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COMMENT

JOHN HANCOCK v. HARRIS TRUST: SHOULD INSURERS' GENERAL ACCOUNTS BE SUBJECT TO ERISA?

The Employee Retirement Income Security Act of 1974 ("ERISA")¹ constituted a fundamental change in the regulation of pension plans.² When Congress enacted ERISA, it was concerned primarily with providing for adequate funding of pension plans, providing employees with plan information, and protecting the assets allocated to fund pension obligations.³ To protect plan assets,

¹ Employee Retirement Income Security Act of 1974, 88 Stat. 829 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (1988)).

² Prior to ERISA, government regulation of private pensions was limited to curbing specific abuses. *See, e.g.*, Labor Management Relations Act, 61 Stat. 136 (1947) (codified as amended at 29 U.S.C. §§ 141-44, 151-67, 171-83, 185-87, 557 (1947)) (requiring management and labor trustees to administer union-sponsored plans and establishing criminal penalties for abuses); Welfare and Pension Plans Disclosure Act, 72 Stat. 997 (1958) (codified as amended at 29 U.S.C. §§ 301-309 (1958)) (requiring limited disclosure of pension plan information), *repealed by* § 111(a)(1), 88 Stat. 829, 851 (1974). ERISA, by contrast, is a broad statute providing guidelines for the establishment, operation, and administration of private employers' welfare and pension plans. *See* BARBARA J. COLEMAN, PRIMER ON EMPLOYEE RETIREMENT INCOME SECURITY ACT 1 (2d ed. 1987); Anthony A. Harris, *Introduction to ERISA: SELECTED LEGISLATIVE HISTORY 1974-1986 v* (1986) ("The enactment of the Employee Retirement Income Security Act marked the beginning of a broadened federal interest in liberalizing and expanding private pension plans . . .").

³ *See* 29 U.S.C. § 1001(a) (1988). The statute's policy declaration observes that "the continued well-being and security of millions of employees and their dependents are directly affected by [employee benefit] plans" and declares it "desirable in the interests of employees and their beneficiaries . . . that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans." *Id.* The statute further states that because the standards in effect prior to ERISA were inadequate, "the soundness and stability of plans with respect to adequate funds to pay promised benefits may [have been] endangered" at the time of ERISA's enactment. *Id.*; *see also* COLEMAN, *supra* note 2, at 3. "ERISA has several major objectives: to ensure that workers and beneficiaries receive adequate information about their employee benefit plans; [t]o set standards of conduct for those manag-

Congress included provisions that governed the behavior of fiduciaries⁴—those responsible for the administration of pension plans and their assets.⁵

In 1993, pension plan group annuity contracts accounted for approximately \$330 billion of insurance companies' general accounts.⁶ Based on ERISA section 401(b)(2)⁷ and the Department of Labor's ("DOL") Interpretive Bulletin 75-2,⁸ the insurance in-

ing employee benefit plans and plan funds; [and] [t]o determine that adequate funds are being set aside to pay promised pension benefits" *Id.*

⁴ See 29 U.S.C. § 1002(21)(A) (1988). This section broadly defines a fiduciary:

[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Id.

⁵ See 29 U.S.C. § 1104(a)(1) (1988). With respect to benefit plans, ERISA requires that fiduciaries act "solely in the interests of the participants and beneficiaries," *id.*, and with "care, skill, prudence, and diligence." *Id.* § 1104(a)(1)(B). In addition, fiduciaries must diversify the plan's investments "to minimize the risk of large losses." *Id.* § 1104(a)(1)(C). Section 1106 specifically prohibits a fiduciary from "deal[ing] with the assets of the plan in his own interest or for his own account." *Id.* § 1106(b)(1); see *Evans v. Bexley*, 750 F.2d 1498, 1500 (11th Cir. 1985) (finding fiduciary may serve as trustee of two employee benefit plans "so long as nothing in the arrangement causes him to violate the general fiduciary duties codified in ERISA"); DANIEL C. KNICKERBOCKER, JR., *FIDUCIARY RESPONSIBILITY UNDER ERISA* § 1.03 (1994) (noting prominence of ERISA's rules designed to assure proper plan management by establishing broad fiduciary rules).

⁶ See *Supreme Court Explains When Assets of an Insurance Company's General Account are Plan Assets*, 2 ERISA Litig. Rep. (P-H) No. 6, at 3 (Dec. 1993) (describing current importance of group annuity contract assets), available in WESTLAW, Pen-tp database.

⁷ 29 U.S.C. § 1101(b)(2) (1988). "In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not . . . be deemed to include any assets of such insurer." *Id.*

⁸ 29 C.F.R. § 2509.75-2 (1992). The DOL stated that the proceeds from a guaranteed investment contract or an insurance policy, sold to an employee benefit plan which is placed in an insurance company's general account, would not convert the account's assets into "plan assets." *Id.*; see Stephen H. Goldberg & Melvin S. Altman, *The Case for the Nonapplication of ERISA to Insurers' General Account Assets*, 21 TORT & INS. L.J. 475, 485-86 (1986). Prior to the issuance of Interpretive Bulletin 75-2, then Assistant Secretary of Labor for Labor Management Relations Paul J. Fasser, Jr. explained to Congress that the purpose of Interpretive Bulletin 75-2 was to ensure that "managers are . . . not restricted from engaging in normal business transactions, including transactions with persons who happen to be parties in interest with respect to the policyholder plans." *Id.* at 486 (citation omitted). Immediately after the publication of Interpretive Bulletin 75-2, the DOL issued Advisory Opinion 75-79, which re-

dustry has relied on the assumption that ERISA's fiduciary duties do not apply to the management of general account assets, because they are not "plan assets,"⁹ and has conducted its affairs accordingly.¹⁰ Recently, in *John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank*,¹¹ the United States Supreme Court ruled that "free funds"¹² of a guaranteed annuity contract are "plan assets,"¹³ and therefore, an insurance company's "actions in regard to their management and disposition must be judged against ERISA's fiduciary standards."¹⁴

This Comment analyzes the way the Court's holding "undermines the fundamental premises on which billions of dollars of insurance contracts" have been sold to retirement plans by the insurance industry.¹⁵ Part I explains how the Supreme Court

affirmed that an insurer's general account funds were not "plan assets" with respect to general account group annuity contracts. *Fiduciary Duties Under ERISA*, *Dol. Adv. Op. 75-79* (Feb. 1, 1975), 1975 ERISA LEXIS 85. Therefore, a transaction between a party in interest and an insurance company will not be prohibited solely because of a contract for life insurance or annuity between the parties. KNICKERBOCKER, *supra* note 5, § 2.05.

