquidation, guaranty association (GA) coverage is triggered. However, the GA(s) and the regulator/receiver typically begin to coordinate efforts well before the liquidation order is entered—sometimes before any receivership proceeding is commenced. The principal responsibility of the receiver as liquidator is to organize and distribute the assets of the failed insurer to those with claims against the estate, as outlined by state law. The impacted GA(s) works with the insolvent insurer's receiver to develop a comprehensive plan to provide continuing coverage to the company's policyholders, including affected PRT annuitants. This is often accomplished by transferring the insolvent insurer's business to a financially healthy insurer.

The Role of NOLHGA

The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) works with its member GAs and the insolvent company's receiver to ensure that policyholders receive coverage for their policies as quickly as possible. The GAs formed NOLHGA in 1983 to coordinate their activities in complex insolvencies and protect policyholders as efficiently as possible.



State Guaranty Association Coverage

In the rare cases when an insurance company fails financially, once an order of liquidation is placed by the relevant court, GA coverage kicks in. Every state, along with the District of Columbia and Puerto Rico, has a nonprofit GA to protect its residents, and every licensed insurance company that writes life, annuity, or health business in the state must become a member of that state's GA. These associations "step into the shoes" of the failed insurer to continue paying claims pursuant to state law.

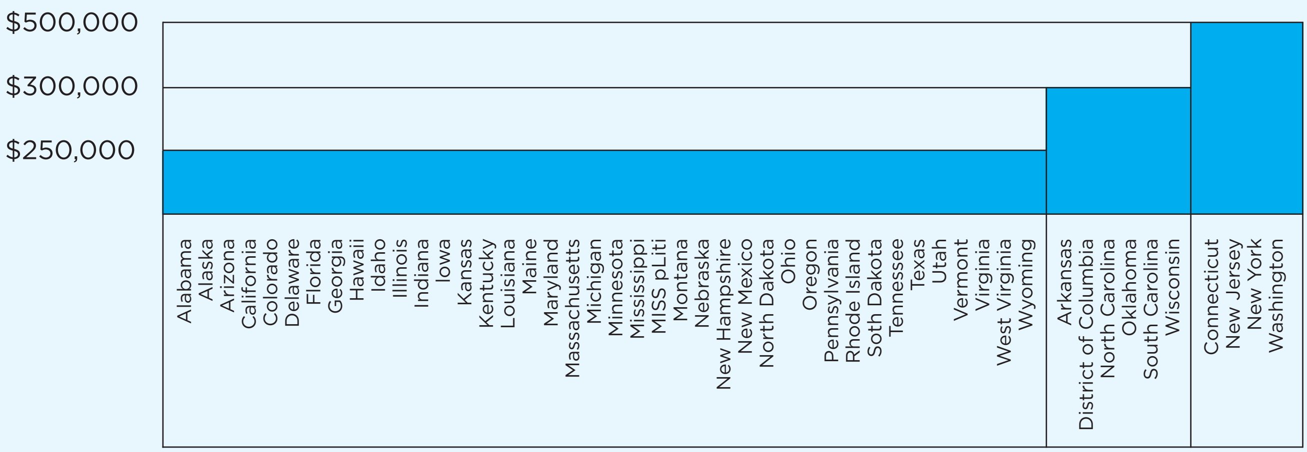
For PRT annuities, all state GAs cover up to $250,000 in the present value of annuity benefits for each covered life, consistent with the NAIC Life & Health Insurance Guaranty Association Model Act (GA Model Act). Some state GAs provide additional coverage, as the chart below shows:[viii]

In a liquidation, each impacted GA funds their guaranteed benefits to policyholders from two primary sources:

1. **Insurer Assets:** The GA has a legal claim against the insolvent insurer's assets to the extent it has provided coverage to the policyholders. Even in a failed insurance company, there can be substantial remaining assets.

