Submitted electronically: EBSA.FiduciaryRuleExamination@dol.gov

April 17, 2017

Office of Regulations and Interpretations
Employee Benefits Security Administration – Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210
Attention: Fiduciary Rule Examination

RE: **RIN 1210-AB79** – The Department's Examination of the Fiduciary Duty Rule Pursuant to President Trump's February 3, 2017 Memorandum Should Result in a Repeal of the Rule

Dear Acting Secretary Hugler:

The National Association for Fixed Annuities ("NAFA")[1] writes today to comment regarding the Department's examination of the Fiduciary Duty Rule ("the Rule"),[2] as directed by President Trump in his February 3, 2017 White House Memorandum ("the Memorandum").[3]

As a preliminary matter, NAFA wishes to note it has previously shared considerable information with the Department in prior comment letters - including its most recent letter dated March 14, 2017 supporting delay of the Rule - and also provided a significant amount of evidence about the Rule and its adverse effects in its federal lawsuit seeking reversal of the Rule. NAFA requests that those prior comment letters and evidence introduced in its litigation be taken into account by the Department in its reexamination of the Rule.[4]

NAFA also wishes to state at the outset that it is disappointed with the recent decision of the Department to proceed with the Rule as of June 9, 2017 and with the requirements relating to impartial conduct standards during the time the Rule is being reexamined pursuant to the Memorandum. NAFA believes the Department's decision in that regard conflicts with the spirit - if not the letter - of the Memorandum which directed the Department to conduct its reexamination

[1] Founded in 1998, NAFA is a trade association dedicated to educating and informing state and federal regulators, legislators, industry personnel, media, and consumers about the value of fixed annuities and their benefits to Americans in financial and retirement planning. NAFA's membership includes insurance companies, independent marketing organizations, and individual producers, representing every aspect of the fixed annuity marketplace and covering 85% of fixed annuities sold by independent agents, advisors, and brokers.

[2] 81 FR 20946, April 8, 2016, Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAS (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 84-24 and 86-218.

[3] 82 FR 9675, February 7, 2017.

[4] NAFA sued the Department of Labor in the federal court in the District of Columbia objecting to the Rule and related exemptions on several grounds. The case is on appeal and litigation is ongoing. Nothing in this letter or attachments are intended nor shall be construed to be inconsistent with positions taken by NAFA in the litigation.

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for the very purpose of deciding whether the Rule should be revised or rescinded. To allow the Rule, and impartial conduct standards, to take effect on June 9, 2017 prior to completion of the reexamination is to undermine the President's stated goal, which was to review the Rule *before* its implementation to determine if the Rule is consistent with the President's stated policy priorities. NAFA urges the Department to honor the President's wishes and avoid unleashing chaos in the financial services marketplace by postponing the applicability date of the Rule and application of impartial conduct standards beyond June 9, 2017.

That said, NAFA welcomes the President's directive to the Department to determine whether the Rule will adversely affect the ability of Americans to access retirement products and information, cause dislocations in the financial services marketplace, and cause increased litigation that will drive up the prices of retirement products and services. We believe the President's directive asked these very questions because it is self-evident those will be the exact effects of the Rule; i.e., it will limit access to products and information, it will create dislocations in the financial services marketplace, and it will increase litigation. Even the acting Chair of the Securities and Exchange Commission Michael Piwowar has observed the Rule "was never about investor protection" and stated it "was about enabling trial lawyers to increase profits."

NAFA and its members, together with its members' customers, are in the unenviable position of being especially hard hit by this Rule and thus NAFA has particularly strong views about the issues raised by the President in the Memorandum. NAFA members are manufacturers and distributors of fixed annuities, which is an enormous segment within the financial services industry and which last year alone entailed sales of over $50 billion of fixed indexed annuity products. However, under this Rule, fixed indexed annuity products are treated improperly as quasi-securities, which will have severe consequences on the availability of these products for consumers. Under this Rule, the existing distribution system for FIAs involving tens of thousands of agents and hundreds of small companies will be thrown into disarray. And because insurers and their agents are not protected by the arbitration dispute resolution system that shelters the securities industry, our members will become, through no fault of their own, easy targets for litigation.

NAFA believes the questions asked by the President for purposes of the reexamination of the Rule each result in a resounding "yes". There can be no doubt the real-world effect of the Rule will be to limit American retirees' access to critical financial services and products, to put thousands of small and mid-sized independent insurance agents, agencies and insurance intermediaries out of business, and to create an explosion of litigation, including class actions, due to the private cause of action created and encouraged as the primary – if not sole -- enforcement mechanism under the Rule. In short, this Rule is a solution in search of a problem, and the Rule should be rescinded consistent with the stated policies of the President, which include encouraging retirement savings and promoting a healthy economy.

The balance of this letter will comment more specifically on the three questions raised by the Memorandum. In addition, there are two accompanying attachments. The first is a more detailed discussion of the Regulatory Impact Analysis ("RIA") prepared by the Department under the prior administration, which NAFA believes is woefully deficient in its consideration of the Rule's impact on our industry. The second is a more detailed discussion of the itemized questions raised

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by the Department in its Notice that go beyond the three overarching questions raised in the Memorandum.

The Rule should be rescinded in its entirety to promote and further the President's public policy vision because the Rule limits consumer choice, kills jobs, and increases litigation.

President Trump's Memorandum rightly observed that the Fiduciary Duty Rule may be inconsistent with the policies of his Administration, which include a priority to "empower Americans to make their own financial decisions [and] to facilitate their ability to save for retirement…" Accordingly, the President directed the Department to examine the Rule to determine if the Rule will have an adverse effect on the ability of Americans to access financial advice and also prepare an updated economic and legal analysis of the Rule's impact. As part of this examination, the Department is directed to consider, among other things, the following:

- Whether the anticipated applicability of the Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;
- Whether the anticipated applicability of the Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and
- Whether the Rule is likely to cause an increase in litigation and an increase in the prices those investors and retirees must pay to gain access to retirement services.

The answer to each of these questions is plainly yes – and resoundingly so with respect to the fixed annuity industry – thus necessitating repeal of the Rule. The mere fact that the President would pose these questions to the Department speaks volumes about this new administration's concerns about the negative consequences of this Rule and the prohibited transaction exemptions associated with the new Rule. Given that, it is very hard to understand how the Department could allow the Rule and the impartial conduct standards which are at the heart of the exemptions to go into effect prior to conducting the reexamination.

The Rule will deprive Americans access to critical retirement savings products and services offered by the fixed annuity industry.

As further explained below, the Rule will lead to dislocation of a profound nature in the fixed annuity marketplace. From NAFA's perspective, this dislocation and its effect on product availability has never been taken seriously nor fully appreciated by the Department, and is a leading reason for conducting the reexamination ordered by the President. That is because the Rule is wholly unfit for regulating the distribution of non-securities insurance-based annuities that protect American retirement savers from market risk while affording greater potential return than provided by short-term depository-type savings vehicles.

As explained below, these guaranteed, non-securities annuities are particularly vulnerable to the dislocation that will be wrought by the Rule because the Rule was never designed for the fixed annuity marketplace and is ultimately unworkable for the independent agent distribution system. Additionally, these annuity products are vulnerable to the potential for rampant litigation based on the Rule's vague standards relative to compensation and its ill-defined best interest standard. The

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repercussions will be magnified for the fixed annuity industry due to the difficulty for insurance producers to protect themselves from unwarranted litigation partly because of lack of pre-dispute, mandatory arbitration, which is only available in the securities industry. The net effect of these forces will be to suppress the offering of fixed annuity products because of the Rule's inherent favoritism towards securities.

NAFA is also deeply concerned that the Rule's overly-broad and ill-defined notification requirements, coupled with the fact that the fixed annuity industry does not have the shelter of dispute resolution through arbitration, will lead to unwarranted litigation based on technical or inadvertent missteps. This will have a further chilling effect on the offering of many non-securities financial products to retirement savers and contribute to the undesirable result of limiting the choice of Americans planning for retirement.

The Rule creates chaos for an entire segment of the fixed annuity distribution marketplace - which will kill jobs and create massive dislocations.

It is clear this Rule was never designed for the fixed annuity industry; nor were the implications for the fixed annuity industry fully considered prior to the Rule's adoption. Although the Department has never been able to own up to this inconvenient truth, lest it admit to a procedural oversight, NAFA is hopeful the Department under its new leadership and in a good faith quest to carry out the President's directive, will look afresh at these concerns and recognize the devastating effects of this Rule on fixed annuity providers who do not fit within the construct of the Rule and consequently will suffer significant harm to their established business models and their very jobs.

During the rulemaking process, the Department originally proposed that FIAs, which are distributed through a well-developed network of insurance intermediaries ("Independent Marketing Organizations," or "IMOs") and independent insurance producers, be covered by the updated Prohibited Transaction Exemption 84-24, a long-standing exemption for insurance products. Inexplicably, and at the last possible moment, the Department swept fixed indexed annuities over to the Best Interest Contract Exemption ("BICE"), which is designed essentially to regulate - and is thus modelled after – the securities distribution systems involving broker dealers with their existing supervisory structures.

The result of this switch of FIAs from PTE 84-24 to BICE is to severely disadvantage the entire fixed indexed annuity industry. This is especially true because the BICE does not recognize insurance intermediary organizations as "Financial Institutions," even though it does recognize brokers and registered investment advisers as such. The Department provided no meaningful logic for this distinction and, in doing so, exposes clear biases within these new regulations against the insurance industry in favor of the securities industry.

In tacit admission that the Rule as published in April 2016 failed to account for the distribution model prevalent in the fixed annuity marketplace, the Department later issued a new proposed class exemption specifically for insurance intermediaries, but that proposed exemption was deeply flawed and proved yet again that the Department's regulatory approach is heavily biased against the fixed annuity business. The proposed Best Interest Contract Exemption for Insurance

Intermediaries, published January 19, 2017,[5] was released more than eight months after insurance intermediaries first asked the Department for exemptive relief. The Department's release of the new proposed class exemption was widely and sharply criticized for creating even more uncertainty regarding the Rule's impact on the fixed annuity industry and thus casting still more doubt on Americans' access to retirement information and financial advice provided through the annuity industry's independent agent system. And, it must be noted, the Department has yet to finalize this latest exemption such that the final contours of the exemption remain unknown and affected parties remain in limbo.

As explained in NAFA's March 14, 2017 comment letter on the proposed delay, as well as its February 17, 2017 comment letter regarding the proposed class exemption for insurance intermediaries, NAFA membership includes most of the IMOs affected by this proposed exemption. Those IMOs, ranging widely in size and business focus, account for distribution of over 60% of all FIAs. Yet the supposed fix embodied in the proposed exemption merely exacerbates problems inherent in the underlying rule by adopting completely unrealistic and highly discriminatory standards for IMOs as compared to other segments of the financial services industry. Based on the capital requirements of the proposed exemption, it is likely only a mere handful out of the approximately 200 IMOs operating in the United States could satisfy the compliance requirements, thus rendering the proposed exemption, like the Rule itself, nothing less than an assault on the fixed annuity industry that will result in heavy loss of jobs and denial of critical products and services to American consumers

But the problems presented by this Rule and the BICE for the fixed annuity industry run even deeper. As explained in detail in NAFA's litigation, the BICE is wholly incompatible with and unworkable for the independent agent distribution system, for which IMOs serve as the backbone. BICE is built for the securities industry, which contemplates a distribution arrangement in which brokers supervise agents who are allowed only to work for a single broker and thus operate under the exclusive control and management of a single supervising entity. By contrast, independent agents can represent multiple carriers offering competing products, and thus there is no single carrier nor any single IMO that can exclusively control the activity of an independent agent.

As the independent agency system currently exists, it is impossible for any single carrier or IMO to serve as the Financial Institution that could warrant an agent's compensation satisfies the requirements of the BICE, i.e., that the agent's recommendations are made without regard to the financial interests of the agent. Absent commission-fixing agreements among carriers, which almost certainly would be prohibited by anti-trust laws, carriers cannot control agent compensation, thus the BICE approach does not work and the inevitable result will to dismantle the independent agency system which in turn will deprive consumers of the breadth of choices currently available to them in the annuity marketplace.