⁹ See 29 U.S.C. § 1002(21)(A) (defining fiduciary as one with "authority or control respecting . . . [plan] assets").

¹⁰ See Jonathan M. Ocker et al., *Executive Compensation: A 1987 Road Map For The Corporate Advisor*, 43 *BUS. LAW.* 185, 243 (1987) (advising corporate attorneys that based on advisory opinions insurance policies will not constitute plan assets); Goldberg & Altman, *supra* note 8, at 486 (noting insurance industry has conducted its affairs under impression that general account assets are not "plan assets" and managers of such assets are not "fiduciaries within the meaning of ERISA"). In addition, cases have held that the insurer is not subject to fiduciary duties. See, e.g., *Trustees of Laborers' Local No. 72 Pension Fund v. Nationwide Life Ins. Co.*, 783 F. Supp. 899, 906 (D.N.J. 1992) (granting partial summary judgment because funds deposited in general account were not plan assets).

¹¹ 114 S. Ct. 517 (1993).

¹² The Court adopted the parties' definition of "free funds" as an amount of pension funds greater than "105 percent of the amount needed to provide guaranteed benefits." *Id.* at 522.

¹³ See 29 U.S.C. § 1101(b)(2) (exempting from insurer's plan assets any guaranteed benefit policy). The Court, while noting this exemption, found that the free funds provided no guaranteed benefit. *Hancock*, 114 S. Ct. at 527-29.

¹⁴ *Hancock*, 114 S. Ct. at 529.

¹⁵ See Scott V. Rozmus, Note, *Insurers Beware: General Account Activities May Subject Insurance Companies to ERISA's Fiduciary Obligations*, 88 *Nw. U. L. REV.* 803, 803 (1994) (noting that investment acumen of large insurance companies draws billions of dollars into group annuity contracts, which are then pooled in insurers' general accounts); Brief of the State of New York and the Commonwealth of Massachusetts as Amici Curiae in Support of Petitioner, *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 114 S. Ct. 517 (1993) (No. 92-1074), available in LEXIS, Genfed Library, Briefs file, [hereinafter Amici Brief] (expressing view that Congress did not intend general account assets of insurance companies to be considered "plan assets" under ERISA).

arrived at its decision. Part II briefly explains the way an insurance company's general account works. Part III discusses ERISA's fiduciary duties and analyzes their effect on insurers' general accounts. Part IV discusses ERISA's prohibited transaction provisions and their effect on insurers' general accounts in light of the Supreme Court's decision. Part V discusses insurers' course of action in light of this decision. This Comment concludes that the Supreme Court has gone too far in applying ERISA to insurers' general accounts, and that it is Congress's responsibility to correct this judicial overstep.

I. FACTUAL BACKGROUND OF *HANCOCK* AND THE SUPREME COURT'S DECISION

In *Hancock*, the John Hancock Mutual Life Insurance Company ("Hancock") entered into a contract known as a "deposit administration contract"¹⁶ or "participating group annuity"¹⁷ with the Harris Trust and Savings Bank ("Harris"), a retirement plan trustee for the Sperry Rand Corporation. Pursuant to their agreement, Hancock received premiums from Sperry's retirement plan which it deposited in its general account and later used to

¹⁶ See *Peoria Union Stock Yards Co. v. Penn Mut. Life Ins. Co.*, 698 F.2d 320, 322 (7th Cir. 1983). *Peoria* defined a "group deposit administration contract" as one in which:

The insurance company determines what the employer must contribute annually to fund the plan; the contributions are deposited with the insurance company, which invests them as a single account rather than setting up a separate account for each employee; and the funds in the account are commingled for investment purposes with the funds of other customers of the insurance company, in much the same way as investments of different investors are pooled in a mutual fund or common trust fund, in order to obtain diversification while minimizing brokerage and management costs. When an employee retires, the insurance company informs the employer how much the employee's retirement annuity will cost. The employer can purchase the annuity from the insurance company with a portion of the funds on deposit or it can withdraw funds and purchase the annuity from another insurance company.

Id.; see also, 2 JEFFREY D. MAMORSKY, *EMPLOYEE BENEFITS LAW ERISA AND BEYOND* § 8.03[3][b] (1994) (noting that insurance company guarantees benefits to extent premiums are paid); Goldberg & Altman, *supra* note 8, at 479-80.

¹⁷ See MAMORSKY, *supra* note 16, § 8.03[3][a] (defining "group annuity plan" as one in which "[b]enefits under the plan are funded through an arrangement governed by a contract between the insurance company and the employer. The employer buys deferred annuities that will pay the planned retirement benefit, usually commencing at normal retirement age.").

purchase annuities to secure retiree benefits.¹⁸ Harris argued that in managing its general account, Hancock was actually managing “plan assets” and was therefore subject to the fiduciary duties under ERISA.¹⁹ Hancock contended that it had no fiduciary responsibility for the management of its general account because the contract fit within ERISA’s “guaranteed benefit policy” exclusion.²⁰ The Supreme Court granted certiorari²¹ to resolve a split among the circuits on whether the guaranteed benefit policy exclusion applied to this type of annuity contract.²²

¹⁸ 114 S. Ct. at 522. The Court noted that Hancock’s general account was also used to pay its business costs and obligations to insureds and creditors. *Id.*

¹⁹ *Id.* at 523. Harris further contended that Hancock breached its fiduciary duties because it did not allow Harris access to “free funds.” *Id.*

²⁰ *Id.* A “guaranteed benefit policy” is defined in 29 U.S.C. § 1101(b)(2)(B) (1988) as 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. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.” 29 U.S.C. § 1101(b)(2) (1988) provides that insurer’s funds are not plan assets solely because of a “guaranteed benefit policy.” *See supra* note 7.

²¹ *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 113 S. Ct. 1576 (1993).

