**DEPARTMENT OF LABOR**

**Pension and Welfare Benefits Administration**

**29 CFR Part 2550**

**RIN 1210–AA58**

## Insurance Company General Accounts

**AGENCY:** Pension and Welfare Benefits Administration, Department of Labor.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains a proposed regulation which clarifies the application of the Employee Retirement Income Security Act of 1974 as amended (ERISA or the Act) to insurance company general accounts. Pursuant to section 1460 of the Small Business Job Protection Act of 1996 (Pub. L. 104–188), section 401 of ERISA has been amended. Section 401 now provides that the Department must issue proposed regulations to: Provide guidance for the purpose of determining, where an insurer issues one or more policies to or for the benefit of an employee benefit plan (and such policies are supported by assets of the insurer's general account), which assets held by the insurer (other than plan assets held in its separate accounts) constitute assets of the plan for purposes of part 4 of Title I of ERISA and section 4975 of the Internal Revenue Code of 1986 (the Code); and provide guidance with respect to the application of Title I to the general account assets of insurers. If adopted, the regulation will affect participants and beneficiaries of employee benefit plans, plan fiduciaries and insurance company general accounts.

**DATES:** Written comments and requests for a hearing (preferably at least three copies) concerning the proposed regulation must be received by March 23, 1998.

**ADDRESSES:** Interested persons are invited to submit written comments (preferably, at least three copies) concerning the proposed rule to: Pension and Welfare Benefits Administration, Office of Exemption Determinations, Room N–5649, 200 Constitution Ave., N.W., Washington, DC 20210. Attention: ''General Account Contracts''. Written comments may also be sent by the Internet to the following address: cmpad@jpwba.dol.gov.

**FOR FURTHER INFORMATION CONTACT:** Lyssa E. Hall, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N–5649, 200 Constitution Avenue, N.W., Washington, D.C. 20210, (202) 219–8194, or Timothy Hauser, Plan Benefits Security Division, Office of the Solicitor, (202) 219–8637. These are not toll-free numbers.

**SUPPLEMENTARY INFORMATION:**

### A. Background

Life insurance companies issue a variety of group contracts for use in connection with employee pension benefit plans, some of which provide benefits the amount of which is guaranteed, some of which provide benefits that may fluctuate with the investment performance of the insurance company, and some of which offer elements of both. Under section 401(b)(2) of ERISA, if an insurance company issues a ''guaranteed benefit policy'' to a plan, the assets of the plan are deemed to include the policy, but do not, solely by reason of the issuance of the policy, include any of the assets of the insurance company. Section 401(b)(2)(B) defines the term ''guaranteed benefit policy'' to mean an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. In addition, in paragraph (b) of ERISA Interpretive Bulletin 75–2, 29 CFR 2509.75–2 (1975), the Department stated that if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets.[1]

On December 13, 1993, the Supreme Court rendered its decision in *John Hancock Mutual Life Insurance Co.* v. *Harris Trust & Savings Bank*, 510 U.S. 86 (1993) (Harris Trust) which interpreted the meaning of ''guaranteed benefit policy''. In its decision, the Court held that a contract qualifies as a guaranteed benefit policy only to the extent it allocates investment risk to the insurer:

> [w]e hold that to determine whether a contract qualifies as a guaranteed benefit policy, each component of the contract bears examination. A component fits within the guaranteed benefit policy exclusion only if it allocates investment risk to the insurer. Such an allocation is present when the insurer provides a genuine guarantee of an aggregate amount of benefits payable to retirement plan participants and their beneficiaries.

Therefore, under the Supreme Court's decision, an insurer's general account includes plan assets to the extent it contains funds which are attributable to any nonguaranteed components of contracts with employee benefit plans. Because John Hancock's contract provided for a return that varied with the insurer's investment performance, the Court concluded that John Hancock held plan assets, and was, therefore, a fiduciary with respect to the management and disposition of those assets. Under the Court's reasoning, a broad range of activities involving insurance company general accounts are subject to ERISA's fiduciary standards.

Because of the retroactive effect of the Supreme Court decision, numerous transactions engaged in by insurance company general accounts may have violated ERISA's prohibited transaction and general fiduciary responsibility provisions. If the underlying assets of a general account include plan assets, persons who have engaged in transactions with such general account may be viewed as parties in interest under section 3(14) of ERISA and disqualified persons under section 4975 of the Code, including fiduciaries with respect to plans which have interests as policyholders in the general account. For example, insurance companies are a source of loans for smaller and mid-sized companies. Many of these companies have party in interest relationships with plans that have purchased general account contracts. Application of the prohibited transaction rules to the general account of an insurance company as a result of the Harris Trust decision could call such loans into question under ERISA. Lastly, the underlying assets of an entity in which a general account acquired an equity interest may include plan assets as a result of the Harris Trust decision.

The insurance industry believed that, absent legislative or administrative action, it would be subject to significant additional litigation and potential liability with respect to the operation of its general accounts. On March 25, 1994, the American Council of Life Insurance (ACLI) submitted an application for a class exemption from certain of the restrictions of sections 406 and 407 of ERISA and from certain excise taxes imposed by section 4975(a) and (b) of the Code. The ACLI requested broad exemptive relief for transactions which included the following: all internal operations of general accounts, all investment transactions involving general account assets, including transactions with parties in interest with respect to plans that have purchased general account contracts, and the purchase by the general account of securities issued by, and real property leased to, employers of employees

[1] Paragraph (b) of 29 CFR 2509.75–2 was removed effective July 1, 1996, 61 FR 33847, 33849 (July 1, 1996).

covered by plans that have purchased general account contracts.

On August 22, 1994, the Department published a notice of proposed Class Exemption for Certain Transactions Involving Insurance Company General Accounts. (59 FR 43134). Although the ACLI requested exemptive relief for activities in connection with the internal operation of general accounts, the Department determined that it did not have sufficient information regarding the operation of such accounts to make the findings required by section 408(a) of ERISA. Accordingly, the proposed class exemption did not provide relief for transactions involving the internal operation of an insurance company general account. The final exemption (Prohibited Transaction Exemption (PTE) 95–60, 60 FR 35925), was published in the **Federal Register** on July 12, 1995.

**B. Public Law 104–188**

In response to the Supreme Court decision in Harris Trust, Congress amended section 401 of ERISA by adding a new subsection 401(c) which clarifies the application of ERISA to insurance company general accounts. Pub. L. 104–188, § 1460. This statutory provision provides that the Secretary shall issue proposed regulations to provide guidance for the purpose of determining, in cases where an insurer issues one or more policies to or for the benefit of an employee benefit plan (and such policies are supported by the assets of such insurer's general account), which assets held by the insurer (other than plan assets held in its separate accounts) constitute assets of the plan for purposes of part 4 of Title I and section 4975 of the Code and to provide guidance with respect to the application of Title I to an insurer's general account assets. The final regulations shall be issued not later than December 31, 1997.

The regulations will only apply to those general account policies which are issued by an insurer on or before December 31, 1998. In the case of such policies, the regulations will take effect at the end of the 18 month period following the date on which the regulations become final. Pub. L. 104–188, however, authorizes the Secretary to issue additional regulations designed to prevent avoidance of the regulations described above. These additional regulations, if issued, may have an earlier effective date.

The Department must ensure that the regulations issued under Pub. L. 104–188 are administratively feasible, and protect the interests and rights of the plan and of its participants and beneficiaries. In addition, the regulations must require, in connection with any policy (other than a guaranteed benefit policy) issued by an insurer to or for the benefit of an employee benefit plan, that: (1) An independent plan fiduciary authorize the purchase of the policy (unless the purchase is exempt under ERISA section 408(b)(5)); (2) the insurer provide information in policies issued and on an annual basis to policyholders (as prescribed in such regulations) disclosing the methods by which any income and expenses of the insurer's general account are allocated to the policy and the actual return to the plan under the policy and such other financial information as the Department determines is appropriate; (3) the insurer disclose to the plan fiduciary the extent to which alternative arrangements supported by the assets of the insurer's separate accounts are available, whether there is a right under the policy to transfer funds to a separate account and the terms governing any such right, and the extent to which support by assets of the insurer's general account and support by assets of the insurer's separate accounts might pose differing risks to the plan; and (4) the insurer manage general account assets prudently, taking into account all obligations supported by such general account.