NAFA believes the Department has not accounted properly for these concerns and the results will be disastrous for the fixed annuity industry. Many small and medium sized companies will go out of business. Thousands of jobs will be lost. The Rule and its exemptions will force massive, irreversible changes in the fixed annuity industry and will inevitably destroy many businesses and

[5] 82 FR 7336, January 19, 2017.

upend many individual careers. NAFA maintains that while no concrete proof has been provided to support any tangible benefits that would result from the Rule as it applies to fixed annuities, the negative consequences for many businesses, and for many individuals and their families, are real and will have clear and direct impact on the fixed annuity industry and on the economy as a whole.

The BICE will bring about excessive litigation and will result in inconsistent enforcement; BICE will also severely disadvantage the fixed annuity industry which is not sheltered by arbitration procedures available only to the securities industry.

In addition to the Rule's negative impact on industry jobs and consumer choice, the Rule will cause an explosion in costly litigation, especially for the fixed annuity industry. This is because the primary enforcement mechanism embedded in BICE is a newly-created private cause of action. Instead of creating rules and requirements enforceable by a federal agency, the Department had to recognize it had no enforcement authority in this area, so it instead came up with the concept of BICE, which by design gives rights to IRA holders to sue providers of retirement products. This is clearly an open invitation for lawsuits and will engender an untold amount of litigation. It leaves enforcement to the whim of the plaintiffs' bar and will force judges and juries to struggle with vague and ill-defined standards set forth in the Rule and the exemptions. The inevitable and inescapable result of this can only be an explosion of litigation producing inconsistent and very costly application of the Rule's requirements. Can there be any doubt that the primary winner in this will be the attorneys, not consumers?

Moreover, this structure is inherently unfair to the fixed annuity industry, which does not have the option of arbitration as is afforded to the securities industry by FINRA. Arbitration can be much more streamlined and less costly to all participants (companies and consumers alike) than traditional litigation in the courts. Unlike securities that already have a well-established and relatively effective system of arbitration to quickly and efficiently resolve disputes, fixed indexed annuities are regulated under state-based insurance regulations with no such mechanism.

The contractual relationship between insurance companies and consumers is subject to the strict review and approval of the insurance regulators in each state. Insurance companies are required to seek approval from each insurance regulator in each state to have arbitration agreements with consumers. Currently, there is no uniform, state-based regulatory framework for the review and approval of arbitration provisions between life and annuity insurers and consumers. Additionally, state insurance regulators generally do not approve such provisions.

Here again the Rule creates an uneven playing field, disrupting entire market segments because one industry is protected by arbitration and another is not. This is just another example of the deeply flawed nature of the Rule which cannot be rectified by "revisions or fixes" and demonstrates the need for outright repeal.

Accordingly, the answer to the three questions posed by the new Administration is clearly a resounding "yes," necessitating a repeal of the Rule in its entirety.

<u>The Regulatory Impact Analysis used to justify the Rule and exemptions is deeply flawed with its lack of any meaningful consideration of the fixed annuity marketplace.</u>

NAFA urges repeal of the Rule because, among other reasons, the original Regulatory Impact Analysis published on April 8, 2016 in support of the Rule is deeply flawed and misleading. As explained more fully in the attached Addendum A, these flaws are especially acute with respect to the Rule's treatment of fixed annuity products in the retirement-oriented IRA marketplace and with respect to the Rule's impact on the businesses of independent insurance agents and independent marketing organizations. This failure to conduct a meaningful impact analysis with respect to the fixed annuity industry is a critical element in NAFA's legal challenge to the Rule.

As explained more fully in Addendum A, the economic analysis of the RIA was based primarily on data derived from one economic market segment: IRA investments in front-load mutual funds. The Department's extrapolation from that segment to the entire financial services industry was flimsy at best. The Department did not include in its economic analysis a genuine appraisal of the potential impact of the Rule on other retirement products. Most notably for NAFA, the RIA did not include any disciplined analysis of the performance of fixed annuity products in the retirement savings marketplace. And, very importantly, no credit or recognition was given to fixed annuity products, or their providers, for the positive effects of moving many consumers from lower-earning or more volatile vehicles to annuities, where consumers benefit from an annuity's potentially higher rates backed by peace-of-mind guarantees. Any impact analysis that fails to factor in benefits that counterbalance costs must be regarded as axiomatically one-sided and flawed.

Nor does the RIA support its dubious claim that conflicts of interest are the cause of economic losses for retirement investors who purchase fixed annuities. Had the Department performed a more balanced and comprehensive RIA, NAFA is confident the cost-benefit analysis would not have supported or justified promulgation of the Rule under the Regulatory Flexibility Act.

<u>Conclusion</u>

NAFA commends President Trump for ordering a closer examination of the Rule and its related exemptions. The President echoes the deeply felt concerns of many that this Rule will limit access to vital financial services and products, will be especially harmful to low and middle-income Americans trying to save for retirement, and will have harmful effects on the financial services industry itself. NAFA urges the Department to repeal the Rule because, in the final analysis, the Rule is plainly inconsistent with the Administration's priorities to empower Americans to make their own financial decisions, to facilitate retirement savings, and to promote a stronger economy.

NAFA appreciates the opportunity to submit these comments. Please do not hesitate to contact me if additional information or clarification is needed.

Sincerely,

Charles "Chip" Anderson
NAFA Executive Director

NAFA
National Association for Fixed Annuities
Securing the Future!

ADDENDUM A

NAFA Comment on the Rule's Regulatory Impact Analysis

In addition to the issues raised in our comment letter, the National Association for Fixed Annuities ("NAFA") writes here to address with greater particularity regarding the analysis used by the Department of Labor to justify adoption of the fiduciary duty rule (the "Rule"). The February 3, 2017 Presidential Memorandum[1] directs the Department of Labor to conduct a *full* examination of the Rule, requiring the Department to, among other considerations, prepare an updated economic analysis addressing the impact of the rule. NAFA is especially encouraged by President Trump's directive to reconsider the economic impact of the Rule, as we contend that the Regulatory Impact Analysis ("RIA") that accompanied the release of the final Rule in April 2016 was inadequate, flawed, and deficient as it relates to fixed annuities.

Title II of the Unfunded Mandates Reform Act of 1995 requires each federal agency to prepare a written statement assessing the effects of any federal mandate in a proposed or final agency rule that may result in an expenditure of $100 million or more in any one year by the private sector.[2] Further, Executive Orders 12866[3] and 13563[4] require regulatory agencies to fully assess the economic impact of any proposed rule. The RIA – a 395-page document – devoted fewer than three dozen pages to address the Rule's likely impact on fixed annuities. Thus, in violation of the Unfunded Mandates Reform Act and the aforementioned executive orders, the Department failed to properly assess the economic impact of its mandate on fixed indexed annuity carriers, independent marketing organizations, and agents.

Moreover, the RIA failed to consider any of the positive economic effects on retirement savings for risk-averse consumers who purchase fixed annuities – and particularly fixed indexed annuities – who might otherwise keep their money in low-yield savings accounts or CDs. There is empirical,

[1] 82 FR 9675, February 7, 2017.
[2] 2 U.S. Code §1532 – Statements to accompany significant regulatory actions.
[3] 58 FR 51735, October 4, 1993.
[4] 76 FR 3821; January 21, 2011.

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demonstrable upside benefits to consumers who purchase higher-earning fixed indexed annuities, both in terms of peace of mind and greater returns on their retirement dollars, all of which is completely ignored by the Department. The sale of these insurance products by commissioned insurance agents help to optimize the retirement preparation of consumers by moving them into higher-earning retirement products without the risks attendant to other kinds of savings vehicles. The failure to account for these benefits renders the cost-benefit analysis in the RIA axiomatically defective.

The Department, in its review of the Rule, must address the inadequacies of the April 2016 RIA and must consider the very negative effects the Rule will have on the millions of Americans who wish to safely and predictably save for their retirement by working with insurance to purchase guaranteed, lifetime-oriented insurance and annuity products. We highlight in greater detail the RIA deficiencies below.

The RIA fails to tie data from alleged losses in the IRA market to the fixed annuity market

The supposed underlying rationale for the Rule is that alleged widespread, material conflicts of interest are causing financial harm to consumers in the IRA advice market. The RIA is the Department's attempt to justify that broad allegation, and to do so it must use quantified empirical data. However, as NAFA's comment letter states, the cost-benefit analysis conducted by the Department and set forth in its RIA is based almost entirely on data derived from just one economic market segment: IRA investments in front-end-load mutual funds.

In Section 3.2.4, "Magnitude of Harm" of the RIA, the Department states, "A wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative." [RIA 158] The next eleven pages of the RIA in this very-important section of the Department's analysis is devoted to alleged "strong evidence" of alleged adviser conflicts tied to poor investments – *but only in the mutual fund market*. There is no analysis whatsoever of the "magnitude of harm" in the annuity market generally, let alone the fixed annuity market specifically.

While there is a paucity of analysis and absence of any hard data to show that there is an existence of conflicts in the fixed annuity market causing economic harm to retirement investors, what scant discussion there is of annuities – and fixed annuities in particular – is superficial, flawed and utterly unconvincing. In discussing the Existence of Conflicts (RIA Section 3.2.3.1 RIA, 127 - 134), virtually all of the analysis concerns other economic sectors outside of the annuity market. In the relatively short discussion that does pertain to supposed conflicts in the annuity market, the analysis is riddled with qualifying language: "may have," "may not be," "can be," "may be," "can encourage" [see e.g., RIA 131]. And, in the discussion regarding the alleged potential conflicts associated with contingent commissions, the Department is forced to acknowledge that the studies examining contingent commissions were focused, not on annuity sales, but on the sale of commercial property-casualty insurance. [RIA 132]

Further, when discussing "Questionable Recommendations" [RIA Section 3.2.3.4.1, 145 – 149], as it relates to advice on insurance products specifically, the Department relies on self-reporting surveys conducted among life insurance professionals taken in 1990, 1995, and 2003 – which are now fourteen, twenty-two, and twenty-seven years old, respectively. The Department's conclusion regarding the surveys' findings opines that "structural and cultural issues deeply embedded in the insurance business model [might make it] extremely difficult for insurance professionals to voluntarily eliminate or reduce conflicts in their practice and align their interests with customers, *in the absence of regulatory changes*." [RIA 148, emphasis added]

Here again the RIA comes up short: what the Department obviously fails to consider is that there have been significant regulatory changes in the insurance industry since these surveys, including the most-recent in 2003, were conducted, which are directly relevant to the issues at hand. Since 2003, state insurance departments – the authorities that regulate with insurance marketplace – have adopted many different National Association of Insurance Commissioners ("NAIC") model rules and regulations

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related to market conduct in annuity sales, including the NAIC Suitability in Annuity Sales Transactions Model Regulation, which was first adopted in 2006 (three years *after* the most-recent cited survey) and then later revised in 2010. To date, the large majority of states have adopted the suitability model rule, and, insurance companies that operate on a nationwide basis have all adopted and enforce the standards and requirements set forth in the current version of the model rule.

The RIA goes on to discuss studies involving insurance sales in Chile [RIA 148] and India [RIA 149], suggesting that the data there is translatable to insurance sales in the U.S. Here, as with the other examples above, the Department's attempt to extrapolate foreign data to the U.S. annuity market is an exercise of comparing "apples to oranges" and has no persuasive value. Ultimately, the Department fails in its duty to properly and fully assess the economic impact of the Rule on the United States annuity market.

In terms of the President's stated aim to help Americans save for their own retirement, it is clear that the Department has failed to make any empirical case that alleged conflicted advice in fixed annuity sales has resulted in financial harm to American consumers in the IRA marketplace. There is a lot of smoke and mirrors, but the Department has produced no meaningful data to support its core proposition as it applies to fixed annuity and fixed annuity providers.