²² *See Mack Boring & Parts v. Meeker Sharkey Moffitt*, 930 F.2d 267 (3d Cir. 1991). In *Mack Boring*, the Third Circuit held that for a general account contract to fit under the guaranteed benefit policy exclusion, it is enough that it provides for “guaranteed benefits to plan participants at some finite point in the future.” *Id.* at 273. This is so even if the amount credited to the pension administration fund fluctuates according to the performance of the general account before the contract funds are converted to fixed annuities (the “payment phase”). *Id.* Similarly, in *Associates in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 568-69 (7th Cir. 1991), *cert. denied*, 112 S. Ct. 1182 (1992), the Seventh Circuit held that an insurance company was not a fiduciary with respect to a “flexible annuity contract” because “it set fixed annual rates” and “backed its promise with its full assets.” The court concluded that the “flexible annuity contract” was a “guaranteed benefit policy” that entitled the insurer to a § 1101(b)(2) exemption. *Id.* Conversely, in *Peoria Union Stock Yards Co. v. Penn Mut. Life Ins. Co.*, 698 F.2d 320, 327 (7th Cir. 1983), the Seventh Circuit held that a deposit administration contract was not a “guaranteed benefit policy” within the meaning of 29 U.S.C. § 1101(b)(2) with respect to the accumulation phase of the contract. Splitting the deposit administration contract into an accumulation phase and an annuity payment phase, the court decided that during the accumulation phase, amounts contributed to the account are subject to the insurance company’s investment discretion with only a “modest income guaranty.” *Id.* The court found the insurance company to be a fiduciary with respect to the investment return on the policy. *Id.* In *Jacobson v. John Hancock Mut. Life Ins. Co.*, 655 F. Supp. 1290 (D. Conn.), *vacated*, 662 F. Supp. 1103 (D. Conn. 1987), the district court followed the *Peoria* rationale. In granting summary judgment, the court held that if it is possible for a plan’s funds to fluctuate because of the insurer’s investment performance, the insurer will be a fiduciary until the funds are converted into a “fixed obligation or guarantee which then provide[s] sufficient protection for the benefits.” *Id.* at 1130; *see Rozmus, supra* note 15, at 808-18 (discussing judicial analysis of pension contracts and guaranteed benefit policy exclusion); Aleta Spence, *The Harris Trust Case*, in

The litigants referred to the contract in dispute as Group Annuity Contract No. 50 ("GAC 50").²³ For bookkeeping purposes, GAC 50 contained two accounts.²⁴ Its assets were recorded in the "Pension Administration Fund" ("PAF") and its liabilities in the "Liabilities of the Fund" ("LOF").²⁵ Hancock commingled premiums from GAC 50 with its general account, out of which Hancock paid its operating costs and satisfied its obligations.²⁶ Funds from the PAF were converted into retirement benefits when the plan administrator notified Hancock that a retiree was entitled to receive benefits.²⁷ At that time Hancock would guarantee payment of the retiree's benefits and would credit the corresponding liability to the LOF.²⁸ The litigation centered around the control of GAC 50's "free funds," the amount by which the PAF exceeded the "Minimum Operating Level" (the LOF plus a five percent contingency cushion).²⁹ "Free funds" increased dramatically between

PENSION PLAN INVESTMENTS 1994: CONFRONTING TODAY'S LEGAL ISSUES, at 203, 204 (PLI Tax Law and Estate Planning Course Handbook Series No. 353, 1994) (discussing split among circuits).

²³ John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 114 S. Ct. 517, 521 (1993).

²⁴ *Id.* at 522. This bookkeeping provision was included in the contract between Hancock and Harris; however, the actual funds were not segregated. *Id.*

²⁵ *Id.* The Court noted that these recording procedures were included when the litigation commenced although the contract had been amended many times since its inception in 1941. *Id.* GAC 50 provided that the PAF maintained by Hancock was to be adjusted by a pro rata share of the general account's investment gains and losses. *Id.*

²⁶ *Hancock*, 114 S. Ct. at 521.

²⁷ *Id.*

²⁸ *Id.* In the event that the liabilities (the LOF plus a five percent contingency cushion) ever exceeded the accumulated funds (PAF), GAC 50 provided that the "active" or "accumulation" phase of the contract would automatically terminate, and the contract would convert back to a simple deferred annuity contract. *Id.* If this occurred, Hancock would be required to cover all benefits that GAC 50 previously guaranteed by purchasing annuities at specified rates stated in the contract. *Id.*

²⁹ See *supra* note 12 (defining "free funds"). In 1977, Harris was granted the right to request that Hancock pay "non-guaranteed benefits" to retirees out of the "free funds." *Hancock*, 114 S. Ct. at 522. These benefits were deemed "non-guaranteed" because they were only payable out of the "free funds," and "free funds" only existed when the PAF exceeded the LOF plus the five percent contingency cushion. *Id.* In May 1982, Hancock terminated Harris' right to request "non-guaranteed benefits." *Id.* The only way that Harris could then access GAC 50's "free funds" was by demanding the transfer of the entire amount of "free funds" from the PAF. *Id.* at 523. This would have required an asset liquidation adjustment, which Harris believed would have undervalued the retirement plan's share of Hancock's general account. *Id.* Harris, therefore, would not request such a transfer and was effectively estopped from controlling the plan's "free funds." *Id.*

1982 and 1988, prompting Harris to seek greater control of these increased assets and eventually resulting in litigation.³⁰

In July 1983, Harris filed suit in the United States District Court for the Southern District of New York,³¹ claiming that "Hancock breached its fiduciary obligations under ERISA by denying Harris any realistic means to make use of GAC 50's free funds."³² Hancock relied on ERISA's exemption for assets of an insurer that provides a guaranteed benefit policy, and argued that ERISA's fiduciary duties did not apply to it because the benefits of GAC 50 were "guaranteed by the insurer."³³

The district court granted Hancock's motion for summary judgment in September 1989.³⁴ The court held that GAC 50 was a "guaranteed benefit policy" in its entirety and, therefore, Hancock was not an ERISA fiduciary.³⁵ The Second Circuit, reversing in part, concluded that Hancock was a fiduciary under ERISA with respect to the "free funds" used to pay nonguaranteed benefits.³⁶

³⁰ *Hancock*, 114 S. Ct. at 523. "Free funds" increased during this time because of the positive investments made by Harris. These gains increased the value of the entire general account and were partly credited to the PAF. *Id.* In addition, a lack of guaranteed benefit payments out of the LOF further increased the difference between the LOF and PAF. *Id.*

³¹ *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 722 F. Supp. 998 (S.D.N.Y. 1989), *rev'd*, 970 F.2d 1138 (2d Cir. 1992), *aff'd*, 114 S. Ct. 517 (1993).

³² 114 S. Ct. at 521 (basing fiduciary duty on theory that Hancock was managing "plan assets").

³³ *Id.* See 29 U.S.C. § 1101(b)(2)(B) (1988); *supra* note 7; *infra* notes 52-53 and accompanying text (defining "guaranteed benefit policy").

³⁴ *Harris Trust*, 722 F. Supp. at 998.

³⁵ *Id.* at 1020. The district court relied heavily on ERISA's legislative history and the DOL's regulations and interpretations. *Id.* at 1017-20. The court concluded that under GAC 50 the covered employees received a fixed amount as provided by the plan's terms which did not depend on fluctuations in Hancock's general account. *Id.* at 1015-16. Hancock was obligated to pay covered employees the amounts to which they were entitled, even if Hancock's general account experienced losses. *Id.* Thus, GAC 50's insurance risks were placed "on the insurer, not on the plan's covered employees." *Id.* at 1015.

