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IS THERE LIFE AFTER EXECUTIVE LIFE? RETIREMENT PLAN PARTICIPANTS AND THE GUARANTEES OF INSURANCE COMPANIES

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The panel will address the current situation relating to insurance company solvency, guaranteed products, and retirement plans. What have the DOL, IRS, PBGC, Congress, and the insurance industry done?

MR. RICHARD G. SCHREITMUELLER: I'm from Alexander & Alexander Consulting Group in Atlanta. First we're going to cover a bit of history over the last few years, involving annuities and GICs. Then we'll hear viewpoints from several players in the exciting game of insurance company solvency. This is a game that many of us pension types didn't care about, but it turns out that we're players in it, too. We'll discuss how insurance company solvency issues are changing the pension world, based on the recent misfortunes of Executive Life and other major life insurers.

Our first speaker will be Angie Arnett, a lawyer with the Pension Benefit Guaranty Corporation (PBGC). Angie studied government and politics at the University of Maryland, and later graduated from the law school at the Catholic University of America in Washington, D.C. She joined the PBGC 10 years ago. Angie is very heavily involved in working with the Department of Labor (DOL) and PBGC officials on these annuity issues. She's working on regulations on disclosure and other requirements of the PBGC.

Our second speaker is Melissa Kahn, also a lawyer. Melissa is with the American Council of Life Insurance (ACLI), which is the Washington trade association representing most of the life insurance companies, especially the larger ones. Melissa also started at the PBGC after graduating from Georgetown Law School in Washington, D.C., and then went to work for a prominent New York law firm. Staying in New York, Melissa moved to The Equitable Life Assurance Company, and just last year she joined the ACLI back in Washington.

Our third speaker is James Kenney, a consulting actuary with his own firm. James is a Fellow of the Society of Actuaries, an Enrolled Actuary, and an Associate of the Casualty Actuarial Society. Graduating from the University of Chicago, James started in the casualty field. In 1974, he got into pension consulting, and in time became the sole owner and President of Coates and Kenney Associates in Berkeley, California.

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Five years ago, I don't believe there was a lot of consciousness among pension actuaries about one insurance company versus another, or about one annuity provider versus another. There was a perception among many that annuities were kind of a generic product. An insurance company stood behind the product, and the industry or the regulators or the PBGC probably stood behind that, and so buying annuities was a low-bid situation in many people's minds.

People were getting nervous about junk bonds toward the end of 1989, and more nervous at the beginning of 1990, when Executive Life's credit ratings were downgraded, leading to a big Senate hearing in the spring of 1990. Only one short year ago, in the spring of 1991, several major life insurers were seized by regulators. These were disasters in the sense of public perception, and there may turn out to be some financial losses also. We're talking about Executive Life, First Capital Life, and Mutual Benefit Life most prominently. These events raised a number of issues about continuity of annuity payments, and have caused quite a bit of turmoil among defined-contribution plans, about what used to be known as guaranteed investment contracts. I'd be interested in what you're calling them today, I don't think it's guaranteed investment contracts.

A lot of players are in this. In addition to those who are represented here, the insurance regulators and Congress very much have an interest in this. Some unions do, and certainly the employers and participants do. Those of us in the pension field are very much aware of that. So we are hoping to hear many of these viewpoints, starting with Angie Arnett from the PBGC.

MS. ANGELA J. ARNETT: I would like to discuss ERISA and insurance company insolvencies and the PBGC perspective. First, I would like to give a brief overview of the PBGC and the Title IV insurance program. I will next discuss: why Title IV does not authorize the PBGC to insure annuity contracts; the safeguards that are in place to protect annuitants; what the PBGC has done to enhance the security of annuities; and, finally, why the PBGC believes that a federal annuity guaranty program is the wrong solution.

Title IV requires the PBGC to guarantee the payment of basic pension benefits when a covered pension plan terminates with insufficient assets to pay benefits. The PBGC receives no funds from the federal tax revenues. Operations are financed by insurance premiums paid by sponsors of covered plans, investment income from assets of pension plans trusteed by the PBGC, and recoveries from employers responsible for underfunded plans.

If a plan terminates with insufficient assets to pay benefits, the PBGC normally assumes trusteeship of the plan and provides guaranteed benefits in monthly payments. Termination of an underfunded pension plan creates statutory liability against a plan sponsor and members of its controlled group to the PBGC that is based on the amount of a plan's underfunding. As trustee of a terminated pension plan, the PBGC is authorized to collect any unpaid contributions and any other money owed to the plan.

I want to discuss termination of sufficient plans. Over 95% of pension plans that terminate have sufficient assets to pay promised benefits. Under the Single Employer

Pension Plan Amendment Act of 1986, which amended ERISA, the PBGC's role is to oversee the plan administrator's allocation of plan assets and distribution of benefits, to ensure that participants receive proper benefits upon termination. Generally, benefits are distributed through a plan's purchase of irrevocable commitments, which I'll refer to as annuities, or payment of lump sums.

Title IV's standard termination procedures are codified in ERISA Section 4041(b) and apply to terminations of sufficient plans. Under those procedures, a plan may not terminate unless plan assets are sufficient to satisfy all plan liabilities. Section 4041(b)(3) requires the plan administrator to distribute plan assets to provide promised benefits by purchasing annuities from an insurer, or by providing benefits in other forms permitted by the provisions of the plan and any applicable regulations.

PBGC regulations provide, generally, that benefits payable as annuities under the provisions of a plan, must be distributed in annuity form through the purchase from an insurer of irrevocable commitments. PBGC regulations define this term in 29 CFR 26.18.4 as "an obligation by an insurer to pay benefits to a named plan participant or surviving beneficiary, if the obligation cannot be canceled under the terms of the insurance contract (except for fraud or mistake), without the consent of the participant or beneficiary and is legally enforceable by the participant or beneficiary." PBGC regulations require that the insurer providing annuities must be "a company authorized to do business as an insurance carrier under the laws of a state or the District of Columbia."

The final distribution of all plan assets in the correct amounts and proper form, followed by the plan administrator's certification that distribution has occurred, completes the standard termination process.

Since ERISA's enactment, plan termination has been the "insurable event" under the single-employer insurance program. Nowhere in ERISA is the PBGC authorized to pay benefits upon occurrence of any other event, such as the failure of an insurance company. The distribution of assets under a standard termination is accomplished through the purchase of annuity contracts, payment of lump-sum amounts, or distribution of benefits in other forms permitted by the plan, and by PBGC and IRS regulations. Once the distribution is completed, the PBGC's guaranty ends.

