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The Effects of the Insurance Industry Insolvency on Pensioners' Incomes: A Plan for Federal Insurance

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I. INTRODUCTION

The Employee Retirement Security Act (ERISA) \(^1\) seeks to ensure that participants in pension plans can rely on the "timely and uninterrupted payment of pension benefits."\(^2\) However, the trend of insolvency within the insurance industry\(^3\) combined with the Pension

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Benefit Guaranty Corporation's (PBGC's) position that it does not insure participants' benefits once insurance products are purchased to satisfy a plan's obligation, challenge ERISA's ability to achieve its goal.

The states are charged with regulation of the insurance industry by the McCarran-Ferguson Act. Therefore, given the PBGC's refusal to protect annuitants, retirees must rely on varying state insolvency laws, which provide for payment through state guaranty funds. The state protection of pensioners varies; if a company must be liquidated, coverage depends on where annuitants live, where the company is headquartered, and whether the company is licensed to do business in its state of residence. Additionally, policy holders may have to wait for payment from state guaranty funds because the guaranty associations assess other insurers in the state to create the fund after the decision has been made to liquidate the insolvent insurer. Many of these state laws cover a smaller portion of

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(statement of Senator Richard Byron).

Measured in terms of the total assets of failed life and health companies only as a percentage of total industry assets, the failure rate through June 1991 was 15 times greater than it was in 1989 and 220 times greater than in 1981. Hearing on Insurance Solvency: Hearings Before the Subcomm. on Commerce, Consumer Protection, and Competitiveness of the House Comm. on Energy & Commerce, 102nd Cong., 1st Sess. 1 (1991) [hereinafter Hearing on Insurance Solvency] (testimony of Martin Weiss, President, Weiss Research, Inc.). See infra Section III.

4 See letter of Carol Rowe, General Counsel for PBGC, to Donald Snyder, Assistant Director of Pension Equality Issues, Human Resources Division, United States General Accounting Office. Pension Annuity Protection, Pt. I, supra note 2, at 163. See infra Section IV A. (There is support in the law for both the position that the guaranty extends to insurance products and that it does not.).


6 Pension Annuity Protection, Pt. I, supra note 2, at 61 (testimony of Joseph Delfico, Dir., Income Security Issues, Human Resources Div.). See infra Section II D.

7 Id. at 65.

8 Hearing on Life Insurance Guarantee Funds: Before the Subcomm. on Commerce, Consumer Protection, and Competitiveness of the House Comm. on Energy and Commerce. 102nd Cong., 1st Sess. 15 (1991) [hereinafter Hearing on Life Insurance Guarantee Funds] (statement of Marcia Horton for the American Council of Life Insurers). A guaranty association's assessment of insurers in the state is subject to an annual limit ranging from between 1% - 4% of the premiums for the type of policy being covered. Id. at 11. Thus, guaranty association assessments can be made over several years. Id. at 15. In 1991, the guaranty associations' national aggregate annual assessment capacity was $784 million for annuity contracts. See infra Section II D 2.
benefits than was promised by PBGC. Moreover, if the state regulator decides to rehabilitate an insurance company, instead of liquidate it, pensioners who rely on products of the seized company for their monthly income may receive only a percentage of that fixed income while the company is in conservatorship. Such occurrences are not consistent with ERISA's mission to secure promised retirement benefits for employees.

PBGC's position that its guaranties do not apply to insurance annuities is premised on a strained reading of the law, which has not been tested in court. In fact, its current position is contrary to its interpretation of the legislation of merely eleven years ago. Given the current state of the insurance industry and the fact that three million workers and retirees rely on insurance-backed annuities to provide their pension payments, the PBGC should insure the benefits of all pensioners who rely on insurance products, participants in pension plans that are terminated, participants who are switched to annuities while the plan is ongoing, and participants in defined contribution plans that invest in insurance annuities and guaranteed investment contracts (GIC's). This goal can be accomplished by

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9 Id. at 63.
10 One month after the seizure of Executive Life, annuitants received 70% of their benefits pursuant to court order. Insurance Company Solvency, supra note 3, at 115 (statement of Senator Richard Bryan).
11 See infra Section II A.
12 Section 4022 of ERISA requires PBGC to ensure payment of pension benefits at the time of termination; however, overseeing the purchase of annuity contracts from an unstable insurer is not ensuring payment. See infra Section IV A.
14 Id., Pt. II, supra note 2, at 68 (testimony of Norman Stein, Prof. of Law, Univ. of Alabama). See infra Section IV.
15 Private Pensions: Millions of Workers Lose Federal Benefit Protection at Retirement. Report to the Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate. Lawrence H. Thompson, Assistant Comptroller General, 4 (1991) [Hereinafter Private Pensions]. "About 7.9 million private pension plan retirees receive annuities. An additional 1.9 million pensioners receive annuities as surviving dependents of a deceased retiree. Annuities are paid either by the plan itself (plan annuities) or by an insurance company (insurance annuities)." Id. at 5. It is estimated that "between 3 and 4 million retirees and their survivors receive benefits payments from insurance companies." Id.
16 See infra Section II B.
17 See infra Section II B.
18 See infra Section II C.
remodeling the PBGC after the Securities Investor Protection Corporation (SIPC), which guarantees the funds and securities holdings of persons with accounts placed with a broker-dealer.19

Part II of this comment will discuss the purpose of ERISA. It will examine the two types of plans qualified under ERISA and will establish the causes of pensioners’ reliance on insurance products, the effects of insurance insolvency on pension plan participants, and the effect of the application of state laws on participants. In order to illustrate the great risk that insurance investments pose to pensioners, part III will address the two major causes of insurance industry insolvency, investment in junk bonds and real estate, and will discuss the inadequacies of industry regulation. Part IV explores the legislative history behind the creation of the PBGC and offers a proposal for remodeling the PBGC after SIPC to make it the insurer of all pension funds with investments in the insurance industry. Part V concludes.

II. PENSION PLANS AND INSURANCE PRODUCTS

A. ERISA

Congress enacted the Employee Retirement Income Security Act20 in 1974 to act in conjunction with Internal Revenue Code21 (IRC) provisions22 to encourage the development of private pension plans23 and to secure promised retirement benefits for employees.24 Legislative history reveals that ERISA was passed in response to the

19 See infra Section IV.
24 The most significant changes that ERISA made to secure promised benefits were: 1) The establishment of minimum vesting standards, 2) The increasing of employer’s minimum annual plan contributions, and 3) Creating the Pension Benefit Guarantee Corp. (PBGC) to insure defined benefits. Stein, supra note 22. at 124.
loss of pension benefits by thousands of plan participants prior to 1974. For example, in 1963, the Studebaker company was shut down and 4,500 workers lost 85% of their promised benefits due to inadequate funding of the company's pension plan. Congress wanted to ensure that, thereafter, participants in pension plans could rely on the "timely and uninterrupted payment of pension benefits." To ensure promised retirement benefits, ERISA established the Pension Benefits Guaranty Corporation (PBGC), a government corporation primarily financed by insurance premiums paid by plan sponsors. Section 4022(a) of ERISA provides that "the corporation shall guarantee, in accordance with this section, the payment of all nonforfeitable benefits . . . under a single-employer plan which terminates at the time when this title applies to it." The two major types of pension plans which are qualified for favorable tax treatment under ERISA and the IRC are the defined benefit plan and the defined contribution plan.