³⁶ *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 970 F.2d 1138, 1143 (2d Cir. 1992), *aff'd*, 114 S. Ct. 517 (1993). The court of appeals determined that, although a portion of the benefits was guaranteed, the benefits stemming from the "free funds" fluctuated with investment performance and, therefore, were not guaranteed. *Id.* at 1143-45. In support of its position, the court looked to ERISA's legislative history which stated that "[i]f the policy guarantees basic payments but other payments may vary with, e.g., investment performance, then the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules." *Id.* at 1143 (citing H.R. REP. No. 1280, 93d Cong., 2d Sess. 296 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5077).

The Supreme Court affirmed the Second Circuit holding that Hancock was an ERISA fiduciary because the "free funds" of GAC 50 were "plan assets."³⁷

Writing for the Court, Justice Ginsburg stated that each component of an annuity contract must be analyzed to determine whether it fits within the guaranteed benefit policy exclusion.³⁸ The Court found that certain characteristics must be present for a contract's free funds to qualify for the exclusion.³⁹ The two crucial elements in this analysis are "the insurer's guarantee of a reasonable rate of return on those funds" and "a mechanism to convert the funds into guaranteed benefits at rates set by the contract."⁴⁰ The Court determined that GAC 50's free funds did not satisfy these requirements, and therefore John Hancock was a fiduciary with respect to the free funds.⁴¹

In a dissenting opinion,⁴² Justice Thomas argued that the Court's decision "abruptly overturns the settled expectations of the insurance industry by deeming a substantial portion of [a contract's free] funds 'plan assets' and thus subjecting insurers to the fiduciary regime of [ERISA]."⁴³

³⁷ *Hancock*, 114 S. Ct. at 529.

³⁸ *Id.* The Court noted that a component fits within the exclusion "only if it allocates investment risk to the insurer." *Id.*; see *infra* notes 39-40 and accompanying text (defining "guaranteed benefit policy").

³⁹ *Hancock*, 114 S. Ct. at 529. The Court suggested that without these elements, plan participants bear the risk that future benefits "attributable to the free funds . . . [will] fall to zero." *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* Although GAC 50 contained a semblance of these elements, the Court found it insufficient to meet the statutory exemption. *Id.*

⁴² *Id.* at 531-38 (Thomas, J., dissenting). Justice Thomas agreed with the majority's contention that the guaranteed benefit policy exception found in § 401(b)(2) of ERISA does not "exclude all general account assets from ERISA's coverage." *Id.* at 532. Justice Thomas disagreed, however, with the majority's "making the exception depend upon whether investment risk is allocated to the insurer." *Id.* He stated that the Court's new test "bears little relation" to the statute as enacted by Congress. *Id.*

⁴³ *Id.* at 532 (Thomas, J., dissenting) The DOL has taken the position that general account assets are not "plan assets." *Id.* at 535 (citing 29 C.F.R. § 2509.75-2 (1992)). Justice Thomas argued that insurers have relied on the DOL's position and have managed general account assets "not in accordance with ERISA's fiduciary obligations, but in accordance with potentially incompatible state law rules." *Id.* at 535. Justice Thomas deemed the relevant question under the statute to be "not whether the contract shifts investment risk, but whether, and to what extent, it 'provides for benefits the amount of which is guaranteed.'" *Id.* at 532 (quoting 29 U.S.C. § 1101(b)(2)(B)). In his view, a contract could "provide for" guaranteed benefits before the funds are actually converted and the investment risk is shifted to the insurer. *Id.*

II. INSURANCE COMPANIES' GENERAL ACCOUNTS

Insurance companies, like banks, are one of the largest holders of private pension plan assets.⁴⁴ Unlike banks, which ordinarily hold plan assets in separate trusts, insurance companies sell annuity contracts to employers or plan sponsors.⁴⁵ This type of contract provides guaranteed benefits and other security to retirees.⁴⁶ The premiums received from annuities are deposited in the insurer's general account, which contains all of the insurance company's assets.⁴⁷ Because of this commingling of assets, it is impossible to determine which of those assets in the general account are allotted to specific contractholders.⁴⁸

⁴⁴ Goldberg & Altman, *supra* note 8, at 478. "General account assets are often invested by the insurance company in private placement loans, corporate bonds, mortgages, real estate and many other investment vehicles." Trustees of Laborers' Local No. 72 Pension Fund v. Nationwide Life Ins. Co., 783 F. Supp. 899, 905 n.10 (D.N.J. 1992) (citation omitted).

⁴⁵ Pension plan sponsors favor annuity contracts because they meet the needs of small and medium sized employers who lack the resources required to create and maintain a pension plan. See Gary M. Ford, *Recent Controversies Involving the Purchase of Irrevocable Annuities and Insurance Company Insolvencies*, 793 ALI-ABA 143, 149 (1993). Without these annuity contracts, many employers would be unable to offer their employees a pension plan. *Id.* "As originally enacted, ERISA did not specify the means by which the administrator should distribute benefits to participants upon plan termination." *Id.* at 158. Nevertheless, Pension Benefit Guaranty Corporation regulations "generally require the plan administrator to satisfy benefit obligations through purchasing annuities from an insurance carrier." *Id.* (citing 29 C.F.R. § 2615 (1981) (recodified at 29 C.F.R. § 2617 (1981))).

⁴⁶ Goldberg & Altman, *supra* note 8, at 478-79; see S.S. HUEBNER & KENNETH BLACK, JR., LIFE INSURANCE 434 (9th ed. 1976). Life insurance companies offer "considerable flexibility" in tailoring individual contracts to meet individual employer needs. *Id.* Because life insurance companies are in the business of accepting risks, they are willing to underwrite the risks associated with pension plans. *Id.*

⁴⁷ Goldberg & Altman, *supra* note 8, at 479. Included in the general account are premiums from the insurer's life, accident and health insurance policies and premiums from plans that ERISA covers. *Id.* The result of this commingling is that the premiums received from annuities are "available to satisfy all of the insurer's obligations to all of its contractholders and other creditors." *Id.*; see also DAN M. MCGILL & DONALD GRUBBS, JR., FUNDAMENTALS OF PRIVATE PENSIONS 492 (6th ed. 1989) (explaining that only funds available to insurance company for routine business expenses, such as rent, are in general account).

⁴⁸ See Goldberg & Altman, *supra* note 8, at 479; see also Brief for Petitioner Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co., 970 F.2d 1138 (2d Cir. 1992) (No. 92-1074), available in LEXIS, Genfed Library, Briefs File, (arguing that there are no specific identifiable assets referable to any particular policy).