Compliance with the regulations issued by the Department will be deemed compliance by such insurer with sections 404, 406 and 407 of ERISA. In addition, under this statutory provision, no person will be liable under part 4 of Title I or Code section 4975 for conduct which occurred before the date which is 18 months following the issuance of the final regulation on the basis of a claim that the assets of an insurer (other than plan assets held in a separate account) constitute plan assets. The limitation on liability is subject to three exceptions: (1) The Department may circumscribe this limitation on liability in regulations intended to prevent avoidance of the regulations which it is required to issue under the statutory amendment; (2) the Department may bring actions pursuant to paragraph (2) or (5) of section 502(a) of ERISA for breaches of fiduciary responsibility which also constitute violations of Federal or State criminal law; and (3) civil actions commenced before November 7, 1995 are exempt from the amendment's coverage.

On November 25, 1996, the Department published a Request for Information (RFI) to solicit information and comments from the public to be considered by the Department in developing the regulations mandated by Pub. L. 104–188. The RFI contained a list of questions designed to elicit information that would be helpful to the Department in developing this notice of proposed rulemaking.

*Discussion of the Comments*

The questions asked by the Department in the RFI requested information regarding disclosures to contractholders, market value adjustments, unilateral contract amendments, state regulatory requirements and guaranteed benefit policies.

A total of eight substantive responses to the RFI were received: one was from the ACLI itself; the remaining comments were from a law firm representing a group of major life insurance companies, an organization representing insurance regulators, two law firms representing plans which have invested in insurance company general account contracts, an insurance company, an association representing senior financial executives and an advocacy organization representing senior citizens.

*Disclosures*

Many of the comments addressed the need for insurance companies to provide adequate and meaningful disclosure regarding the financial soundness of the insurance company, the nature of the insurer's general account assets, transactions with affiliates and the investment policies/objectives of the insurer as well as contract specific information regarding fees, commissions, expenses, termination requirements, and allocation methodologies.

Several of the commenters stressed that such information must be presented in ''plain English'' using a format which would be understood by lay persons. Two commenters suggested that the Department require that information be supplied in standardized form. Another commenter stated that the information in the Statutory Annual Statement could be adapted to provide appropriate disclosures.

A commenter noted that, in order for a plan fiduciary to make a prudent decision regarding the investment of plan assets in an insurance company general account contract, the insurance company must provide the fiduciary with sufficient information. In this regard, another commenter stated that many general account investments are tantamount to an illiquid investment in a corporate bond; thus, the general level of disclosure required should be comparable to that made available to investors of other illiquid investments. A number of commenters agreed that

the items of information identified in the RFI should be disclosed to plan investors on an annual basis. In addition to those items, a commenter suggested that the disclosure requirements should recognize the fact that the general account supports products not covered by ERISA. Another stated that information regarding the current value of the investment compared to the purchase price of the contract should be provided annually. Finally, a commenter noted that gross and net returns on the contract before and after adjustments should be reported.

With respect to the effective date of the disclosure provisions in the regulation, one commenter stated that the disclosure provisions should become effective prior to the end of the 18th month following publication of the final regulation.

*Market Value Adjustments (MVAs)*

Two commenters expressed concern that MVAs may operate as penalties imposed on plans which terminate or withdraw funds from general account contracts. They represent that MVAs should not be used to enrich the insurer, but should be fair to terminating contractholders as well as remaining contractholders. One commenter suggested that MVAs should ''cut both ways,'' i.e., if market value is above book value, the terminating policyholders should receive the difference between book and market value as the adjustment. This commenter stated that MVAs should be based on regularly published indices that reflect the categories of investments in the insurer's general account. To the extent that such adjustments represent lost opportunity costs, the insurer should be required to articulate a justification for its estimate of the lost opportunity.

Finally, one commenter stated that MVAs should not be circumscribed by the Department since they protect remaining contractholders.

*Unilateral Contract Amendments*

Three commenters either opposed an insurer's ability to unilaterally amend contract terms or believed that the Department should impose limits on such amendments. In the alternative, two commenters suggested that if unilateral amendments are made and the parties cannot agree on such changes, the matter should be referred to binding arbitration. Another commenter suggested that the account holder be permitted to exit the arrangement if the unilateral change was not satisfactory.

*State Regulatory Requirements*

Two commenters stated that the Department should not take state insurance requirements into account in drafting the regulation either because ERISA should govern employee benefit plans or consideration of state regulatory requirements would dilute the strength of ERISA. Another commenter noted that state regulatory requirements either overlap or address each of the requirements imposed by section 1460 of Pub. L. 104–188.

*Guaranteed Benefit Policies*

Two commenters urged the Department to issue a regulation defining guaranteed benefit policy under section 401(b)(2) of the Act concurrently with the regulations the Department is required to issue under section 401(c).[2]

*Description of Proposal*

The proposal amends 29 CFR Part 2550 by adding a new section, 2550.401c–1. This new section is divided into ten major parts. Paragraph (a) of the proposal describes the scope of the regulation and the general rule. Proposed paragraphs (b) through (f) contain conditions which must be met in order for the general rule to apply. Specifically, paragraph (b) addresses the requirement that an independent fiduciary expressly authorize the acquisition or purchase of a Transition Policy. Paragraph (c) describes the disclosures that an insurer must make both prior to the issuance of a Transition Policy to a plan and on an annual basis. Paragraph (d) provides for additional disclosures regarding separate account contracts. Paragraph (e) contains the procedures that apply to the termination or discontinuance of a Transition Policy by a policyholder. Paragraph (f) contains notice provisions regarding contract terminations and withdrawals in connection with insurer-initiated amendments. Proposed paragraph (g) sets forth a prudence standard for the management of general account assets by insurers. The definitions of certain terms used in the proposed regulation are contained in paragraph (h). Proposed paragraph (i) describes the effect of compliance with the regulation and proposed paragraph (j) contains the effective dates of the regulation.

1. Scope and General Rule

Proposed § 2550.401c–1(a) and (b) essentially follow the language of section 401(c) of ERISA. Paragraph (a) describes, in cases where an insurer issues one or more policies to or for the benefit of an employee benefit plan (and such policies are supported by assets of an insurance company's general account), which assets held by the insurer (other than plan assets held in its separate accounts) constitute plan assets for purposes of Subtitle A, and Parts 1 and 4 of Subtitle B, of Title I of the Act and section 4975 of the Internal Revenue Code, and provides guidance with respect to the application of Title I and section 4975 of the Code to the general account assets of insurers.

Proposed paragraph (a)(2) states the general rule that when a plan acquires a policy issued by an insurer on or before December 31, 1998 (Transition Policy), which is supported by assets of the insurer's general account, the plan's assets include the policy, but do not include any of the underlying assets of the insurer's general account if the insurer satisfies the requirements of paragraphs (b) through (f) of the regulation. The term Transition Policy is defined in paragraph (h)(6) as a policy or contract of insurance (other than a guaranteed benefit policy) that is issued by an insurer to, or on behalf of, an employee benefit plan on or before December 31, 1998, and which is supported by the assets of the insurer's general account. A policy will not fail to be a Transition Policy if it is amended solely for the purposes of complying with the provisions of this regulation.

2. Authorization by an Independent Fiduciary

Proposed paragraph (b)(1) states the general requirement that an independent fiduciary who has the authority to manage and control the assets of the plan must expressly authorize the acquisition or purchase of the Transition Policy. In order to be independent, the fiduciary may not be an affiliate of the insurer issuing the policy.

Paragraph (b)(2) of the proposed regulation contains an exception to the requirement of independent plan fiduciary authorization if the insurer is the employer maintaining the plan, or a party in interest which is wholly-owned by the employer maintaining the plan,

[2] The Department notes that the statute requires the promulgation of regulations under section 401(c) but does not require the Department to promulgate regulations defining guaranteed benefit policies. At this time, the Department has not made a decision regarding whether to initiate a regulatory project on this matter. Therefore, this proposed regulation does not address the definition of guaranteed benefit policy.

and the requirements of section 408(b)(5) of ERISA are met.[3]

3. Disclosure

Section 401(c)(3)(B) of the Act, as added by Pub. L. 104–188, provides that the regulations prescribed by the Secretary shall require in connection with any policy issued by an insurer to or for the benefit of an employee benefit plan to the extent the policy is not a guaranteed benefit policy * * * (B) that the insurer describe (in such form and manner as shall be prescribed in such regulations), in annual reports and in policies issued to the policyholder after the date on which such regulations are issued in final form * * * (i) a description of the method by which any income and expenses of the insurer's general account are allocated to the policy during the term of the policy and upon termination of the policy, and (ii) for each report, the actual return to the plan under the policy and such other financial information as the Secretary may deem appropriate for the period covered by each such annual report.