B. Defined Benefit Plans

In a defined benefit plan, the sponsoring employer promises to pay the employee a specified benefit upon retirement. The benefit


26 Id.

27 ERISA, § 4002(a)(2).

28 Title IV of ERISA creates the Pension Benefit Guarantee Corporation as an insurer of certain defined benefit plans. Stein, supra note 22, at 120 n.31. See, ERISA, §§ 4021 - 22B. "The PBGC also has broad regulatory powers to investigate whether plans are solvent, ERISA, § 4003(a); to involuntarily terminate insolvent plans, ERISA, § 4042(a); and to supervise the voluntary termination of covered defined benefit plans, ERISA, § 4041." Id. at 120.

29 Guarantees of Retirement Annuities: Hearing before the Senate Committee on Finance, 102nd Cong., 2d Sess. 20 (1990) [hereinafter Guarantees of Retirement Annuities] (statement of Sen. Lloyd Bentsen). Single-employer defined benefit plans pay a premium of $16 per participant, underfunded plans pay additional premium of up to $34. See infra Section IV A for a detailed analysis of the legislative history of the PBGC.


32 Stein, supra note 22, at 121. Today, 12 million retirees are receiving $220 billion in pension benefits, annually. One half of the American work force is covered by a pension plan and 50% of these are defined benefit plans. Pension Annuity Protection, Pt. I, supra note 2, at 9 (statement of Sherwood Boehlert, U.S. Congressman, N.Y.).
is calculated based on the participant's compensation, service, or a combination of the two.\textsuperscript{33} Once the benefit is determined, the employer makes contributions to a common fund based on annual actuarial determinations such that the contributions will suffice to pay the participant's promised benefits at normal retirement age.\textsuperscript{34} The employer bears the market risk of investments made to meet the obligation.\textsuperscript{35} Defined benefit plans are guaranteed by PBGC; if the plan assets are insufficient to cover its promised benefits, PBGC pays the benefits.\textsuperscript{36} However, under PBGC's current interpretation of ERISA, defined benefit plan participants may be robbed of their federal PBGC protection as a result of annuitization of ongoing plans and as a result of plan reversions.\textsuperscript{37}

Defined benefit plan sponsors with ongoing plans often annuitize retirees each year in order to lower administrative costs and avoid PBGC premiums.\textsuperscript{38} Of the three to four million retirees receiving annuities, most were covered by ongoing plans.\textsuperscript{39} Moreover, federal law permits an employer to capture surplus assets in a defined benefit plan by terminating the plan and purchasing annuities from an insurer to meet benefit commitments to participants and beneficiaries.\textsuperscript{40} Excess funds in defined benefit plans result from a number of factors; the large investment yield which pension trusts received in recent years,\textsuperscript{41} higher long term interest rates which served to


\textsuperscript{34} \textit{Id.} at 1116.


\textsuperscript{36} \textit{Id.} at 776. \textit{See infra Section IV A.}

\textsuperscript{37} \textit{See generally,} Stein, \textit{supra} note 22. \textit{See infra Section IV A.}

\textsuperscript{38} \textit{Certain Issues Related to the Conservatorship, supra} note 3, at 82 n.1 (testimony of Joseph Delfico, Director Income Security Issues, Human Resources Division).

\textsuperscript{39} \textit{Id.} at 82.

\textsuperscript{40} ERISA, § 4044(d)(1). Reversions are allowed on the assumption that excess funds were created through "erroneous actuarial computations." 26 C.F.R. § 1.401.2(b) (1987). Since defined benefit plans promise a specific benefit at retirement, it is logical that overfunding be returned to the employer at the time of plan termination. Arguably, Congress did not envision plan terminations for the purpose of obtaining excess funds. Congress is currently trying to curb abuses of the law through the enactment of various bills. \textit{See generally,} Abbott, \textit{supra} note 33, at Section III A.

\textsuperscript{41} Abbott, \textit{supra} note 33, at 1118.
lower the cost of annuity contracts, the use of projected salary amounts in determining funding, the use of conservative long term investment assumptions by plan actuaries, and recent legislative cutbacks on maximum benefit limitations.

During the 1980's, these excess funds in company pension plans appealed to corporate raiders. These raiders took over companies with surplus benefits through leveraged buyouts intending to revert the overfunded plan and use the excess funds to pay back the interest on the buyout. Existing plan sponsors may also view the surplus assets as a cheap source of capital, which can be used to revive economically strapped enterprises or to expand healthy ones.

Three conditions must be met for a plan to be reverted. ERISA and IRC require that the plan be permanent, it must be established for the exclusive benefit of the employees and their beneficiaries, and the plan instrument must expressly provide for a reversion. However, ERISA and IRC permit reversions where all liabilities have been satisfied, notwithstanding the fact that the

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42 Id.
43 Some funding methods lead to greater contributions than other methods. For example, using the level funding method, an employer estimates what an employee will be earning when he reaches retirement age and contributes to the fund based on the projected salary. This alleviates increased contributions toward the end of the worker's career. McGeoch, supra note 35, at 779.
44 Abbott, supra note 33, at 1118.
45 Id.
47 See generally, Pension Annuity Protection, supra note 2. Examples of this occurring where annuities were purchased from Executive Life include Revlon (bought out by Ronald Perelman in Nov. 1985. In Dec. 1985 Perelman initiated the reversion capturing $40 million in excess) and Pacific Lumber (taken over by Charles Hurwitz and the Maxxam Group in 1985. In 1986, the plan was reverted and Hurwitz captured $55 million in excess funds). See Pension Annuity Protection, Pt. I, supra note 2, at 20 (statement of E. Schefer, Retiree from Revlon Co.); Id. at 28 (statement of J. Lewis, Attorney for Annuitants of Pacific Lumber Co.).
48 Stein, supra note 22, at 127.
51 Abbott, supra note 33, at 1119.
52 Id.
53 Id. at 1120.
ERISA plan is established for the exclusive benefit of the employees. Moreover, if an original plan instrument does not provide for reversion, it may be amended to provide for them. Thus, an employer can legally terminate a pension plan, cause the plan to satisfy its liabilities by purchasing annuity contracts for plan participants and their beneficiaries, and then recover the remaining assets.

There are several techniques by which an employer may receive a reversion. The first of these is a standard plan termination: The employer terminates the defined benefit plan and offers the plan participants annuities designed to provide each employee with the benefit he has accrued to date. Once the annuities are purchased, the employer may take the remaining assets as a reversion. Often the least expensive annuities are purchased to increase the amount of the reversion. ERISA requires only that the annuities be purchased from an insurer licensed in the state; there are no further restrictions on choosing an insurer. However, the choice of an insurer is an investment decision subject to the fiduciary duties of ERISA.

The second method by which an employer can receive a reversion is the spinoff termination. Using this technique, a single plan is divided into two plans, one comprised of retired employees, one

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54 Id. at 1119.
55 Id. at 1120.
56 Stein, supra note 22, at 118.
57 Abbott, supra note 33, at 1122.
58 Id.
59 Id.
60 Pension Annuity Protection, Pt. I, supra note 2, at 34 (testimony of Jeffrey Lewis, Esq.).
61 Certain Issues Related to the Conservatorship, supra note 3, at 63 (testimony of James Lockhart, Exec. Dir. PBGC).
63 Id. at 37 (testimony of Jeffrey Lewis, Attorney for Annuitants of Pacific Lumber Co.). The Department of Labor (DOL) has the power to investigate a plan sponsor's choice of an annuity provider; however, DOL has not responded quickly to complaints. For example, investigations into the selection of Executive Life as an annuity provider which were opened in 1987 were still ongoing in 1991. Id. at 49.
comprised of current employees. The excess assets are placed in the retired employees' plan, which is then terminated so that the funds revert to the employer. The third technique of reverting assets is termination and reestablishment. Here a defined benefit plan is terminated, the employer recaptures the excess funds and then establishes a new defined benefit plan or a defined contribution plan. PBGC currently takes the position that it does not provide coverage for a defined benefit plan once the annuities are purchased to satisfy the plan liabilities. The corporation argues that its guaranties are triggered by the termination of plans with insufficient funds and, since annuitants have received a full distribution of their pension share in the form of insurance annuity contracts, the corporation's guaranties do not cover them if their annuity provider becomes insolvent. The next level of protection for annuitants who are previous members of PBGC-insured defined benefit plans is the state guaranty funds.