The RIA fails to account for the fixed annuity industry's unique distribution system

The RIA spends twenty-one pages assessing the economic impact of the Rule on securities broker/dealers and advisory firms, one page on the impact of the Rule on insurance companies, one paragraph on the impact of the Rule on insurance agents, but not one word on the project cost or impact of the Rule on IMOs. [RIA 216-238]

The Department seemingly tried to show it had assessed the impact of the Rule on annuity marketing organizations by listing some of the common terms used in marketing to reference parties in the independent annuity channel [RIA 102]. As to any real information, the Department fails to provide

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a list of the specific entities active in the marketing organization channel, fails to provide any breakdown of the market share of any IMOs, fails to provide the percentage or amount of sales of different annuity and insurance products represented in the IMO channel, fails to state the number of agents in the IMO channel, fails to show any type of sales ranking, and, even though the Department provides names of the types of entities active in the marketing organization channel, fails to provide definitions of each entity. (The Department, however, defines a "DMO" saying, "Many insurance intermediaries have adapted to digital environments, and use digital marketing organizations (DMOs) to assist with marketing efforts" [RIA 103], but there are no such things as DMOs in the annuity channel.")

It is also quite telling that the RIA cites comments from two companies, TIAA and Northwestern Mutual, on the cost of compliance with the Rule's mandates, which are held out as representative of the insurance industry. [RIA 237]. Here, the Department truly exposes its lack of understanding of the fixed annuity market, failing to note or account for the fact that neither TIAA nor Northwestern Mutual sells fixed indexed annuities. Even more to the point, neither TIAA nor Northwestern Mutual sells through the IMO channel or through independent agents, a critical distinction lost entirely by the Department in its RIA. Accordingly, the data on the cost of compliance derived from these two firms do not – cannot – reflect the cost of compliance for providers and distributers of fixed indexed annuities, particularly through the IMO channel and independent agent system.

The RIA fails to support the decision to remove fixed indexed annuities from PTE 84-24

The final Rule excluded fixed indexed annuities from PTE 84-24 and, instead, moved these non-securities products to the Best Interest Contract Exemption ("BICE" or "BIC" Exemption), alleging that "[fixed index annuities] are particularly complex, beset by adviser conflicts, and vulnerable to abuse." [RIA 8] However, the "evidence" to support this assertion is scant and suspect at best. The Department cites as support a Financial Industry Regulatory Authority ("FINRA") piece titled "Equity-Indexed

Annuities—A Complex Choice"[5] [RIA 140], but it fails to note that this "alert" obviously consists of nothing more than an editorial issued by a securities self-regulatory body with its own self-interest, not backed by any listed resources and even containing descriptions of interest crediting methods that have not been used in the industry for well over a decade.

The Department further attempts to justify the exclusion of fixed indexed annuities from PTE 84-24 saying, "Similarly, in its 2011 'Investor Bulletin: Indexed Annuities,' the SEC staff stated, 'You can lose money buying an indexed annuity. If you need to cancel your annuity early, you may have to pay a significant surrender charge and tax penalties. A surrender charge may result in a loss of principal, so that an investor may receive less than his original purchase payments. Thus, even with a specified minimum value from the insurance company, it can take several years for an investment in an indexed annuity to 'break even.'" [RIA 284] However, that exact same potential for loss of principal also happens with fixed rate annuities, which are left remaining in PTE 84-24. The Department either fails to understand or fails to note that both fixed rate annuities and fixed indexed annuities share this same contract feature with respect to surrender charges. Thus, there is no difference whatsoever in this regard to justify treating fixed indexed annuities from fixed rate annuities.

In another part of the RIA, the Department states that fixed indexed annuity sales reached $48.2 billion in 2014, and "increased sales of fixed-indexed annuities have been followed by complaints that the products were being sold to customers who did not need them." [RIA 132] However, records maintained by the NAIC show that, in 2014, actual complaints were 50% lower than they were five years previously, even though fixed indexed annuity sales were 50% higher, and there were very few complaints about fixed indexed annuity sales compared to other products.[6]

The RIA analysis regarding annuity commissions causing conflicts is flawed

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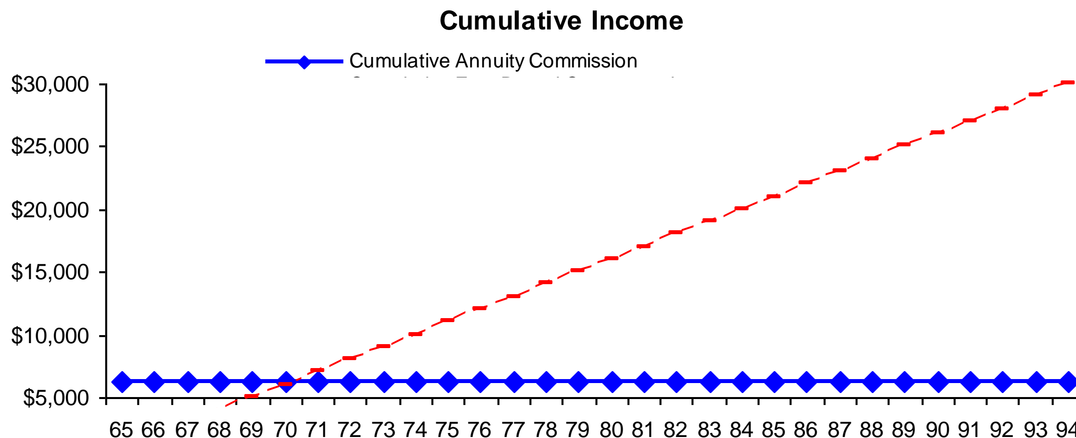
[5] http://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice
[6] NAIC Consumer Information Source (https://eapps.naic.org/cis/); Beacon Research Fixed Annuity Premium Study

The Department gives an unsupported opinion that "conflicts of interests in the annuity market can be more pronounced than the mutual fund market because commissions in the annuity market, ranging from 6 to 9 percent of premiums, are generally higher than commissions earned in connection with the recommendation of mutual funds" [RIA 168], but the facts are otherwise. In 2015, the last year for which were available from the North American Securities Administration Association ("NASAA"), state securities departments brought enforcement actions against 397 fiduciary investment advisors and firms, and FINRA brought disciplinary actions against 1512 securities representatives.[7] By contrast, state insurance departments in 2015 brought disciplinary actions against just 86 agents of fixed annuity carriers.[8]

The Department claims that insurance product commissions are often substantially higher than mutual fund commissions or advisor fees. [RIA 131] This may be facially true, but in reality it is not so because the accumulation of fee-based compensation outpaces that of annuity commissions. The following chart compares the compensation of a commission-based agent selling a fixed indexed annuity with a guaranteed lifetime withdrawal benefit versus a fee-based method of advisor compensation based on assets under management. For the purpose of this example, we will assume that we start with $100,000 at age 65 and that the purchase of a fixed indexed annuity generates a one-time 6.3% commission, which is the average commission listed by the Department. It is further assumed that, by comparison, the fee-based advisor charges 1% a year for assets under management and that this annual compensation never increases. How much cumulative compensation does the commission paid agent get with the annuity versus the fee-only advisor?

[7] https://www.finra.org/newsroom/statistics
[8] NAIC Consumer Information Source https://eapps.naic.org/cis/; Beacon Research Fixed Annuity Premium Study



The annuity provides a *one-time* commission of $6,300. As is demonstrated in the example above, the fee-based advisor matches that agent's commission income by year seven, more than doubles it by year thirteen and, by year twenty-one, the fee-based advisor more than triples the commission that he would have received had he sold a fixed annuity.

Aside from this failure to adequately compare cumulative commissions to cumulative fees under different compensation models, the Department cites just one study in the RIA to support its position on alleged conflicts created by insurance commissions, stating that high and variable commissions can encourage agents and brokers to recommend products that are not suitable for their customers and/or to favor one suitable product over others that would better serve their customers' interests. [FIA 131, citing Schwarcz 2009]. However, the Department neglects to mention that the cited study did not involve insurance professionals in the United States, and, even there, the study's authors describe evidence of bad behavior of foreign insurance agents as "scant."[9]

The RIA misunderstands the fixed annuity distribution channel regarding IMOs

[9] Schwarcz, Daniel & Peter Siegelman. 2015. "Insurance agents in the 21st century: The problem of biased advice." Research Handbook in the Law and Economics of Insurance.

There are over 100 major IMOs offering fixed annuities. Two-thirds of fixed indexed annuity sales are conducted through IMOs, and IMOs account for over $35 billion of annual fixed indexed annuity purchases. Yet, based on research conducted in November 2016, only a handful of IMOs would be in a position to qualify as a financial institution under the Department's proposed prohibited transaction exemption for insurance intermediaries that was recently released but never adopted.[10] Under the BIC exemption, IMOs do not qualify as financial institutions eligible to receive commissions. Thus, without financial institution status, it appears insurers cannot continue to pay fixed indexed annuity compensation on IRA sales to IMOs, and, even if the Department adopted its proposed class exemption for IMOs, the resulting restriction on compensation would still adversely affect or even devastate the vast majority of IMOs.

Based on the proposed class exemption, it is apparent the Department looks at and treats IMOs as the annuity industry equivalent of the securities industry's Office of Supervisory Jurisdiction ("OSJ"). However, IMOs have never functioned as OSJs, nor is the supervisory system in the securities industry remotely the same as the compliance systems in the insurance industry. An OSJ is owned, managed and supervised by a FINRA broker/dealer that is primarily regulated at the federal level. An IMO is regulated at the state level as an insurance agency; there is nothing in state insurance law that creates anything remotely similar to the securities OSJ.

In the securities world, an OSJ directly supervises the registered representative and is responsible for approval of new customer accounts, order execution, approval of customer correspondence, maintenance of records of customer complaints, actions taken to resolve issues, and custody of customer funds or securities. In the fixed annuity world the insurance company performs all of these functions – the IMO performs none of them.

[10] See e.g., http://www.investmentnews.com/article/20170118/FREE/170119925/dol-proposes-allowing-some-insurance-intermediaries-to-use-a-bice and http://insurancenewsnet.com/innarticle/imos-decry-dols-exclusive-club-approach

The attempt to 'cure' the RIA Oversight with a New Proposed IMO PTE is unavailing

Under the final Rule, the Department left open the possibility that IMOs could act as a financial institution if approved by the Department, but it did not provide any guidelines for how an IMO might apply for and become a financial institution. Even so, beginning last May, twenty-two IMOs applied to the Department in an attempt to become financial institutions. These IMOs – and indeed the entire IMO industry – was kept in limbo on this issue for eight months. Finally, in January 2017, with fewer than 90 days remaining before the Rule was scheduled to become applicable, the Department proposed a brand-new insurance intermediary PTE.[11] This new exemption is based on an examination of only four IMOs, none of which are representative of the typical IMO; in fact, these few IMOs were atypical of over 95% of annuity IMOs.[12] If adopted, many knowledgeable observers fear the Department's financial institution guidelines for IMOs would create a monopoly or cartel in which "a small group of distributors benefit from undue influence over pricing to the detriment of consumers."[13]

The Department's proposed new IMO PTE requires that IMOs must do in excess of $1.5 billion a year in annuity sales to be eligible for financial institution status, a threshold that unto itself eliminates all but seven IMOs from qualifying based on current market data.[14] The proposed IMO PTE guidelines further require the IMO to post cash reserves of at least $15 million dollars. The Department gives the option of allowing the IMO to "obtain fiduciary liability insurance coverage" instead of posting the cash reserves, but ignores the reality that no company offers this fiduciary liability coverage and that no such coverage exists.[15]

The Department's position that only an IMO that does at least $1.5 billion a year in annuities can be a financial institution, and that there must be $15 million in excess cash is arbitrary, capricious and is further evidence that the Department did not bother to conduct a meaningful economic

[11] 82 FR 7336, January 19, 2017, Proposed Best Interest Contract Exemption for Insurance Intermediaries.
[12] https://insurancenewsnet.com/innarticle/imos-bice-for-insurance-intermediaries-arbitrary-and-onerous
[13] https://insurancenewsnet.com/innarticle/fia-distribution-danger-turning-monopoly
[14] http://insurancenewsnet.com/innarticle/imos-decry-dols-exclusive-club-approach
[15] https://insurancenewsnet.com/innarticle/reserving-requirements-premium-volume-top-dols-imo-exemptions

impact analysis on the effects of the fiduciary Rule on fixed annuity providers, distributors, sellers, and consumers.