Proposed paragraph (c)(1) similarly imposes a duty on the insurer to disclose specific information to plan fiduciaries prior to the issuance of a Transition Policy and at least annually for as long as the policy is outstanding. Proposed paragraph (c)(2) requires that the disclosures be clear and concise and written in a manner calculated to be understood by a plan fiduciary. Although the Department has not mandated a specific format, the information should be presented in a manner which facilitates the fiduciary's understanding of the operation of the policy. The Department expects that, following disclosure of the required information and any other information requested by the fiduciary pursuant to paragraph (c)(4)(xii), the plan fiduciary, with independent professional assistance, if necessary, will be able to ascertain how various values or amounts relevant to the plan's policy such as, the actual return to be credited to any accumulation fund under the policy, will be determined.

Paragraph (c)(3) sets forth the content requirement for the information which must be provided to the plan either as part of the Transition Policy, or as a separate written document which accompanies the Transition Policy. For Transition Policies issued before the date which is 90 days after the date of publication of the final regulation, the insurer must provide the information identified in paragraph (c)(3)(i) through (iv) no later than 90 days after publication of the final regulation. For Transition Policies issued 90 days after the date of publication of the final regulation, the insurer must provide the information to a plan before the plan makes a binding commitment to acquire the policy.

Under paragraph (c)(3), an insurer must provide a description of the method by which any income and expenses of the insurer's general account are allocated to the policy during the term of the policy and upon its termination. The initial disclosure under this paragraph must include, among other things, a statement of the method used to determine ongoing fees and expenses that may be assessed against the policy or deducted from any accumulation fund under the policy. The term ''accumulation fund'' is defined in paragraph (h)(5) as the aggregate net consideration (i.e., gross considerations less all deductions from such considerations) credited to the Transition Policy plus all additional amounts, including interest and dividends, credited to the contract, less partial withdrawals and benefit payments and less charges and fees imposed against this accumulated amount under the Transition Policy other than surrender charges and market value adjustments.[4]

The insurer must also include, in its description of the method used to allocate income and expenses to the Transition Policy, an explanation of the method used to determine the return to be credited to any accumulation fund under the policy, a description of the policyholder's rights to transfer or withdraw all or a portion of any fund under the policy, or to apply such amounts to the purchase of benefits, and a statement of the precise method used to calculate the charges, fees or market value adjustments that may be imposed in connection with the policyholder's right to withdraw or transfer amounts under any accumulation fund. Upon request, the insurer must provide the information necessary to independently calculate the exact dollar amounts of charges, fees or market value adjustments.

In developing the proposed regulation, the Department reviewed the disclosure requirements imposed by New York insurance regulations, and incorporated several provisions which we believe would be helpful to plan fiduciaries prior to their commitment to purchase a Transition Policy. The information disclosed pursuant to this paragraph will address many of the concerns expressed by the commenters in response to the RFI regarding the lack of contract-level disclosure by insurers. The information disclosed pursuant to this paragraph should enable plan fiduciaries to adequately evaluate the suitability of a particular policy for a plan.

Proposed paragraph (c)(4) describes the information which must be provided at least annually to each plan to which a Transition Policy has been issued. In general, the information is intended to provide the policyholder with an overview of all the activity that has occurred in the accumulation fund during the applicable period. These disclosures should enable the policyholder to evaluate the insurer's performance under the policy. In this regard, the insurer must provide the following information to each plan regarding the applicable reporting period: the balance in the accumulation fund on the first and last day of the period; any deposits made to the accumulation fund; all income attributed to the policy or added to the accumulation fund; the actual rate of return credited to the accumulation fund; any other additions to the accumulation fund; a statement of all fees, charges or expenses assessed against the policy or deducted from the accumulation fund; and the dates on which the additions or subtractions were credited to, or deleted from, the accumulation fund.

In addition, insurers must annually disclose all transactions with affiliates which exceed 1 percent of group annuity reserves of the general account for the prior reporting year. The annual disclosure must also include a description of any guarantees under the policy and the amount that would be payable in a lump sum pursuant to the request of a policyholder for payment of amounts in the accumulation fund under the policy after deduction of any charges and any deductions or additions resulting from market value adjustments.

As part of the annual disclosure, an insurer must inform policyholders that it will make available upon request certain publicly-available financial information relating to the financial condition of the insurer. Such

[3] This exception for in-house plans of the insurer under section 401(c)(3) of ERISA is similar to the statutory exemption contained in section 408(b)(5) of ERISA which provides relief from the prohibitions of section 406 for purchases of life insurance, health insurance or annuities from an insurer if the plan pays no more than adequate consideration and if the insurer is the employer maintaining the plan.

[4] This definition is substantially similar to the definition contained in New York insurance regulations. In this regard, see 11 NYCRR 40.2 (1996).

information would include rating agency reports on the insurer's financial strength, the risk adjusted capital ratio, an actuarial opinion certifying to the adequacy of the insurer's reserves and the insurer's most recent SEC Form 10K and Form 10Q (if a stock company).

The Department believes that the annual disclosures required under paragraph (c)(4) will provide sufficient information to the plan fiduciaries to enable them to assess the appropriateness of continuing the plan's investment in the Transition Policy. The Department's primary intent in mandating the disclosures under paragraphs (c)(3) and (4) is to ensure that plan fiduciaries are provided with relevant information, including the financial strength of the insurer, in an understandable form in order to make a meaningful, informed decision regarding both the initial investment in a Transition Policy, and the advisability of leaving the accumulation fund with the insurer. Lastly, the information provided by the insurance company with respect to its allocation methodologies must be in sufficient detail to enable the policyholder to calculate the expenses charged against the Transition Policy as well as the income credited to the policy. This information will allow plan fiduciaries to monitor the actions of the insurer with respect to the Transition Policy.

The Department solicits comments on the proposed disclosure requirements and procedures, both as to their usefulness for plans and the impact on plans and insurers.

It was Congressional intent under section 401(c) of ERISA to require substantive disclosure from insurance companies in order to enable plans to effectively monitor the performance of insurance company general account contracts. In this regard, the Department does not intend to promulgate regulations which require the disclosure of proprietary information if Congressional intent for meaningful disclosure can otherwise be effectuated. Accordingly, the Department requests comments from interested persons on whether any of the items of disclosure specified in the proposed regulation would place an insurer at a competitive disadvantage by giving other insurance companies access to their proprietary information. In responding to this request, please specify which items of information would be considered proprietary and the rationale for that conclusion.

Proposed paragraph (d)(1) contains an additional disclosure requirement regarding the availability of separate account contracts. Under this paragraph, the insurer must explain the extent to which alternative contract arrangements supported by assets of separate accounts of the insurer are available to plans; whether there is a right under the policy to transfer funds to a separate account; and the terms governing any such right. An insurer also must disclose the extent to which general account contracts and separate account contracts pose differing risks to the plan. Proposed paragraph (d)(2) contains a standardized statement describing the relative risks of separate accounts and general account contracts which, if provided to policyholders, will be deemed to comply with paragraph (d)(1)(iii) of the regulation.

4. Termination Procedures

Paragraph (e)(1) of the proposed regulation provides that a policyholder must be able to terminate or discontinue a policy upon 90 days notice to an insurer. The policyholder must have the option to select one of two payout alternatives, both of which must be made available by the insurer.

Under the first alternative, an insurer must permit the policyholder to receive, without penalty, a lump sum payment representing all unallocated amounts in the accumulation fund after deduction of unrecovered expenses and adjustment of the book value of the policy to its market value equivalency. The Department notes that for purposes of paragraph (e), the term penalty does not include a market value adjustment (as defined in proposed paragraph (h)(7)) or the recovery of costs actually incurred including unliquidated acquisition expenses, to the extent not previously recovered by the insurer.

In response to the concerns expressed by some commenters regarding an insurer's use of market value adjustments as a penalty to a withdrawing policyholder, the Department has defined the term market value adjustment to reflect the economic effect on a Transition Policy of an early termination or withdrawal in the current market. Since the purpose of the adjustment is to protect the remaining policyholders, it should represent the economic effect on the policy of a termination under current economic conditions and not penalize the withdrawing policyholder.

Under the second alternative, proposed paragraph (e)(2), an insurer must permit the policyholder to receive a book value payment of all unallocated amounts in the accumulation fund under the policy in approximately equal annual installments, over a period of no longer than five years, with interest.

These termination provisions are designed, in part, ''to protect the interests and rights of plan[s] * * *'' (See ERISA § 401(c)(2)(B)) by ensuring that plans are not locked into economically disadvantageous relationships.[5] Under the terms of the proposed regulation, plan fiduciaries will receive full disclosure of the general account contract's investment performance, and have the ability to transfer plan assets from the general account to other investments. In this manner, the regulation enables plans to rationally protect their own economic interests without imposing detailed federal regulations on the day-to-day operation of general accounts.