C. Defined Contribution Plans

In a defined contribution plan, the employer makes no representations about the level of benefits employees can expect to receive upon retirement. The employer promises to make contributions to a trust, wherein the contributions are allocated among participating

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64 Abbott, supra note 33, at 1125.
65 Id.
66 Id. at 1127.
67 Id.
68 Pension Annuity Protection, Pt. I, supra note 2, at 163 (letter of C. Flowe, General Counsel, PBGC). See infra Section IV A.
69 Certain Issues Related to the Conservatorship, supra note 3, at 13 (testimony of John Garamendi, Insurance Commissioner, State of CA).
70 Private Pensions, supra note 15, at 152 (Lawrence Thompson, Assistant Comptroller General).
71 McGeoch, supra note 35 at 775 (quoting Stein, Raiders of the Corporate Pension Plan: The Reversion of Excess Plan Assets to the Employer, 5 AM. J. TAX POL'Y. 121)

The term "defined contribution plan" is defined as a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts for other participants' account. ERISA, § 3(34), 29 U.S.C. § 1002(34) (1982). See Abbott, supra note 33, at 1116.
employees and then invested for their benefit. The employee expects to receive the amount contributed to the plan (e.g. his deferred payments plus employer contributions) plus earnings upon his retirement or another specified event such as separation from service, layoff, or disability. In a defined contribution plan, the employee, not the employer, bears the investment risk. Increasing numbers of plan sponsors are deciding to terminate defined benefit plans and replace them with defined contribution plans. Additionally, many new plans offer only defined contribution plans.

Although defined contribution plans are not insured by the PBGC, sponsors often invest these plans with insurance companies and the pensioners receive annuities; thus, they are equally affected by insurance company insolvency as participants in defined benefit plans and they ultimately depend on the same patchwork of state laws. Additionally, of 174 large pension plans, 28% of the defined contribution plan assets are held in Guaranteed Investment Contracts (GIC’s) issued by insurance companies. GIC’s are similar to certificates of deposit. They are fixed rate, fixed term debt instruments. This investment enables pensioners to avoid negative account balances because GICs do not fluctuate in market value. Although the rate of return is guaran-

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72 Stein, supra note 22, at 121.
73 Id.
74 Id.
76 Id.
77 Private Pensions, supra note 15, at 148. While the plan termination insurance provisions of ERISA do not affect defined contribution plans, these plans are subject to the fiduciary requirements of ERISA, the reporting and disclosure requirements, and the participation and vesting requirements. The minimum funding requirements of ERISA had “almost no impact on the few defined contribution plans they affected.” Donald Grubbs, Defined Benefit Plans vs. Defined Contribution Plans: A Reassessment, J. PENSION PLAN. & COMPLIANCE 97, 101 (1989).
78 Private Pensions, supra note 15, at 150.

In contrast, in defined benefit plans only 2% of all assets are held in GIC’s.
80 Certain Issues Related to the Conservatorship, supra note 2, at 10 (testimony of John Garamendi, Insurance Commissioner, State of California).
82 Grubbs, supra note 77, at 111.
teed by the issuer, "no specific pool of funds backs a GIC and most are not backed by federal insurance or government guarantees." 83 Instead, the assets of the insurance carrier back the principal contract, so any default of an underlying issue or drop in interest rates is absorbed by the insurance company." 84 For the investor, GIC's are unmarketable and illiquid; penalties are charged if they are cashed in before maturity. 85 As aforesaid, defined contribution plans are not guaranteed by PBGC; the only coverage for GIC holders in the event of an insurance company insolvency are the state guaranty funds.

D. State Insurance Insolvency Laws

1. Liquidation Proceedings

Once pensioners are outside of the PBGC's guaranties, they are simply policy holders of the insolvent insurance company. They must compete with other creditors for distribution of the company's assets. Pursuant to the McCarran-Ferguson Act, 86 the regulation of insurers, including treatment of insolvency, is the responsibility of the state legislature and regulatory agencies of the state where the company is domiciled. 87 The states are aided by uniform laws that allow consistent treatment of claims arising in a number of states against a particular insurer. 88 The majority of the states have adopted a version of one of two uniform laws dealing with insurance insolvency. Thirty-two states have adopted the Uniform Insurers

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83 Dunnan, supra note 81, at 263.
84 Id.
86 15 U.S.C. §§ 1011-1015 (1982). Section 1011 of the Act provides that "the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation and taxation of such business by the several states."
87 Frank Darr, Federal Claims in Insurance Insolvencies, TORT & INS. L. J. 601, 603.
88 Id. at 602. However, many provisions of the proposals have extra-territorial effect and sometimes non-domiciliary courts refuse to recognize their validity. See Davis Howard, Uncle Sam Versus the Ins. Comm'rs: A Multi-level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act, 25 WILLIAMETTE L. REV. 1, 10.
Liquidation Act (UILA). Thirteen states have adopted the Insurers Supervision, Rehabilitation and Liquidation Model Act.

Each of these insurance solvency statutes provides for the standard activities associated with the administration of a bankruptcy. The state's insurance commissioner is appointed as liquidator; in this role, he will marshall assets, identify claims, distribute assets, deposit company records, and close the liquidation. The order of asset distribution is as follows: Administrative expenses are paid first; next come salaries of the company's employees, then policyholders, beneficiaries, third party claimants, and guaranty associations are paid; finally, the general creditors receive any remaining assets. Since an insolvent insurer's liabilities usually exceed assets, and since administrative expenses are substantial, policy holders rarely receive 100 cents on the dollar. For policy holders, this loss is mitigated by the state guaranty associations.

2. The State Guaranty Funds

Forty-seven states have some form of guaranty association in place to guard against annuity holder losses due to the failure of insurance companies. Only sixteen of these states provide some form of coverage for GIC holders. When an insolvency occurs, the guaranty association raises the funds to meet contract obligations by assessing the insurance companies licensed to do business in the state. Each company is assessed based on its pro-rata share of

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90 Id. at 616 note 124. 2 MODEL INSURANCE LAWS, REGULATIONS AND GUIDELINES, 555-1, 555-44-47. (Nat'l Ass'n of Ins. Comm'rs)(1984 & Supp 1987).
91 Id. at 616.
92 Howard, supra note 88, at 9.
93 Darr, supra note 87, at 617.
94 Howard, supra note 88, at 10.
95 Id. at 13.
96 Id. at 14.
98 See infra notes 110-112 and accompanying text.
99 Hearing on Life Insurance Guarantee Funds, supra note 8, at 10 (statement of Marcia Horton for the American Council of Life Insurers).
total premiums in the previous year. Policy holders must wait while the association raises funds to meet the obligations of the insolvent insurer. Although insurance companies pay into the guaranty funds, their assessments are deducted from income for federal income tax purposes and it is ultimately the tax payers who pay for insolvencies.

There are two basic models for the protection offered by states. First, some state laws guarantee benefits for annuitants who hold annuities issued by companies headquartered in that state, regardless of where the annuitants reside. Under the second model, state laws guarantee their own residents against loss if the failed company was licensed to do business in that state at the time it failed. These models, coupled with the three states that do not provide guaranty funds, create a patchwork of coverage for annuitants depending on where they reside and where the issuing insurance company is headquartered.