The PBGC remains responsible for the payment of guaranteed benefits if the plan has not made a proper distribution; for example, if a participant is overlooked or paid an incorrect amount and the plan administrator does not promptly correct the error in distribution. The PBGC does not stand behind benefits distributed in a lump-sum payment, nor protect from loss a participant who chooses to "roll over" a lump-sum distribution into an IRA. Similarly, the failure of an insurance company, subsequent to the purchase of annuities, does not result in an insurable event or does not reinstate the PBGC's guarantee.

Congress, in establishing the PBGC's premium structure, did not evidence any intent that the PBGC would guarantee annuities. The PBGC's guarantee is financed primarily through the payment of premiums by covered plans. Once a sufficient plan terminates in a standard termination, no further premiums are paid with respect to that plan. If Congress had intended the PBGC to guarantee annuities against the post-termination insolvency of an insurer, it would not have provided that the premium obligation ends upon plan termination. If the PBGC were to guarantee annuities, the agency estimates its exposure could be as high as $50 billion. The PBGC believes that, if Congress intended to make the PBGC responsible for an exposure of that magnitude, it would have provided the agency with authority to collect premiums to cover it.

In 1987, Congress amended ERISA to supplement the existing flat-rate premium with an additional premium amount based on plan underfunding. Congress thereby reinforced the concept that premiums are based on the PBGC's exposure from insufficiently funded plans.

As is the case with a terminating plan, an ongoing plan distributes a benefit when it purchases an irrevocable annuity for a participant. The individual to whom the annuity is distributed ceases to be a participant, and no further premiums are paid with respect to that individual. Consequently, the ongoing plan's distribution of an annuity satisfies, and thereby extinguishes, the obligation of both the plan and the PBGC to that individual, even if the plan subsequently terminates.

The selection of annuity providers and certain other acts associated with plan termination are subject to the fiduciary provisions of Title I of ERISA. If the PBGC becomes aware of an insurer selection that may merit further investigation, the PBGC refers the matter to the Pension and Welfare Benefits Administration (PWBA) of the Department of Labor. Pension plan participants and beneficiaries may also take private legal action to redress a violation of ERISA's fiduciary provisions.

All states and Puerto Rico now have guaranty programs. State guaranty programs have certain limitations and restrictions on the benefits they guarantee. Recently, however, there has been activity in the states to strengthen guaranty programs and state regulation of insurance.

The insurance industry recognizes that it may be in its own best interest to protect annuitants hurt by the collapse of an insurance company. In the Baldwin-United case in the early 1980s, other insurers took actions to prevent losses to annuitants. The insurance industry and the state guaranty programs have also been active in the Executive Life insolvency and the Mutual Benefit insolvency.

Since March 1990, the PBGC has asked standard termination filers to provide the name of the anticipated annuity provider 45 days before the expected distribution date. Questionable insurer selections are referred to the PWBA for investigation.

The PBGC has issued a proposed rule that would require plan administrators to provide advanced notice to the PBGC and plan participants, the identity of the annuity company that the plan intends to use. We expect this regulation to be published as final in the near future. The PBGC also issued a final regulation that requires plan administrators to notify participants that the PBGC does not guarantee annuities distributed in a plan termination.

The PBGC believes that a federal annuity guaranty program is the wrong solution. Historically, insurance companies have been regulated at the state level, as reflected by the enactment in 1945 of the McCarran-Ferguson Act. All 50 states now have guaranty programs to protect policyholders against insurer insolvency. If these guaranty programs are not adequate, the states and the insurance industry should be encouraged to make them adequate. If the federal government were to guarantee annuities, states might have an incentive to exclude from state guaranty protection annuity contracts covered by the federal guarantee.

The federal government should not take on a huge new risk without the ability to control its losses. With regulation of insurance located at the state level, a federal guaranty would constitute an unreasonable risk. Insurance companies might have an incentive to invest in lower quality assets if a federal guaranty stood behind their annuity products. This could lead to the same moral hazards that resulted in the savings and loan bailout. The PBGC cannot afford to take on a huge new risk without the ability to control its losses. The PBGC already is financially weak, and cannot afford a $50 billion increase in its exposure.

Designing a federal guaranty program would be difficult. Complex and contentious issues would need to be addressed concerning how such a program would be financed and what benefits it would cover:

- Establishing an appropriate premium to finance the guaranty program would be difficult, since the scope of the insurer insolvency program and its impact upon annuitants is unknown.

- A decision would have to be made, whether coverage should extend to annuities that were purchased prior to enactment of the program. Today's plan sponsors, already paying high premiums to the PBGC, might find it unfair to pay premiums to finance a guarantee of the estimated $50 billion of annuities already in place.

- Other decisions would be needed on how to integrate a new federal program with existing state guaranty programs, at what benefit levels the federal guaranty would be capped, and what priority the guarantor's claims would have against the insurer and its controlled group in bankruptcy and insolvency proceedings.

The bottom line, as far as the PBGC is concerned, is that we want to encourage states and the insurance industry to fix whatever is wrong in the present guarantee system so that annuitants are safe. We believe the answers should come at the state level and from the insurance industry.

MS. MELISSA KAHN: We have a motto in the insurance industry these days, "No news is good news," and we agree we've had a lot of good news lately. So what I'd like to do is talk about the general state of the solvency of the industry. I'd also like to discuss a number of the things that Angie has just mentioned, in terms of what is being done both by the industry and the regulators to strengthen the guarantees and mechanisms that are currently in place. I'll also address what is being done both at the legislative and the regulatory levels back in Washington on this subject.

The first thing I'd like to say is that the insurance industry takes this situation of what's happened in the industry over the past few years very, very seriously. Our industry, of course, is committed to long-term promises that we'll provide benefits on a long-term basis to people out there, and we take that commitment very seriously. We are the first to acknowledge that there have been problems. We cannot say today that there won't be insurers in the future that get into trouble. We're hoping that the mechanisms that are in place and that are being implemented are going to help alleviate future problems in the system. Any kind of analogies that have been made in the past, and that may still be made today, comparing us to the savings and loan industry, are really ill-founded. We are certainly not the next savings and loan crisis waiting to happen. And primarily that's because we do make long-term commitments, and we invest our assets accordingly.

I'm going to go over a few key statistics as I just want to give you a sense of where the industry is, in terms of its asset portfolio, and why we primarily feel that we are so strong.

Generally our assets are well diversified among asset classes and, in particular, when it comes to mortgages and real estate, across geographic regions. Sixty percent of the industry's portfolio is made up of bonds, and 90% of those bonds are in the top two National Association of Insurance Commissioners (NAIC) rating categories. Thirteen percent of bonds are issues of the federal government or agencies that carry a U.S. government guarantee. At the end of 1990, only 0.3% of those bonds were in default. Approximately 20% of the industry's assets are invested in mortgages, and as I said, they're basically spread out geographically. At the end of 1991, less than 1.2% of those mortgages were in default.