III. FIDUCIARY DUTIES UNDER ERISA AND THE IMPLICATIONS FOR INSURERS

Section 1002 of ERISA states that a fiduciary of an employee benefit plan is one who "exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets."⁴⁹ The "assets" of a plan, however, are undefined except by exclusion in section 401. This section reads in part:

In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer.⁵⁰

⁴⁹ 29 U.S.C. § 1002(21)(A)(i) (1988). The entire definition of a fiduciary reads: (A) Except as otherwise provided in subparagraph (B) [which deals with companies registered under the Investment Company Act of 1940], a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Id.; see Fredrick C. Kneip, *Plan Investments: Prohibited Transactions and Other Fiduciary Problems*, 40TH N.Y.U. INST. ON FED. TAX 11-1, 11-2 (ERISA Supp.) (1982). Persons and firms that perform any of the basic statutory functions such as exercising discretionary authority over plan management or plan assets have been held to be ERISA fiduciaries. *Id.*; see, e.g., *Chicago Bd. of Options Exch., Inc. v. Connecticut Gen. Life Ins. Co.*, 713 F.2d 254, 260 (7th Cir. 1983) (holding that power to amend insurance contract made insurance company ERISA fiduciary because amendment effectively determined type of plan investments and constituted exercising control of plan assets); *Peoria Union Stock Yards Co. v. Penn Mut. Life Ins. Co.*, 698 F.2d 320, 327 (7th Cir. 1983) (turning plan assets over to insurance company to manage with full investment discretion made insurance company ERISA fiduciary); see also *Greenblatt v. Prescription Plan Servs. Corp.*, 783 F. Supp. 814, 820 (S.D.N.Y. 1992) ("One who exercises actual control over disposition of assets is a fiduciary under ERISA; one who engages in purely 'ministerial' functions is not."); cf. *Jacobson v. John Hancock Mut. Life Ins. Co.*, 662 F. Supp. 1103, 1110-11 (D. Conn. 1987) (purchase of insurance contract from insurer will not cause insurer's assets to be treated as plan assets if contract is guaranteed benefits policy under ERISA).

⁵⁰ 29 U.S.C. § 1101(b)(2) (1988); see *Bozeman v. Provident Nat'l Assurance Co.*, No. 90-2925-4, 1992 WL 328804, at *6 (W.D. Tenn. May 15, 1992) (explaining ERISA does not contain definition for "plan assets," but nonetheless exempts from that category certain assets of insurers associated with "guaranteed benefit policies"); see also H.R. REP. NO. 1280, 93d Cong., 2d Sess. 296 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5077. The House Report provides in part:

An insurance company also is not considered to hold plan assets if a plan purchases an insurance policy from it, to the extent that the policy provides payments guaranteed by the company. If the policy guarantees basic pay-

Section 401(b)(2)(B) defines a "guaranteed benefit policy" as "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."⁵¹ The policy includes any surplus held in a separate account, but excludes any other portion of that account.⁵² The Supreme Court has narrowly construed the guaranteed benefit policy exception by focusing on the phrase "to the extent."⁵³ The Court bifurcated the GAC 50 into guaranteed and nonguaranteed portions, and concluded that the exemption only applies "to the extent" that guaranteed benefits are provided.⁵⁴

As a fiduciary, a life insurance company is required under ERISA to manage its general account assets "solely in the interest of participants and beneficiaries" of employee benefit plan contract holders and "for the exclusive purpose of providing benefits to such participants and beneficiaries."⁵⁵ ERISA's fiduciary responsibility provisions, however, are fundamentally incompatible with the operation of an insurer's general account, which requires the pooling of risks and the collective management of assets.⁵⁶

ments but other payments may vary with, *e.g.*, investment performance, then the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to fiduciary rules.

Id.

⁵¹ 29 U.S.C. § 1101(b)(2)(B) (1988); *see also* John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 114 S. Ct. 517, 521 (stating that "guaranteed benefit policy" is statutory invention and not insurance industry trade term); *Bozeman*, 1992 WL 328804, at *6 ("In general the purpose of these provisions [*i.e.*, defining 'plan assets' and 'guaranteed benefit policy'] was to exempt from fiduciary status insurers who issue standard insurance policies, including standard annuities.")

⁵² 29 U.S.C. § 1101(b)(2)(B) (1988) ("Such term includes any surplus in a separate account, but excludes any other portion of a separate account.")

⁵³ *Id.* The *Hancock* Court commented in a footnote that "the term 'guaranteed benefit contract . . . has never been a part of the insurance industry lexicon.'" *See Hancock*, 114 S. Ct. at 524 n.4 (citation omitted). The Court concluded that "ERISA itself must thus supply the term's meaning." *Id.*

⁵⁴ *Hancock*, 114 S. Ct. at 524, 527. The Court suggested that the entire contract was not "guaranteed" merely because the free funds could be used in the future to purchase additional guaranteed benefits. *Id.* at 528. *Contra* Mack Boring & Parts v. Meeker Sharkey Moffitt, 930 F.2d 267, 273 (3rd Cir. 1991) (indicating statutes' use of "provides for" language does not require that benefits contracted for be delivered immediately; it is enough that contract provides for guaranteed benefits "at some finite point in the future").

⁵⁵ 29 U.S.C. § 1104(a)(1) (1988). The Court in *Hancock* noted that "[t]o help fulfill ERISA's broadly protective purposes, Congress commodiously imposed fiduciary standards on persons whose actions affect the amount of benefits retirement plan participants will receive." 114 S. Ct. at 524 (emphasis added) (citations omitted).

⁵⁶ *See* Amici Brief, *supra* note 15, at 6-7. The Amici Brief argued that:

These requirements are also in conflict with state insurance laws, which require that risks be spread "fairly and equitably" among policyholders.⁵⁷

Because an insurer's general account is its operating account and is not segregated in any way, the general account cannot be managed for the "exclusive benefit" of anyone.⁵⁸ Applying ERISA's exclusive benefit rule would therefore divide an insurer's loyalties, a situation that ERISA was "expressly designed to prevent."⁵⁹

Plans that choose to purchase general account contracts do so with the full understanding that their payments to the insurer will become part of the insurer's general corporate assets and will not be managed solely in their interest or applied exclusively for their benefit. Indeed they generally draw comfort from the fact that the contractual rights which they have acquired in exchange for such consideration will be supported on an unsegregated basis by a large pool of assets derived from various classes of business.

Id.

⁵⁷ Stephen H. Goldberg, *The Application of ERISA's Fiduciary Responsibility Provisions to the Management of General Account Assets and General Account Contracts*, 783 ALI-ABA 19, 22 (1992); see N.Y. INS. LAW § 4224 (McKinney 1994) (prohibiting discrimination among contract holders); see also *Amici Brief*, *supra* note 15, at 8, which noted that:

The interests of employee benefit plans and other general account contractholders are protected by state insurance laws. These laws are designed to assure that all contractholders are treated equitably and on a non-discriminatory basis, and that an insurer is able to satisfy its contractual obligation to all contractholders.