States also place varying limits on the amount of individual coverage. Twenty-two states limit coverage of individual annuities

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100 *Id.* at 11. Total assessments for any year cannot exceed a fixed percentage of the company's premiums written in the state during the preceding year for the type of policy being covered.
101 *Id.*
102 *Id.*Note 87, at 621. "The solvent insurers then pass these costs to their customers or the public through either premium increases or premium tax deductions." *Id.*
104 *Id.*
105 *Id.*
106 *Id.* The three areas that do not provide guaranty funds are New Jersey, the District of Columbia, and Colorado.
107 Example:
Consider a pensioner in New Jersey, a state which has no guarantee law. If the failed insurance company's headquarters are in New Jersey, or one of the other jurisdictions without a guarantee law, such as D.C., the pensioner would not receive any protection. Similarly, if the insurance company was headquartered in a state such as Texas or Florida, which only guarantee their own residents, there would not be any protection. A New Jersey resident would be protected only if the failed insurance company was headquartered in a state, like Virginia or Pennsylvania, that guarantees all company policies regardless of where the pensioner resides.

*Id.* at 70.
ERISA to $100,000 in present value. Other states limit coverage to $300,000. Moreover, within the patchwork of state laws, there is significant variation among the states in the treatment of Unallocated Funding Obligations (UFO's), which include GIC's. Twenty states have not yet explicitly addressed whether or how such products are covered; two states cover them fully; fourteen states limit coverage; and thirteen states exclude UFO's from coverage. The states that do insure GIC's generally provide a $5 million limit of protection for any one contract holder (regardless of how many employees are under the contract). In March 1990, IDS Financial Services stated that "the insolvency of one or more major insurers conceivably could lead to the collapse of the state guaranty system by exceeding its current administrative and financial capacity to deal with large losses.

This section (II B-D) has discussed why millions of pension plan participants ultimately rely on insurance products for payment of their benefits and how, in the event of an insurance company insolvency, many of them will be deprived of their benefits because of the inconsistencies in state coverages. The next section will illustrate the breadth of the insurance company insolvency issue and demonstrate that, unless the federal government guarantees the pension benefits of American retirees, ERISA will fail in its goal to guarantee the "timely and uninterrupted payment of pension benefits."

108 Id. at 57. This totals about $944 a month.
109 Hearing on Life Insurance Guarantee Funds, supra note 8, at 4 (statement of Marcia Horton for the American Council of Life Insurance). $300,000 is the NAIC Model Act Limit.
110 Id. at 7 (testimony of Eden Sarfaty, President, National Organization of Life and Health Insurance Guaranty Associations). "Unallocated funding obligations (UFOs), are 'group' contracts that are not issued to and owned by an individual, and do not provide guarantees to any individual . . . ." Id.
111 Pension Annuity Protection, Pt. I, supra note 2, at 91 (testimony of Eden Sarfaty, President National Organization of Life and Health Insurance Guarantee Associations).
112 Id. at 92.
113 Hearing on Life Insurance Guarantee Funds, supra note 8, at 1 (statement of Cardiss Collins, Chairwoman). But see Id. at 10 (testimony of Sarfaty). The annual financial capacity of the life-health insurance guaranty system is approximately $3.06 billion. This is based on a total premium base of $165.8 billion. An average of $110,312 was assessed nationally for life, health and annuity lines in the three year period 1987 through 1989. That is less than 4% of total annual assessment capacity. Id.
III. INSURANCE INSOLVENCY

Until the 1980’s, the insurance industry was stable: its long term liabilities, such as death benefits and annuities, allowed it to be a long term, low risk investor. However, the destabilization of interest rates in the 1980’s caused life insurance consumers to become interested in the rate of return rather than in security, and the industry was forced to adapt to consumers’ demands. The industry switched from pure life products to investment products and mixed life/investment products in order to benefit from the high interest rates. This transition increased the industry’s involvement with defined benefit plans and defined contribution plans. The insurance industry’s involvement with defined benefit pension plans grew as the demand for annuity and pension products increased more rapidly than sales of life insurance. Also, the industry’s involvement with defined contribution plans grew as more employers switched to providing defined contribution plans and as purchases of GIC’s became more popular.

GIC’s are an example of the new short term, high interest investment product which changed the nature of the insurance

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114 Hearing on Insurance Solvency, supra note 3, at 2 (testimony of Terrence Lennon, Ass’t. Deputy Superintendent and Chief Examiner N.Y. State Insurance Dep’t.). "The stability and predictability of these long term liabilities afforded the industry a significant partial immunity from normal interest cycles and to some extent from other economic cycles." Id.

115 Id. at 4.

116 Examples of new products are universal life and variable rate annuities. Insurance Company Solvency, supra note 3, at 160 (statement of Martin Weiss, President, Weiss Research, Inc.).

117 Hearing on Insurance Solvency, supra note 3, at 3 (testimony of Terrence Lennon, Ass’t. Deputy Superintendent and Chief Examiner N.Y. State Insurance Dep’t.). The following table illustrates the shift in policy reserves:

<table>
<thead>
<tr>
<th>Year</th>
<th>Life</th>
<th>Annuity/Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>69.4%</td>
<td>26.0%</td>
</tr>
<tr>
<td>1979</td>
<td>53.5%</td>
<td>42.2%</td>
</tr>
<tr>
<td>1989</td>
<td>29.9%</td>
<td>66.6%</td>
</tr>
</tbody>
</table>

Source: ACLI 1990 Fact Book.

industry. A GIC is a "general asset debt obligation of an insurance company." They are typically written with three to five year maturities, and thus reduce the average liability duration of insurers. Seeking to match these high yield liabilities, the industry increased the yield on its asset base with junk bonds and real estate investments.

The quality of the insurance industry's assets currently suffers from the contraction of the junk bond market and poor real estate investments. High-interest/high-risk investments in junk bonds enabled insurance companies to match assets to their new high yield products. However, the decline of the price of junk bonds and their record level of defaults, which began in the late 1980's, impaired the asset base of insurance companies, who own 30% of all junk bonds. Therefore, pension plans that invest in insurance companies' products are ultimately affected by the junk bond defaults. At the end of 1990, the insurance industry had $85 billion invested in junk bonds but only $109 billion in capital, surplus and loan loss reserves. "Thirty-seven companies, accounting for about 16% of the industry's invested assets, have junk bond portfolios in excess of 100% of their surplus (including

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120 Hearing on Insurance Solvency, supra note 3 at 7 (testimony of Terrence Lennon, N.Y. Department of Insurance).
121 Insurance Company Solvency, supra note 3 at 160 (testimony of Martin Weiss, President, Weiss Research Inc.).
123 Insurance Company Solvency, supra note 3 at 160 (testimony of Martin Weiss, President, Weiss Research Inc.).
125 Gary Hector, Junk's Bad Times Are Just Starting. FORTUNE. June 4. 1990. at 81.
126 Id. at 81.
127 Hearing on Insurance Solvency, supra note 3 at 11 (testimony of Martin Weiss, President, Weiss Research Inc.).
MSVR, the mandatory securities valuation reserve). 128 Twelve companies with about 5% of the industry’s assets have junk bond holdings in excess of 200% of surplus (including MSVR). 129

This high concentration of junk bonds was effectively concealed for many years for two reasons; statutory accounting practices 130 and inaccurate bond quality designations previously used by the National Association of Insurance Commissioners (NAIC). 131 Under statutory accounting practices which insurance companies keep for industry regulators, the companies carry junk bonds at or near cost rather than at market value. 132 This practice conceals insurers’ losses until the sale of the securities. 133 Such inaccuracy is compounded by the faulty NAIC quality designations for bonds held by insurance companies. 134 Bonds identified as “speculative investments” (junk bonds) by Moody’s or Standard & Poor’s were classified as “investment grade” by insurance regulators. For example, under NAIC’s old rating method, First Capital Life Insurance Company (CA) appeared to have 20.2% of its invested assets in junk bonds, based on 1989 data. 135 First Capital Life actually held 40.7% of its investments in junk bonds. 136 Similarly, the 1990 data which reflects NAIC’s new, more realistic rating

128 Testing the Mettle, supra note 122, at 94.
129 Id.
130 Junk’s Bad Times Are Just Starting, supra note 125, at 82.
131 Hearing on Insurance Solvency, supra note 3, at 3 (testimony of Martin Weiss, President, Weiss Research Inc.).