To put everything in perspective for you, when people talk about Executive Life and Mutual Benefit Life and the problems that they had, Executive Life had over 33% of its assets invested in junk bonds. The industry as a whole has less than 6% of its assets invested in lower-quality bonds, and those are the higher of the lower-quality bonds. Mutual Benefit Life had a very large percentage of its portfolio, approximately 40%, invested in mortgages that were primarily construction loans; that's not what the industry generally invests in, because insurers invest much more in income-producing mortgages. In addition, Mutual Benefit's mortgages were predominantly concentrated in the state of Florida. So it's in one state, and it's in construction loans, just to put things in perspective.

I'm not saying that there aren't insurers out there that have concentrations of one sort or another in these areas, but the industry as a whole is aware of the problems in the real estate market, and they have made conscious efforts to deal with those problems. Some insurers have increased their reserves on their real estate, they have taken real estate write-downs and, in addition, they have generally decreased their holdings in real estate. That may give you a flavor of where our assets are.

The other positive thing I would note is that, as a whole, it seems that the industry has turned around since 1988 in terms of its profitability. In 1990, net operating gain increased 26% from the prior year, and in 1989 there was a 33% increase. So we'd like to think that things are turning around.

I'd like to turn for a minute now to what we consider one of the greater challenges that we've faced in the past few years, and that is dealing with what the PBGC and DOL were initially thinking of doing in this area to try to protect annuitants. And that is to put out standards that would have relied on what we like to refer to as a bright-line test. Originally, when all of these industry insolvencies came out, people felt that the easy answer was to just purchase annuities from companies that had a certain claims-paying ability rating. The industry feels very strongly that that is a totally inappropriate way to go, for several reasons.

First of all, ratings, if used as a bright-line test to determine which annuity writer you should choose, are going to be used for a totally inappropriate purpose. Ratings are good at what they do, and that is to try and point out the good players and the bad players within an industry. Ratings give you a relative sense of the strengths and weaknesses. They also are able to give a sense of the relative financial strength of the industry, with a good degree of statistical accuracy, as to historical default rates. They're not good at being able to pick out any particular company to say that the company is going to fail at a given point in time, which is what certain people feel that they should be used for. The ratings look at a snapshot and, since insurance company commitments, particularly annuities, are long-term commitments, they can't tell you that 20 years from now XYZ company is still going to be around to pay off on those commitments. We always like to say that if you looked at Executive Life's and Mutual Benefit Life's ratings, within a year before or, in Mutual Benefit's case, at the time that it was seized by regulators, their ratings would have fallen within the range of a bright-line test, because both companies were fairly highly rated within a year prior to their takeovers.

Another point to make about the ratings is that the rating services do have limitations, and they vary in terms of their comprehensiveness. Also, smaller insurance companies that may be very good at what they do and are very viable, aren't rated by more than one, or perhaps two rating agencies. They still are strong enough to provide the benefits for annuitants.

We also feel very strongly that, if the federal government were to say that you need a bright-line test or a ratings standard to purchase annuities, this would have a spillover effect onto other lines of business. So even for those companies that were not in the annuity business, it would sort of fall over onto their other lines of business.

In September, when we filed our comment letter, which was quite extensive, we suggested to the PBGC and the DOL that, instead of looking at ratings, if the fiduciary standards in ERISA needed bolstering, then plan fiduciaries should be given guidelines to follow. I'll just quickly go through those. I know they're fairly complicated, but you, as experts, I'm sure would be able to meet these very easily.

1. We suggested to the PBGC that plan fiduciaries should consider the concentration and diversification of the insurer's general account assets, including the degree of compliance with the recently adopted NAIC model regulations on investments in medium- and lower-quality obligations.

2. The plan fiduciary should determine whether the insurer has filed with state regulatory authorities a statement of actuarial opinion based on an asset adequacy analysis, which I'm sure most of you are familiar with.

3. Capital comparison standards should be evaluated to determine the financial capacity of the insurer. The NAIC is right now, as I speak, working on a regulation in this regard, and the industry is working closely with the NAIC to try and make that standard as good as it can be.

4. Another factor that we named was, in fact, ratings; not just the letter, but also the background reports that are given so that you can get a more balanced and complete evaluation.

5. The history and size of the insurer should be taken into account; how long it has been in the annuity business.

6. The last factor, and this I'll talk about a little more, because it also deals with one of the strengthening mechanisms that's going on at the state level, is whether or not the insurer is licensed to do business in a state that's been accredited by the NAIC. I don't know how many of you are familiar with it, but the NAIC now has an accreditation program that it is trying to have all 50 states adopt by the end of 1994. The accreditation program basically includes a whole list of new financial regulation standards for insurers to do business in a certain state. To date, nine states are accredited, representing approximately 35% of the life insurance business that's out there. They're hoping to have 20 states accredited by the end of 1992, and over 40 by the end of 1993. The industry is working very closely with the NAIC and with the states to try and get as many states accredited as possible. We think that will also bring uniformity to the system of regulation that's out there and help strengthen it.

Now we understand that a lot of these factors are very complicated, and for some plan sponsors it would be almost impossible for them on their own to be able to judge an insurer, so we suggested in our comments that an expert, such as yourselves, could be hired to help with that evaluation. We feel that a plan fiduciary should gain as complete a picture of the financial situation of the annuity writer as possible, and that it's impossible to do that just from looking at the claims-paying ability rating.

We strongly agree with the comments that Angie made about federal regulation of the insurance industry. We strongly believe that the states and the industry should be seeking solutions, and they are, in fact, seeking solutions and should be strengthening the regulation that is out there. Having a layer of federal legislation or regulation on top of that is clearly inappropriate. If you look at what's happened to the savings and loan industry, it speaks for itself. In addition, having federal legislation out there would just take more money from all of our pockets, as we're seeing, as they go back again and again for the savings and loan bailout. So that's how we feel about federal legislation. But, unfortunately, some of the people on Capitol Hill don't agree with us.

You may be aware that several Senators and Congressional Representatives are looking at federal regulation. Two bills are out there or will be out there soon. Senator Metzenbaum introduced a bill last year that would have established a national guarantee fund and set up an independent insurance regulatory commission to basically regulate the insurance industry. That bill is still out there, but I think that people on the Hill, or at least in his office, are taking a wait-and-see attitude to see if some of the insurance industry problems do work out. So that bill is not being pushed currently.