The Department recognizes, however, that insurers have a legitimate interest in avoiding adverse selection and excessive liquidity demands by plan contractholders. Accordingly, the regulation permits insurers to impose a market value adjustment on lump sum withdrawals, and authorizes insurers to spread book value withdrawals over a five-year period at a rate of interest as much as one percentage point below the rate credited to the contract's accumulation fund on the date of termination. Many general account contracts already permit a ten-year book value withdrawal in accordance with provisions of state law. *See, e.g.,* 11 NYCRR § 40.5 (1997) (giving contractholders the right to a ten-year book value withdrawal under specified contracts with interest at a rate not less than 1.5 percent below the rate credited at the time of termination). In proposing a five-year period and a one percent interest adjustment for book value withdrawals, the Department has sought to balance plans' interest in a meaningful right to book value withdrawals with insurers' interest in maintaining balanced and stable portfolios of investments with varying maturities. Neither the book value option nor the market value option should require any fundamental changes in current investment practices or strain the cash flows of well-managed insurers.

The Department solicits comments from interested persons on: (1) The effect on insurers and non-terminating plan policyholders of allowing terminating plans to choose either a

[5] The proposal is similar to the Department's rule governing contracts between plans and service providers. *See* 29 CFR § 2550.408b–2(c) (providing that ''[n]o contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act * * * if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous'').

book value payment or market value adjustment on termination of the contract; (2) the benefit to plans of the proposed termination option and; (3) the accuracy and burden of the proposed market value adjustment.

5. Insurer Initiated Amendments

Paragraph (f) describes the notice requirements and payout provisions governing insurer-initiated amendments. Under paragraph (f), if an insurer makes an insurer-initiated amendment, the insurer must provide written notice to the plan at least 60 days prior to the effective date of the amendment. The notice must contain a complete description of the amendment and must inform the policyholder of its right to terminate or discontinue the policy and withdraw all unallocated funds in accordance with paragraph (e)(1) or (e)(2) by sending a written request to the name and address contained in the notice. Proposed paragraph (f), unlike the more general termination provisions set forth in paragraph (e), is effective upon publication of the final regulation in the **Federal Register**.

An insurer-initiated amendment is defined in paragraph (h)(8) as: (1) An amendment to a policy made by an insurer pursuant to a unilateral right to amend the policy terms that would have a material adverse effect on the policyholder; or (2) certain unilateral enumerated changes that result in a reduction of existing or future benefits under the policy, a reduction in the value of the policy or an increase in the cost of financing the plan or plan benefits, if such change has more than a *de minimis* effect.

It is the Department's view that section 401(c) is similar to a statutory exemption to the general fiduciary responsibility provisions of ERISA and, accordingly, an insurer will have the burden of proving that such changes will not have more than a *de minimis* effect on the policy. The regulation's insurer-initiated amendment provisions ensure that a plan fiduciary can terminate or discontinue a contract that has become disadvantageous as a result of unilateral action on the part of the insurer.

The Department solicits comments on the effect of the insurer-initiated amendment provisions in the proposed regulation.

6. Prudence

Proposed paragraph (g) sets forth the prudence standard applicable to insurance company general accounts. Unlike the prudence standard provided in section 404(a)(1)(B) of ERISA, prudence for purposes of section 401(c)(3)(D) of ERISA is determined by reference to all of the obligations supported by the general account, not just the obligations owed to plan policyholders. In this regard, the Department notes that nothing contained in the proposal modifies the application of the more stringent standard of prudence set forth in section 404(a)(1)(B) of ERISA as applicable to fiduciaries, including insurers, who manage plan assets maintained in separate accounts, as well as to assets of the general account which support policies issued after December 31, 1998.

7. Definitions

Proposed paragraph (h) contains definitions of certain terms used in the proposed regulation.

8. Limitation on Liability

Proposed paragraph (i)(1) provides that no person shall be liable under parts 1 and 4 of Title I of the Act or section 4975 of the Code for conduct which occurred prior to the effective dates of the regulation on the basis of a claim that the assets of an insurer (other than plan assets held in a separate account) constitute plan assets. Paragraph (i)(1) further provides that the above limitation on liability does not apply in the following three circumstances: (1) An action brought by the Secretary of Labor pursuant to paragraph (2) or (5) of section 502(a) of the Act for a breach of fiduciary responsibility which would also constitute a violation of Federal or State criminal law; (2) the application of any Federal criminal law; or (3) any civil action commenced before November 7, 1995.

Proposed paragraph (i)(2) states that the regulation does not relieve any person from any State law regulating insurance which imposes additional obligations upon insurers to the extent not inconsistent with this regulation. Thus, for example, nothing in this regulation would preclude a state from requiring an insurer to make additional disclosures to policyholders, including plans.

Proposed paragraph (i)(3) of the regulation makes clear that neither ERISA nor the regulations promulgated thereunder precludes a claim against an insurer or others for a violation of the Act which is not contingent upon the assertion that the insurer's general account assets are plan assets, regardless of whether the violation relates to a Transition Policy. Thus, for example, a Transition Policy may give rise to fiduciary status on the part of the insurer based upon the insurer's discretionary authority over the administration or management of the plan, rather than its authority over the management of general account assets. *See* section 3(21) of the Act. Nothing in ERISA or this regulation would preclude a finding that an insurer is liable under ERISA for breaches of its fiduciary responsibility in connection with plan management or administration prior to the effective dates of the regulation. Similarly, neither ERISA nor the regulation precludes a finding that an insurer is a fiduciary by reason of its discretionary authority or control over plan assets other than the insurer's general account assets. If the insurer breaches its fiduciary responsibility with respect to plan assets, it may be liable under ERISA regardless of whether the insurer has issued a Transition Policy to a plan or ultimately placed the plan's assets in its general account.

Paragraph (i)(4) of the proposed regulation provides that if an insurer fails to meet the requirements of paragraphs (b) through (f) of the regulation with respect to a specific plan policyholder the result of such failure would be that the general account would be subject to ERISA's fiduciary responsibility provisions with respect to the specific plan for that period of time during which the requirement of the regulation was not met. Once back in compliance with the regulation, the insurer would no longer be subject to ERISA or have potential liability for subsequent periods of time when the requirements of the regulation are met. In addition, the regulation makes clear that the underlying assets of the general account would not constitute plan assets for other Transition Policies to the extent that the insurer was in compliance with the requirements of the regulation.

9. Effective Date

Proposed paragraph (j)(1) states the general rule that the regulation is effective 18 months after its publication in the **Federal Register**.

Paragraph (j)(2), (3) and (4) of the proposed regulation provide earlier effective dates for paragraph (b) relating to independent fiduciary approval, paragraphs (c) and (d) relating to disclosures, and paragraph (f) relating to insurer initiated amendments.

Paragraph (j)(2) of the proposed regulation states that if a Transition Policy is issued before the date which is 90 days after the date of publication of the final regulation, the disclosure provisions in paragraphs (c) and (d) shall take effect 90 days after the publication of the final regulation.

Paragraph (j)(3) of the proposed regulation provides that paragraphs (c) and (d) are effective 90 days after the date of publication of the regulation for a Transition Policy issued after such date. In this regard, the Department believes that the earlier effective dates are consistent with section 401(c)(3)(B) of the Act, as added by Pub. L. 104–188, which states that the disclosures required by the regulation be provided after the date that the regulations are issued in final form.

Proposed paragraph (j)(4) provides that the effective date for paragraphs (b) and (f) of the proposed regulation is the date of publication of the final regulation in the **Federal Register**. In addition, this paragraph provides special rules for insurer-initiated amendments which become effective during the period between the dates of publication of the proposed and final regulations. For example, assume that an insurer makes an insurer-initiated amendment to a Transition Policy after publication of the proposed regulations in the **Federal Register** but prior to the issuance of the final regulations. If adopted as proposed, the insurer would have 30 days to notify the plan of the amendment. The notice must contain a complete description of the amendment and must inform the plan of its right to terminate the contract and withdraw all unallocated funds. If the plan elects to receive a lump sum payment, the insurer must calculate such amount using the more favorable (to the plan) of the market value adjustments determined as of: (1) The effective date of the amendment; or (2) the date upon which the insurer received written notice from the plan requesting a lump sum payment. Specifically, the insurer must provide notice of the amendment to the plan within 30 days of publication of the final regulation. The notice must contain, among other things, a complete description of the amendment and must inform the plan of its right to terminate or discontinue the policy and withdraw all unallocated funds in accordance with the requirements of paragraph (e) and this paragraph. If the policyholder elects to receive a lump sum payment on termination or discontinuance of the policy, the insurer must use the more favorable (to the plan) of the market value adjustments determined on either the effective date of the amendment or determined upon receipt of the written request from the plan.