The National Association of Insurance Commissioners (NAIC) uses the following incorrect designations for bond quality:

1. NAIC Class 1 bonds = highest quality. However, most of these bonds are rated AA or A by S&P or Moody’s.
2. NAIC Class 2 bonds = high quality. Moody’s and S&P say these are medium grade bonds with “speculative characteristics” (near junk).
3. NAIC Class 3 bonds = medium grade. Actually, these are junk bonds.
132 Junk’s Bad Times Are Just Starting, supra note 125, at 82.
133 Id.
134 Hearing on Insurance Solvency, supra note 3, at 11 (testimony of Martin Weiss, President, Weiss Research Inc.). Until 1989, the companies used the old NAIC definitions and reported that they held $51 billion in junk bonds. The correct total is near $85 billion.
135 Insurance Company Solvency, supra note 3, at 170 (testimony of Martin Weiss, President, Weiss Research, Inc.).
136 Id.
system, reveals that Executive Life (CA) held 67.7% of its assets in junk bonds instead of the 50.7% previously claimed.\textsuperscript{137}

In addition to the public junk bond market, insurance companies also purchase junk bonds directly from below investment grade companies.\textsuperscript{138} Into the 1990's, insurance companies were major investors in private placements. For example, as of January 1991, Prudential had $34 billion in private placements, Cigna had $12 billion and Metropolitan Life had a $14 billion private placement portfolio.\textsuperscript{139} However, NAIC has now imposed stricter guidelines for such private placements which will prohibit companies from investing in below investment grade companies.\textsuperscript{140}

In addition to the public and private placement junk bond investments, many insurance companies have large holdings in investment grade bonds with speculative characteristics.\textsuperscript{141} These are "near junk" bonds which carry triple B ratings.\textsuperscript{142} When near junk bond investments are combined with the junk bond holdings of many insurance companies, the result is a large holding of low quality bonds.\textsuperscript{143}

\textsuperscript{137} Id.
\textsuperscript{139} Id.
\textsuperscript{140} Id. at 57. To illustrate, Continental Cablevision offered a $150 million private issue prior to November 1990, but was forced to withdraw it when NAIC issued the new guidelines for insurance companies.
\textsuperscript{141} \textit{Hearing on Insurance Solvency, supra} note 3, at 5 (testimony of Martin Weiss, President, Weiss Research, Inc.).
\textsuperscript{142} Id. These bonds are rated BAA by Moody's. Moody's assessment of them is as follows:

Bonds which are rated BAA are considered as medium grade obligations, i.e., they are neither highly protected or poorly secured. Interest payments and principal security appear adequate for the present, but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

\textsuperscript{Id.} at 5.

The default rate for these bonds between 1970 and 1990 was 5.7% after 15 years. Additionally 15% of these bonds were downgraded to junk bonds within 5 years of their issue date.

\textsuperscript{Id.} at 6.
\textsuperscript{143} \textit{Insurance Company Solvency, supra} note 3, at 172 (testimony of Martin Weiss, President, Weiss Research, Inc.).
Low grade bond holdings represent only one threat to insurance solvency; another major risk is the industry's investments in real estate and mortgages.\textsuperscript{144} Total mortgage and real estate investments represent over one quarter of the total invested assets of the life and health insurance industry.\textsuperscript{145} During the 1980's, some companies' real estate holdings comprised 45\% or 50\% of their total invested assets.\textsuperscript{146}

Like junk bonds, primary and secondary real estate mortgage obligations are attractive because they are easily match-funded with the new short term insurance products\textsuperscript{147} as well as the more traditional long term obligations. Regarding primary mortgage obligations, one form of loan which became popular in the 1980's to

The following is a sampling of low quality bond holdings of U.S. life insurance companies:

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>JUNK BONDS/ INVESTED ASSETS</th>
<th>BBB BONDS/ INVESTED ASSETS</th>
<th>JUNK+ BONDS/ INVESTED ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lincoln Liberty Life Ins.</td>
<td>71.0</td>
<td>0.7</td>
<td>71.6</td>
</tr>
<tr>
<td>Executive Life of NY</td>
<td>65.5</td>
<td>3.1</td>
<td>68.6</td>
</tr>
<tr>
<td>Executive Life of Ca.</td>
<td>67.7</td>
<td>0.8</td>
<td>68.5</td>
</tr>
<tr>
<td>United Pacific Life</td>
<td>32.9</td>
<td>31.9</td>
<td>64.8</td>
</tr>
<tr>
<td>Colonial Penn. Annuity &amp; Life Ins. Co. 6</td>
<td>16.4</td>
<td>47.3</td>
<td>63.7</td>
</tr>
</tbody>
</table>

\textsuperscript{144} Thomas Borman, \textit{Hitting the Mark on Real Estate Values}, \textit{BEST'S REVIEW}, April 1991, vol. 91, no. 12., at 18.
\textsuperscript{145} Maggie Mahar, \textit{The Great Collapse: Commercial Real Estate is on the Skids Across the Nation}, \textit{BARRON'S}, July 22, 1991, 10, 22. "In 1980 insurers had $100 billion invested in commercial real estate; by 1991, their commitment had grown to over $260 billion. . . ." Life insurers are responsible for over $250 billion of the $260 billion of the industry’s commitment. \textit{Id.}

\textsuperscript{146} Borman, \textit{supra} note 144, at 18. Moreover, an insurer's portfolio may be deceptive as to quantity of real estate holdings. Portfolios may appear diverse with investments in real estate, bonds, stocks, etc.; however, many bonds are mortgage backed. See Mark Ellis, \textit{Managers and Dodging Bullets}, \textit{PENSION WORLD}, Feb. 1990, at 52, 53.

\textsuperscript{147} \textit{Id.} See also Hearing on Insurance Solvency, \textit{supra} note 3, at 16 (testimony of Martin Weiss, President, Weiss Research). There is some correlation between reserves allocated to GICs and the percentage of investments in mortgages. "Bullet mortgages, with predetermined pay-offs at a specified date, can and are matched to many GICs. The need to earn high yields may also have been an incentive to favor mortgages rather than zero-coupons or Treasury notes." \textit{Id.}
match-fund GIC liabilities was the bullet loan.\textsuperscript{148} This form of mortgage has a 5, 7, or 10 year maturity and requires little amortization of principle during the life of the loan. However, a large balloon payment is called for at maturity.\textsuperscript{149} The problem with these short term loans is that many mortgages written in 1986, when interest rates were low, came due in 1991, during a real estate recession,\textsuperscript{150} and they rolled over at higher interest rates.\textsuperscript{151} Instead of new mortgages by new lenders paying the balloon payments, the insurance companies were faced with refinancing these loans in the tougher economic marketplace.\textsuperscript{152}