This bias of the Department comes shining through when comparing IMOs to entities such as registered investment advisors that are allowed under BICE to serve as financial institutions. For example, a registered investment adviser may cash customer checks, manage customer money, and place customer money at market risk, including even the risk of total loss. Yet, according to NASAA, an advisory firm only needs net capital of $35,000.[16] In an IMO, customer checks are made payable to and are cashed by the insurance company – not the IMO. The IMO does not manage customer money, nor does the IMO place customer money at market risk. And yet, without any evidence of additional risk – and frankly without evidence of any risk at all – the Department would require an IMO to have reserves that are over four hundred times greater than the financial advisor is required to have in order to be a financial institution.

The RIA fails to take into account the positive net benefits that fixed indexed annuities provide

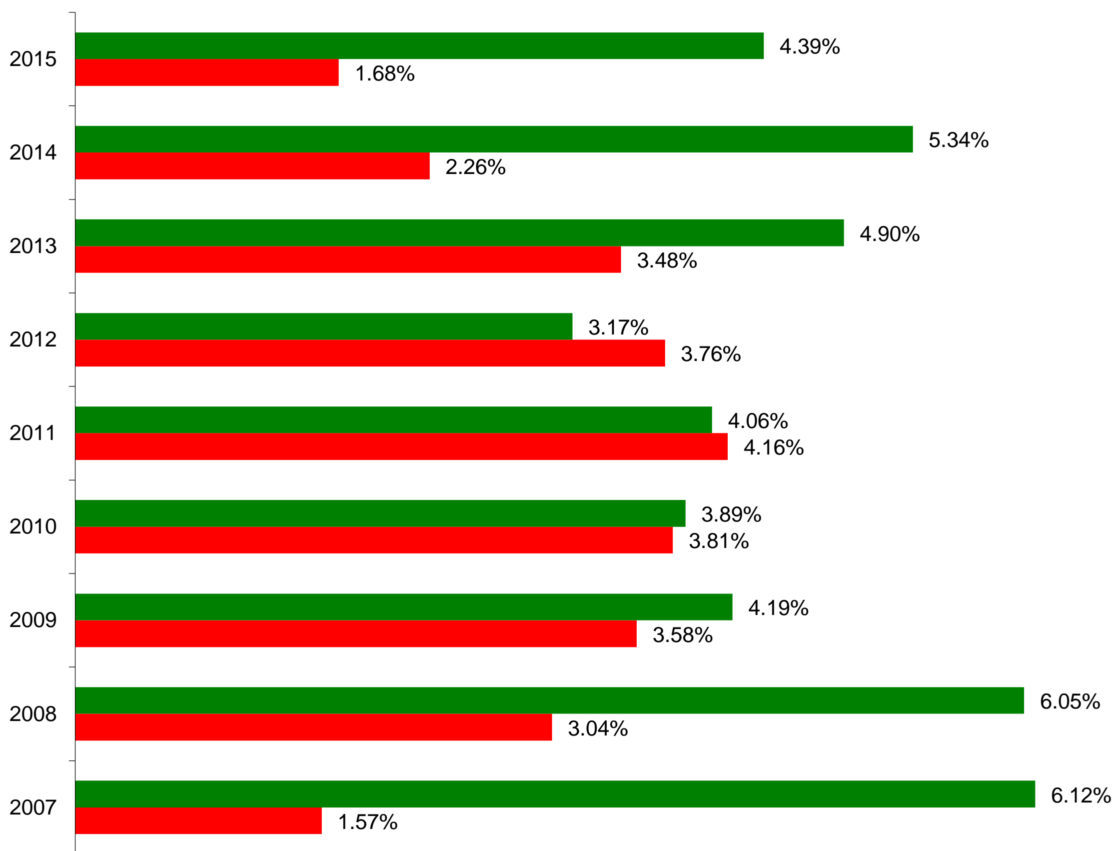
The most obvious flaw in the RIA is its failure to account for the positive influence of commissions that compensate agents to seek out clients and sell them annuity products that may provide them with both higher returns as well as greater peace of mind, which is a critical emotional element that addresses issues of economic security and well-being. The RIA says not one word about the possibility that removing or suppressing incentives in the marketplace can mean consumers will not hear about or be prompted to make purchases of retirement products that would benefit them in these ways.

It is interesting to note that almost three centuries ago the cousins Nicolas and Daniel Bernoulli introduced the theory that people will choose the outcome that provides the maximum utility for their situation, taking into account their tolerance for risk. This *expected utility theory* maintains that consumers will always make the most economically-rational decision, but it acknowledges that there is

[16] N*ASAA Minimum Financial Requirements For Investment Advisers MR 202(d)-1*

an emotional element that comes into play when making those decisions. If you examine fixed indexed annuities, you find that not only do they often provide the maximum economic utility, but they also solve the emotional need as well.

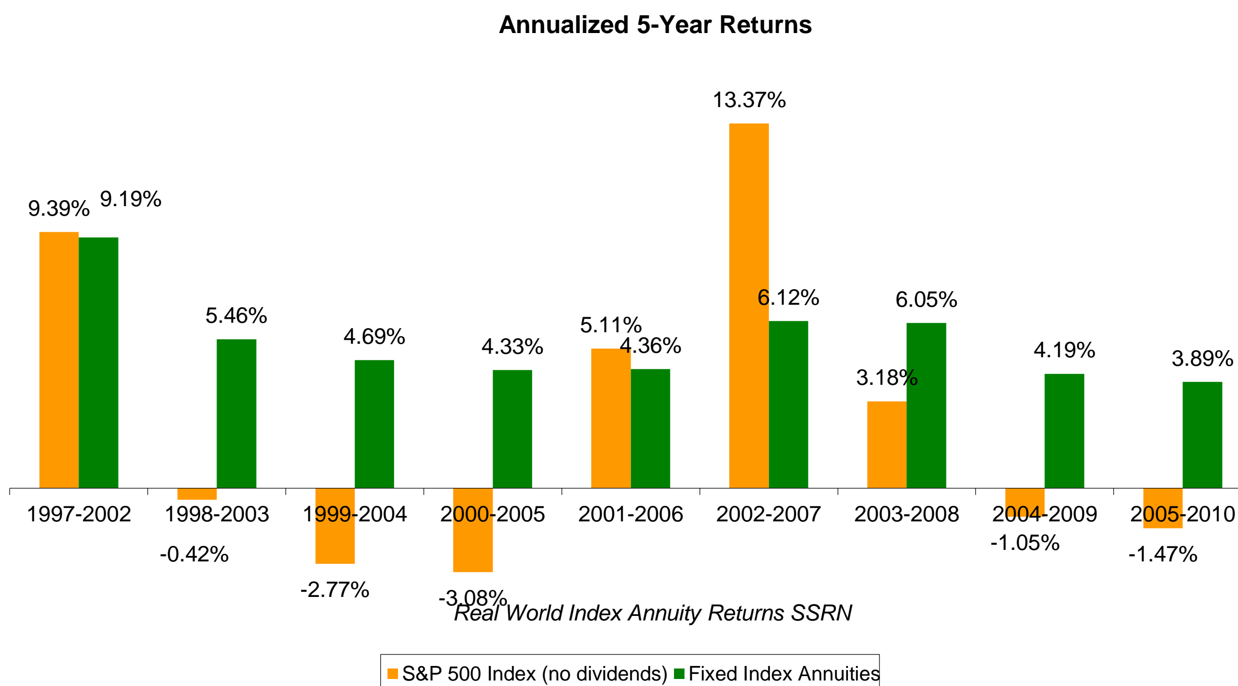
Fixed indexed annuities were introduced during a time of falling interest rates as a means of providing competitive interest rates. Fixed indexed annuities offer an alternative to low-yield banking vehicles. This chart compares five year annualized yields of the fixed indexed annuities with the average five-year certificate of deposit (CD) rate for the same period. The chart shows the average annuity return reported was, at times, very competitive and still remained competitive when the period included the bear market.



* Carrier issue dates clustered around 30 September 2006, but since different companies have slightly different issue dates the interest periods counted by one carrier may be significantly different than another. Carrier was permitted to pick the product, method and index to submit and to send in results using multiple indices or even a combination of fixed and indexed interest. This is an average of those returns submitted and is not intended to be comprehensive.

The purpose of a fixed indexed annuity is to provide a return consistent with that of other vehicles that protect principal and credited interest from market risk. A fixed indexed annuity is not an investment in the stock market, and the best way to show this is to compare it with the stock market.

The following chart [17] was created from data from a peer-reviewed study that examined actual fixed indexed annuity returns and contrasted them with returns of the index itself. Although the average fixed indexed annuity in the study did outperform the index two-thirds of the time, the main point is that during periods when the index was down, the fixed indexed annuity still generated positive yields.



A fixed indexed annuity is not a direct alternative to stock market investments, but it is an alternative retirement vehicle that shields against the risk of possible loss inherent with stock market

[17] Babbel, David F. and VanderPal, Geoffrey and Marrion, Jack, Real World Index Annuity Returns (December 27, 2010). Available at SSRN: https://ssrn.com/abstract=1482023 or http://dx.doi.org/10.2139/ssrn.1482023.

investments. Indeed, a study using the criteria of multi-period utility analysis found that fixed indexed annuities were judged superior in performance to combinations of stocks and bonds when the individuals were moderate to strongly risk-averse.[18] Fixed indexed annuities are also attractive to consumers for whom retirement is looming, who are not necessarily risk-averse and who might otherwise have invested in the stock market had they the luxury of time to recover from market downturns. These individuals look to purchase fixed indexed annuities because they offer a variety of benefits that other, low-yield options do not provide: guaranteed lifetime income and the protection from downside market risk, while still allowing for the potential for greater account value growth based on gains in external indices.

Conclusion

As discussed here in great detail, the original RIA published on April 8, 2016 in support of the Rule is deeply flawed and misleading. The President clearly recognized that in his February 3, 2017 Memorandum to the Secretary of Labor, directing the Secretary and the Department to prepare an updated economic and legal analysis concerning the likely impact of the rule. The failures inherent in the RIA are especially acute with respect to the fixed indexed annuity industry. The Rule will have especially devastating consequences to the businesses of independent insurance agents and independent marketing organizations. The Rule will also have devastating consequences on the ability of low and middle income Americans to save for their retirement. With such far-reaching consequences, it is incumbent upon the Department to justify its actions with a credible regulatory impact analysis. It failed to do so when it promulgated the rule in April 2016, and NAFA believes absent a meaningful cost-benefit analysis, the Rule should be reconsidered and ultimately repealed.

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[18] Babbel, D., M Herce & K. Dutta. 2008. "Un-Supermodels and the FIA."
http://corporate.morningstar.com/ib/documents/UserGuides/UnSupermodelsFIA.pdf

ADDENDUM B

NAFA Commentary on Specific Questions

The National Association for Fixed Annuities ("NAFA") provides this supplement to its response to the Department of Labor's ("DOL" or "the Department") March 2, 2017 Notice of Proposed Rule, RIN 12010-AB79 ("Notice") to comment specifically on itemized questions raised by DOL in its Notice that appear on pages 12324 and 12325 of the Federal Register.

It bears emphasis that NAFA's comment letter addresses the three overarching critical issues raised in the President's February 3, 2017 Memorandum. NAFA believes strongly the President's Memorandum focuses much needed attention on deep-seated flaws in the Fiduciary Duty Rule (the "Rule"). These flaws include the Rule's adverse impact on consumers by limiting access to products and services, its dire impact on the cost of financial products and services by causing a surge in unnecessary litigation, and its devastating impact on segments of the financial services industry which will be forced to reconfigure in ways that will be harmful to our economy, and result in the destruction of jobs, careers, and businesses. These negative effects are downplayed and in many cases ignored in the result-oriented Regulatory Impact Analysis that the prior Administration conducted.