Section 401(c)(5)(B)(i) of the Act, as added by Pub. L. 104–188, provides an exception to the general 18-month effective date for regulations intended to prevent the avoidance of the regulations set forth herein. The Department is proposing an earlier effective date for the provisions relating to the independent fiduciary approval, disclosures and insurer-initiated amendments. The Department believes that the earlier effective dates protect the interests and rights of a plan and its participants and beneficiaries by minimizing the potential for insurers to change their conduct in ways which are disadvantageous to plan policyholders without compliance with the terms and conditions of the regulation. The Department notes that compliance with the specific requirements of the regulation must occur as of the date that such requirement becomes effective. Failure to comply with any of the requirements listed in paragraphs (b) through (f) of this regulation after the effective date of such paragraphs will result in the general account of the insurer holding plan assets as provided in paragraph (i)(4).

**Economic Analysis Under Executive Order 12866**

Under Executive Order 12866 (58 FR 51735, Oct. 4, 1993), the Department must determine whether the regulatory action is ''significant'' and therefore subject to review by the Office of Management and Budget (OMB) under the requirements of the Executive Order. Under section 3(f), the order defines a ''significant regulatory action'' as an action that is likely to result in, among other things, a rule raising novel policy issues arising out of the President's priorities. Pursuant to the terms of the Executive Order, the Department has determined that this regulatory action is a ''significant regulatory action'' as that term is used in Executive Order 12866 because the action would raise novel policy issues arising out of the President's priorities. Thus, the Department believes this notice is ''significant,'' and subject to OMB review on that basis.

The Office of Management and Budget has determined that this regulatory action is economically significant because it may adversely effect in a material way a sector of the economy. The Department therefore solicits additional information from the interested public regarding the economic impact of the proposed regulation. Specifically, the Department requests current data on the number and characteristics of potentially affected insurance contracts that would provide the basis for a more extensive analysis of the costs and benefits of the proposed regulation.

These regulations mitigate the constraints imposed by ERISA on the operation of insurance company general accounts. The Department believes that insurers are likely in nearly all circumstances to avail themselves of the relief provided under the proposed regulation. The consequences for an insurer, of not complying with the safe harbor afforded by the regulation, would subject the insurer's general account to potential liability under part 4 of Title I of ERISA. Because the statute simply directs the Department to issue a regulation and specifies much of the regulation's content, its costs and benefits may be estimated simply by analyzing the regulation. The Department is not aware of any published analysis of the nature or level of the costs the statute will not impose.

The Department has endeavored to control the compliance costs associated with the regulation by providing model language, by requiring disclosures at the outset of the contract or no more than annually, and by allowing disclosure materials to be based on materials prepared for other reasons. The Department's analysis of the impact of the regulation has concluded that it will provide greater protections for 130,000 pension plans holding contracts with 110 insurers. The net cost of these protections is estimated to be no more than $2 to $5 million per year. This estimate of the potential impact of the proposed regulation is based on the Department's estimates of assets held in life insurers' general accounts and the proportion of these that might be deemed to be holding ERISA plan assets. The total of all assets held by life insurers in their general accounts amounts to approximately $1.7 trillion. Based on data reported on Schedule A available from Form 5500 series reports, the Department estimates that the assets of contracts potentially directly affected by the regulation have a current value of approximately $40 billion or slightly less than 3 percent of general account assets. This estimate of $40 billion represents the amount reported by plans to be held in contracts categorized as unallocated general account contracts whose performance is linked with that of the general accounts in the annual financial reports filed by plans. As such it represents an upper bound of the value of the contracts potentially affected by the regulation because some portion of these contracts may in fact already meet the conditions specified in the regulation. The Department solicits additional data which would permit a further delineation of the affected assets.

It is estimated that the costs of this regulation will primarily arise from the cost of compliance with its disclosure requirements. The benefits to plans,

participants and beneficiaries arise from the improved understanding of their investment that comes from the disclosure, and from the limits on the calculation of the market value adjustment by the insurer at the time of termination of the contract.

The insurance contracts affected by this regulation have a wide range of characteristics that cannot in a comprehensive way be precisely defined. They may differ widely, in particular with respect to the conditions associated with their termination provisions. However, the regulation's disclosure and termination provisions establish minimum standards, which may be more favorable to plans than their terms absent the regulation. As a result, some plans that have been unable to terminate, or might not have terminated, their contractual arrangements may now terminate those arrangements. The Department does not believe, however, that the regulation will have a significant adverse financial impact on other general account policyholders or insurers. As the American Council of Life Insurance has noted in various submissions, the relevant contracts typically already permit the termination and withdrawal of plan assets in a lump sum (subject to a market value adjustment) or in installments over a period of years at book value with interest. Although the regulation protects plans by permitting them to withdraw plan assets in a lump sum without penalty, it also protects the legitimate interests of insurers by permitting them to recover incurred costs and to impose a market value adjustment designed to ''accurately reflect the effect on the value of the accumulation fund of its liquidation in the prevailing market for fixed income obligations.'' Similarly, the regulation mitigates any adverse economic impact by permitting insurers to spread book value withdrawals over a five-year period at a reduced rate of interest (assuming the relevant contract does not give the plan more favorable termination and withdrawal rights). The Department believes that these provisions adequately protect the insurers from the risks of ''adverse selection'' or disintermediation, while providing significant protection to plan policyholders. In many respects, the regulation simply parallels the pre-existing rule under ERISA that a contract between a plan and party in interest is impermissible unless it permits termination without penalty so as to ''prevent the plan from becoming locked into an arrangement that has become disadvantageous.'' 29 CFR 2550.408b–2(c).

A portion of the estimated costs of the regulation is attributed to the termination of some contracts which, absent the regulation, would have remained in force. Some of the costs that the insurers may incur are offset, however, by commensurate benefits to plans. The only net costs of the regulation therefore, are the cost of supplying the disclosure information and transaction costs for plans terminating their insurance contracts. In the view of the Department, these costs must be weighed against the benefits that accrue to plans and the economy in general from the enhanced transparency of general account products, and the resulting increased ability plans will have to rationally manage their portfolios and allocate assets more efficiently. The regulation is designed to ensure that a plan fiduciary will have access to all the information necessary to assess the potential and actual performance of a general account contract both before and after entering into the initial agreement with the insurer. The regulation's termination and withdrawal provisions additionally ensure that the plan fiduciary can act on the information disclosed by withdrawing the plan's assets in favor of other investment vehicles or expenditures if it is prudent or economically advantageous to do so. The net result is to safeguard plans' ability to allocate their resources in the most economically rational manner possible.

The analysis of the impact of the regulation does not attribute any cost to the possible effect of the regulation on the management or composition of insurers' general account portfolios. This is because the total value of the contracts potentially affected represent less than 3 percent of general account assets. According to data published by the American Council of Life Insurance, general account reserves are primarily invested in fixed income securities of relatively short maturities. The maximum liquidity requirement imposed by the regulation in the highly unlikely event that all of the affected plans chose to terminate the contracts would be less than 6-tenths percent of the general accounts (this reflects the distribution of 3 percent of general assets over 5 years). This should be readily available from the cash flow derived from the current distribution of investments. The Department therefore has not assigned any cost of the regulation to other general account policyholders.

The insurance industry has not provided the Department with any information regarding the magnitude of their costs. Accordingly, the Department solicits additional information from the interested public regarding the economic analysis in the proposed regulation. Specifically, the Department requests comments and supporting data on the costs and benefits of the proposed regulation, as well as information on whether more frequent contract terminations which may result from enhanced opportunities provided by the proposed regulation will result in an increase in brokerage, appraisal and/or other transactions costs.

**Regulatory Flexibility Act**

The Regulatory Flexibility Act of 1980 requires each Federal agency to perform an Initial Regulatory Flexibility Analysis for all rules that are likely to have a significant economic impact on a substantial number of small entities. Small entities include small businesses, organizations, and governmental jurisdictions. The Pension and Welfare Benefits Administration has determined that this rule will not have a significant economic impact on a substantial number of small entities. A summary for the basis of that conclusion follows:

(1) PWBA is promulgating this regulation because it is required to do so under section 1460 of the Small Business Job Protection Act of 1996 (Pub. L. 104–188).

(2) The objective of the proposed regulation is to provide guidance on the application of ERISA to policies held in insurance company general accounts. The legal basis for the proposed regulation is found in new ERISA section 401(c); an extensive list of authorities may be found in the Statutory Authority section, below.