2. **Assessments on Member Insurance Companies:** If additional funds are needed to pay policyholders' claims, GAs assess the solvent insurers in their states that write the same lines of business as the failed insurer. These assessments are based on each insurance company's market share in that state, and there are limits on how much each company can be assessed in a particular year.

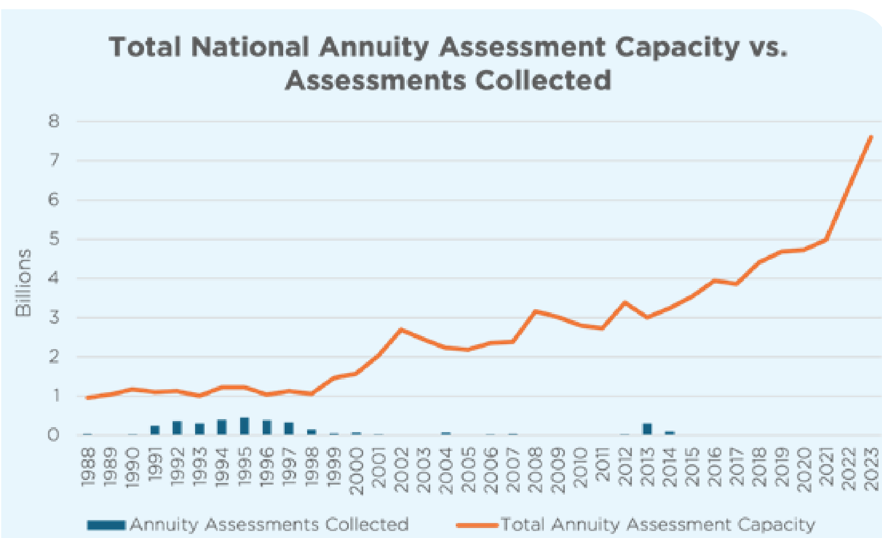
Annuity Coverage By State*



* The above protection applies to individual annuity contract or group annuity certificates, subject to applicable state limits and exclusions. California covers 80% of the annuity contract value with a $250,000 benefit limit. In Florida and Georgia, the $250,000 benefit limit applies if the annuity is deferred. If the annuity is in payout status a $300,000 limit applies. In Minnesota, the benefit is $410,000 for annuities that have been annuitized for not less than lifetime or for a period certain not less than 10 years. In New Jersey, the $500,000 benefit limit applies if the annuity is in payout status. If the annuity is deferred, a $250,000 limit applies.

The GA Model Act lays out the specific parameters of the assessment process that states generally follow.[ix] Notably, the GA system follows a post-liquidation assessment structure. The post-assessment process has historically worked well, especially for long-duration liabilities such as PRT annuities, because payments may extend for years or even decades.

In most states, annual assessments are capped at 2% of net premium.[x] As such, assessments could occur over multiple years, if necessary, to fund the GAs' coverage obligations. However, even in the 1990s, a period that saw the most life insurance companies liquidated since the inception of the guaranty system, the assessments levied did not approach the projected maximum annual assessment capacity of the guaranty system.[xi] The chart below shows the approximate maximum annual capacity of the life and health guaranty system for annuity products relative to the assessment amounts that have been needed for insolvency funding since this data has been available.



Under the state GA system, individuals—including those who have their pension payments annuitized through a PRT transaction—are entitled to the maximum benefit allowable under their state GA's law. If individuals have policy benefits above the state GA's limit, they are allowed their proportional share of the insurer's remaining assets in most states. In other words, GA coverage provides a minimum protected benefit—in effect a "floor"—but does not limit the ability of a PRT annuitant to recover additional benefits above that floor, based on a claim against the insolvent insurer's remaining assets.

