DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

29 CFR Part 2509

[Interpretive Bulletin No. 95-1]

Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974

AGENCY: PWBA, Department of Labor. **ACTION:** Interpretive Bulletin.

SUMMARY: This document announces the Department of Labor's (the Department's) view of the legal standard imposed by section 404(a)(1) (A) and (B) of part 4 of title I of the Employee Retirement Income Security Act of 1974 (ERISA) on a plan fiduciary's selection of an annuity provider when purchasing annuities for the purpose of distributing benefits under an employee pension benefit plan. Under this standard, plan fiduciaries choosing to purchase annuities have a duty to select the safest available annuity provider, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise. The document also provides guidance to plan fiduciaries regarding circumstances when it may be in the interest of the participants and beneficiaries to purchase other than the safest available annuity.

EFFECTIVE DATE: The standard announced in this bulletin is effective January 1, 1975.

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SUPPLEMENTARY INFORMATION: In order to provide a concise and ready reference to its interpretations of ERISA, the Department of Labor publishes its Interpretive Bulletins in the Rules and Regulations section of the **Federal Register**.

Published in this issue of the **Federal Register** is ERISA Interpretive Bulletin 95–1, which describes the application of the fiduciary standards set forth in section 404(a)(1) (A) and (B) of ERISA, 29 U.S.C. 1104(a)(1) (A) and (B), in

selecting an insurer to provide pension benefit distribution annuities to plan participants and beneficiaries. The Department is publishing this Interpretive Bulletin because it believes there is a need for further guidance regarding the selection of such annuity providers by plan fiduciaries.

(Sec. 505, Pub. L. 93–406, 88 Stat. 894 (29 U.S.C. 1135))

Background

Annuities are issued by insurers in a variety of forms designed to suit different purposes. This interpretive bulletin addresses only annuities that are purchased by pension plans with the intention to transfer liability for benefits promised under the plan to the annuity provider (i.e., the insurance company).1 Annuities designed to serve this purpose are sometimes referred to herein as benefit distribution annuities. Regulations issued by the Department explicitly recognize a transfer of liability from the plan when such an annuity is purchased from an insurance company licensed to do business in a State. 29 CFR 2510.3-3(d)(2)(ii).2 Pension plans purchase benefit distribution annuity contracts in a variety of circumstances. Such annuities may be purchased for participants and beneficiaries in connection with the termination of a plan, or in the case of an ongoing plan, annuities might be purchased for participants who are retiring or separating from service with accrued vested benefits.

The selection of an annuity provider under these circumstances is a fiduciary decision governed by part 4 of title I of ERISA. Specifically, pursuant to ERISA section 404(a)(1), 29 U.S.C. 1104(a)(1), fiduciaries must discharge their duties with respect to the plan solely in the interest of the participants and

beneficiaries. Section 404(a)(1)(A), 29 U.S.C. 1104(a)(1)(A), states that the fiduciary must act for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable plan administration expenses. In addition, section 404(a)(1)(B) requires a fiduciary to act with the care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in a like capacity would use.³

Several developments over the past few years have resulted in questions being raised about the security of the pension benefits promised to participants and beneficiaries under benefit distribution annuity contracts purchased on their behalf. In particular, concerns have been expressed about the ability of certain insurance carriers to satisfy their annuity liabilities because their investment portfolios contain or contained substantial amounts of highrisk, high-yield debt securities (also known as "junk bonds") or troubled real-estate loans, or a combination of both. The basis for such concerns is best exemplified by the well-publicized developments involving the Executive Life Insurance Companies of California and New York. State regulators in both California and New York were forced to take control of the operations of the Executive Life Companies, whose poor financial condition is principally attributable to substantial investments in high risk bonds. In response to such developments, the Department has acted in the following areas to enforce ERISA's fiduciary standards and determine whether additional regulatory action is warranted.

Litigation

Subsequent to the failure of Executive Life, the Department's enforcement activities have centered on, among other things, the process by which plan fiduciaries selected annuity providers.

The Department has filed lawsuits against numerous companies whose plans purchased annuities because the plan fiduciaries who, acting in their fiduciary capacities, failed to follow adequate procedures designed to select

¹ In particular, the interpretive bulletin does not address fiduciary responsibilities in connection with the purchase of annuities for investment purposes. *See infra* note 5.

² This regulation defines the term "participant covered under the plan" for certain purposes under title I of ERISA. The Department notes that the regulation was issued primarily to define the class of participants entitled to receive copies of certain plan documents without charge and without request under ERISA sections 101(a) and 104(b)(1), 29 U.S.C. 1021(a) and 1024(b)(1). 40 FR 24649 (June 9, 1975), 40 FR 34528 (Aug. 15, 1975). A premise of the regulation was that, by using the term "participant covered under the plan," Congress had provided a ground for distinguishing between the class of all participants within the meaning of ERISA § 3(7) and participants entitled to receive copies of plan documents without charge and without request. 40 FR 24649 (June 9, 1975). Thus, the regulation is not intended to define the term "participant" or "beneficiary" for all purposes under ERISA, and, in particular, is not intended to define these terms for purposes of standing to bring a civil action under ERISA section 502(a), 29 U.S.C.

³ On March 13, 1986, the Department released an information letter addressed to John N. Erlenborn, who was then the Chairman of the Advisory Council on Employee Welfare and Plans. In the letter, the Department stated in pertinent part:

Consistent with the functional analysis of fiduciary activity, the choice of an insurer would appear to involve the type of discretionary authority over the disposition of plan assets covered in section 3(21)(A) [of ERISA]. . . . Therefore, it appears that the fiduciary provisions of ERISA, including the prudence requirement of section 404(a)(1)(B), will apply to the choice of an insurer to issue annuities upon plan termination.