(3) The direct cost of compliance will be born by insurance companies; the Department estimates that no ''small'' insurance companies (as defined by the Small Business Administration at 61 FR 3280, Jan 31, 1996) offer the type of policies regulated here. No small governmental jurisdictions will be affected. It is estimated that 121,000 small employee benefit plans (those with fewer than 100 participants) purchase the regulated policies, and will therefore receive the benefit of the enhanced disclosure provided by the regulation. Some of the costs of disclosure may be passed on to the plans by the insurers.

(4) No federal reporting is required under the proposed rule. It is anticipated that the majority of the disclosure requirements may be handled by clerical staff; however, there will be

a need for professional staff involvement.

(5) No federal rules have been identified that duplicate, overlap or conflict with the proposed rule. To the extent possible, the overlap in disclosures between this rule and state and SEC reporting requirements have been designed to allow the same materials to meet both requirements while providing the necessary protections for employee benefit plans.

(6) No significant alternatives which would minimize the impact on small entities have been identified. It would be inappropriate to create an alternative with lower compliance criteria, or an exemption under the proposed regulation, for small plans because those are the entities that have the greatest need for the disclosures and other protections offered by the regulation.

**Paperwork Reduction Act**

The proposed regulation contains information collections which are subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995. The title, summary, description of need, respondents description, and estimated reporting and recordkeeping burden are shown below.

*Title:* Disclosure Regarding Plan Assets in Insurance Company General Accounts.

*Summary/Description of Need:* Section 1460 of the Small Business Job Protection Act of 1996 (Pub. L. 104–188) amended ERISA by adding new Section 401(c), which requires that certain steps be taken by insurance companies which offer and maintain policies for private sector employee benefit plans where the assets are held in the insurer's general account. Pursuant to the authority given to the Secretary under the statute, the regulation requires certain disclosures be provided at the outset of the contract and annually, and other disclosures be provided upon request.

*Respondents Description:* Individuals or households; Business or other for-profit institutions; Not-for-profit institutions.

*Estimated Reporting and Recordkeeping Burden:* Based upon Form 5500 filing data, an estimated 134,000 plans, primarily pension plans, have invested in 138,000 policies offered by approximately 110 insurance companies. Because insurers must already assemble much of the information to be disclosed for purposes of state disclosure requirements and their own administration of the contracts, the Department does not believe the additional disclosure obligations imposed by the regulation will be unduly burdensome. The additional costs can be divided into start-up expenses incurred immediately after the regulation takes effect, and a yearly expense thereafter. Initially insurers will be required to modify disclosure forms and computer programs to comply with the new obligations imposed by the regulation. In total, the Department estimates that this initial expense will cost no more than $2 to $5 million. Thereafter, the Department estimates that insurers will generally incur disclosure and reproduction expenses of between $100 and $200 for each contract to which the regulation applies.

The Department of Labor has submitted a copy of the proposed information collection to the Office of Management and Budget in accordance with 44 U.S.C. § 3507(d) of the Paperwork Reduction Act of 1995 for its review of its information collections. Interested persons are invited to submit comments regarding this proposed new collection of information.

The Department of Labor is particularly interested in comments which:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Comments should be sent to the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget (OMB), Room 10235, New Executive Office Building, Washington, D.C. 20503; Attention: Desk Officer for the Pension and Welfare Benefits Administration. OMB requests that comments be received within 30 days of publication of the Notice of Proposed Rulemaking.

**Statutory Authority**

The proposed regulation set forth herein is issued pursuant to the authority contained in sections 401(c) and 505 of ERISA (Pub. L. 93–406, Pub. L. 104–188, 88 Stat. 894; 29 U.S.C. 1101(c), 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), 3 CFR 1978 Comp. 332, and under Secretary of Labor's Order No. 1–87, 52 FR 13139 (April 21, 1987).

**List of Subjects in 29 CFR Part 2550**

Employee benefit plans, Employee Retirement Income Security Act, Employee stock ownership plans, Exemptions, Fiduciaries, Insurance Companies, Investments, Investment foreign, Party in interest, Pensions, Pension and Welfare Benefit Programs Office, Prohibited transactions, Real estate, Securities, Surety bonds, Trusts and trustees.

For the reasons discussed in the preamble, it is proposed to amend 29 CFR part 2550 as follows:

## PART 2550—[AMENDED]

1. The authority for Part 2550 is revised to read as follows:

**Authority:** 29 U.S.C. 1135. Section 2550.401b–1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713, 3 CFR, 1978 Comp., p. 332. Section 2550.401c–1 also issued under 29 U.S.C. 1101. Section 2550.404c–1 also issued under 29 U.S.C. 1104. Section 2550.407c–3 also issued under 29 U.S.C. 1107. Section 2550.408b–1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713, 3 CFR, 1978 Comp., p. 332, and 29 U.S.C. 1108(b)(1). Section 2550.412–1 also issued under 29 U.S.C. 1112. Secretary of Labor's Order No. 1–87 (52 FR 13139).

2. New section 2550.401c–1 is added to read as follows:

**§ 2550.401c–1 Definition of ''plan assets''—insurance company general accounts.**

(a) *In general.* (1) This section describes, in the case where an insurer issues one or more policies to or for the benefit of an employee benefit plan (and such policies are supported by assets of an insurance company's general account), which assets held by the insurer (other than plan assets held in its separate accounts) constitute plan assets for purposes of Subtitle A, and Parts 1 and 4 of Subtitle B, of Title I of the Employee Retirement Income Security Act of 1974 (ERISA or the Act) and section 4975 of the Internal Revenue Code (the Code), and provides guidance with respect to the application of Title I of the Act and section 4975 of the Code to the general account assets of insurers.

(2) Generally, when a plan acquires a policy issued by an insurer on or before

December 31, 1998 (Transition Policy), which is supported by assets of the insurer's general account, the plan's assets include the policy, but do not include any of the underlying assets of the insurer's general account if the insurer satisfies the requirements of paragraphs (b) through (f) of this section.

(b) *Approval by fiduciary independent of the issuer.*—(1) In general. An independent plan fiduciary who has the authority to manage and control the assets of the plan must expressly authorize the acquisition or purchase of the Transition Policy. For purposes of this subparagraph, a fiduciary is not independent if the fiduciary is an affiliate of the insurer issuing the policy.

(2) Notwithstanding paragraph (b)(1) of this section, the authorization by an independent plan fiduciary is not required if:

(i) The insurer is the employer maintaining the plan, or a party in interest which is wholly owned by the employer maintaining the plan; and

(ii) The requirements of section 408(b)(5) of the Act are met.

(c) *Duty of Disclosure.*—(1) *In general.* An insurer shall furnish the following information to a plan fiduciary acting on behalf of a plan to which a Transition Policy has been issued. Paragraph (c)(2) of this section describes the style and format of such disclosure. Paragraph (c)(3) of this section describes the content of the initial disclosure. Paragraph (c)(4) of this section describes the information that must be disclosed by the insurer at least once per year for as long as the

Transition Policy remains outstanding.

(2) *Style and format.* The disclosure required by this paragraph should be clear and concise and written in a manner calculated to be understood by a plan fiduciary, without relinquishing any of the substantive detail required by paragraphs (c)(3) and (c)(4) of this section. The information does not have to be organized in any particular order but should be presented in a manner which makes it easy to understand the operation of the policy. To the extent paragraphs (c)(3) and (c)(4) of this section require the disclosure of the insurer's methods or methodologies for determining various values or amounts relevant to the plan's policy, the disclosure must be made in sufficient detail and with such clarity that the plan fiduciary, with relevant data from the insurer and appropriate professional assistance, can determine the values or amounts applicable to the plan's policy. The insurer must disclose any data necessary for application of the methods or methodologies without unreasonable delay upon the request of the plan fiduciary.