Generally, policy-level claims (including those of the GAs for the protections they provide) have absolute priority over all other claims on the insolvent insurer's general estate assets, except for claims for administration expenses.[6] The high priority afforded policy-level claims, together with the assets insolvent insurers typically hold

6 In 2014 the Pennsylvania Supreme Court ruled in the insolvency of a warranty company that there were no policyholder claims against the insolvent insurer for any future policy benefits under unique Pennsylvania statutory provisions and case law. This precedent was extended by the Pennsylvania courts in 2022 to long-term care insurance. This unique legal approach under Pennsylvania law has not been extended to annuity contracts issued by an insolvent Pennsylvania insurance company. While there are strong legal and public policy arguments to oppose such an extension, uncovered annuity benefits owed by an insolvent Pennsylvania insurance company could receive no protection if the Pennsylvania courts did extend this legal principle to annuities. However, of the 21 insurance companies that provided group annuity contracts to corporate pension plans through PRTs in 2023, none appear to be domestic companies in the state of Pennsylvania.

at the time they are placed in liquidation (as a result of the conservative life insurance business model and strict financial regulation), has normally resulted in those claims ultimately receiving significant coverage from estate assets.

Importantly, GA coverage does not automatically reduce coverage for annuity benefits purchased shortly before insolvency, which occurs with some coverage provided by the Pension Benefit Guaranty Corporation (PBGC). Nor are the holders of uncovered benefits subject to different priority rights to the insurer's remaining assets. All annuity benefits have the same priority claim to the insurer's assets, without regard to the annuitant's age or retirement status; however, the older the annuitant, the lower the mortality adjustment would be to the present value of any benefit stream ("present value" is discussed below) and, therefore, the higher the monthly benefits that would be protected by the GA.

How GA Coverage Works: "Present Value" Explained

All state GAs cover up to at least $250,000 in present value of annuity benefits (this includes PRT annuities) for each covered life—this is the amount set out in the NAIC GA Model Act. As of year-end 2024, 10 state GAs provide up to $300,000 in annuity benefits, and 4 GAs provide up to $500,000 (see the chart on p. 11).[xii]

GA coverage is based on the "present value" of future annuity benefits for each covered life. "Present value" is the current value of a future stream of payments, considering theoretical future investment returns and mortality for life-contingent contracts. Consequently, the GA present value coverage limit as applied to a PRT annuity —whether $250,000 or more—is not an absolute limit on the amount of annuity payments that can be covered over time. Rather, as described in the next few paragraphs, the payments covered by the GA over time can exceed the dollar value of the stated present value limit.

The present value of future annuity payments under a PRT annuity is generally determined using appropriate mortality tables (i.e., actuarial calculations of life expectancy) and discount rates (i.e., interest rates). If the present value of annuity benefits under a PRT annuity does not exceed the GA's present value benefit limit for annuities, the GA will pay all future annuity benefits promised by the failed life insurer, even if the aggregate amount of all payments ultimately exceeds the GA limit.

If the present value of an annuitant's benefits under a PRT annuity exceeds the GA's coverage limit, the GA will pay a percentage of the annuity benefits, equal to the ratio of the GA coverage level to the total annuity benefit, and the GA will continue those payments for the annuitant's lifetime, even if the aggregate amount of all payments eventually exceeds the dollar amount of the GA limit (e.g., 250,000 in the GA Model Act). As noted above, an annuitant will also have a claim against the insurer's estate for any benefits above the GA limit.

For example, if an individual has a PRT annuity with a present value of $300,000, and they live in a state with a $250,000 GA coverage limit, here's how much coverage they would receive if the failed insurer has enough remaining assets to cover 80% of its policyholder liabilities.