However, on the House side, Congressional Representative Dingell is probably going to introduce a bill this week or next that would be similar to Senator Metzenbaum's bill. It would establish a federal insurance solvency corporation and there would be federal licensing of insurance companies. To the extent that a company is federally licensed, it would then get out from under state regulation. But it would have to meet federal capital surplus and reserving requirements, and a whole host of other requirements. It's unclear at this point how much support there is on the Hill for a bill like that. As I mentioned before, we are strongly opposed to any kind of federal regulation. We just feel it will add another layer of bureaucracy and not solve any problems.

I'd like to address one more area that Angie didn't touch on. The Department of Labor is, we believe, doing through the backdoor what it hasn't done through the frontdoor yet, in terms of a bright-line test. The DOL has filed, to date, five lawsuits against plan sponsors that purchased Executive Life annuities and, most recently, filed a lawsuit against a company that purchased Presidential Life annuities. The latter, of course, we find particularly troubling because Presidential Life, although it has had financial difficulties, is still a viable company. It is still continuing, to this date, to pay 100% of the benefits to all annuitants. We take this as a very bad sign from the Department of Labor.

Basically the allegations that the DOL has made in most of these lawsuits are that the fiduciaries did not fulfill their responsibilities because, in the cases where a consultant was used and recommended, they go with an insurer other than Executive Life, the advice was disregarded. In those cases where a consultant was not used, the DOL basically alleged that the plan sponsor did not take into account claims-paying ability ratings, on the basis of wanting to obtain the greatest asset reversion with either Executive Life or Presidential Life. We find this very troubling, because obviously it puts into the lawsuit the theory that you have to buy the safest annuity available, and they're basing that primarily on the ratings of the different insurance carriers out there. We don't know how the lawsuits will come out, but we are following them very closely.

MR. JAMES A. KENNEY: I think that the failure of Executive Life is a major event for our industry. As a pension consultant, I'm particularly troubled by the response of the industry to the failure of Executive Life. I think it's amazing that the participants have gotten as much as they have; however, I don't think this is the general public view. I believe that the failure of Executive Life has led to the loss of the life insurance industry's greatest asset, and that's public confidence that benefits will be paid. The public is jittery. As a consultant, I've been involved in a lot of annuity purchases. Lately I've been asked by these clients over and over, is our annuity safe? What is our responsibility if the insurance company goes under? And, most important, what do we tell our retirees? How do we reassure them?

The retirees did not have any say in the selection of the insurance provider. The PBGC, which was established 15 years ago to absolutely guarantee that pension benefits would be paid, now says the pension benefits will be paid only if an insurance company is not involved. This isn't going to work. If, as I believe, more insurance company failures do occur, there's going to be an enormous amount of pressure on our Congress, and Congress is going to put an enormous amount of pressure on you and on the PBGC.

Something has got to be done to guarantee these benefits. It's just impossible to allow a situation to continue, where major insurance companies fail and benefits are not paid, when the PBGC was established to guarantee those benefits. Either we work out a sensible, workable system, whereby 100% of pension benefits up to the PBGC guarantee are paid as soon as the insurance company fails, or the federal government will make such a guarantee for us. It is going to make us pay for that guarantee. It is not going to make the taxpayers pay for it. It is going to make the insurance industry pay for it. And that's the right thing to do. We should deal with this problem now before it's too late. We should deal with the problem before the federal government deals with it for us. That's the end of my sermon. Now I'd like to go on to the rest of my talk, which has three parts: (1) choosing an insurance company; (2) IRS issues raised by the failure of Executive Life; and (3) current efforts that are ongoing to guarantee that benefits will be paid.

As a consultant, I've been involved in a lot of annuity purchases, and have a pretty good understanding of the process whereby an insurer is chosen. One of the most important factors in choosing an insurance company is the ratings that that company has from Best's and similar rating agencies. Obviously these ratings are a very poor method of determining which insurance company is going to stay in business and which one is not. It's impossible, when buying an annuity that will be in place for 40 or 50 years, to determine whether that insurance company is going to be able to pay that annuity based on a snapshot of its investments and liability situation today. It just doesn't make sense. Nevertheless, in order to satisfy your fiduciary liability as a purchaser you have to look at those ratings.

The PBGC and the DOL suggested in their Advance Notice of Proposed Rulemaking, that purchasers try to evaluate the insurers themselves. They set forth a bunch of factors that you could use to evaluate these insurers. I think this is completely unworkable. Even if the employers could afford to do that, they're still going to come down to the same problem, which is that because a company is sound today, it is no guarantee that the company will be sound 10 years from now, much less 40 or 50 years from now.

A second factor involved in choosing an insurance company is the reputation of the company. This is a particularly important factor for two reasons. First, once you buy the annuity, the thing that really matters is its service. Second, an important part of the annuity purchase process is the reaction of employees to the purchase. If you buy an annuity from some company that the employees know has a good reputation, and if they've heard of it, they're more likely to feel comfortable and less likely to feel nervous than if you buy from some company they've never heard of, or that they've heard bad things about.

One problem is that most of these annuity purchases tend to be rather small. By small, I'm talking about what the insurance industry views as small, and that's anything under about $10 million. To the average person on the street, $10 million is a lot of money. But when you shop for an annuity, $10 million is not a lot of money.

I read all the comments that the PBGC received in response to their Advance Notice of Proposed Rulemaking. One comment was that for employers terminating plans with a small number of participants, the issue is not how safe the insurer is, but how to find someone who will sell an annuity. I know this is an accurate comment, because I've been through this process. Many insurers won't bid on anything less than $10 million.

If the PBGC and the DOL adopt strict standards such as outlined in the Advance Notice of Proposed Rulemaking, it's going to squeeze out the smaller insurers who will bid on these size contracts. And what's going to happen is, the big insurance companies will come into this area and they will jack the premiums up enormously; plans that once were fully funded will now be underfunded, because when you want to buy an annuity, you're not going to be able to get a price that's reasonable. I have seen incredible spreads on bids, as much as 20% between the low bid and the high bid. When you start squeezing out the low-bid end, you'll wind up with many plans that thought they were fully funded and are now insufficient, simply because of the way the federal government has put out some regulations. I don't think that makes sense.

Where can you get information when you want to evaluate an insurance company? Suppose you want to do the due diligence that goes beyond just looking at a rating. Well there are a couple of sources of information that are publicly available, and they both derive from the annual statement filed by the insurance companies that you may be considering. Obviously you've got to have a bid big enough in order to invest the money necessary to pay the consultant to go through this process.