The focus of this attachment is on the questions that the Notice asked as they pertain to the fixed annuity industry. While a number of those questions inquire about effects of the Rule during implementation prior to the Rule's applicability date, NAFA will reply to the questions both with respect to the implementation period and the Rule's impact should it become effective at any time in the future.[1] And while many of the questions ask about the impact of the Rule more broadly on

[1] NAFA recognizes the Rule is theoretically in effect with a current applicability date of June 9, 2017. However, because the Rule has not yet been implemented and does not as a practical matter take effect until the Rule becomes "applicable," NAFA uses the terms "effect" and "effective" here to reference the point at which the rule would actually become operational and enforceable.

consumers and the financial services industry, NAFA focuses its comments on how the Rule impacts the client base of its membership, which is low and middle income Americans, and how the Rule impacts the fixed annuity segment of the financial services industry consisting of tens of thousands of people working hard to manufacture, market, and distribute fixed annuity products to help millions of Americans save for a secure retirement.

At the heart of NAFA's comments here is the fact that the Rule is causing tremendous havoc within the fixed annuity industry because it compels a complete overhaul of the industry's distribution system. That distribution system, which has served the fixed annuity industry well over several decades, is responsible for issuance and delivery of tens of millions of annuities amounting last year alone to over $50 billion in premium. As a direct consequence of this assault on the fixed annuity distribution system, the Rule will harm consumers by limiting access to crucial annuity products and related services needed for retirement planning. This is especially unfortunate with respect to fixed indexed annuities which provide a conservative option for middle-class families to safely grow their retirement savings when they prefer not to leave hard-earned savings in banks or money markets accounts yielding little interest, nor invest lifetime savings in risky securities that are subject to uncontrolled fluctuations and the possibility of complete loss.

Perhaps the most unique aspect of the fixed annuity industry distribution system – as compared to the securities industry – are specialized Independent Marketing Organizations ("IMOs") that serve to distribute life insurance products, including fixed annuities, using an independent agent structure.[2] IMOs are central to the annuity distribution system and yet they are not recognized as Financial Institutions under BICE nor does BICE account for the fact that

[2] Anderson Affidavit at ¶ 13.

independent insurance agents oftentimes work for multiple IMOs and represent multiple insurance carriers. This highly developed distribution model stands in marked contrast to the captive nature of the brokerage model that the securities industry uses, and illustrates how the Rule, tailored to the securities industry and its distribution system, is not an appropriate fit for the fixed annuities industry. As a result, allowing the Rule to go forward will destroy or significantly reshape the well-established fixed annuity distribution model which, in turn, will adversely affect the ability of Americans preparing for retirement to gain access to valuable fixed annuity retirement products. Those are the primary concerns that animate many of NAFA's answers below because the damaging effects of the Rule on the annuity distribution system will be deeply felt by consumers.

Please note that as to each question, the question is stated as it appears in the Federal Register, and then NAFA's reply follows. Much of the documentation supporting NAFA's commentary here is taken from positions and affidavits proffered in its lawsuit against the Rule and, where appropriate, those affidavits are cited.

(1) Do firms anticipate changes in consumer demand for investment advice and investment products? If so, what types of changes are anticipated, and how will firms respond?

This question – in NAFA's view – should be reversed because it is changes in investment advice and investment products the Rule mandates that will change consumer demand. It is also certain those changes on the whole will adversely impact consumers.

Consumer demand for investment advice and products is driven by, and often a function of, changes in product availability and distribution models. Given the Rule's adverse impact on *fixed annuity* products and their distribution, as explained at length in NAFA's lawsuit against the Rule, the effect will be that consumers, particularly lower and middle-class Americans, will have less access to financial information and products that the fixed annuity industry provides.[3]

[3] Perkins Affidavit at ¶ 20.

In its lawsuit, NAFA showed the Rule is having – and if ever put into effect, will certainly have – a devastating impact on the fixed annuity industry because it requires nothing less than a complete overhaul of the industry's distribution system. As a result, the independent agent distribution system would be decimated, product innovation crippled, and consumer choice narrowed. The Rule's obvious bias against independent insurance agents and fixed indexed annuities will have undesirable effects on consumers who will no longer be able to access fixed annuity products in the same way through the existing agency structure. Instead, consumers likely be forced to work with captive insurance agents, or possibly securities brokers, who offer a more limited set of product choices and services redesigned to comply with the Rule's inherent bias favoring fee-based investment advice and limited products with one-size-fits-all compensation structures.

NAFA believes many Americans saving for retirement desire the very features that fixed annuities offer which include protection against fluctuating markets and income alternatives that last a lifetime. Regrettably, these very kinds of products, along with the advice and services that independent insurance agents offer today, will be suppressed or eliminated by the effects of this Rule, which imposes unrealistic requirements on fixed annuities and their agents.

(2) Are firms making changes to their target markets? In particular, are some firms moving to abandon or deemphasize the small IRA investor or small plan market segments? Are some aiming to expand in that segment? What effects will these developments have on different consumer segments, especially small IRA investors and small plans?

NAFA believes this Rule is having, and will have, an especially negative effect on the smaller IRA market – i.e., the less affluent or less sophisticated retirement-oriented consumer who

prefer the services of a commissioned agent selling annuity products versus fee-based brokers or advisers selling riskier investments typically held in managed accounts.

Should the Rule become applicable, NAFA believes the adverse effects on annuity sellers as described above will cause the financial service industry to de-emphasize focus on small IRA investors who today make up a large proportion of the fixed annuity industry's client base. The fact is that many of the clients that NAFA members serve are low or middle-income retirement savers who cannot afford fee-only providers, but can readily access assistance with retirement and insurance planning through commissioned insurance agents who oftentimes seek out and welcome non-affluent consumers.[4]

More specifically, fixed annuities offered through independent agents and IMOs provide lower and middle-income Americans with financial and retirement planning assistance they would not otherwise receive based on what our members see firsthand in their work helping average everyday Americans. Many of these lower and middle-income consumers simply cannot meet asset thresholds of securities broker-dealers and investment advisory firms.[5] Many others are simply not in the target markets of such firms. That said, it is also true many of these consumers with modest savings are particularly well served by fixed annuities as a relatively easy method to plan for retirement and end-of-life scenarios.[6]

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[4] *See, e.g.*, Cousinet Declaration at ¶ 10 ("[O]ur customer base is made up of low and middle income clients needing assistance with retirement and insurance planning. [and] are typically between 50 and 75 years old and have an average net worth of $200,000 to $600,000."); Rice Declaration at ¶ 14 ("The customers generally served by [the insurance agents], on average are middle income Americans with a net worth between $200,000 and $500,000, and an age range of 50 to 80 years old."); Tripses Declaration ¶ 16 ("Another benefit of the independent channel is that it provides access to financial and retirement planning services to an underserved segment of the population; namely, hard-working, middle-income Americans who do not meet the asset thresholds of many securities broker-dealers and investment advisory firms.").

[5] Rice Declaration at ¶ 17; Cousinet Declaration at ¶ 14; Shreves Declaration at ¶¶ 10, 19.

[6] Shreves Declaration at ¶ 10.

Many of the lower income clients of independent insurance agents that the Rule would force out of business would have nowhere to turn.[7] This could be especially unfortunate in underserved areas of the country where there are few broker-dealers or investment firms that would take these clients because of their modest means, and because those firms would now face significantly increased legal exposure.[8] Clients like these would lose access to face-to-face meetings and many financial planning services.[9] Small IRA investors would be left with fewer and less favorable investment offerings, as annuity sellers who have aimed at less affluent client bases must turn away from qualified IRA transactions to avoid running afoul of the Rule.

On a side point, NAFA sharply disagrees with the Department's attempt to depict the widespread use of IRAs today as a problem requiring additional federal regulation. Far to the contrary, movement towards savings within IRAs in the last forty years has been a positive development, resulting in much greater consumer choice, far better access to information, and greater control than ever over personal retirement matters, which on the whole has been a remarkable boon to retirement savers. Competition in the financial services arena has flourished and consumers today have a wide range of options which include many products and services for the small IRA investor which includes a wide range of annuity products and related services through commissioned insurance agents. NAFA believes the Rule will stifle this healthy competition, hurt small IRA consumers the most, and negatively impact retirements savings in this country at a time when government should be promoting retirement savings rather than making it even harder for the financial services industry to deliver and meet the needs of retirement consumers.

[7] Cousinet Declaration at ¶ 23.
[8] Cousinet Declaration at ¶ 23.
[9] Cousinet Declaration at ¶ 24.

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(3) Are firms making changes to their line-ups of investment products, and/or to product pricing? What are those changes, what is the motivation behind them, and will the changes advance or undermine firms' abilities to serve their consumers' needs?

As discussed above, there is no doubt the Rule will change the way fixed annuities are designed, marketed, distributed, and serviced. These changes will be highly detrimental to consumers in the IRA marketplace. As the Rule seeks to reduce or levelize commissions, paradoxically, its real world effect will be to stifle competition, suppress innovation, drive agents out of the business, force more sales through securities brokers and dealers, favor riskier securities products and costlier fee-based accounts. Further, it will undermine the ability of a major segment of the financial services industry - the fixed annuity industry - to address and meet the needs of clients who, by and large, are average Americans that commissioned insurance agents often can best serve.

It is well established that independent agents and IMOs make up the backbone of the distribution system for the fixed annuity industry. But under the Rule and the Best Interest Contract Exemption ("BICE"), independent agents and IMOs are virtually forgotten, with no provision made for how independent insurance agents operate, and no recognition given to IMOs in their key role in the annuity distribution system. The result will be devastating. As spelled out in detail in numerous affidavits filed in NAFA's lawsuit, none of which were disputed by the government, a large number of independent agents will stop offering FIAs if the Rule goes into effect.[10] Of the 80,000 insurance agents who now sell FIAs, it was estimated at least 20,000 of those agents will leave the business.[11]

This sweeping transformation in the industry will be accompanied by major product changes, all causing a significant and harmful reduction in available annuity products. While the

[10] Marrion Affidavit at ¶ 48.
[11] Marrion Affidavit at ¶ 49.

exact nature of those changes is uncertain, changes will be inevitable, as insurance carriers must respond to this changing landscape and onerous new legal requirements. Some insurance carriers have indicated they may discontinue sale of FIAs in the tax-qualified marketplace, and instead sell fixed rate annuities possibly with enhanced benefit features. Other carriers have signaled they will change product features to compete in the broker dealer channel which is a more restrictive distribution system and characterized by different compensation structures all designed to accommodate and promote securities as their primary product offering.[12] It is important to note many of these product changes could take months or years to implement, during which time consumer choice will be disrupted in addition to the fact that over time many of today's products and tomorrow's innovations will be lost because of the Rule.

Product introductions in the annuity marketplace take significant time to implement across the country – especially given products are approved on a state by state basis – often taking several years and even in a best case scenario taking at least 18 months.[13] Launching new products is a time consuming process which involves product conception, product design, pricing, agent contracting, filing with and approval by state regulators, systems development, preparation of product materials and advertisements.[14] Filing and obtaining approval of policies and required product forms in all 50 states alone can take two years.[15]

Consumer choice among annuity products will also dwindle as insurance carriers are forced by the Rule to abandon true independent agents. Instead, carriers will be forced to distribute annuity products through quasi-captive agents who sell for only one company or a single IMO, or alternatively through agents who sell fixed annuity products through securities broker-dealers or

[12] Marrion Affidavit at ¶ 35.
[13] Marrion Affidavit at ¶ 36.
[14] Marrion Affidavit at ¶ 36.
[15] Marrion Affidavit at ¶ 36.

other financial institutions.[16] As explained in NAFA's lawsuit, the Rule is designed in a way that works for the securities industry but is at odds with the independent agency system in which agents offer competing products of different insurance carriers. The result is the independent agency system will be impossible to maintain and will atrophy, and with it, consumer choices will be curtailed.[17]

(4) Are firms making changes to their advisory services, and/or to the pricing of those services? Are firms changing the means by which consumers pay for advisory services, and by which advisers are compensated? For example, are firms moving to increase or reduce their use of commission arrangements, asset-based fee arrangements, or other arrangements? With respect to any such changes, what is the motivation behind them, and will these changes advance or undermine firms' abilities to serve their consumers' needs?

NAFA believes the longer term effects of the Rule on advisory services are uncertain, but the foreseeable effects are adverse and costly for consumers. Many consumers will be forced into fee-based advisory services they do not need. Many insurance agents today will be forced to become investment advisers which will add another layer of costly compliance that serves no meaningful purpose. Many insurance agents who today give advice to clients incidental to their role as salespersons - which has considerable value to consumers with no direct cost - will no longer provide such advice because many of those agents will have been forced out of the business.