Regardless of the amount of assets in the insurer's estate, the annuitant would receive the total GA coverage of $250,000:

Annuity Value	**$300,000**
GA Coverage Limit	**$250,000**
Benefits Over GA Limit	**$50,000**

This $50,000 becomes a priority claim against the estate of the failed insurer, which has enough assets to cover 80% of its policyholder liabilities (this is known as the "liquidation ratio"). So in this case:

Benefits Over GA Limit (80% Liquidation Ratio)	**$50,000**
Benefits from Estate Assets	**$40,000 (80% of $50,000)**
Total Coverage	
GA Coverage	**$250,000**
Benefits from Estate Assets	**$40,000**
Total Benefit	**$290,000**

In this case, the individual would receive $290,000 (97%) of the $300,000 in annuity benefits. As explained above, the GA benefits would continue as long as the contract is in force, so the total benefits received by the individual could exceed the original $300,000 value, depending on how long they live.

Put another way, in this example an annuitant receiving $3,000 a month from a PRT life annuity with an insurance company that went insolvent would be entitled to receive $2,900 ($2,500 from the GA and $400 from the insurer's estate) a month for life following the insolvency. Usually, NOLHGA and its member GAs would work with the receiver to transfer the annuity to a financially sound insurer. In that scenario, the individual would receive their monthly $2,900 annuity payment for life from that new insurer and they would have a single point of contact for receiving and servicing their monthly payments.

Finally, if an annuitant had a PRT annuity that provided for a survivorship right for their spouse (i.e., continued payments for a spouse if the annuitant dies before the spouse), those payments are also eligible for GA coverage.

Conclusion

In summary, PRT buyout transactions allow pension plan sponsors to settle the plan's financial obligations by transferring those obligations to an insurer through the purchase of a group annuity contract. The insurer then issues certificates under the contract to the pension plan participants, who thereby become their annuitants. The certificates provide for a permanent commitment by the insurer to pay the covered benefits. The annuitant benefits are safeguarded through an extensive state regulatory regime. Insurance regulators have an outstanding record of monitoring and ensuring insurer solvency—no insurer with PRT obligations has failed since the early 1990s—and state GAs play a crucial role as the "safety net" in the rare occasions when insurers do fail. If an insurance company that issued PRT annuities were to fail and be placed in liquidation, the GAs would ensure that annuitants are still safeguarded by continuing coverage and annuity payments (up to the limits under state law).

Appendix A: Executive Life Insurance Summary

The only insurance company failure that included PRT obligations, Executive Life Insurance Company (ELIC) and its subsidiary, Executive Life of New York (ELNY), occurred in the 1990s. ELIC and ELNY were both placed in rehabilitation in April 1991 when the junk bond market collapsed. ELIC was liquidated shortly thereafter, while ELNY was liquidated several years later. Notably, the failure of ELIC and ELNY dates back to an era before states imposed many of the solvency and risk management safeguards outlined in this paper and before the DOL issued IB 95-1, which means that a repeat of an ELIC and ELNY scenario is extremely unlikely.

Regarding ELIC specifically, GA coverage of the qualified retirement annuity contracts that were made available via PRT transactions began in the 1990s.[7] A 2008 study by the California State Auditor found that across all policyholders, 86% of their expected benefits, measured as the estimated amount their ELIC polices would have been worth if ELIC had not become insolvent, were recovered."[xii] These recoveries are attributable to coverage from state GAs and distributions by the ELIC estate.

Further, some of the PRT transactions themselves were subject to prolonged litigation, which resulted in various additional recoveries from court settlements. In 1993, most ELIC policies, including qualified retirement annuity contracts covered by the GAs, were assumed and continued by Aurora National Life Assurance Company. Aurora's business has been owned by Reinsurance Group of America (RGA) since 2014, and RGA continues to administer this business and provide payments to annuitants.

Despite an unusually lengthy rehabilitation period, attempts to repair ELNY were unsuccessful, and the company was liquidated in 2013. Upon liquidation, substantially all ELNY's remaining assets were transferred to the Guaranty Association Benefits Company (GABC), a newly created not-for-profit captive insurance company owned by the impacted GAs. Since then, GABC has been managing assets and making payments to annuity contract owners, payees, and beneficiaries. While most ELNY annuitants owned structured settlements annuities, the company did have 4,718 PRT annuitant certificates on its books. All the PRT annuity certificates were assumed by GABC, and all but eight were fully covered by their state GAs. As of year-end 2023, 3,264 PRT annuitant certificates are still active (i.e., in payout mode or not yet in payment).[xiv]

7 ELIC also sold a small number of guaranteed investment contracts (GICs) to pension plans. GICs are a type of investment product sold by insurance companies that operate like bank certificates of deposit in that you deposit money for a specific period and earn your investment plus interest when that period concludes.