(3) *Initial Disclosure.* Prior to obtaining a binding commitment from a plan to acquire a Transition Policy, the insurer must provide to the plan, either as part of the policy, or as a separate written document which accompanies the policy, the disclosure information set forth in paragraph (c)(3)(i) through (iv) of this section. In the case of a Transition Policy that has been issued before the date which is 90 days after the date of publication of the final regulation, the insurer must provide the disclosure information no later than 90 days after publication. The disclosure must include all of the following information which is applicable to the Transition Policy:

(i) A description of the method by which any income and expenses of the insurer's general account are allocated to the policy during the term of the policy and upon its termination, including:

(A) A statement of the method used by the insurer to determine the fees, charges, expenses or other amounts that are or may be assessed against the policyholder or deducted by the insurer from any accumulation fund under the policy, including the extent and frequency with which such fees, charges, expenses or other amounts may be modified by the insurance company;

(B) A statement of the method by which the insurer determines the return to be credited to any accumulation fund under the policy, including a statement of the method used to allocate income and expenses to lines of business, business segments, and policies within such lines of business and business segments, and a description of how any withdrawals, transfers, or payments will affect the amount of the return credited;

(C) A description of the rights which the policyholder or plan participant has to withdraw or transfer all or a portion of any fund under the policy, or to apply the amount of a withdrawal to the purchase of or payment of benefits, and the terms on which such withdrawals or other use of funds may be made, including a description of any expense charges, fees, experience rating charges or credits, market value adjustments, or any other charges or adjustments, both positive and negative;

(D) A statement of the method used to calculate the charges, fees, credits or market value adjustments described in paragraph (i)(C) of this section, and, upon the request of a plan fiduciary, the information necessary to independently calculate the exact dollar amounts of the charges, fees or adjustments. The initial disclosure provided to the plan must set forth and describe each of the provisions and elements of the formula for making the market value adjustment in sufficient detail and with such clarity that the plan fiduciary, with relevant data from the insurer and with professional assistance, if necessary, can replicate any adjustment proposed by the insurer. If the formula is based on interest rate guarantees applicable to new contracts of the same class or classes, and the duration of the assets underlying the accumulation fund, the contract must describe the process by which those components are ascertained or obtained. If the formula is based on an interest rate implicit in an index of publicly traded obligations, the identity of the index, the manner in which it is used, and identification of the source or publication where any data used in the formula can be found, must be disclosed;

(ii) A statement describing the expense, income and benefit guarantees under the policy, including a description of the length of such guarantees, and of the insurer's right, if any, to modify or eliminate such guarantees; and

(iii) A description of the rights of the parties to make or discontinue contributions under the policy, and of any restrictions (such as timing, minimum or maximum amounts, and penalties and grace periods for late payments) on the making of contributions under the policy, and the consequences of the discontinuance of contributions under the policy.

(iv) A statement of how any policyholder or participant-initiated withdrawals are to be made: first-in, first-out (FIFO) basis, last-in, first-out (LIFO) basis, pro rata or another basis.

(4) *Annual disclosure.* At least annually and not later than 90 days following the period to which it relates, an insurer shall provide the following information to each plan to which a Transition Policy has been issued:

(i) The balance of any accumulation fund on the first day and last day of the period covered by the annual report;

(ii) Any deposits made to the accumulation fund during such annual period;

(iii) An itemized statement of all income attributed to the policy or added to the accumulation fund during the period, and a description of the method used by the insurer to determine the precise amount of income;

(iv) The actual rate of return credited to the accumulation fund under the policy during such period, stating whether the rate of return was calculated before or after deduction of

expenses charged to the accumulation fund;

(v) Any other additions to the accumulation fund during such period;

(vi) An itemized statement of all fees, charges, expenses or other amounts assessed against the policy or deducted from the accumulation fund during the reporting year, and a description of the method used by the insurer to determine the precise amount of the fees, charges and other expenses;

(vii) An itemized statement of all benefits paid, including annuity purchases, to participants and beneficiaries from the accumulation fund;

(viii) The dates on which the additions or subtractions were credited to, or deleted from, the accumulation fund during such period;

(ix) A description, if applicable, of all transactions with affiliates which exceed 1 percent of group annuity reserves of the general account for the prior reporting year;

(x) A statement describing any expense, income and benefit guarantees under the policy, including a description of the length of such guarantees, and of the insurer's right, if any, to modify or eliminate such guarantees;

(xi) The amount that would be payable in a lump sum at the end of such period pursuant to the request of a policyholder for payment or transfer of amounts in the accumulation fund under the policy after the insurer deducts any applicable charges and makes any appropriate market value adjustments, upward or downward, under the terms of the policy; and

(xii) An explanation that the insurer promptly will make available upon request of a plan, copies of the following publicly-available financial data or other publicly available reports relating to the financial condition of the insurer:

(A) National Association of Insurance Commissioners (NAIC) Statutory Annual Statement, with Exhibits, General Interrogatories, and Schedule D, Part 1A, Secs 1 and 2 and Schedule S-Part 3E;

(B) Rating agency reports on the financial strength and claims-paying ability of the insurer;

(C) Risk adjusted capital ratio, with a brief description of its derivation and significance, referring to the risk characteristics of both the assets and the liabilities of the insurer;

(D) Actuarial opinion (with supporting documents) of the insurer's Appointed Actuary certifying the adequacy of the insurer's reserves as required by New York State Insurance Department Regulation 126 and comparable regulations of other states; and

(E) The insurer's most recent SEC Form 10K and Form 10Q (stock companies only).

(d) Alternative separate account arrangements.—(1) *In general.* An insurer must provide the plan fiduciary with the following additional information at the same time as the disclosure required under paragraph (c) of this section:

(i) A statement explaining the extent to which alternative contract arrangements supported by assets of separate accounts of insurers are available to plans;

(ii) A statement as to whether there is a right under the policy to transfer funds to a separate account and the terms governing any such right; and

(iii) A statement explaining the extent to which general account contracts and separate account contracts of the insurer may pose differing risks to the plan.

(2) An insurer will be deemed to comply with the requirements of paragraph (d)(1)(iii) of this section if the disclosure provided to the plan includes the following statement:

a. Contractual arrangements supported by assets of separate accounts may pose differing risks to plans from contractual arrangements supported by assets of general accounts. Under a general account contract, the plan's contributions or premiums are placed in the insurer's general account and commingled with the insurer's corporate funds and assets (excluding separate accounts and special deposit funds). The insurance company combines in its general account premiums received from all its lines of business. These premiums are pooled and invested by the insurer. General account assets in the aggregate support the insurer's obligations under all of its insurance contracts, including (but not limited to) its individual and group life, health, disability, and annuity contracts. Experience rated general account policies may share in the experience of the general account through interest credits, dividends, or rate adjustments, but assets in the general account are not segregated for the exclusive benefit of any particular policy or obligation. General account assets are also available to the insurer for the conduct of its routine business activities, such as the payment of salaries, rent, other ordinary business expenses and dividends.

b. An insurance company separate account is a segregated fund which is not commingled with the insurer's general assets. Depending on the particular terms of the separate account contract, income, expenses, gains and losses associated with the assets allocated to a separate account may be credited to or charged against the separate account without regard to other income, expenses, gains, or losses of the insurance company, and the investment results passed through directly to the policyholders. While most, if not all, general account investments are maintained at book value, separate account investments are normally maintained at market value, which can fluctuate according to market conditions. In large measure, the risks associated with a separate account contract depend on the particular assets in the separate account.

c. The plan's legal rights vary under general and separate account contracts. In general, an insurer is subject to ERISA's fiduciary responsibility provisions with respect to the assets of a separate account (other than a separate account registered under the Investment Company Act of 1940) to the extent that the investment performance of such assets is passed directly through to the plan policyholders. ERISA requires insurers, in administering separate account assets, to act solely in the interest of the plan's participants and beneficiaries; precludes self-dealing and conflicts of interest; and requires insurers to adhere to a prudent standard of care. In contrast, ERISA generally imposes less stringent standards in the administration of general account contracts which were issued on or before December 31, 1998.

d. On the other hand, state insurance regulation is typically more restrictive with respect to general accounts than separate accounts. In addition, insurance company general account policies often include various guarantees under which the insurer assumes risks relating to the funding and distribution of benefits. Insurers do not usually provide any guarantees with respect to the investment returns on assets held in separate accounts. Of course, the extent of any guarantees from any general account or separate account contract will depend upon the specific policy terms.

e. Finally, separate accounts and general accounts pose differing risks in the event of the insurer's insolvency. In the event of insolvency, funds in the general account are available to meet the claims of the insurer's general creditors, after payment of amounts due under certain priority claims, including amounts owed to its policyholders. Funds held in a separate account as reserves for its policy obligations, however, may be protected from the claims of creditors other than the policyholders participating in the separate account. Whether separate account funds will be granted this protection will depend upon the terms of the applicable policies and the provisions of any applicable laws in effect at the time of insolvency.

(e) *Termination procedures.* Within 90 days of written notice by a policyholder to an insurer, the insurer must permit the policyholder to exercise the right to terminate or discontinue the policy and to receive without penalty either:

(1) a lump sum payment representing all unallocated amounts in the accumulation fund. For purposes of this paragraph (e), the term penalty does not include a market value adjustment (as defined in paragraph (h)(7) of this section) or the recovery of costs actually incurred which would have been

recovered by the insurer but for the termination or discontinuance of the policy, including any unliquidated acquisition expenses, to the extent not previously recovered by the insurer; or

(2) a book value payment of all unallocated amounts in the accumulation fund under the policy in approximately equal annual installments, over a period of no longer than five years, together with interest computed at an annual rate which is no less than the annual rate which was credited to the accumulation fund under the policy as of the date of the contract termination or discontinuance, minus 1 percentage point.