You can look at Schedule A of the annual statement, which is a summary of the assets standing behind that insurance company. As you may know, this schedule provides both the book value and market value. However, the solvency of the company is not determined on the market value of its assets, it's determined on the book value of its assets. In an era when interest rates fluctuate widely, the value of bonds fluctuates widely. What this means is that the book value of assets is not a reliable method of determining the safety of the company from which you may be considering buying an annuity. Therefore, it's important to review the relationship of the market value of assets to the book value that the solvency of the company is measured by. If you have a big spread, a negative spread, between the book value and market value, I would be wary.

Another important source of information is Schedule S, which concerns reinsurance. Obviously companies are extremely sensitive to their reinsurance. The safety of the insurance companies involved, particularly smaller companies, hinges on their reinsurance agreements. You can get some sense of what these reinsurance agreements are by looking at Schedule S. But as an actuary who's filled out Schedule S, I can tell you that it's very hard to interpret. Nevertheless, you can find out who the reinsurers are and which of them has the bulk of the reinsurance. And if you know something about the reputation of reinsurers, you can get some idea of whether or not their reinsurance arrangements are sufficient.

Another very important factor in choosing the insurer is planning your communication with your employees. This was not a big factor in the old days, which means before the failure of Executive Life. You could just buy an annuity and your employees would just more or less accept whatever you bought, because everybody in this country believed in the insurance industry. They may not have liked it, they may have thought that insurers' profits were too high. They may have thought there were problems with the way insurers settled claims, but everyone expected that annuities would get paid. That faith has been shaken. And as a consultant I know that it's been shaken, because I hear this question over and over.

Therefore, if you're an employer who's considering buying an annuity, you should plan an employee communications program. And you should be aggressive about it. Don't wait for them to come to you and say they're concerned that you bought this annuity from somebody they've never heard of. Get them all together, have a meeting. Tell them why you bought this particular annuity, and what the great strengths and virtues of this company are, and how it's just not in danger. Because if you don't, there will be rumors, there will be talk, there will be concern, particularly among your retirees, but also among your active employees.

I'd like to switch now to topics concerning the IRS. The failure of Executive Life raises two kinds of issues from an IRS perspective. First, we have concerns about qualification of the plan.

One of these issues concerns the requirement of paying minimum distributions to employees who are age 70 1/2 or older. If the plan does not provide that, or if the plan has a systematic pattern of not meeting this requirement, then the plan could be disqualified. In the case of a failure of an insurer like Executive Life, this issue becomes potentially important. The reason is, if you have a defined contribution plan where people can direct their investments, they've put some of them into a guaranteed investment contract. You cannot just pay out everything except that, and meet the minimum distribution requirements, unless there's a specific exception for that by the IRS.

Another area where there could be a problem is with a defined-benefit plan where retirees are receiving benefits. If they do not receive the full amount of their benefits, the plan may not meet the minimum distribution requirement, and the employee could be subject to a 50% tax on the amount that fell short. Now the IRS is not actually doing this, because it has moved to forgive this problem. I think that was wise of the IRS. I think IRS will continue to do that in the future, but there's no guarantee that it will.

Another qualification issue raised involves Section 401(a)(2), which is the exclusive benefit rule, Section 401(a)(4), which is the rule against discrimination in favor of the highly paid, and Section 415. These issues come into play when the plan sponsor wishes to make the plan whole. What is the tax treatment of any contribution that the employer makes? Is it subject to 415 limits? If most of the money is going in favor of the higher-paid, the ones who directed their investment into the GICs, does that violate the nondiscrimination requirements of 401(a)(4)? If the plan finally receives 50 cents on the dollar for its GICs, and it returns the 50 cents that it receives to the employer, does that violate the exclusive benefit rule?

All of these questions have been answered by Revenue Procedure 92-16. Under this procedure, the IRS will waive these particular provisions of the tax code if you have made an application for a prohibited transaction exemption with the DOL or you fall within the parameters for a class exemption. You must ask the IRS for a closing agreement by February 1, 1993. One of the problems with this revenue procedure is that the contribution that the company makes to the plan to make it whole will probably not be fully deductible in the year in which it is made. Any contribution is deductible under the usual rules of Section 404 of the code, and the closing agreement will stipulate what proportion of it will be tax-deductible, what proportion will be nondeductible in the year in which it is made, and what future deduction stream the employer will get from this contribution.

Another tax issue is the lump-sum treatment of distributions. Suppose you, the employer, do not make a contribution to make the plan whole. Suppose participants have invested in a GIC contract, and they are terminating and want a lump-sum benefit from the plan. Typically what happens is that you would pay them everything except the GIC money, because you don't know how much that is. Two, three years later, this whole mess gets cleaned up, and employees get 60 cents on the dollar for their GICs. When they get a distribution of the remaining amount of money, that will probably not be a lump-sum distribution, because it's the second stage of a two-part distribution. It will probably be subject to ordinary income tax, unless the IRS issues a special procedure. Those are the IRS issues that I'm aware of, and I suggest you take a look at 92-16 if you had anything with Executive Life and the employer wants to make employees whole.

I'd like to talk a bit about the Advance Notice of Proposed Rulemaking by the PBGC and the DOL, and about some issues these agencies' proposal raises. First, it's likely to increase the fiduciary liability of the plan sponsor. Obviously, when you start setting out additional requirements, some people will be capable of dealing with these requirements and some people will not. In particular, the smaller the plan sponsor and the smaller the amount of money involved, the less compliance there will be. This will put additional risk on small defined-benefit plans during the termination process.

I'm particularly concerned by the DOL's practice with respect to Executive Life. As you may know, Executive Life had an A+ rating from Best's. It was not a poorly rated company. In the typical selection process that I've seen, if the plan sponsor had approved the selection of Executive Life as one of the companies that was being considered as an annuity provider, and it had come in with the low bid, the sponsor would have looked at the Best's rating. It was A+. It had the low bid and it would probably have been selected. It looks to me like what the DOL is saying is, if the company fails, the DOL will go after you regardless of what their rating was, and regardless of the process you used to select them. In essence, the failure of an insurer means that you weren't prudent in selecting them. I think that's a dangerous principle. I think it's a natural result, unless there is a good solid guarantee system, because sooner or later we have to get money out of somebody in order to make the affected retirees whole. If the life insurance industry won't do it and the federal government won't do it, it's got to be the plan sponsor. Who else can it be? And if the plan sponsor won't do it voluntarily, then the government's going to have to coerce them.

Another conclusion from the proposed rule-making is that the cost of the annuity purchase process will increase, because plan sponsors will have to do more work. Also, the cost of the annuity itself will probably increase, because smaller companies or more marginal companies will be squeezed out of the marketplace. When there's less competition, you can afford to charge higher premiums and still have a market. This will mean a loss of capacity. It will mean that the bigger, stronger insurers can be more selective and more pricey.