Appendix B: The PBGC and State Guaranty Association Summary Chart

	Federal Pension System	Annuity (Insurance) System
Legal Framework	The PBGC is a government corporation established by the Employee Retirement Income Security Act of 1974 (ERISA). Several additional federal laws regulate single-employer pension plans (e.g., the Pension Plan Amendments Act of 1986, the Retirement Protection Act of 1994, and the Pension Protection Act of 2006). In addition, the Department of Labor and the Internal Revenue Service regulate single-employer pension plans.	Every state has adopted a version of the NAIC Life and Health Insurance Guaranty Association Model Act. Each GA also works closely with their state's insurance department. Additionally, there are several NAIC model laws that every state has enacted in some form that govern the solvency of the insurance companies operating in the state. (e.g., the Insurance Company System Model Regulatory Act, the NAIC Risk-Based Capital for Insurers Model Act, and the NAIC Risk Management and Own Risk and Solvency Assessment Model Act).
Funding Source	Insurance premiums charged to active pension plans on an annual basis at levels set by Congress, investment income, the assets of insolvent plans the PBGC has taken over, and some additional recoveries against plan sponsors. PBGC receives no direct funding from general tax revenues, and its obligations are not backed by the full faith and credit of the United States government.[xv]	Each GA receives funding from assessments against licensed insurers, the recovered assets of failed insurance companies, and some other sources (e.g., premium receipts on covered policies, reinsurance recoveries, investment income, lines of credit). Assessments against licensed insurers occur after a failure and can take place over multiple years if needed. The GAs are not directly funded by taxpayers and are not backed by any state's full faith and credit.[xvi]
Company Assessments/ Premium Collection (2023)	In 2023, single-employer program premium cash receipts collected from pension plans were $4.595 billion.[xvii]	There are currently no insolvencies with PRT annuity obligations ongoing, so no PRT annuity assessments were issued in 2023. However, for 2023, if an assessment had been needed to fund a PRT annuity liability, approximately $7.6 billion would have been available.[xviii]
Level of Coverage Provided	The PBGC maximum guarantee is determined using a formula in federal law tied to the Social Security index. The formula provides lower amounts for younger ages because younger people are expected to receive more monthly pension checks over their lifetime. Conversely, amounts are higher for older ages. In addition, amounts are lower for retirees who choose an annuity with survivor benefits. PBGC may not fully guarantee your benefits if a plan was created or amended to increase benefits within five years before its termination date.[xix]	For PRT annuities, all state GAs provide coverage for at least $250,000 in "present value" for each covered life (see p. 13 for a more in-depth explanation of how coverage works).
Claims on Estates	The benefit guarantee limit is a cap on what the PBGC guarantees, not on what it pays. In some cases, such as when the PBGC recovers sufficient plan assets to pay more than just the maximum guaranteed benefit, the PBGC pays benefits above the benefit guarantee limit.	All benefits have the same priority claim to the insurer's assets, without regard to the annuitant's age or retirement status. Any claims an annuitant has above the applicable state GA limits can be recovered directly by priority claim on the insurer's estate and will not impact GA coverage availability.
Payments Made to Policyholders (2023)	In FY 2023, the PBGC made benefit payments of over $6 billion to 917,185 individuals.[xx]	In 2023, approximately 2,300 PRT annuitants from the 2013 liquidation of ELNY were receiving benefits from the state GA system.
2023 Failure Information	In FY 2023, PBGC trusteed 26 single-employer plans, which provide pension entitlements to approximately 4,500 current and future retirees.	In FY 2023, one insurance company with approximately 60 annuity obligations failed, but none of those annuity obligations were PRT annuities.
Historical Failure Information	Since the inception of the PBGC in the 1970s, over 5,000 underfunded single-employer pension plans in the United States have been terminated, becoming subject to PBGC coverage. The PBGC has paid benefits to millions of individuals since it was established in 1974.	Since the inception of most state GAs in the 1980s, only the ELIC/ELNY failure included any PRT annuity obligations. Since 1983, NOLHGA has assisted its member GAs in nearly 100 liquidations (45 of which involved annuities) to provide coverage benefits for millions of policyholders and annuitants.
Covered Participants	The Single-Employer Program protects about 20.6 million workers and retirees in about 23,500 pension plans.	This data was not collected by LIMRA until 2020, but between 2020 and the second quarter of 2024, 102,057 workers were included in a PRT buy-out transaction.

