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Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration

U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Re: *Definition of the Term Fiduciary; Conflict of Interest Rule (RIN 1210-AB32;) Proposed Amendment to Proposed Partial Revocation of Prohibited Transaction Exemption 84-24 (ZRIN: 1210-ZA25); Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)*

Dear Sir/Madam:

Ohio National Financial Services (Ohio National) appreciates the opportunity to comment on the Department of Labor's ("DOL") fiduciary proposal (the "Rule") published on April 20th, 2015 redefining the term "fiduciary" as it relates to an employee benefit plan under the Employee Retirement Income Security Act of 1974 ("ERISA"), and to plans and individual retirement accounts ("IRA") under section 4975 of the Internal Revenue Code of 1986 ("Code"). This letter contains comments on the proposed regulation, as well as the proposed amendment to Prohibited Transaction Exemption 84-24 ("PTE 84-24") and the proposed new prohibited transaction, the Best Interest Contract Exemption (the "BIC Exemption").

Ohio National understands and supports DOL's efforts to promulgate rules that will lead to more effective retirement investing, in light of the significant changes made in the retirement market place since ERISA became effective in 1974. In today's retirement market, it is not uncommon for individuals to invest outside of a Pension Plan with the help of a financial advisor. Furthermore, as compared to 1974, the amount to be invested, frequently comprising as it does 401(k) proceeds, as well as proceeds associated with Defined Benefit Pension Plan De-Risking activity, is typically much larger. Given these changes, we agree with DOL in principle that financial advisors should be expected to make investment recommendations that are in the retiree's best interest. Regrettably, the approach as suggested by DOL to accomplish this very important goal fails to fully appreciate the practical implications involved in sales of retirement products, servicing such products, and the ultimate cost incurred by the investment advisers and product issuers.

It is Ohio National's belief that the Rule will have the unintended consequence of radically altering how the insurance and financial services industry offers its products and services to the

general public, making it more difficult for IRA owners and plan participants to get quality, affordable advice. If adopted in a way that even resembles its current form, the Rule and the associated exemptions have the potential to significantly reduce the availability of many retirement planning products, most notably variable annuity products with guarantees that provide a much-needed stream of income benefit for consumers. This would negatively impact the general public who may one day very soon be denied the ability to obtain the advice and purchase the products they need to fulfill their financial and insurance needs for retirement.

As set forth below, we have highlighted the major areas of concern and identified several key concepts in the proposed rule that will need to be modified in order to preserve continued access of the retirement products market by consumers regardless of their wealth:

PTE 84-24 Must Preserve the Existing Exemptions for Annuities and other Insurance Contracts.

Under ERISA section 406(b) and Code section 4975(c)(1)(E) and (F), a fiduciary is not permitted to use its authority in making investment advice to receive payment unless it is provided under an exemption. For more than two decades, insurers and financial professionals who distribute insurance contracts to plans and IRAs, including both fixed annuity and variable annuity, have relied on PTE 84-24 as a way to comply with such restriction.

As proposed, PTE 84-24 revokes the exemption for IRAs, other than for insurance or annuity products that are not considered securities under the federal law, making the BIC Exemption the only available exemption for "securitized" products. This distinction between security and non-security product is artificial in nature since both types of products can offer valuable income stream and insurance benefits that are widely enjoyed by customers on both individual and plan levels.

This artificial distinction will confuse IRA owners seeking to choose among guaranteed income products. The disclosure requirements are different in PTE 84-24 and the BIC Exemption, resulting in IRA owners getting information about the products that are not readily comparable. Having two different regulatory regimes apply to products in the same category will not serve the IRA owner's best interest, as he or she will likely be unaware of the material differences in the information an advisor is required to provide about these products. This issue seems especially confusing when one considers that equity indexed annuities appear to fall into one or the other exemption depending upon whether they are registered securities. The end result for the IRA owner is that variable annuities present one set of information, fixed annuities present a different set of information, and equity indexed annuities could fall into either category depending upon their structures. Far from protecting IRA owners from conflicts, this will make it nearly impossible for the IRA owner to understand and evaluate with his or her advisor which type of annuity fits his or her needs.

Often, a variable annuity that is considered a security can offer higher return on the underlying contract during an up market as compared to a fixed annuity while providing some form of guaranteed stream of income and insurance benefits even in a down market. It cannot be overemphasized that many retirement investors are far more concerned with protection and

security than earnings—acquiring a product that guarantees income for life. By removing securities products like variable annuities from PTE 84-24, the proposed rule jeopardizes the insurers' ability to compensate financial professionals for the sale and continued servicing of the contracts sold to IRAs in the form of commission and trails. Although the Best Interest Contract ("BIC") Exemption may serve as an alternative means to allow compensation for security product like a variable annuity, it is significantly more burdensome for the insurer and financial professionals to satisfy, and otherwise unworkable as currently proposed. A full discussion on the BIC Exemption is provided below. The resulting change by removing variable annuity and other security product for sale to IRAs is likely to result in less product choices for new potential customers and "orphaned" contract holders who can no longer be serviced by the insurer. Ohio National strongly recommends that PTE 84-24 be revised to be available for all annuities as well as all other insurance products.

A Robust Regulatory Framework Already Exists for Insurance Products.

Insurers and the financial professionals that offer life insurance, disability insurance and annuity products in connection with welfare benefit plans are already heavily regulated by the state-based regulatory system, with oversight by the federal government under Dodd-Frank (FSOC and FIO), as well as the SEC and FINRA for securities-related products. Additionally, qualified plan assets are currently subject to the fee disclosure regulations currently in existence.