I don't believe that the PBGC and DOL suggestions make any sense at all. I think they're ridiculous. I think all they will do is drive up the cost of an annuity and put pressure on small plan sponsors. I'm not talking about doctors and lawyers now, I'm talking about companies with 200 and 300 lives; companies that have $10-15 million worth of assets in their plans. This is not what most people think of as a small employer. But from the point of view of the insurance industry, this is a small employer. It is this kind of employer that will suffer, and there are an awful lot of them.

What are we going to do about seeing that these benefits are paid? One proposal is to rely on the state guarantee funds. Unfortunately, there are some problems with the state guarantee funds. One is that some states are vigorous in their efforts to regulate, and they always come up with different ways of regulating. So we have a lack of uniformity among these state guarantee funds. In addition, because they are state-based, there are issues of domicile. If you are in California and you're drawing an annuity, the California State Guarantee Fund will see that you get paid in one way, shape, or form, to whatever percentage it is going to pay. If you're domiciled somewhere else, or the insurance company was domiciled somewhere else, you may or may not get your annuity, because you were out of state or the insurer is out of state. This is not a sensible way to guarantee payments.

Finally, there are issues of adequacy. Are the state guarantee funds adequate to deal with a major failure? I don't believe that Executive Life was a major failure. I believe that there are major failures waiting for us, because of the life insurance industry's switch from the product that it was selling. When I was taking actuarial exams, the product that was being sold was the guarantee about human mortality. That was what we sold then, and now we're selling investments. We're selling universal life, and we're selling GICs. These have very little to do with what we originally started from, and what the industry built on. Now we're competing with banks and brokerage houses and stock markets for investment dollars.

One problem with this approach is that the public is fickle. There are rumors, concerns, higher interest rates, and rising stock markets. They don't draw our money away gradually, they draw it away in big hunks. That's what brought Continental Bank down. That's what drove Executive Life down. Once large numbers of policyholders perceive a problem, they begin yanking their money. The life insurance company has typically invested this in long-term investments. Depending on interest rates when the rumor occurs, or when capital flight occurs, this can cause the assets to be insufficient. I believe that the life insurance industry faces major potential failures because of its change in emphasis on what it is selling. Are the state funds adequate to deal with this? I believe the answer to that is no.

What about the PBGC? Well, the PBGC apparently lacks legal authority. I say *apparently*, because in 1981 this was not its opinion. In 1981, its opinion, as stated in the preamble to some of its regulations at that time, was that in the unlikely event of life insurance failure, the PBGC would guarantee the benefits. We called the PBGC in 1986 when we were going through a major annuity purchase, and asked what would happen if the insurer failed. The person we talked to said there would be no problem; the PBGC would guarantee those benefits. It has changed its position now. Well, it has the right, I guess. There's a legal issue. Does the PBGC have the legal authority to guarantee these benefits or not? I don't know. Its position is no.

There's a political issue: will Congress sit still while the PBGC takes this position? I think that if Executive Life is the only failure, and we go for another three or four years, and nobody else fails, then all this pressure will go away and people will think everything's fine. If we have another failure, the pressure on the PBGC from Congress will become enormous. And either Congress will create a new agency, or Congress will force the PBGC to insure these benefits. It's better to deal with this issue now before that happens, because the PBGC already faces a big deficit. The PBGC doesn't have the money to guarantee these benefits, and we all know it. And frankly, the way things are going, the federal government doesn't have the money to guarantee these things either. It is already having trouble paying for the S&Ls.

What are we going to do about this? I believe there are two basic solutions. One is that the life insurance industry can create a national guarantee fund that has some muscle and will begin immediate benefit payments upon failure of an insurer, and not dillydally around, and not pay 70%, but pay 100% starting right away. If you're going to do this, if you're going to prevent the federal government from coming in and dealing with it, and creating chaos in a system that has worked, you've got to do it before the next failure comes down the road. Doing it afterward is going to be too late. I'm a consultant, I'm not part of the life insurance industry. But for those of you who are part of the life insurance industry, if you want to avert federal government meddling in how you do business, it's time to act now.

The other proposal is to have a federal agency take up the slack. Personally, I think that it would make more sense to have the PBGC do it than to create a new agency. We've already got an agency that is in place. And I have a proposal for this. The first part of the proposal deals with future annuity purchases. Under this proposal, the PBGC would guarantee the benefits that were purchased, up to the usual PBGC limit. The life insurance company selling the annuity would be required to segregate these assets in an account that could not be touched in the event of insurer bankruptcy. The insurer would pay premiums to the PBGC on an annual basis, either just like everybody else or on a special rate, considering that it is an insurance company. The insurance companies would be required to fill out Schedule Bs for these funds, and demonstrate that they have adequate reserves or, if they don't have adequate reserves, that they make minimum required contributions to that reserve fund.

What are we going to do about the existing annuities? There are an awful lot of them out there, because there was a huge wave of plan terminations. Over five or six years, billions of dollars worth of annuities were purchased. I would have a 10-year phase-in, whereby the insurance companies would be required to have 0.1 of the reserve in the first year, 0.2 in the second year, and so on. The PBGC would phase in its guarantees, and the PBGC would collect phased-in premiums. If we don't do something like this, we will wind up getting something a lot worse.

MR. SCHREITMUELLER: I'm going to start out with some comments on Angie's presentation. She used the words that the PBGC always uses in talking about why it has no further obligation in this, what some might call a granny-dumping situation. When an employer buys annuities, Angie says that the liability switches from the plan to the annuity provider. I somehow always viewed it, not as a transfer of the liability, but more of a delegation of the liability, whereby the plan doesn't really rid itself of the liability, the liability is simply being taken over by somebody else for as long as possible, we hope forever but it will not necessarily be forever. Anyway, that's just a different view that perhaps helps explain why James and I look at this issue a bit differently from the PBGC.

Another comment is that there was some talk that if the PBGC was to get into the act in guaranteeing annuities, there would be some buck passing between the PBGC and the state guaranty associations as to who would pay first. I'm reminded of quite a few years ago when coordination of benefits was coming onto the scene in group medical plans. One of the very early coordination-of-benefits provisions was that the other insurance company paid first. So it could be one of those situations, but there are ways of moving beyond that.