Appendix C: Glossary of Terms

Annuity: A form of insurance entitling the owner to an agreed upon sum of money payable at regular intervals for some term, usually the life of the owner (and often a contingent annuitant). There are several types of annuities.

Defined Benefit Pension Plan: An employer-sponsored retirement plan in which employee benefits are computed using a formula that considers several factors, such as length of employment and salary history. The plan generally offers a specified monthly benefit in retirement.

Guaranty Association: State life and health insurance guaranty associations protect policyholders (the owners of life, health, and annuity policies) and beneficiaries of policies issued by life or health insurance companies that have gone out of business (also known as being placed in Liquidation—see below). If a company goes out of business, affected guaranty associations continue coverage and pay claims under the company's covered policies in accordance with state laws. All 50 states, the District of Columbia, and Puerto Rico have a life and health insurance guaranty association.

Liquidation: When an insurer's financial difficulties cannot be resolved, the state's chief insurance regulator petitions the court to find the company insolvent and order it to be liquidated (similar to a Chapter 7 bankruptcy). The goal of liquidation is to ensure an orderly and complete accounting and distribution of the company's liabilities. Liquidation also triggers the affected guaranty associations to provide continuing coverage and benefits to covered policyholders.

Pension Risk Transfer (PRT) Buy-Out Transaction: A transaction in which a company with a defined benefit pension plan seeks to settle some (or all) of the plan's future financial obligations to pay retirement benefits by pre-paying those costs. The company (also called the plan sponsor) pays a single premium to an insurance company in exchange for the insurer's permanent commitment to pay all or some portion of the plan's future pension payment obligations.

Present Value: The current value of a future sum of money or stream of cash flows. Present value is determined by discounting the future value by an appropriate interest rate. For life-contingent annuities, this calculation also considers life expectancy.

Receivership: When an insurer encounters financial problems, the insurance department in its home state can step in to oversee the company in a process known as receivership. Receivership actions include three different types of judicial proceedings—conservation (in some states), rehabilitation, and liquidation. The state's chief insurance regulator petitions the court for the appropriate form of receivership. Each state requires that the chief insurance regulator of the insurer's home state be appointed receiver of the insurer to administer the receivership under court supervision.

Rehabilitation: The chief insurance regulator may petition a state court for an order of rehabilitation as a mechanism to remedy an insurer's financial problems (similar to Chapter 11 bankruptcy). If rehabilitation is successful, the company exits the Receivership (see above) and returns to independent operations. If it is unsuccessful, the receiver petitions the court for an order of liquidation (see above).

Separate Account: A pool of assets in an insurance company's portfolio that is dedicated solely to a pension risk transfer (PRT) transaction. These accounts are "walled off" from the company's general account, insulating them from other risks that may be present related to the insurance company's other products. These accounts also have plans of operations that can be customized for an individual PRT transaction.