Id. The Supreme Court, however, has opined that the traditional preemption doctrine calls for the supremacy of federal law when a state law impedes congressional objectives. *Hancock*, 114 S. Ct. at 526. The Court reasoned that ERISA in general, and the guaranteed benefit policy exception in particular, relate to insurance. *Id.* at 525 (quoting from United States Brief as Amicus Curiae).

⁵⁸ See, e.g., *Mack Boring & Parts v. Meeker Sharkey Moffitt*, 930 F.2d 267, 268 (3d Cir. 1991). In *Mack Boring*, the court noted that the company's general account included "all the assets and liabilities of its insurance and ancillary operations, except those assets and liabilities specifically allocated to separate accounts." *Id.* The court also observed that "[g]eneral account assets are often invested by the insurance company in private placement loans, corporate bonds, mortgages, real estate, and many other investment vehicles." *Id.*

⁵⁹ *Levy v. Lewis*, 635 F.2d 960, 968 (2d Cir. 1980) (citation omitted); accord *Mack Boring*, 930 F. 2d at 275 n.17 ("[I]f Congress had intended so severe a disruption of insurance practices, practices that had been in existence for almost three decades before the enactment of ERISA, it would have made its intention perfectly clear."); see also Goldberg, *supra* note 57, at 40 (emphasizing that one should consider whether Congress intended to make general account management under ERISA incompatible with state insurance laws and responsibilities to policyholders other than those that ERISA covers); cf. *Marshall v. Kelly*, 465 F. Supp. 341, 349 (W.D. Okla. 1978) (noting that ERISA was designed to protect plan participants and beneficiaries with fiduciary standards and remedies for breach).

IV. PROHIBITED TRANSACTIONS AND GENERAL ACCOUNTS

The Court's decision will also significantly disrupt insurers' transactions with companies whose pension plans they fund.⁶⁰ Furthermore, the Court's interpretation of section 401(b)(2) will not only impose general fiduciary duties on insurers, but will also restrict prohibited transactions.⁶¹

ERISA's prohibited transactions rules apply to transactions between a plan and a party in interest⁶² and transactions that involve fiduciary self-dealing.⁶³ Under ERISA, a party in interest includes fiduciaries and employees of benefit plans, persons providing services to these plans, and employers whose employees are covered by a plan.⁶⁴ A fiduciary may not sell or lease property, lend money, furnish goods or services, or transfer any plan assets, either directly or indirectly, to a party in interest.⁶⁵ These prohibitions were designed to protect fiduciaries of plan assets from undue influence by a party in interest.⁶⁶

⁶⁰ *Hancock*, 114 S. Ct. at 536 (Thomas, J., dissenting). ERISA expressly prohibits fiduciaries from engaging in any transaction directly or indirectly between the plan and a party in interest. *Id.*; see 29 U.S.C. § 1106(a).

⁶¹ See 29 U.S.C. § 1106 (prohibiting certain transactions between plan and party in interest and fiduciary).

⁶² 29 U.S.C. § 1106(a) (1988).

⁶³ 29 U.S.C. § 1106(b) (1988).

⁶⁴ See 29 U.S.C. § 1002(14) (listing those entities considered to be parties in interest). The statute lists among those considered to be a party in interest "any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan." *Id.* § 1002(14)(A).

⁶⁵ 29 U.S.C. § 1106(a)(1). This section provides in pertinent part:

Except as provided in section 1108 of this title:

- (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
 - (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
 - (B) lending of money or other extension of credit between the plan and a party in interest;
 - (C) furnishing of goods, services, or facilities between the plan and a party in interest;
 - (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
 - (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

Id.

⁶⁶ *Kneip*, *supra* note 49, at 11-1, 11-8. The party in interest prohibitions were "created to prevent individuals close to benefit plans from exerting an undue influence

The statutory prohibitions against fiduciary self-dealing dictate that plan assets may not be used to benefit a fiduciary; that a fiduciary must not act for a party adverse to the plan or its beneficiaries in any plan-related transaction; and that a fiduciary may not accept personal compensation for a transaction with the plan.⁶⁷ These prohibitions follow the common-law duties of loyalty and exclusive benefit.⁶⁸ They protect a fiduciary from dual loyalties, which would prevent it from acting exclusively for the benefit of the plan's participants or beneficiaries.⁶⁹

The definitions of a "party in interest" and "prohibited transactions" are so broad, however, that they might include persons whose relationships to a plan are so attenuated that the fiduciary may be unaware of its status as a party in interest. This may prevent the fiduciary from protecting itself from liability for prohibited transactions.⁷⁰

The Supreme Court has effectively declared all assets in the insurer's general accounts to be "plan assets."⁷¹ As a result, many transactions that were previously considered unobjection-

on fiduciaries charged with the responsibility for the management of plan assets." *Id.* at 11-8.

⁶⁷ 29 U.S.C. § 1106(b). This section provides in pertinent part:

A fiduciary with respect to a plan shall not—

- (1) deal with the assets of the plan in his own interest or for his own account,
- (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or
- (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Id.

⁶⁸ See Kneip, *supra* note 49, at 11-8.

⁶⁹ See *Marshall v. Kelly*, 465 F. Supp. 341, 354 (W.D. Okla. 1978) (citing *Udall v. Tallman*, 380 U.S. 1 (1965)) (noting that fundamental purpose of ERISA is to insure that fiduciaries do not act in situations in which their judgment might be affected).

⁷⁰ See Kneip, *supra* note 49, at 11-6 to 11-7 (discussing prohibited transactions); *accord M & R Inv. Co. v. Fitzsimmons*, 685 F.2d 283, 285 (9th Cir. 1982) (holding subsidiary of corporation to be party in interest to another subsidiary of corporation though not participating in same employee benefit plan).