I agree with Melissa that we do not want a bright-line test of an insurer, but she and the ACLI conclude that ultimately you've got to pick a strong insurer. I think it's very difficult to do. For example, when you've got a small consulting firm, there needs to be a workable arrangement. You can't expect the pension consultant, who suddenly gets a termination, to become an expert in that field for the sake of his one client. I think if this situation were to continue, you'd find service firms, similar to what we have in the computer field. Some of you might want to set up a little shop and service the small consultants. Provide the consultant with a tailored report with his name on it that shows, by his criteria, what's a strong company and what isn't a strong company. You provide the expertise, the consultant gets a fee, and everybody's happy. That would help.

But I do view the suggestions from the PBGC and the ACLI as a nonviable long-term approach. I believe that it won't work.

But I don't agree with James that it's ridiculous, that it makes no sense at all. It makes perfect sense if you're a politician. Because it will work over the short run, and that's what a politician wants, something that will work over the short run. But we are not short-run people, we're long-run people. It's up to us to let the politicians know why that won't work; to help educate the public that there are better things to do than get through the short run. James and I have been at this a little bit. We had several articles in the *Enrolled Actuaries Report* last summer, about why we don't think this approach will work and what might work better.

Melissa talked about asset diversification. A short time ago, I saw an annual report from an insurance company, where I hold a few shares of stock, and I was quite surprised. There was a huge display of its asset diversification, by type of asset and by states where these mortgages and loans were, and they were about as diversified as you would want to see. It never showed that before; I've held this stock for many years. So there's a lot of response and sensitivity to some of the needs in the marketplace.

My last comment is really a question directed at Angie and the PBGC. There must be some criteria that the PBGC and the DOL are using to launch these investigations of annuity purchasers. Somehow, I don't think they're making up the rules as they go along. And my question is: has anyone yet asked under the Freedom of Information Act what those procedures are, and if so, what has been the response of the PBGC?

MS. ARNETT: The PBGC is referring questionable insurer selections to the Department of Labor for further investigation. It has been doing that since March 1990. The criteria for these referrals have been requested under the Freedom of Information Act, and we are not providing that information, since the referrals are part of an investigatory process.

I personally think that James' suggestion regarding an employee information package about an annuity provider is an excellent idea. I certainly think that is something that is going to become more and more important, and that employers should be prepared to do that.

He talked about the problems with small plans. The PBGC is very aware of that and very concerned about that. It is also aware of the argument that standards are going to make the annuity purchase more expensive and more costly. That is also a concern. I know that a lot of you think that the PBGC should insure annuities so that participants will not have benefits cut back in the case of an insurer insolvency. I touched on some of the problems associated with that earlier, but simply as a practical matter, let me remind you that even if there was a federal guaranty of insurer insolvency in place, payment to participants could not be instantaneous. Payment would involve a participant-by-participant calculation, based on the maximum guaranteeable benefit in the year a particular plan terminated. This could involve taking into account what the participant has already been paid in excess of that maximum amount, to see what the future stream of payments would be, and to figure out what the participant is going to receive from the insolvent insurer and the appropriate state guaranty funds. Therefore, a federal guaranty would not be an easy or a quick solution.

MS. KAHN: First of all, I know I said it in the beginning of my remarks, but I really do want to emphasize that the insurance industry knows that it is having a crisis of confidence by the public, by the consultants, and by the plan fiduciaries out there. It is the most critical problem that we in the industry face today, and believe me, we take it very, very seriously.

I'd also like to take issue with something that James said, in terms of the industry's response. I think that we are being very responsive. We have spent countless months and years dealing with this problem, the Executive Life rehabilitation, Mutual Benefit, and everything else that has fallen out from that. We deal with this every day and we are trying to come up with solutions that will work. We agree with Angie and the PBGC that having the PBGC be the insurer of last resort is not the answer here. The industry is being responsive. I think that the Executive Life rehabilitation is a perfect case in point. If the industry hadn't stepped in as it did voluntarily with its enhancement plan, those participants would not be getting what they will ultimately get, assuming that the Muni-GIC resolution comes out as we're hoping it will. I think that the industry really has taken it upon itself to try and make sure that the confidence of the public is restored. Because without public confidence, our industry is nothing.

MR. JOHN T. LONGMOORE: I have a question and a comment. I concur with the PBGC about staying away from this because of the track record of the federal government with the Federal Savings and Loan and Federal Deposit Insurance. It's just terrible. It would be bad for the government, bad for the taxpayers, and bad for the industry, because I think it would encourage some high-flying that should not occur.

The observation was made that five years ago, nobody was thinking about the quality of the insurance companies within the industry. There were a lot of concerns within the industry about Executive Life at that time. So we knew what was going on. It was competition in a way, but a lot of people in the industry would say this is extremely unfair, nonquality, and there were concerns about management at Executive Life. So we knew what was going on. I don't think the industry is too dumb. A statement was made that 97% of the pension participants and beneficiaries under Executive Life would be covered and 3% wouldn't. I question that because --

MS. ARNETT: I'm sorry. I think the figure is 97% of policyholders would be paid 100%. Three percent would be paid in a range from 70 cents on the dollar to 80 cents on the dollar depending on --

MR. LONGMOORE: Okay, you're talking policyholders. What about pension beneficiaries under the annuity contracts?

MS. ARNETT: My understanding is that includes the annuity holders.

MR. LONGMOORE: Could you elaborate on the 3%?

MS. ARNETT: I can only state what I have seen reported in the press on Executive Life's proposed payout.

MR. SCHREITMUELLER: These are people whose benefits are above the $100,000 cap.

MS. ARNETT: Right.

MR. SCHREITMUELLER: Because if the present value is more than $100,000, that's the limit of what gets insured.

MS. ARNETT: Under state guarantee funds, the general limit is not consistent from one state to another, but generally the limit is $100,000 present value. Anything in excess of that would not get paid.

MR. LONGMOORE: Right, but the guarantee association, along with the insurance industry, along with the purchaser, are going to fill that in, no? You have to leave something for the lawyers to sue people, that somebody fell short.

I would like to take issue with Mr. Kenney's comments that the insurance industry should have bailed out Executive Life and made all its contractholders whole. As a practical matter, most individuals who purchased insurance and annuity contracts will eventually be covered by state guaranty funds.

However, with respect to institutions purchasing GIC contracts, the presumably sophisticated purchaser should have realized that the reason that he was able to obtain a significantly higher rate from Executive Life was because of the higher risk -- just as you can get a higher rate from lower quality bonds than you can get from government or higher quality corporate bonds. So the purchaser was making a risk/return tradeoff. He could have purchased a GIC at a lower rate of return from a major insurance company such as the Prudential or Metropolitan, but made a clear choice for a higher return rather than more safety. Further, it was well known and widely reported that Executive Life's portfolio was heavily invested in lower quality junk bonds purchased in connection with leveraged buyouts.