In general, annuities are sold by insurance agents who receive commissions in the form of upfront percentage-of-premium payments (some of which are front loaded and some of which may be paid out over time).[18] The sales transaction for a fixed annuity contract is made between the consumer and the insurance company.[19] Premium payments made by the consumer for the purchase of the fixed annuity contract are paid to the insurance company, not the agent or advisor.[20]

[16] Second Marrion Affidavit at ¶ 12.
[17] Second Marrion Affidavit at ¶ 13.
[18] Marrion Affidavit at ¶ 24.
[19] Anderson Affidavit at ¶ 8.
[20] Anderson Affidavit at ¶ 8.

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The insurance agent – unless separately providing insurance advice for a disclosed fee – receives no payment from the consumer and instead is paid directly by the insurance company. Thus the advice and assistance provided by an insurance agent is free of charge to the consumer except to the extent a product is purchased, in which case the insurance carrier pays compensation to the agent, not the policyholder.

This scenario differs markedly from the typical investment advice scenario where a consumer pays an investment advisor specifically to maintain an account, provide advice, and actively manage money.[21] In those instances, ongoing fees are charged to an investor for the investment advisor to "invest" by making common investment decisions including buying, selling, and reallocating.[22] Typically the fees are asset-based and charged regardless of how well the assets perform.

The other hidden cost caused by this Rule – that will ultimately catch up with consumers – is the need for independent agents to become investment advisers which carries with it significant added compliance infrastructure and cost. Independent insurance agents – unless dually licensed under both insurance and securities laws – will be forced to register as investment advisers in order to provide the kind of investment advice required under the BICE to satisfy vaguely defined impartial conduct standards.[23] This would apply to any insurance-only agent who sells fixed annuities to IRA owners, even if the agent does not sell any securities products,[24] because under the BICE, insurance-only agents must consider "investment objectives" of a client. The fiduciary duties the Rule and the BICE impose on insurance agents, which duties today are reserved for true ERISA plan managers, go well beyond the kind of incidental advice and guidance that insurance

[21] Anderson Affidavit at ¶ 9.
[22] Anderson Affidavit at ¶ 9.
[23] Marrion Affidavit at ¶ 54; *see also* 81 Fed. Reg. at 21,174.
[24] Marrion Affidavit at ¶ 54.

agents currently provide, and who otherwise purposefully conduct themselves to avoid triggering investment adviser licensure requirements.[25]

For those agents who remain in the business, and who continue to offer fixed annuities in the IRA marketplace, costs are sure to go up as they must take on added burdens associated with becoming an investment adviser. One way or another, consumers will pay for those compliance costs through new fees or lower returns on products.

(5) Has implementation or anticipation of the Rule led investors to shift investments between asset classes or types, and/or are such changes expected in the future? If so, what mechanisms have led or are expected to lead to these changes? How will the changes affect investors?

As discussed in response to prior questions, the clear impact of this Rule will be to favor certain securities products – especially fee based accounts – over other kinds of products - most particularly fixed indexed annuities offered through commissioned agents. This bias in the Rule is highly unfortunate because so many consumers (especially those with smaller amounts of assets) cannot afford, or do not want, expensive fee-loaded advice.[26] These consumers have specifically chose to put their hard-earned money into insurance-only products, including FIAs, because that is what suits them best. They often choose FIAs because they earn better returns than simple savings or money market accounts, while also providing opportunity for higher returns without the downward market risk that the insurance carrier absorbs.[27] For these consumers, an important factor is that they do not pay for incidental advice and only pay for products they actually purchase. But under the Rule and BICE, it is certain the range of choices now available to consumers, and the role of traditional insurance agents, will be repressed. In short, this Rule will deprive consumers of the spectrum of choices they have today and will cause shifts in asset types – at least

[25] Marrion Affidavit at ¶ 56.
[26] White Affidavit at ¶ 13.
[27] White Affidavit at ¶ 7.

as between securities products that are more heavily favored versus insurance products that are disfavored – which will place retirement savings more at risk.

(6) Has implementation or anticipation of the Rule led to increases or reductions in commissions, loads, or other fees? Have firms changed their minimum balance requirements for either commission-based or asset-based fee compensation arrangements?

NAFA wishes to comment more broadly on how the Rule will impact certain aspects of compensation relating to the offering of fixed annuities.

A particularly troubling aspect of the Rule and its Prohibited Transaction Exemptions is the uncertain effect on IMOs, and in particular whether IMOs will be allowed to collect any compensation under the Rule given they are not recognized as Financial Institutions under the BICE. Further, there is no recognition whatsoever in BICE for the role of intermediary organizations, including IMOs and other middle-level agencies, within the annuity distribution system hierarchy.[28] The recent Department proposal to create a special prohibited transactions exemption for insurance intermediaries only exacerbated this concern by setting unrealistic standards that would permit only a handful of IMOs – at most – to qualify as Financial Institutions out of hundreds of such agencies. The effect of the Department's failure to account properly for the role of IMOs in the annuity industry distribution system has left big questions about how IMOs will survive in the new world order the Rule and the prohibited transaction exemptions create.

Consequently, should IMOs be prevented from receiving adequate compensation, or worse yet, be cut out entirely, there will be massive layoffs and dislocation, affecting potentially hundreds of small businesses. The IMOs that survive could suffer a 50% drop in annuity sales resulting in enormous profit losses to their businesses.[29]

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[28] Marrion Affidavit at ¶ 63.
[29] Wong Affidavit at ¶ 9.

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Another unresolved – and disconcerting – issue regarding compensation is the Rule's requirement that compensation paid to commissioned agents under the BICE be "reasonable." The fact of the matter is that the Department has provided no meaningful guidance on what is considered reasonable and indeed it has declined to provide any such guidance. Worse yet, the Department in its preamble to the Rule provided conflicting information on how the industry should determine what is reasonable compensation. At the same time, the Rule leaves the insurance industry vulnerable to dire economic consequences in the event compensation is found to be "unreasonable" even by a penny.

To elaborate, enforcement of the reasonable compensation requirement will be achieved through private lawsuits which means industry will have no ability to clarify the rule's reasonable compensation parameters through administrative process because it will be the courts that hold the ultimate say on what is reasonable under the BICE. In other words, once the reasonable compensation requirement is baked into millions of Best Interest Contracts ("BICs"), those contracts will be a source of private litigation brought pursuant to the BICE in state courts scattered across the country. NAFA submits this will be a boon for the plaintiffs' bar but costly and ultimately detrimental to the interests of the fixed annuity industry, and, even more importantly, its customers.

(7) Has implementation or anticipation of the Rule led to changes in the compensation arrangements for advisory services surrounding the sale of insurance products such as fixed-rate, fixed-indexed, and variable annuities?

NAFA believes implementation of the Rule will have dramatic impact on compensation arrangements for annuities. This particular question seems aimed at "advisory services surrounding the sale of insurance products" but NAFA will comment regarding the effect on compensation for sale of annuities themselves.

Without evidence, the preamble to the BICE implies that conflict of interest concerns are acute with fixed indexed annuities and used that contention to support the last minute decision to move FIAs from 84-24 to BICE. Presumably the heightened concern over commissions paid to agents selling fixed indexed annuities was driven by a perception that commissions for annuities are higher than commissions on other kinds of financial products. Of course that is an "apples and oranges" comparison since annuities are intended to be long term vehicles and so higher compensation paid to agents represents both (a) requisite efforts to identify and assist potential clients who do not otherwise proactively shop for annuities and insurance, and (b) the fact that annuities are held longer term and do not turn over as quickly as mutual funds which thus pay out compensation to salespersons with higher frequency compared to annuities.

Under the new Rule and BICE, for those companies that continue to offer fixed annuities, and for those agents that continue to sell them, there will be pressure to reduce and levelize commissions, which superficially sounds beneficial to consumers, but in reality is a disservice because it pressures compensation. In turn, this squeezes out service, innovation, longer duration products, and other elements and factors that the free market has demanded and fixed annuity providers have satisfied. Now through excess regulation and social engineering, market forces will be replaced with rules and regulations that do not fit the annuity marketplace, and will have a corrosive effect on the spectrum of products and services currently available. This is all to the detriment of consumers, who ordinarily want the best product at the best price to get the best value.

While the precise effect of the Rule and BICE on commissions is impossible to quantify at this stage, what can be said for sure is that the Rule and BICE, if allowed to go effective, will impact compensation which, of course, is why the Rule and BICE are being adopted in the first place. There are approximately 280,000 insurance agents in the United States, and approximately

80,000 sell fixed annuities, with roughly 60% of those sales being made by independent agents free to represent one or more carriers and their products. Compensation for those agents - if they remain in the business - will almost certainly go down and that will have a ripple effect throughout the segment of the American economy represented by the insurance industry comprised primarily of small and medium-sized businesses.

IMOs may be particularly hard hit as explained above in response to prior questions. Insurance carriers work with IMOs as intermediaries to recruit agents to distribute their products, provide product information and support, and offer other services such as marketing support and coordinating submission of annuity applications.[30] IMOs are critical for independent agents so that insurance companies do not have to create internal sales departments or a captive agent system. Because of this, insurance agents earn commissions and IMOs earn override payments in an up-front percentage-of-premium payment. This payment is made upfront because annuity purchases often involve large initial deposits, and the efforts of the agent are the most significant up front at the point of purchase.[31] Accordingly, fixed annuities do not lend themselves to compensation based on assets that are actively managed or other non-commission forms of payment.[32]

Commissions will be significantly reduced, or in the case of IMOs possibly eliminated, as a result of the Rule. With reduced commissions, fixed annuity providers will not be able to pay for necessary marketing to reach potential clients.[33] Reduction or elimination of commissions would also shrink the ability of agents and IMOs to conduct client outreach and education.[34]

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[30] Anderson Affidavit at ¶ 13.
[31] Marrion Affidavit at ¶ 24.
[32] Marrion Affidavit ¶ 24.
[33] Engels Affidavit at ¶ 13.
[34] Engels Affidavit at ¶ 13.

(8) For those firms that intend to make use of the Best Interest Contract Exemption, what specific policies and procedures have been considered to mitigate conflicts of interest and ensure impartiality? How costly will those policies and procedures be to maintain?

First, it must be pointed out that the insurance and annuities industry as a whole has long adhered to and enforced strict policies and procedures – in part driven by state law – to ensure full disclosure and fair marketing practices in connection with sales of their products to the consuming public. Indeed, consumer complaints related to fixed annuities are exceptionally low compared to securities and securities-type products such as variable annuities.[35]

However, implementation and maintenance of policies and procedures emanating from Washington that the BICE dictates, over and above existing state regulation, will be extraordinarily expensive, in large part because the policies and procedures prescribed by BICE are built around the securities model and are not consonant with the fixed annuity industry's distribution model. Unlike the securities industry, which has an existing apparatus for supervision and which can more readily adjust existing policies and procedures to accommodate BICE requirements, such an infrastructure does not exist in the fixed insurance industry and the focus of policies and procedures in the insurance industry have been on full disclosure and suitability as opposed to elimination of conflicts of interest. The net result is that the efforts and cost associated with the fixed insurance industry to meet these new requirements will be sizeable and will add significantly to the industry's overhead expenses.