⁷¹ *Hancock*, 114 S. Ct. at 527 (holding that plan deposits put into insurance company's general account are not per se outside ERISA's fiduciary duties). The Court stated that Congress's failure to pass a blanket exclusion for funds held in an insurer's general account indicates that there are times when such funds could be "plan assets." *Id.* at 526-27; see 29 C.F.R. § 2510.3-101 (1993) (providing "[d]efinition of 'plan assets'—plan investments").

able are now proscribed.⁷² An insurance company, for example, will no longer be permitted to invest its premium receipts in bonds or equity securities issued by any of the employers contributing to the policyholder plan.⁷³ Neither will the insurance company be able to lease space to such employers in a building on which it holds a mortgage.⁷⁴ Additionally, it will not be permitted to purchase any "goods, services or facilities from any one of those employers."⁷⁵

The size and wide-ranging investment activities of general accounts make it likely that insurance companies have invested in securities of employers whose employees are covered by a plan.⁷⁶ These investments are now prohibited under section 406(a), and both fiduciaries and parties in interest may be subject to liability.⁷⁷

As previously noted, an insurance company that leases office space may be in violation of section 401.⁷⁸ If the lessor is a party

⁷² See 29 C.F.R. § 2509.75-2 (1993) (explaining how to determine whether party in interest is engaged in prohibited transaction with employee benefit plan).

⁷³ See Goldberg & Altman, *supra* note 8, at 485 (quoting *Oversight on ERISA: Hearings on Public Law 93-406 Before the Subcomm. on Labor Standards of the House Comm. on Education and Labor*, 94th Cong., 1st Sess. 390-91 (1975) [hereinafter *Oversight on ERISA*]) (describing why general account assets were not treated as plan assets for purposes of fiduciary responsibility provisions of ERISA prior to *Hancock*).

⁷⁴ See Goldberg & Altman, *supra* note 8, at 485.

⁷⁵ See *supra* note 72 and accompanying text (providing example of prohibited transaction since general account assets are now treated as plan assets for purposes of fiduciary responsibility provisions of ERISA); see also *Supreme Court Expands Reach of ERISA Fiduciary Provision to Group Annuity*, Pens. & Ben. Daily (BNA), Dec. 14, 1993, available in WESTLAW, BNA-PBD database [hereinafter *Supreme Court Expands Reach*]. The dissent in *Hancock* argued that the majority "abruptly overturns the settled expectations of the insurance industry." *Hancock*, 114 S. Ct. at 532 (Thomas, J., dissenting). The holding could have a far-reaching effect: "[L]arge insurance companies that may have sold policies to thousands of pension plans could suddenly find themselves restricted in contracting with the corresponding thousands of employers whose goods and services they may require." *Id.* at 536.

⁷⁶ See 114 S. Ct. at 536.

⁷⁷ See 29 U.S.C. § 1106 (1988); *Hancock*, 114 S. Ct. at 529 ("[T]he free funds are 'plan assets,' and . . . [Hancock's] disposition must be judged against ERISA's fiduciary standards."). Fiduciaries will be subject to liability under ERISA section 409(a). 29 U.S.C. § 1109(a) (1976). Parties in interest will be subject to an excise tax of five percent of the amount involved in the prohibited transaction until the transaction is corrected. *Id.*; see I.R.C. § 4975(a) (1988) (computing tax on prohibited transactions).

⁷⁸ Goldberg & Altman, *supra* note 8, at 485. "Section 401(b) could be read to mean that the insurance company . . . could not allow any [employers contributing to the policyholder plan] to lease space in a building on which it held a mortgage . . ." *Id.* (quoting *Oversight on ERISA*, *supra* note 73).

in interest of a plan with assets in the insurer's general account, the transaction would be prohibited.⁷⁹ Insurance companies' contracts for services may also be prohibited.⁸⁰ If services, such as cleaning or photocopying, are provided by a party in interest who maintains a plan with assets in the insurer's general account, the transaction will violate section 406.⁸¹

If an insurance company handled a small number of plans, it would not be difficult to monitor whether lessees or providers of goods and services were also employers who contributed to the policyholder plan, thus allowing the insurance company to avoid potential self-dealing situations.⁸² Larger carriers, however, would find such recordkeeping impractical.⁸³ In these instances, not only would this recordkeeping be enormously difficult, if not impossible, but the insurers would find themselves unable to transact with thousands of employers whose goods or services they need.⁸⁴

Although ERISA's prohibited transactions are designed to avoid conflicts of interest, the plan premiums in an insurance company's general asset account are only a small part of the account.⁸⁵ The "general account" is the insurance company's general corporate account, from which it pays all of its obligations to its contractholders and its creditors, supports all of its business activities, and in the case of stock insurance companies, pays dividends

⁷⁹ 29 U.S.C. § 1106(a)(1)(A) (1988). "A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . leasing of . . . any property between the plan and a party in interest . . ." *Id.*

⁸⁰ *Id.* § 1106 (a)(1)(C). Such a prohibition "may . . . significantly disrupt insurers' transactions with companies whose pension plans they fund." *Hancock*, 114 S. Ct. at 536 (Thomas, J., dissenting).

⁸¹ 114 S. Ct. at 536 (Thomas, J., dissenting); see Goldberg & Altman, *supra* note 8, at 845 (quoting *Oversight on ERISA*, *supra* note 73 (criticizing effects of majority holding in *Hancock*)).

⁸² See Goldberg & Altman, *supra* note 8, at 485. "[T]hese restrictions might have been manageable if the insurance company insured the benefits of only one or a few plans, but some of the large carriers have sold policies to thousands of plans." *Id.* (quoting *Oversight on ERISA*, *supra* note 73).

⁸³ Goldberg & Altman, *supra* note 8, at 485 (quoting *Oversight on ERISA*, *supra* note 73).

⁸⁴ See *Supreme Court Expands Reach*, *supra* note 75. In *Hancock*, the plaintiff argued "that the [Second Circuit] decision was contrary to the language and purpose of ERISA and would be impossible to implement because the commingled general account assets are not identifiable with any particular contract." *Id.*

⁸⁵ Goldberg & Altman, *supra* note 8, at 486 (citing *Oversight on ERISA*, *supra* note 73).

to its shareholders.⁸⁶ Therefore, “the risk of any one plan being able to influence the investment policy of the insurance company respecting the general asset account is extremely slight.”⁸⁷ The application of ERISA’s prohibited transactions regulations to an insurer’s general account impugns almost every transaction to which the insurance company is a party—from leasing office space and hiring a cleaning service to investing in securities.⁸⁸

V. INSURANCE COMPANIES’ COURSE OF ACTION

On March 25, 1994, the American Council of Life Insurance (“ACLI”) filed a request with the DOL in the form of a class exemption for retroactive relief from ERISA’s prohibited transactions.⁸⁹ A class exemption would allow insurance companies to engage in prohibited transactions without being subject to ERISA’S rules and penalties.⁹⁰ It would not, however, relieve in-

⁸⁶ See Goldberg & Altman, *supra* note 8, at 476; Petitioners Brief at 5-6, John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 114 S. Ct. 517 (1993) (No. 92-1074).