End Notes:

i 29 CFR § 2509.95-1, Interpretive bulletin relating to the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit pension plan (60 FR 12329, Mar. 6, 1995, as amended at 72 FR 52006, Sept. 12, 2007; 73 FR 58447, Oct. 7, 2008). Available at: https://www.govinfo.gov/app/details/CFR-2023-title29-vol9/CFR-2023-title29-vol9-sec2509-95-1

ii Department of Labor Report to Congress on Employee Benefits Security Administration's Interpretive Bulletin 95-1 (June 2024). Available at: https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/laws/secure-2.0/report-to-congress-on-interpretive-bulletin-95-1.pdf

iii National Association of Insurance Commissioners (NAIC), Solvency Modernization Initiative ROADMAP (Aug. 31, 2021). Available at: https://content.naic.org/sites/default/files/inline-files/committees_ex_isftf_smi_roadmap_120831.pdf

iv NAIC Risk Based Capital (RBC) For Insurers Model Act (2012). Available at: https://content.naic.org/sites/default/files/inline-files/MDL-312.pdf

v NAIC Insurance Company System Model Regulation with Reporting Forms and Instructions (2020). Available at: https://content.naic.org/sites/default/files/inline-files/MDL-450_0.pdf

vi NAIC Standard Non-Forfeiture Law for Life Insurance Model Law (2014). Available at: https://content.naic.org/sites/default/files/model-law-808.pdf; NAIC Standard Valuation Model Law (2010).

vii NAIC Risk Management and Own Risk and Solvency Assessment Model Act (2012). Available at: https://content.naic.org/sites/default/files/model-law-505.pdf

viii Information on specific limits in any state can be obtained from that state's guaranty association. An overview of the state-by-state limits is available at: https://www.nolhga.com/resource/code/file.cfm?ID=ba7e7388-a3ea-4283-bdee-b1a9b73b69fd

ix NAIC Life and Health Insurance Guaranty Association Model Act (2018). Available at: https://content.naic.org/sites/default/files/inline-files/MDL-520.pdf

x NAIC Life and Health Insurance Guaranty Association Model Act, Section 9(E)(1)(a).

xi Peter G. Gallanis, Policyholder Protection in the Wake of the Financial Crisis, *Modernizing Insurance Regulation* (2014).

xii Information on specific limits in any state can be obtained from that state's guaranty association. An overview of the state-by-state limits is available at: https://www.nolhga.com/resource/code/file.cfm?ID=ba7e7388-a3ea-4283-bdee-b1a9b73b69fd

xiii California State Auditor, "Department of Insurance: Former Executive Life Insurance Company Policyholders Have Incurred Significant Economic Losses, and Distributions of Funds Have Been Inconsistently Monitored and Reported," Report 2005-115.2 (January 2008) at page 2. Available at: https://information.auditor.ca.gov/pdfs/reports/2005-115.2.pdf

xiv Information was obtained by contacting GABC. For further information about GABC, please visit the GABC website at www.gabenefitsco.com.

xv The Pension Benefit Guaranty Corporation was created "within the Department of Labor as a body corporate" and given "the powers conferred on a nonprofit corporation" under District of Columbia law. ERISA §1302, 29 U.S.C. §4002. The United States "is not liable for any obligation or liability of the [PBGC]." ERISA §1302(g)(2), 29 U.S.C. §4002(g)(2).

xvi NAIC Life and Health Insurance Guaranty Association Model Act (2018).

xvii PBGC 2023 Annual Report at page 8. Available at: https://www.pbgc.gov/sites/default/files/documents/pbgc-annual-report-2023.pdf

xviii This datapoint combines assessable premium data collected annually by the NAIC and NOLHGA from life, annuity and health insurance companies. In general, assessable premium is a company's written premium adjusted to correspond with each state guaranty association's covered and uncovered products and limitations.

xvix PBGC Maximum monthly guarantee tables. Available at: https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee

xx PBGC 2023 Annual Report at page 29.