Aside from cost, it should be emphasized that many insurance carriers and IMOs will not be able to comply with the BICE compliance requirements in the first instance and will be forced to change their business models, which unto itself will be very challenging and expensive. For example, under the BICE, an insurance carrier must determine whether the specific FIA that an

[35] Marrion Affidavit at ¶ 71.

independent insurance agent recommends is in the "best interest" of the consumer, which cannot be done without taking into account investment products that the carrier does not sell.[36] This requires the insurer to police all of the agents' activities, including presentation of competitors' products and compensation paid to the agent by competitors to ensure that the "best interest" of the consumer are being met, without regard to the "financial or other interests" of the agent or all the other insurers represented by the agent.[37] The FIA industry has considered formulating BICE policies, but they all have inherent limitations and costs, and are at odds with the historical business methods of the industry.[38]

Insurance compliance systems are very different from securities compliance systems, because in the insurance context each agent is not affiliated with just a single broker. Securities compliance systems cannot be replicated wholesale for insurance products, because independent agents often represent several competing carriers.[39] And while annuity carriers could work only with agents affiliated with a broker dealer or investment advisory firm, many independent agents are not securities registered, and insurance-only agents would be required to pass multiple securities examinations (at their own time and expense).[40] These agents would then need to find a broker dealer or investment advisory firm to affiliate with in order to remain in the business of selling FIAs, which are not regulated as securities under federal securities law.[41]

Another alternative is for annuity carriers to create a captive agent distribution system. However, this would require insurers to "create layers of supervisory personnel and to incur the additional cost of treating these agents as employees and not independent contractors."[42] This

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[36] Marrion Affidavit at ¶ 30.
[37] Marrion Affidavit at ¶ 30.
[38] Marrion Affidavit at ¶ 61.
[39] Marrion Affidavit at ¶ 31.
[40] Marrion Affidavit at ¶ 32.
[41] Marrion Affidavit at ¶ 32.
[42] Marrion Affidavit at ¶ 33.

change alone would result in over $160 million of additional annual cost to the insurers. It would also reduce the choice of products that independent agents provide to consumers.

With practically no explanation or analysis, the Rule exempts fixed declared rate annuities from the BICE, but does not exempt fixed indexed annuities. With this seismic shift, the Department is treating FIAs like securities products, grouping them together with mutual funds, variable annuities, and other investments that carry risk of loss.[43] There is nothing from the rulemaking process that indicates the Department even considered the impact of the decision to treat FIAs as securities. As explained throughout this letter (and comments that NAFA and others submitted during the 2015 rulemaking), FIAs are very different than securities products because FIAs are guaranteed by the issuer and protected against market loss. Curiously, FIAs are the only widely marketed non-securities product covered by the BICE.[44] And while fixed rate annuities are included in PTE 84-24 based on "predictability of interest payments," FIAs are not included in that exemption.

The Rule and the BICE will never achieve the Rule's goal to "facilitate continued provision of advice to . . . retail investors under conditions designed to safeguard the interest of these investors."[45] Instead, it will force many of the industry participants to go out of business, reduce annuity product offerings, or replace annuity product offerings with risky securities investments. Of the approximately 100 IMOs that sell FIAs, 90% would not qualify for an exemption under the proposed IMO PTE; in fact, only ten (10) "might be in a position to qualify as a Financial Institution without an exemption from the [Department], because those 10% already own a securities-registered broker-dealer or investment advisor."[46] Of the 10% of IMOs that do qualify,

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[43] Marrion Affidavit at ¶ 27.
[44] Marrion Affidavit at ¶ 27.
[45] 81 Fed. Reg. 21,002.
[46] Second Marrion Affidavit at ¶ 20.

it is estimated that each will lose 25% of current revenue.[47] For the remaining 90% of IMOs, those IMOs' annual revenue will decrease by upwards of 60% because they will be limited to selling non-qualified fixed annuities (i.e., sales excluding IRAs) in the independent agent market.[48]

Fixed Annuities are Already Closely Regulated

Fixed annuities are already subject to policies and procedures that ensure proper conduct and are closely regulated by state insurance departments.[49] State regulation is pervasive over insurance companies, the content and approval of policies, the ongoing financial condition of the carrier, the licensing of the insurance agents, the manner in which policies are advertised and sold, and virtually all other facets of the insurance business.[50] For starters, fixed annuity contracts must be filed with and approved by each state in which the contracts are sold. Insurance agents who sell fixed annuities are bound by common-law requirements of agency and must pass tests of both competency and character before being granted a state license.[51] In many states, the agent must also contract with and be appointed by an insurance carrier prior to selling products on behalf of an insurer.[52] Insurance carriers also perform their own due diligence as part of the agent appointment process.

After being licensed and appointed, but prior to selling annuities, agents in most states must complete mandatory product training provided by the carrier and a suitability training course approved by the state.[53] Once fully qualified, the agent is subject to comprehensive state regulations including disclosure, suitability, "free look" (or right to return) requirements, unfair

[47] Second Marrion Affidavit at ¶ 22.
[48] Second Marrion Affidavit at ¶ 23.
[49] Anderson Affidavit at ¶ 14.
[50] Anderson Affidavit at ¶ 14; *see also* Selzer Declaration at ¶¶ 7-17.
[51] Anderson Affidavit at ¶ 16.
[52] Anderson Affidavit at ¶ 17.
[53] Anderson Affidavit at ¶ 18.

trade practices laws, and market conduct exams.[54] Simply put, state insurance regulators oversee all aspects of fixed annuity transactions—from the development and approval of each fixed annuity product sold to the licensure and sales activities of individual agents to the operations and compliance protocols of insurance companies.[55]

In light of this, the Rule's creation of new private litigation rights through the BICE is unnecessary. The structure governing the manufacture, distribution, and sale of fixed annuity products is effective; there are only a minimal number of consumer complaints—for example, in 2014, consumer complaints involving securities and advisors represented over 97% of combined annuity and security complaints.[56] However, only 0.03% of the complaints made were from owners of fixed annuities.[57]

(9) What innovations or changes in the delivery of financial advice have occurred that can be at least partially attributable to the rule? Will those innovations or changes make retirement investors better or worse off?

Prior discussion of the financial advice in Question #2 discusses the concerns and challenges that consumers would face if the Rule is made applicable—namely, that many middle-class consumers would have reduced access to services from insurance agents who sell fixed annuities. It is beyond question that this will make retirement investors worse off, as they turn to risky, fee-based investment advice and products that will expose their hard-earned retirement savings to the whims of the market with no guarantees or downside protection. In other words, the Rule will reduce consumer choice and lead to investment decisions not in their best interest.

[54] Anderson Affidavit at ¶ 19.
[55] Anderson Affidavit at ¶ 20.
[56] Anderson Affidavit at ¶ 21; Rice Declaration at ¶ 15 ("Moreover, of the tens of thousands of customers representing billions of dollars in sales, I am aware of less than a handful [of] complaints about fixed indexed annuities sold to clients of any of our insurance-only agents.").
[57] Anderson Affidavit at ¶ 21.

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(10) What changes have been made to investor education both in terms of access and content in response to the rule and PTEs, and to what extent have any changes helped or harmed investors?

If the Rule is made applicable, "average middle-class American[s] will have less access to the financial education" provided to them by independent insurance agents.[58] With fewer choices and more limited access to advisors and products from more affluent investors, these "average middle-class Americans" are the "very clients that benefit the most from securing guaranteed income they cannot outlive to provide for their basic needs."[59] With reduced FIA sales and reduced commissions, agents and others will be limited in their ability to market and educate current and prospective clients on the benefits of FIAs and other annuity options.[60] These potential changes will reduce Americans' ability to gain access to retirement information and financial advice.

(11) Have market developments and preparation efforts since the final rule and PTEs were published in April 2016 illuminated whether or to what degree the final rule and PTEs are likely to cause an increase in litigation, and how any such increase in litigation might affect the prices that investors and retirees must pay to gain access to retirement services? Have firms taken steps to acquire or increase insurance coverage of liability associated with litigation? Have firms factored into their earnings projections or otherwise taken specific account of such potential liability?

Yes, experience and preparation efforts show that the Rule and PTEs will cause an increase in litigation. Indeed, they are designed to do just that. Yes, many annuity sellers have taken steps to acquire or increase their insurance coverage of liability associated with the forthcoming increase in litigation, and those increased costs are being factored into earnings projections.

Prior to the Rule, an insurance agent spent around $600 annually on Errors and Omissions ("E&O") insurance.[61] E&O insures against professional negligence, but does not typically insure

[58] Perkins Affidavit at ¶ 20.
[59] Perkins Affidavit at ¶ 20.
[60] Engels Affidavit at ¶ 13.
[61] White Affidavit at ¶ 8; Engels Affidavit at ¶ 16.

against claims for breach of fiduciary duty.[62] Under the Rule, FIAs will now be treated as securities, FIAs will now require coverage for breach of fiduciary duty, and E&O costs will rise significantly.[63] While the Department initially estimated that E&O premiums would increase by 10%, IMOs that are considering to serve as Financial Institutions under the proposed IMO PTE are being quoted premium increases of 100% to 300%.[64] As one example, the same $600 annual premium could rise to as much as $10,000 a year, without even the assurance that the policy would cover claims for breach of contract or breach of fiduciary duty.[65] The aggregate cost to agents for new E&O insurance alone would exceed $100 million annually.[66] This assumes that insurance policies are even made available to agents for coverage including claims for breach of fiduciary duty, something that is far from certain.[67]

Similarly, the Rule would result in extraordinary compliance costs. A typical IMO is spending $500,000 to attempt to meet the Rule's compliance requirements.[68] Compliance costs would be in the hundreds of millions of dollars over the next ten years across all insurance agencies. IMOs would also have to create and staff compliance teams, costing IMOs an estimated $10 million annually.[69]

While it is unclear the extent to which industry participants have calculated the potential liability, the annual cost in lost revenue alone to IMOs could be $700 million.[70]

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[62] White Affidavit at ¶ 8.
[63] White Affidavit at ¶ 11.
[64] Second Marrion Affidavit at ¶ 25; *see also* Foguth Affidavit at ¶ 14 ("[M]y E&O costs are likely to increase dramatically because E&O providers do not insure against fiduciary liability and will only know in hindsight what they could or should have covered.").
[65] Engels Affidavit at ¶ 17.
[66] Marrion Affidavit at ¶ 74.
[67] Second Marrion Affidavit at ¶ 25.
[68] Marrion Affidavit at ¶ 24.
[69] Marrion Affidavit at ¶ 46.
[70] Marrion Affidavit at ¶ 76.

As to litigation risks, there can be no doubt that the Rule and PTEs will create an increase in litigation, for that is their stated purpose. The BICE requires the Financial Institution to enter into a BIC with the IRA owner and also acknowledge that it is a fiduciary to the IRA owner, and that the BIC creates a private cause of action for that IRA owner against the Financial Institution under state law for a breach of all the duties delineated in the BIC.[71] These new private litigation rights, according to the Department, serve a "critical function for IRA owners and participants and beneficiaries of non-ERISA plans."[72] Unfortunately, the litigation and liability risk will put businesses "in serious jeopardy in the event that [they] are sued for a breach of fiduciary duty."[73]

Litigation is also likely to arise over required BIC contract language involving "reasonable" compensation. With no guidance from the Department on what it considers "reasonable compensation," compensation off by a few cents could give rise to class action litigation. This will energize the plaintiffs' bar and others to bring claims against insurance agents and IMOs. The litigation exposure for the fixed annuity industry will be enormous, and quite possibly catastrophic.

(12) The Department's examination of the final rule and exemptions pursuant to the Presidential Memorandum, together with possible resultant actions to rescind or amend the rule, could require more time than this proposed 60-day extension would provide. What costs and benefit considerations should the Department consider if the applicability date is further delayed, for 6 months, a year, or more?

Throughout this comment letter, we have identified several adverse impacts that will occur if the Rule becomes applicable. Each of these impacts, standing alone, is detrimental to the ability of Americans to have access to quality, affordable investment products and services. Taken

[71] *See* 29 C.F.R. § 2550.
[72] 81 Fed. Reg. at 21,020.
[73] Foguth Affidavit at ¶ 14.

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together, the negative consequence of the Rule are enormous and illustrate why the Rule should be rescinded in full.

NAFA supports additional delay of the applicability date should the Department require more than the 60-day extension to fully consider the significant costs and negative consequences that would result from allowing the Rule to become applicable. The more the Department understand the adverse impact of the Rule on the fixed annuity industry, the more it will realize how misguided this Rule is. If the Department needs additional time to evaluate the adverse consequence of its Rule, it should take it.

Allowing the Impartial Conduct Standards ("ICS") to go into effect for the annuities industry on June 9, 2017 would be a tremendous mistake. The ICS standards are the heart of the Rule, and most of the adverse consequences of the Rule, described above, will occur if the Department permits ICS to become applicable. The ICS makes insurance agents fiduciaries, and once that occurs there will likely be no going back. If the Department is truly reevaluating the Rule, it must not let ICS go into effect on June 9, 2017.