⁸⁷ Goldberg & Altman, *supra* note 8, at 486 (quoting *Oversight on ERISA*, *supra* note 73). “[N]one of [the general account] assets is solely or directly attributable to employee benefit plan contracts inasmuch as each asset stands behind all of the insurer’s other obligations as well.” *Id.* at 476; see Petitioner’s Brief at 8, John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 114 S. Ct. 517 (1993) (No. 92-1074).

⁸⁸ See *supra* notes 77-81 and accompanying text (discussing prohibited transactions); see also Petitioner’s Brief at 14-15, John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 114 S. Ct. 517 (1993) (No. 92-1074). Treating such transactions as prohibited would be beyond the expectations of the insurance industry. *Id.* The DOL “has never once stated that ERISA’s fiduciary provisions are applicable to the General Account practices of insurance companies and has never once sought to invoke those provisions with regard to those practices.” *Id.*

⁸⁹ *ACLI Seeks Retroactive Relief in Class Exemption Submitted to DOL*, 21 Pens. Rep. (BNA) No. 13, at 660 (Mar. 28, 1994) [hereinafter *Retroactive Relief*]. ACLI, which represents 90% of the nation’s insurers, sought this unconditional relief retroactive to January 1, 1975. *Id.* ACLI reasoned that *Hancock* “potentially calls into question the normal operations of insurance company general accounts and the contractual arrangements that have been relied upon to provide investment income and benefit stability for employee benefit plans and their participants and beneficiaries.” *Id.* (citation omitted).

⁹⁰ *Id.* (ruling could create large tax liability for insurance companies). Such a ruling would force the DOL to choose the lesser of two evils. *Id.* The DOL cannot abandon John Hancock at this juncture, after having openly supported them in this dispute. *Id.* The DOL would “appear to be deserting the insurance company” if it failed to grant a blanket exemption for insurance companies. *Id.* Conversely, the DOL would be compromising its position as defender of pensioners’ rights if it did offer such an exemption. *Id.* “Such an exemption would also contradict the Clinton administration’s pro-participant stance.” *Id.*

insurance companies of their fiduciary responsibilities.⁹¹ On April 15, 1994, the ACLI also requested an advisory opinion from the DOL to reinforce the notion that insurance companies' ordinary operations do not violate the fiduciary standards of ERISA.⁹²

On August 22, 1994, the DOL issued a proposed exemption that attempts to deal with some of the consequences of the Supreme Court's decision.⁹³ The exemption, however, only deals with external transactions. For example, the proposed exemption would provide relief for a transaction between a party in interest and the insurer's general account, in which the plan's interest was as a contractholder.⁹⁴ This is subject, however, to a restriction that limits any plan's interest in the insurer's general account to ten percent.⁹⁵ The ten percent limitation applies to employer securities or real property held by the general account.⁹⁶ Therefore, the holding of employer securities and employer real property through an insurer's general account is exempt from ERISA as long as the ten percent test is met.

This proposed exemption does not address the internal activities of the general accounts, which could now be potentially viewed as prohibited.⁹⁷ For example, salaries of employees of the insurer and provisions for office space and advertising expenses, which could now be subject to ERISA because of the pooled nature of general accounts, are not addressed.

If insurance companies fail to persuade the DOL and Congress to completely overturn the ruling, they will likely be re-

⁹¹ John Hancock *Decision Puts Insurers in Limbo*, INS. REGULATOR, Feb. 7, 1994 at 1, available in LEXIS, Insurance Library, Curnws File [hereinafter *Insurers in Limbo*] ("[The DOL] can't exempt fiduciary responsibility . . ."). Section 408 explicitly states that the DOL may grant exemptions "from all or part of the restrictions imposed by sections 1106 and 1107(a)"; however, an exemption will not "relieve a fiduciary from any other applicable provision of this chapter." 29 U.S.C. § 1108(a).

⁹² *ACLI Requests DOL Advisory Opinion on "Customary" Practices of Insurers*, 21 Pens. Rep. (BNA) No. 17, at 813 (April 25, 1994) [hereinafter *ACLI Requests DOL Advisory Opinion*]. The ACLI is not asking whether specific transactions violate ERISA, rather, it seeks to verify that the "general account operating practices do not inherently violate ERISA." *Id.*

⁹³ 59 Fed. Reg. 43,134 (1994).

⁹⁴ *Id.* at 43,138.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ See *DOL Issues Proposed Class Exemption to Grant Insurers Relief from Ruling*, Pens & Ben. Daily (BNA), Aug. 22, 1994, available in WESTLAW, BNA-PBD Database. The DOL has determined that it does not have sufficient information to address these issues and is awaiting information from the American Council of Life Insurance. *Id.*

quired either to monitor returns separately on pension fund assets held in their general accounts, or separate these funds from their general account.⁹⁸ Either of these options would increase record-keeping and administrative costs, which in turn will raise transaction costs for their pension fund clients and increase the cost of annuities.⁹⁹

CONCLUSION

The consequences of applying ERISA's fiduciary responsibility provisions to the management of general account assets and contracts are far-reaching and create fundamental problems for the insurance industry. ERISA requires a fiduciary to act "solely in the interest of" and "for the exclusive purpose of" paying benefits to employee plan participants and beneficiaries. This standard, however, is incompatible with an insurer's obligations to policyholders, creditors, and shareholders who are not covered by ERISA. The standard also conflicts with state insurance laws and regulations that require insurers to administer general accounts equitably for all policyholders. The application of ERISA's prohibited transactions provisions could also disrupt billions of dollars in investment activity in light of the numerous investment transactions between employee benefit plan contractholders and parties in interest that would be prohibited.

In rendering its decision, the *Hancock* Court did not consider the practical effects of its ruling on the established expectations of the insurance industry. Although the proposed exemption is a step in the right direction, it does not go far enough. It is Congress' responsibility to determine whether the benefits of applying ERISA's fiduciary duties and prohibited transactions provisions to insurer's general accounts outweigh the resulting costs to the insurance industry. The outcome is likely to increase the cost of an-

⁹⁸ See *ACLI Requests DOL Advisory Opinion, supra* note 92, at 813 ("[I]nsurers would no longer be able to offer products which have proven to be valuable for funding employee benefits . . ."). Insurance companies previously represented that the money they were investing from the general accounts was not ERISA plan money. See *Insurers in Limbo, supra* note 91, at 1. Insurance companies affected by the decision, however, have either ceased to make such representations or attempted to segregate tainted and safe assets in order to prevent their representations from being misleading. *Id.*

⁹⁹ See, e.g., *Insurers in Limbo, supra* note 91, at 1. "[T]ransactions are prohibited when . . . any plan participant has a relation to another party involved in the deal. This is a difficult requirement in an asset backed deal since there are so many parties involved . . ." *Id.*

nuity contracts, which will ultimately operate to the detriment of those whom ERISA is intended to protect.

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