Moreover, the insurance industry has no rating system to evaluate the quality of its mortgages and real estate investments; therefore, the amount of mortgages that risk default is inestimable.\textsuperscript{153} However, the industry’s statutory filings reveal that in 1990, non-performing mortgages\textsuperscript{154} totaled $11.4 billion.\textsuperscript{155}

Overall, life insurers’ assets invested in primary mortgage obligations decreased from 36\% in 1970, to 27\% in 1980, down to 19 \% in 1989.\textsuperscript{156} However, the insurance industry has increased its investments in secondary mortgage obligations.\textsuperscript{157} The traditional pass through programs, wherein the Government National Mortgage

\textsuperscript{148} \textit{Hearing on Insurance Solvency}, supra note 3, at 6 (testimony of Thomas Borman, Esq., Former Commissioner of the Minnesota Dep’t. of Commerce).
\textsuperscript{149} \textit{Id.}
\textsuperscript{150} \textit{Id.} at 7. The real estate industry is in its worst condition since the 1930’s. Vacancy rates are rising, rents continue to drop.
\textsuperscript{151} \textit{Hearing on Insurance Solvency}, supra note 3, at 2 (statement of Cardiss Collins, Chairwoman, Subcommittee on Commerce, Consumer Protection, and Competitiveness). \textit{See also Id.} at 6 (testimony of Thomas Borman, Esq.) “According to Solomon Bros., some $15 billion in loans will come due this year [1991] and another $20 billion in 1992.” \textit{Id.}
\textsuperscript{152} \textit{Id.} at 6 (testimony of Thomas Borman, Esq.).
\textsuperscript{153} \textit{Id.}, at 9 (testimony of Martin Weiss, President, Weiss Research Inc.). No one knows the amount of mortgages which are 30-60 days overdue, 60-90 days overdue, or which are “secured by real estate appraised below principal amount,” which are “secured by real estate in depressed regions which has not been appraised or marked to estimated market within the past two years or more,” or “where cash flows and debt load of mortgagee make loan repayment uncertain.” \textit{Id.}
\textsuperscript{154} \textit{Id.} Non-performing mortgages include those which are 90 days overdue, or are in the process of foreclosure, or have been foreclosed during the calendar year.
\textsuperscript{155} \textit{Id.}
\textsuperscript{156} \textit{Id.} at 10 (testimony of Terrence Lennon, N.Y. Insurance Dept.).
\textsuperscript{157} \textit{Id.}
Association (Ginnie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac and Fannie Mae) guarantee the timely receipt of payments from pools of mortgages, are unresponsive to the insurance industry’s new short term needs because these programs have final payment dates of up to 30 years. Once insurers sell GIC’s to pension funds, promising to pay a fixed rate over a specific number of years, the insurance company must put that money to work at more than the fixed rate. Mortgage backed bonds thus offer a more attractive vehicle to the insurance industry. First, they offer an intermediate term (5-10 years). Second, since the obligations are overcollateralized by mortgages, they receive ratings as high as the government insured pass-through programs. Although secondary mortgage obligations are highly rated, they carry risks to medium term investors because the underlying mortgages are subject to prepayment. During periods of falling interest rates, a high percentage of the underlying mortgage pool may be prepaid and the investor will have to reinvest this early return at the lower interest rates. A new investment vehicle, the Collateralized Mortgage Obligation (CMO), was created in 1983 to reduce this call risk.

CMO’s allow insurance companies to structure individualized mortgage portfolios and meet both short term GIC obligations and long term death liabilities. The CMO can be divided into four or more tranches with different maturities. Banks and thrifts tend to be interested in the earlier (“fast pay”) tranches, while life insurance companies and pension funds prefer the intermediate

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159 Mahar, supra note 145, at 22.
160 Maller, supra note 158, at 303-305.
161 Edwin Duett, An Economic Analysis of REMIC’s, 18 REAL EST. REV. 66, 67 (Winter, 1989).
164 Id. at 17.
and later ("slow pay") tranches. Prepayment in a CMO is consolidated into the shortest tranche of the multiclass maturity structure. Once the shortest tranche is retired, then subsequent prepayments are funneled into the next tranche, until each is retired. The price yield of each class reflects its exposure to prepayment and the later tranches are protected from prepayment. However, these later tranches, which insurance companies invest in, are risky investments. They are last in line for principal repayments, so as the underlying mortgages are prepaid, the underlying collateral pool shrinks.

Insurers' risks in real estate are compounded by the fact that the companies have shifted from residential to commercial investments. Commercial loans comprised 34% of mortgages in 1969 and 81% in 1989.

Junk bond and real estate investments led to the insurance industry's weak financial condition; however, the risk involved in purchasing insurance products has been further increased by certain accounting practices. These practices distort insurance companies' financial statements and make them appear strong. Two such practices are reinsurance and surplus notes.

"[R]einsurance is a 'contract whereby one insurer [the reinsurer] for a consideration contracts with another [the reinsured or ceding company] to indemnify it [the reinsured or ceding company] against loss or liability by reason of a risk which the latter has assumed under a separate and distinct contract as the insurer of a third person'.” Thus, reinsurance is insurance for insurance companies. However, the reinsurance policy is one of indemnity and not

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166 Mallor, supra note 158, at 307-308.
167 Duett, supra note 161, at 67.
168 Id.
169 Id. 163, at 17.
170 Hearing on Insurance Solvency, supra note 3, at 11 (testimony of Terrence Lennon, N.Y. Insurance Dep’t).
171 Id.
172 Insurance Company Solvency, supra note 3, at 136 (testimony of Salvadore Curiale, Superintendent, N.Y. State Ins. Dep’t).
173 Id. at 118, 120 (testimony of Howard Metzenbaum, U.S. Senator from Ohio).
primary liability. The primary insurer remains liable for payment of its claims and, if the reinsurer is unable to pay, the responsibility falls on the primary insurer.\textsuperscript{175} The financial advantage is that the company which ceded the policies decreases its liabilities by removing the business from its books; however, it has failed to transfer the risk.\textsuperscript{176}

Another way that companies claim a positive net worth is through the use of surplus notes.\textsuperscript{177} A surplus note is a "debt instrument which carries a conditional obligation to repay a specified principal amount."\textsuperscript{178} Pursuant to statutory accounting practices, the surplus note appears under the equity section on the insurer's balance sheet.\textsuperscript{179} The principal and interest owing on the note may only be paid if the insurer's surplus after such payments will equal or exceed a stated amount.\textsuperscript{180} Currently, there is approximately $4.5 billion in surplus notes outstanding in the insurance industry.\textsuperscript{181}

These accounting practices which make the insurance companies appear strong are reflected in the assessments by the major rating firms. A.M. Best and Standard & Poors gave Executive Life, Fidelity Bankers, and First Capital top ratings until a few months before they were seized.\textsuperscript{182} In fact, Best's gave Mutual Benefit an A+ rating until 16 days before it was seized.\textsuperscript{183} Thus, the investment practices of the insurance industry make it likely that the trend of failures will continue. Given pension plans' increased involvement with this industry, as well as the states' patchwork protection for plans so involved, the PBGC's guaranties must be extended to

\textsuperscript{175} Id.
\textsuperscript{176} Insurance Company Solvency, supra note 3, at 136 (testimony of Salvadore Curiale, Superintendent, N.Y. State Ins. Dep't).
\textsuperscript{177} Id. at 118, 120 (testimony of Howard Metzenbaum, U.S. Senator from Ohio).
\textsuperscript{179} Id. at 111.
\textsuperscript{180} Id. at 32.
\textsuperscript{181} Insurance Company Solvency, supra note 3, at 118, 120 (testimony of Howard Metzenbaum, U.S. Senator from Ohio).
\textsuperscript{182} In March 1990, Moody's lowered Executive Life's rating to BA (Questionable), and in April 1991, to B1.
\textsuperscript{183} Jane Quinn, Is Your Insurance Company Really Safe?, NEWSWEEK, July 7, 1991. at 38, 39. The rating company was aware of Mutual Benefit's portfolio of bad real estate loans but chose to retain the solid rating while the company worked on its problems.
insure all pension plan investments in the insurance industry, if ERISA is to realize its goals.