In short, a delay is of no detriment to the consumer or to the general public; the Rule has never been applicable. Furthermore, states continue to adequately and comprehensively regulate FIAs, as they have for decades. Getting the Rule right (by rescinding it) is more important than rushing to judgment. The same is true for letting ICS become applicable.

(13) Class action lawsuits may be brought to redress a variety of claims, including claims involving ERISA-covered plans. What can be learned from these class action lawsuits? Have they been particularly prone to abuse? To what extent have class action lawsuits involving ERISA claims led to better or worse outcomes for plan participants? What other impacts have these class action lawsuits had?

In general, ERISA class actions have done little to protect plan participants. Class action settlements make headlines, but consumers receive a relatively small amount compared to their

investments (and compared to the payouts their lawyers receive.) For annuities transactions involving qualified IRA accounts in particular, Congress has never authorized class actions (or any private right of action), so the potential liability exposure class action lawsuits will have on the industry cannot be overstated. The Rule, by design, encourages the plaintiffs' bar to bring class actions against the fixed annuity industry.

The BICE exposes advisers and financial institutions to an unacceptable level of risk associated with class actions. The ambiguities with "reasonable compensation," as well as the required warranties and representations in the BIC, will result in class action lawsuits in state courts over these ambiguities. Additionally, as raised during the Rule's comment period, "any warranty that differentiated commissions, sales loads, trail commissions, 12b-1 fees and other payments from third parties do not 'tend to encourage' violations of the best interest standard would expose financial institutions to the risk of class action litigation. To avoid that risk, financial institutions would be forced to eliminate differential and third party compensation arrangements with advisers (including attendance at training or other seminars to which advisers may be invited), as well as any bonus or incentive programs for advisers, in the provision of investment products and services to small plans and IRAs."[74] Thus, the impacts from class actions are likely to be significant.

(14) Have market developments and preparation efforts since the final rule and PTEs were published in April 2016 illuminated particular provisions that could be amended to reduce compliance burdens and minimize undue disruptions while still accomplishing the regulatory objective of establishing an enforceable best interest conduct standard for retirement investment advice and empowering Americans to make their own financial decisions, save for retirement, and build individual wealth?

[74] SIFMA Comment Letter, App'x 3 at 21 (July 21, 2015), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00506.pdf (last visited March 30, 2017).

No. The Rule and PTEs have been flawed from the outset, flowing from the Department's lack of statutory authority to redefine "fiduciary" status under ERISA as it has under the Rule. There is a straightforward way to reduce compliance burdens, minimize undue disruptions, and empower Americans to make their own financial decisions and save for retirement: the Department should rescind the Rule in its entirety.

The Rule is not needed because fixed annuities are adequately regulated by the states.[75] Further, there is no need for the BICE standard in the FIA context because there are practically no consumer complaints, unlike in the securities industry. In 2014, actual complaints regarding FIAs were 50% lower than they were five years previously, even though sales were 50% higher, and they comprised less than 0.03% of all consumer complaints.[76] Also, the Department performed no analysis or made no effort to quantify any savings to consumers that may result from a fiduciary model as it applies to FIAs.[77]

IMOs have already faced compliance burdens with the Rule's onerous requirements. For example, Partners Advantage, an IMO, has been forced to spend more than $400,000 to begin to implement the Rule's onerous, confusing, and unworkable mandates.[78] Partners Advantage has engaged industry consultants at a cost of over $200,000 to analyze the effect of the Rule on business operations and whether compliance is even feasible.[79] Given the Department's complete lack of meaningful guidance, it does not know whether compliance is even feasible. Partners Advantage has also spent over $400,000 in new technology platforms in order to begin to satisfy document retention requirements of the Rule that were previously not required under state laws.[80]

[75] *See* discussion, *infra*.
[76] Anderson Affidavit at ¶ 21; Marrion Affidavit at ¶ 71.
[77] Marrion Affidavit at ¶ 72.
[78] Second Wong Affidavit at ¶ 7.
[79] Second Wong Affidavit at ¶ 8.
[80] Second Wong Affidavit at ¶ 9.

Given the short time frame IMOs were given to comply with the Rule and the vast uncertainty about the Rule, IMOs (like Partners Advantage) were forced to begin investing in technology before receiving any guidance from the Department.[81] In the end, Partners Advantage, a single IMO, will spend $1.5 million for initial compliance costs.[82] The average cost incurred by annuity carriers for compliance is roughly $8-10 million, plus thousands of personnel hours.[83] These compliance burdens and disruptions have occurred prior to the Rule or the BICE ever being made applicable. The costs and disruptions if the Rule is made applicable will be even higher.

Because fixed annuities are regulated closely by state insurance departments, they should not be subject to the BICE.[84] Fixed annuity contracts must be filed with and approved by each state in which the contracts are sold. State regulation is comprehensive and pervasive over every aspect of the process—structuring and licensing of insurance companies, reviewing and approving content and policies, monitoring ongoing financial conditions of the insurer, providing licensing of the insurance agents, prescribing the manner in which policies are advertised and sold, and virtually every other facet of the insurance business.[85]

(15) How has the pattern of market developments and preparation efforts occurring since the final rule and exemptions were published in April 2016, compared with the implementation pattern prior to compliance deadlines in other jurisdictions, such as the United Kingdom, that have instituted new requirements for investment advice? What does a comparison of such patterns indicate about the Department's prospective estimates of the rule's and exemptions' combined impacts?

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[81] Second Wong Affidavit at ¶ 9.
[82] Second Wong Affidavit at ¶ 7.
[83] Second Marrion Affidavit at ¶ 17.
[84] Anderson Affidavit at ¶ 14.
[85] Anderson Affidavit at ¶ 14.

The Rule is based on evidence pertaining to regulatory steps taken in the United Kingdom, and the Department's conclusion that advisors will remain in business because the UK regulations did not cause a large exit of advisers. The Department, however, simply misreads the UK data.

During the two-year period when UK regulators banned commissions, the number of registered investment advisors fell 25%.[86] During hearings on the Rule, it was noted that "according to a survey conducted by the UK Financial Conduct Authority, several advisors stopped providing retail services" and "advisor numbers did fall."[87] The consequences in the UK were so severe that the "[UK] Economic Secretary of the Treasury launched an examination into the advice gap that exists in the country or if there is an advice gap and what it is only two years after their rule. Again, I'm not an expert, but I would just say that action I would hope would give great pause to the Department to at least see what exactly their findings are [in the UK]."[88] A comparison of such patterns in the United States should yield similar concerns. Many have expressed legitimate concerns that banning commissions will result in advisors exiting the market.

(16) Have there been new insights from or into academic literature on contracts or other sources that would aid in the quantification of the rule's and exemptions' effectiveness at ensuring advisers' adherence to a best interest standard? If so, what are the implications for revising the Best Interest Contract Exemption or other regulatory or exemptive provisions to more effectively ensure adherence to a best interest standard?

Prior discussion of the BICE in response to Question #8 discusses the concerns and challenges with revising (rather than rescinding) the BICE, as well as regulating through

[86] *See* Cass Business School, *The Impact of the RDR on the UK's Market for Financial Advice* at 7-9 (June 2013), available at https://www.cass.city.ac.uk/__data/assets/pdf_file/0016/202336/The-impact-of-RDR-Cass-version.pdf (last visited March 30, 2017).
[87] *See* Tr. of Proceedings, Aug. 10, 2015, at 79, Testimony of Ken Bentsen, SIFMA President and CEO; *id.* at 140 Testimony of Joe Piacentini, DOL EBSA Chief Economist.
[88] Tr. of Proceedings, Aug. 12, 2015, at 755, Testimony of Caleb Callahan, Senior Vice President and Chief Marketing Officer for ValMark Securities.

exemptive provisions. And again, fixed annuities are competently and comprehensively regulated by the states. Further attempts to revise the BICE or other regulatory or exemptive provisions to ensure adherence to a "best interest" standard will lead to the same unworkable and unsustainable outcomes that are equally harmful.

(17) To what extent have the rule's and exemptions' costs already been incurred and thus cannot, at this point in time, be lessened by regulatory revisions or delays? Can the portion of costs that are still avoidable be quantified or otherwise characterized? Are the rule's intended effects entirely contingent upon the costs that have not yet been incurred, or will some portion be achieved as a result of compliance actions already taken? How will they be achieved and will they be sustained?

While most IMOs, insurers, and independent agents have, through necessity, commenced compliance efforts, it is difficult to quantify precisely what costs have already been incurred, which costs are contingent, and whether the Rule's intended effects are contingent on costs that have not yet been incurred. To give an example, one IMO (that is a NAFA member) reported spending over $400,000 "to implement the Rule's onerous, confusing, and unworkable mandates" in addition to $200,000 "to engage industry consultants . . . to analyze the effect the DOL Conflict of Interest rule" and another $400,000 "in new technology platforms in order to begin to satisfy document retention requirements of the rule."[89] That IMO expected to expend $1.5 million before the April 10, 2017 applicability date.[90] Bottom line, while significant resources have been expended getting ready for the Rule, much work is left to be done and those future costs will be substantial.

The biggest change for the fixed annuities industry is the ICS, which turns an insurance salesperson into a fiduciary for the first time. Classifying insurance salespersons as fiduciaries is a quantum leap in regulatory terms, and should not be done without the exhaustive analysis the

[89] Second Wong Affidavit at ¶ 7-9.
[90] *Id.* ¶ 7.

President's Executive Order requires. For that reason, the ICS should not become applicable until review of the Rule is completed.

(18) Have there been any changes in the macroeconomy since early 2016 that would have implications for the rule's and exemptions' impacts (for example, a reduction in the unemployment rate, likely indicating lower search costs for workers who seek new employment within or outside of the financial industry)?

No. The Rule has been a huge problem for the fixed annuity industry since it was promulgated. As explained above, the adverse impacts have always been grave. Changes in the macroeconomy have neither increased nor decreased the problems with the Rule.

(19) What do market developments and preparation efforts that have occurred since the final rule and exemptions were published in April 2016—or new insights into other available evidence—indicate regarding the portion of rule-induced gains to investors that consist of benefits to society (most likely, resource savings associated with reduced excessive trading and reduced unsuccessful efforts to outperform the market) and the portion that consists of transfers between entities in society?

As NAFA explains in greater detail in Addendum A to this comment letter, we believe that the RIA supporting the promulgation of the Rule in April 2016 was deficient and flawed as it relates to "rule-induced gains to investors that consist of benefits to society," particularly as the RIA relates to the fixed annuity marketplace, and the activities taken thus far in the retirement services industry all indicate a constriction of services and products available to low- and middle-income Americans. We believe that the rule will have a chilling effect on the choices available to consumers who wish to purchase insurance-guaranteed products as part of their retirement savings plan.

(20) In response to the approaching applicability date of the rule, or other factors, has the affected industry already responded in such a way that if the rule were rescinded, the regulated community, or a subset of it, would continue to abide by the rule's standards? If this is the case, would the rule's predicted benefits to consumers, or a portion thereof, be retained, regardless of whether the rule [was] rescinded? What could ensure compliance with the standards if they were no longer enforceable legal obligations?

The fixed annuity industry would not voluntarily abide by the Rule's "standards" if the Rule was rescinded. As explained throughout this comment letter, the Rule forces FIAs to be regulated like securities, forces FIAs into the BICE thwarting IMO FIA offerings through independent agents, and forces the unnecessary redesign of compensation systems (likely eliminating commission-based compensation) that is established and beneficial to consumers. It also turns the average insurance salesperson into a fiduciary, which is unprecedented, unnecessary and causes havoc on the distribution model for fixed annuities. The regulatory system in place prior to the Rule's promulgation worked well, and protected consumers, making the Rule unnecessary. That old system should remain in place.

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NAFA strongly believes, as explained above, that the Rule will adversely affect consumer investment, reduce access to retirement savings options, and decrease the quality of affordable investment services. The Rule is contrary to the President's Memorandum and should be rescinded in its entirety.

NAFA appreciates the opportunity to submit these comments. Please do not hesitate to contact us if additional information or clarification is needed.