(f) *Insurer-initiated amendments.* In the event the insurer makes an insurer-initiated amendment (as defined in paragraph (h)(8) of this section), the insurer must provide written notice to the plan at least sixty days prior to the effective date of the insurer-initiated amendment. The notice must contain a complete description of the amendment and must inform the plan of its right to terminate or discontinue the policy and withdraw all unallocated funds without penalty by sending a written request within such sixty day period to the name and address contained in the notice. The plan must be offered the right to receive a lump sum or installment payment described in paragraph (e)(1) or (e)(2) of this section. An insurer-initiated amendment shall not apply to a contract if the plan fiduciary exercises its right to terminate or discontinue the contract within such sixty day period and to receive a lump sum or installment payment.

(g) *Prudence.* An insurer shall manage those assets of the insurer which are assets of such insurer's general account (irrespective of whether any such assets are plan assets) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, taking into account all obligations supported by such enterprise. This prudence standard applies to the conduct of all insurers with respect to policies issued to plans on or before December 31, 1998, and differs from the prudence standard set forth in section 404(a)(1)(B) of ERISA. Under the prudence standard provided in this paragraph, prudence must be determined by reference to all of the obligations supported by the general account, not just the obligations owed to plan policyholders. The more stringent standard of prudence set forth in section 404(a)(1)(B) of ERISA continues to apply to any obligations which insurers may have as fiduciaries which do not arise from the management of general account assets, as well as to insurers' management of plan assets maintained in separate accounts. The terms of the regulation do not modify or reduce the fiduciary obligations applicable to insurers in connection with policies issued after December 31, 1998, which are supported by general account assets, including the standard of prudence under section 404(a)(1)(B) of the Act.

(h) *Definitions.* For purposes of this section:

(1) an *affiliate* of an insurer means:

(i) Any person, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the insurer,

(ii) Any officer, director, partner or employee of such insurer or of a person described in paragraph (i) of this definition including in the case of an insurer, an insurance agent or broker thereof, whether or not such person is a common law employee, and

(iii) Any corporation, partnership, or unincorporated enterprise of which a person described in paragraph (ii) of this definition is an officer, director, partner or employee.

(2) The term *control* means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(3) The term *guaranteed benefit policy* means a policy described in section 401(b)(2)(B) of the Act and any regulations promulgated thereunder.

(4) The term *insurer* means an insurer as described in section 401(b)(2)(A) of the Act.

(5) The term *accumulation fund* means the aggregate net consideration (i.e., gross considerations less all deductions from such considerations) credited to the Transition Policy plus all additional amounts, including interest and dividends, credited to such Transition Policy less partial withdrawals, benefit payments and less all charges and fees imposed against this accumulated amount under the Transition Policy other than surrender charges and market value adjustments.

(6) The term *Transition Policy* means:

(i) a policy or contract of insurance (other than a guaranteed benefit policy) that is issued by an insurer to, or on behalf of, an employee benefit plan on or before December 31, 1998, and which is supported by the assets of the insurer's general account.

(ii) A policy will not fail to be a Transition Policy merely because the policy is amended or modified to comply with the requirements of section 401(c) of the Act and this section.

(7) For purposes of this regulation, the term *market value adjustment* means an adjustment to the book value of the accumulation fund to accurately reflect the effect on the value of the accumulation fund of its liquidation in the prevailing market for fixed income obligations, taking into account the future cash flows that were anticipated under the policy. An adjustment is a *market value adjustment* within the meaning of this definition only if the insurer has determined the amount of the adjustment pursuant to a method which was previously disclosed to the policyholder in accordance with paragraph (c)(3)(i)(D) of this section, and the method permits both upward and downward adjustments to the book value of the accumulation fund.

(8) The term *insurer-initiated amendment* is defined in paragraphs (h)(8) (i) and (ii) of this section:

(i) An amendment to a policy made by an insurer pursuant to a unilateral right to amend the policy terms that would have a material adverse effect on the policyholder; or

(ii) Any of the following unilateral changes in the insurer's conduct or practices with respect to the policyholder or the accumulation fund under the policy that result in a reduction of existing or future benefits under the policy, a reduction in the value of the policy or an increase in the cost of financing the plan or plan benefits, if such changes have more than a *de minimis* effect on the policy:

(A) A change in the methodology for assessing fees, expenses, or other charges against the accumulation fund or the policyholder;

(B) A change in the methodology used for allocating income between lines of business, or product classes within a line of business;

(C) A change in the methodology used for determining the rate of return to be credited to the accumulation fund under the policy;

(D) A change in the methodology used for determining the amount of any fees, charges, or market value adjustments applicable to the accumulation fund under the policy in connection with the termination of the contract or withdrawal from the accumulation fund;

(E) A change in the dividend class to which the policy or contract is assigned;

(F) A change in the policyholder's rights in connection with the termination of the contract, withdrawal of funds or the purchase of annuities for plan participants; and

(G) A change in the annuity purchase rates.

(iii) For purposes of this definition, any amendment or change which is made with the affirmative consent of the policyholder is not an insurer-initiated amendment.

(i) *Limitation on liability.* (1) No person shall be subject to liability under Parts 1 and 4 of Title I of the Act or section 4975 of the Code for conduct which occurred prior to the effective dates of the regulation on the basis of a claim that the assets of an insurer (other than plan assets held in a separate account) constitute plan assets. Notwithstanding the foregoing, this section shall not:

(i) Apply to an action brought by the Secretary of Labor pursuant to paragraphs (2) or (5) of section 502(a) of ERISA for a breach of fiduciary responsibility which would also constitute a violation of Federal or State criminal law;

(ii) Preclude the application of any Federal criminal law; or

(iii) Apply to any civil action commenced before November 7, 1995.

(2) Nothing in this section relieves any person from any State law regulating insurance which imposes additional obligations or duties upon insurers to the extent not inconsistent with the provisions of this section. Therefore, nothing in this section should be construed to preclude a State from requiring insurers to make additional disclosures to policyholders, including plans. Nor does this section prohibit a State from imposing additional substantive requirements with respect to the management of general accounts or from otherwise regulating the relationship between the policyholder and the insurer to the extent not inconsistent with the provisions of this section;

(3) Nothing in this section precludes any claim against an insurer or other person for violations of the Act which do not require a finding that the underlying assets of a general account constitute plan assets, regardless of whether the violation relates to a Transition Policy; and

(4) If the requirements in paragraphs (b) through (f) of this section of the regulation are not met with respect to a plan that has purchased or acquired a Transition Policy, the plan's assets include an undivided interest in the underlying assets of the insurer's general account for that period of time for which the requirements are not met. However, an insurer's failure to comply with the requirements of this section with respect to any particular Transition Policy will not result in the underlying assets of the general account constituting plan assets with respect to other Transition Policies if the insurer is otherwise in compliance with the requirements contained in the section.

(j) *Effective date.* (1) *In general.* Except as provided below, this section is effective from the date which is 18 months after its publication in the **Federal Register**.

(2) With respect to a Transition Policy issued before the date which is 90 days after the date of publication of the final regulation, paragraphs (c) and (d) of this section shall apply to the policy 90 days after the date of such publication.

(3) With respect to a Transition Policy issued 90 days after the date of publication of the final regulation, paragraphs (c) and (d) of this section shall apply to the policy as of the date of such publication.

(4) Paragraph (b) of this section, relating to independent fiduciary approval, and paragraph (f) of this section, relating to insurer-initiated amendments, are effective on the date of publication of the final regulation in the **Federal Register**. In the event an insurer makes an insurer-initiated amendment to a Transition Policy during the period between the dates of publication of the proposed and final regulations, the insurer must provide written notice to the plan within 30 days of publication of the final regulation. The document must contain a complete description of the amendment; inform the plan of its right to terminate or discontinue the policy and withdraw all unallocated funds without penalty in accordance with the requirements of paragraph (e) of this section and this paragraph; and provide that the plan may exercise its right by sending a written request to the name and address contained in the notice within sixty days of its receipt of the notice from the insurer. In the event that the plan exercises its right to terminate or discontinue the policy, the insurer must disregard the effect of any insurer-initiated amendment which would have the effect of decreasing the amount distributed to the plan. In the case of a plan electing a lump sum payment, the insurer must use the more favorable (to the plan) of the market value adjustments determined on either the effective date of the amendment or determined upon receipt of the written request from the plan in calculating the lump sum representing the unallocated funds in the accumulation fund.

Signed at Washington, DC this 15th day of December, 1997.

**Olena Berg,**

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[FR Doc. 97–33088 Filed 12–19–97; 8:45 am]

BILLING CODE 4510–29–P