IV. PBGC AS INSURER OF INSURANCE ANNUITIES

A. PBGC is Not Precluded From Insuring Pension Obligations Held by Insurance Companies

ERISA does not explicitly state whether or not the PBGC guaranty extends to commercial annuities distributed to a plan participant in satisfaction of the plan’s obligation for benefits. However, the law and its surrounding history lend stronger support to the position that annuity contracts are covered by the PBGC guaranty than to the position, presently held by the PBGC, that they are not.

The most fundamental support for the proposition that the PBGC remains liable for pension benefits when the obligation is transferred from the plan trust to an insurer is the mission of the PBGC as provided in Section 1302(a) of ERISA:

(1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,

(2) to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this subchapter applies, and

(3) to maintain premiums established by the corporation under section 1306 of this title at the lowest level consistent with carrying out its obligations.184

Thus, considering that Congress’ concern in establishing the PBGC under ERISA was to protect pension plan participants by guarantying certain benefit payments and ensuring their timely payment,185 it is illogical to argue that Congress intended for participants to lose this

184 29 U.S.C. § 1302(a) (emphasis added).
protection merely because the obligation is transferred from the pension trust to an insurance carrier.

Further support for the position that, under current law, the PBGC remains liable after the plan obligation is transferred is found in amendments to ERISA. Originally, Section 4041 of ERISA provided that after filing notice of intent to terminate with PBGC and upon receipt of a notice of sufficiency from PBGC, the plan administrator could proceed to close out the plan.186 However, to provide guidance to plan administrators, PBGC issued regulations in January, 1981 dealing with the determination of plan sufficiency and the termination of sufficient plans.187 The regulations provide that "a participant with a benefit payable as an annuity under a terminating plan receive that benefit in annuity form," unless the participant elects another form of distribution, such as a lump sum distribution.188 PBGC stated that the purpose of this requirement is compliance with their mission "to provide for the timely and uninterrupted payment of pension benefits."189 The corporation stated: "A pension is a retirement annuity. It would be inconsistent with the Act for the PBGC to grant a plan administrator the discretion to deprive a participant entitled to a retirement annuity of that annuity."190

Moreover, when the PBGC published the proposed version of this regulation in the Federal Register, some commentators questioned whether the PBGC would provide benefits in situation where a plan terminated under a notice of sufficiency and the insurance company selected to provide annuity contracts subsequently became unable to meet its obligations.191 In response to these concerns, the preamble to the final regulations stated that the concern was unwarranted because insurance companies were strictly regulated.192 "However, in the unlikely event that an insurance company should fail and its

188 Id.
189 Id.
190 Id.
192 Id.
ERISA obligations cannot be satisfied (e.g. through a reinsurance system) the PBGC would provide the necessary benefits.\textsuperscript{193}

Furthermore, in 1986, Congress passed the Single-Employer Pension Plan Amendments Act (SEPPAA) in order to streamline termination procedures for sufficient plans.\textsuperscript{194} SEPPAA established the "standard termination" procedure.\textsuperscript{195} In a standard termination, the plan administrator may close out the plan, if he provides 60 days advance notice of the intent to terminate to plan participants and other affected parties.\textsuperscript{196} As soon as practicable after the 60-day notice is provided to participants, the plan administrator (a) sends to the PBGC an actuarial certification that the plan has sufficient assets to cover benefits liabilities and certain other information,\textsuperscript{197} and (b) notifies each participant and beneficiary of their share of benefit liabilities;\textsuperscript{198} and the PBGC does not issue a notice of non-compliance with regard to the termination within 60 days.\textsuperscript{199} The plan administrator must then purchase irrevocable commitments from an insurer to provide the benefit liabilities or pay the participant a lump sum.\textsuperscript{200} Within 30 days after the final distribution is completed, the plan administrator must certify to PBGC that all liabilities have been paid.\textsuperscript{201}

When these procedures for standard termination were being considered, questions were raised about whether PBGC would continue to guaranty benefits in a situation where, after plan assets were distributed through the purchase of annuities from an insurer, the insurer became insolvent. Congress added 29 U.S.C. § 1341(b)(4), the section on continuing authority, to address these concerns. The section provides:

Nothing in this section shall be construed to preclude the continued exercise by the corporation, after the termination

\textsuperscript{193} Id.
\textsuperscript{194} Comprehensive Omnibus Budget Reconciliation Act of 1986. Title XI.
\textsuperscript{195} 29 U.S.C. § 1341(b).
\textsuperscript{196} 29 U.S.C. § 1341(b)(1)(A).
\textsuperscript{198} 29 U.S.C. § 1341(b)(2)(B).
\textsuperscript{199} 29 U.S.C. § 1341(b)(2)(C).
\textsuperscript{201} 29 U.S.C. § 1341(b)(3)(B).
date of a plan terminated in a standard termination under this subsection, of its authority under section 1303 with respect to matters relating to the termination. A certification under paragraph (3)(B) shall not affect the corporation's obligations under section 1322 of this title.\(^{202}\)

The legislative history pertaining to this provision reveals that:

Even if the plan administrator has certified to the PBGC that the assets of the plan have been distributed so as to provide when due all benefit entitlements and all other benefits to which assets are allocated under Section 4044, the PBGC is still obligated to guarantee the payment of benefits under Section 4022 if it is subsequently determined that not all guaranteed benefits were in fact distributed under a standard termination, and the contributing sponsors of the plan and the members of their controlled groups do not promptly provide for the payment of such benefits.\(^{203}\)

Furthermore, during consideration of SEPPAA, the PBGC proposed an amendment which would have expressly exempted benefits provided under annuity contracts from the termination insurance program. Section 112(a) of Bill H.R. 2995, introduced on July 15, 1985, would have amended Section 4005(b)(2) of ERISA to provide that "no amount in such fund shall be available to pay benefits in the event of the insolvency of an insurance company with respect to an insurance contract." This section of the bill was rejected by Congress.

Finally, the shift in the nature of insurance companies must be considered. PBGC provides for the purchase of insurance annuities to satisfy plan liabilities because insurance companies have traditionally been stable, long term, low risk investors and, thus, their products were sound investments. However, since the insurance industry is now suffering from a poor investment portfolio, the assumption in the law that insurance annuities are a secure invest-

\(^{202}\) 29 U.S.C § 1341(b)(4).

ment with which to provide pension obligations is unwarranted. Thus, the thrust of the law, protecting the retirement money of the pensioners, dictates that the PBGC must continue to insure pension funds when they are transferred to an insurer.

Clearly, there is strong support within the law and its history for the position that the PBGC remains liable when the pension obligation is transferred from the plan to an insurer. PBGC’s mission to guaranty promised benefits to pensioners has been reaffirmed by the Corporation itself when ERISA was amended in 1981 and 1986 and, in 1985, Congress rejected PBGC’s attempt to extinguish this liability.