Also, in connection with the leveraged buyouts, the pension plan was often terminated, annuities were purchased to cover the accrued benefit under the plan, and the excess assets were recovered, in effect, to cover part of the cost of the buyout. Executive Life was a major player in this market, and as Mr. Kenney properly points out, the annuitant had no say in the selection of the annuity provider. However, the purchaser of the annuity, who was a fiduciary under ERISA, had an obligation to act in the best interest of plan participants, not in the best interests of the new management. If Executive Life was selected solely because it quoted the lowest price, which would result in the maximum reversion of assets from the plan, it would appear to me that it is the fiduciary's obligation, not the other insurance companies who quoted a more realistic price, to make up the difference. As a practical matter, most of the annuitants will not lose a significant portion of their benefits, because of the protection afforded by state guaranty laws.

Another point that Mr. Kenney makes is that large, well-known companies will not bid on small blocks of business. To some extent, what he says is true. It is uneconomic for large insurers to bid on a piece of business that is going to be offered to a large number of insurers, and then be given to the one with the lowest price, regardless of the quality of the company. He is also right that the large companies will charge more than Executive Life, which was underpricing the business and ended up in receivership. However, the safety of annuitants should be of paramount importance in the purchase decision. When that happens, more large, well-known companies will be willing to quote on this business.

Mr. Kenney is, of course, right that it is difficult to evaluate the quality of an insurance company, but there are additional things that one can do somewhat easily. You can see whether the asset distribution of the company is similar to that of the industry in type and in quality. Does it have an undue percentage of assets in lower quality categories like Executive Life, or in subsidiary or related company investments like Baldwin United? Is there an undue concentration in a single credit or in a few large investments in comparison to surplus? It becomes more difficult to evaluate the liabilities, but it is important to determine whether there are large blocks of business that can be withdrawn at book value without any market value or other penalties.

I agree that the communication to participants is extremely important, and that participants understand why the particular company was chosen, and why the participant should be confident that the company will be around to pay benefits many years into the future. However, I think that the important lesson to be learned from this whole mess is that a fiduciary making a purchase must look at both price and quality and, at all times, remember that he or she is required to act in the best interests of plan participants.

MR. LIANGAN LIU: As someone who works for a large employer, Arco, I disagree with the speakers who said that five years ago none of the employers worried about life insurance or the insurance companies' ability to back the annuities. In fact, back in 1987, Arco had already looked at this as a very serious problem, and we were very cautious about those issues.

I agree with Mr. Kenney's comments about all the confidence issues. As an employer, we do not understand the federal regulations that limit employer's ability to be able to pay out lump sums to the participants so that you can transfer all the future investment returns directly to the participants when you terminate their pension plans. The mandatory lump sum distribution is so low that it is primarily a joke, and that's dealing with a very young participant; otherwise $3,500 is almost nothing.

The other thing I don't understand as an employer is why the life insurance companies are making an annuity purchase so complicated. We look at the annuities as being very straightforward calculations. You can calculate the annuity purchase as a setting up of a dedicated bond portfolio. Either the states or the federal government can regulate the minimum grade of the dedicated bond portfolios, and the insurance company can add on the profit margins and the service industry charges, and that's all you need for the annuity contracts. I don't understand why a lot of the insurance companies want to make the whole issue so complicated. The state or federal government can mandate the life insurance companies to set up the annuity contracts or the GICs as a separate line of business and regulate from that point of view. Then, the problem can always be solved.

MR. SCHREITMUELLER: I want to respond, because I'm the one who said that five or so years ago there was not much awareness, and I will stand by that. Yes, there are perhaps a good number of consultants and knowledgeable insurance industry people, who were onto this via the grapevine and so forth, but I would say that the majority of people involved in purchasing annuities were not. Certainly the prevailing wisdom was that insurer strength was not a major consideration, and I'll back that up.

I went back several years into the records of actuarial meetings and discussions that were held in the late 1980s, about how to go about winding up a plan, purchasing annuities. There was a lot in there about how to get the bids and do all sorts of things, but there was very, very little about having a good insurer, a strong insurer. It was mentioned, but that's about as far as it went, there was nothing about the kind of homework one should do in choosing an insurer. Those of you who happened to have given it a lot of thought, yes, you would come to that conclusion, but there were enough people who didn't, and Executive Life was selling plenty of business just the same.

One could make a case that those actuaries who knew of unsound practices owed it to their fellow professionals and the public to sound a note of caution. Perhaps if the average pension actuary or plan sponsor had seen a few articles or talks warning about risky insurers with low bids, the course of history would have been different.

MR. KENNEY: I'd like to disagree with that. I knew about Baldwin United and I followed it quite closely and I --

MR. SCHREITMUELLER: You're proving my point. You're a knowledgeable person. You're a very thoughtful person. Yes, I knew about that, too.

MR. FRANK E. MORRIS: I'd like to say I agreed with almost everything Mr. Kenney said. Looking at Baldwin United, those policyholders got nowhere near 100 cents on the dollar. Many of them bought 12.5%, 13% guarantees. They're now getting about 7-8%, and in actuarial terms, no one would say that they really got what they bought, 100 cents on the dollar. I particularly like his idea of the insurance industry setting up a pool of guaranteed-type funds. Had you viewed that as something voluntary or mandated from some agency? Or would the insurance companies get together and have some kind of underwriting pool themselves?

MR. KENNEY: I'd like to say this is not my idea. This idea came from the comments that were submitted to the Advance Notice for Proposed Rulemaking. I understood it to be an industrywide association. In order for it to work, I would imagine it would have to be mandatory.

MR. SCHREITMUELLER: I would suggest that if the idea is any good, the politicians will quickly mandate it and take credit for it.

MR. KENNEY: You're talking about some kind of federal legislation.

MR. MORRIS: Okay. I like the idea more as a voluntary type of thing, where the market would decide. If people put their premiums in there and, in effect, bought a guarantee, the policyholders, in effect, would be paying for that with some type of reduced rate. If they wanted to pay for that, fine. If they didn't want to pay for it, and the company didn't join, and it just went belly up, that would be tough luck. It went out of business, it owed you money. You're just a creditor like any other; if GM went belly up, you'd lose out on whatever investment you had in it. Let the market decide, is this worth it, or isn't it worth it?

MR. KENNEY: The thing that concerns me is that prior to the termination process, these benefits are guaranteed. As a result of the termination process, by transferring the liability to life insurance companies, that guarantee disappears. The problem is that a lot of these sponsoring entities are dissolved in coordination with the termination of the plan. That's why the plans are being terminated.