Nonetheless, PBGC presently claims that its guaranty does not apply to commercial annuities distributed pursuant to a plan termination because the participant has received his total benefits under the plan. On January 14, 1991, The general counsel for PBGC stated the corporation’s position on its liability for insurance annuities: "[T]he statute does not authorize PBGC to guarantee benefits distributed in the form of irrevocable annuity contracts from insurance companies." PBGC reasons that when a covered plan terminates with insufficient funds to pay its benefit obligations, PBGC becomes trustee of the plan and pays the guaranteed benefits. However, when a plan terminates with sufficient assets, ERISA simply oversees the allocation of plan assets and the distribution of benefits. This position is contrary to that expressed in the corporation’s preamble to final regulations on termination procedures for sufficient plans (e.g., "[i]n the unlikely event that an insurance company should fail and its obligations cannot be satisfied, . . . the PBGC would provide the necessary benefits")

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204 Guarantees of Retirement Annuities, supra note 29, at 24 (statement of Sen. Lloyd Bentsen).

205 Pension Annuity Protection, Pt.I, supra note 2, at 163. (Letter of Carol Flowe, General Counsel, PBGC to D. Snyder, Assistant Director, Pension Equity Issues, Human Resources Division, U.S. Accounting Office.)

206 Id. (referring to ERISA §§ 4022, 4041(c), 4042, 4044, 4061).

207 Id. (referring to ERISA, §§ 4041(b), 4044).

PBGC now argues that since the insurable event is the termination, that where there exist sufficient funds upon termination, PBGC's obligation is met when annuity contracts are distributed to participants. This position relies on a somewhat strained reading of section 4022 of ERISA. Section 4022 provides that PBGC must guarantee "the payment of all nonforfeitable benefits ... under a single-employer plan which terminates at a time when this title applies to it." Norman Stein, formerly an attorney specializing in tax and pension law, currently teaching pension law at University of Alabama School of Law, argues that "there is no reason to believe that Congress intended for the guarantee to expire the moment of plan termination simply because the plan has made nominal provision for the future payment of benefits." "The purchase of an annuity contract from a company without the ability to pay the plan's liabilities is simply not the payment of all plan benefits." PBGC's current position on its liability has not yet been tested in court.

B. Remodeling PBGC After SIPC

Having established that PBGC's mission is to ensure the "timely and uninterrupted payment of pension benefits," that PBGC is not legally precluded from insuring the benefits of previous defined pension plan participants who rely on insurance products, and that the current condition of the insurance industry poses a real threat to all plan participants who rely on insurance products, this article

\textsuperscript{209} Guarantees of Retirement Annuities, supra note 29, at 25 (statement of Sen. Lloyd Bentsen).
\textsuperscript{210} Id. at 68.
\textsuperscript{211} ERISA, § 4022.
\textsuperscript{212} Id., Pt. II, at 70 (testimony of Norman Stein, Esq. Prof. of Law, University of Alabama).
\textsuperscript{213} Id.
\textsuperscript{214} Id., Pt. I, at 77 (testimony of Joseph Delfico, Dir., Income Security Issues, Human Resources Div.).
\textsuperscript{215} PBGC's guaranty should extend to insurance products purchased not only from ongoing defined benefit plans, defined benefit plans that terminate, and those which are reverted, but also from defined contribution plans. Defined contribution plans have gained popularity since the law was written and the retirement income of pensioners participating in these plans is also at risk from insolvent insurance companies. See supra Section II C.
ERISA

now focuses on remodeling PBGC after SIPC in order to protect American retirees in this time of insurance company vulnerability.

The Securities Investor Protection Corp. (SIPC) was created when Congress passed the Securities Investor Protection Act in 1970.216 All persons registered as brokers or dealers under the Securities Exchange Act of 1934 or who are members of a national securities exchange generally belong to SIPC.217 The corporation protects customer funds and securities such as notes, stocks, bonds, debentures, and certificates of deposit from dealer failure.218 SIPC consults with and cooperates with the SEC and the self regulatory organizations (SRO's) within the industry; each dealer belongs to one of these organizations.219 The self regulating organizations notify SIPC upon discovering that a member broker-dealer is in, or is approaching, financial difficulty. SIPC then reviews the facts with the examining SRO.220 The corporation determines whether the member has failed, or is in danger of failing, to meet its obligations to customers.221 If the broker-dealer is unable to make the necessary corrections, SIPC will intervene to protect the customers.222 The customer accounts may be transferred to another SIPC broker-dealer, or, if transfer is not possible, a SIPC appointed trustee will take over the member assets and fulfill the SIPC protection to customers.223 The maximum protection provided is $500,000 of customer assets.224 SIPC is financed by assessing members three-sixteenths of one percent per year of business.225 Additionally, the law provides that SIPC could borrow up to $1 billion dollars from the U.S. Treasury if its funds prove to be insufficient.226

Using SIPC as a model, the two major problems with extending PBGC coverage can be overcome. PBGC is concerned with

217 Id.
218 Id. at 79.
219 Id.
220 Id.
221 Id.
222 Id.
223 Id.
224 Id.
225 Id. at 80.
226 Id.
providing guaranties to an industry that it does not regulate and with adequately funding such extended coverage. First, in order to avoid the "moral hazard" that could arise from the PBGC insuring an industry that it does not regulate, insurers interested in selling insurance products to pension plans should be required to register with the PBGC in order to qualify for pension product insurance. To encourage pension plans to deal with these federally registered insurance companies, favorable tax treatment under ERISA and the IRC would be available only to plans that purchased products from registered companies. In order to allow for uniform regulation of the registered insurance companies and for uniform federal insolvency proceedings, the McCarran-Ferguson Act would have to be modified to permit federal regulation in addition to the state regulation. Then, the PBGC could work in conjunction with NAIC to monitor and regulate the insurance companies much like SIPC works with the SROs. Working together with NAIC, the PBGC can readily discover when an insurer is approaching financial difficulty.

The second concern of the PBGC in extending pension plan guaranties is adequately funding the extended coverage. First, this concern may be abated by early intervention. Since the PBGC and the NAIC will be closely monitoring the insurance companies that provide pension products, PBGC will be able to intervene at the first signs of financial distress and place the pension plan assets with other registered insurers. This would parallel SIPC's power to transfer customer accounts to another broker-dealer. Since the insurers currently pay policy obligations when an insurer in the state is seized by contributing a pro rata portion to the state guaranty funds, this will not be an additional burden on the companies. Secondly, instead of obtaining funding from the pension plans, PBGC could assess the insurance companies based on a percentage of the pension products they sell each year in order to provide for its larger liability. Such a premium structure would not burden plan sponsors

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227 Certain Issues Relating to the Conservatorship, supra note 3, at 65 (testimony of James Lockhart, Exec. Dir., PBGC).

228 Id. at 66. At the end of 1991, PBGC's deficit for single-employer plans was $2.5 billion. "The program has assets of $5.7 billion and liabilities of $8.2 billion." THE MIAMI HERALD, Feb. 19, 1992, at 3C.
and create a disincentive to provide pension plans. These proposals address the concern of adequate funding.

Aside from providing consistent guaranties to all pension plans investing in insurance products by allowing for uniform regulation and liquidation proceedings, this federal regulatory scheme will eliminate pensioner’s wait while the state funds raise the money following a liquidation.

V. CONCLUSION

The federal government passed ERISA and established the PBGC in order to protect the pension funds of American retirees. However, the protections offered by the current system are inadequate to insure pensioners’ earned benefits because plan investments in insurance products, such as annuities and GICs, remove pensioners’ benefits from federal coverage. Pensioners thus depend on state insurance guaranty funds to insure their earned benefits; this protection is insufficient in light of the trend of insurance insolvency in the nation. In order for ERISA to fulfill its mission of assuring the timely and uninterrupted payment of pension benefits, the federal government should insure pension plan investments in insurance products. This can be accomplished by restructuring the PBGC to work like SIPC; such a restructuring will allow PBGC to regulate insurance companies that provide investment vehicles to pension plans and will allow PBGC to increase its premiums to cover the increased liability.

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