Although the DOL has indicated that the Rule is directed at retirement plans, and that it did not intend to include traditional insurance products such as life and disability insurance within the scope of the Rule, this is not made clear in the current language. To avoid potential litigation due to ambiguity in the Rule, we request that any final rule makes this point explicitly.

In addition, we are concerned that the Rule could be read to apply to other insurance products. The Rule currently includes variable annuities with guarantees, which is primarily an insurance product that provides consumers a much-needed retirement vehicle that can provide a guaranteed stream of income, a unique and secure means of saving for retirement. An additional layer of regulation to such product and others retirement vehicles will only add further cost and complexity to the ability to offer this particular retirement product to consumers, the majority of whom are middle class and typically do not use fee-based planners due to cost considerations.

Small Plans Will Be Negatively Impacted.

The Rule as proposed conditionally carves out sales to large plans fiduciaries with more than 100 participants or more than $100MM in assets, which will put small plans at a distinct disadvantage. Because the fiduciary standard and all of its accompanying requirements will apply to these smaller plans, they will end up with less selection than the large plan market since fewer providers will want to sell to them given all of the onerous requirements. As a result, this proposal will have a chilling effect on the small plan market.

For advisors attempting to service the small plan marketplace, even providing a small business with marketing materials containing suggested investments for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain

educational materials that reference specific investment funds available, regardless of the suitability for the individual. This will result in an 'advice gap" for small businesses and consumers that is discussed in more detail below.

In addition, many advisors and financial institutions will have to change the structure of their products and services and how the retirement plans and IRA accounts are charged fees. As a result, the cost of offering these products and services will likely increase. In light of the costs and risks of compliance with the proposed rule, some advisors and institutions may choose to exit the small business retirement plan marketplace entirely. Because the DOL already has in place fee disclosure regulations that require disclosure of all direct and indirect compensation paid as a result of a sale, we respectfully question whether another layer of "protection" is necessary, particularly when this suggested protection will negatively impact small plans that comprise the bulk of American savers in the workplace.

Statutory Employee Benefits Should Not Be Included in Compensation for Purposes of Disclosure Requirements or Fee Leveling.

Ohio National, like many insurers, has insurance agents who are statutory employees. Their employee benefits, such as health and retirement plans, are earned by meeting certain production requirements. We do not believe DOL intended to upset these long-standing employee relationships, but a broad reading of level fee and compensation disclosure requirements related to the Rule, the BIC Exemption, and the amendments to PTE 84-24 could include consideration of these employee benefits. This employment relationship does not present a conflict of interest with respect to any specific transaction. Accordingly, we ask that DOL to specifically exclude statutory employee benefits from all applicable provisions and definitions relating to compensation and disclosure in the Rule, the BIC Exemption and PTE 84-24.

The Rule Incents Advisors to Move to Fee-Based Accounts—Such Accounts Often Are Not in the Best Interest of Small Investors.

A likely outcome of the level-fee requirements will be a shift from transaction-based accounts to fee-based accounts. The push toward account management fees directly contradicts the SEC/FINRA suitability and know-your-customer rules requiring financial advice to be individualized. In fact, both the SEC and FINRA have stated repeatedly that managed accounts are usually not suitable for lower and middle income investors that do not actually need to trade regularly, the so-called buy-and-hold investors. Investigating "reverse-churning," in which advisors use a fee-based account to receive higher fees than they would otherwise receive in a transaction-based account, is an enforcement priority for the SEC in 2015. In its NTM 03-68, the NASD reminded members that, in its 1995 Tully Report, the SEC noted that "Fee based accounts <u>may</u> be appropriate for investors who prefer a consistent and explicit monthly or annual charge for services, and whose level of trading activity is moderate." But the NASD warned advisers that it "is inconsistent with just and equitable principles of trade—and therefore a violation of Rule 2010—to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the member that provides the same services and benefits to the customer."

It would be to the benefit of the American consumer for the SEC and DOL to harmonize their rules so as not to subject advisors and financial institutions to varying or even inconsistent standards, as well as to the additional cost associated therewith.

Consumer Education Needs to Be Broadened Rather than Narrowed.

As mentioned immediately above, the current proposal will have a chilling effect on information provided by financial advisors. Consumers, including plan participants and IRA owners, need more education on annuities and other plan distribution options than what is currently proposed. The proposed education carve-out, which requires avoidance of specific references to distribution or investment alternatives, should be amended to preserve specific recommendations that serve to manage one's retirement portfolio. This includes "anti-cashout" interventions that discourage consumers from cashing out their accounts and education furthering IRA rollovers. Today's consumer saving for retirement needs more educational information, not less. The current standard in Interpretive Bulletin 96-1 has been in place for nearly 20 years and has been extremely valuable in educating participants. In the Rule, DOL offered no evidence that is has been abused or otherwise harmed participants. Any final rule should not restrict this very successful educational tool for participants.

The Analysis Overlooks the Negative Impact of the Proposed Rule on Lower-Wealth Investors.

The current proposal will have unintended consequences on lower wealth investors. We do have a recent example from which to draw. Several years ago, the UK implemented a Retail Distribution Review (RDR) which, among other things, prohibited commissioned-based compensation for advisory services. It was intended to ameliorate the same evil sought to be addressed in the DOL's fiduciary duty proposal, the so-called "commission product bias." It clearly accomplished that.

The regulations, unfortunately, had unmistakable unintended consequences in the UK. The consumers that RDR was most intended to serve—the middle and lower wealth individuals and small business employers faced with planning a financial retirement with little investment experience, knowledge or interest—were left behind. Advisors segmented their existing clients and switched their business models from commission-based advice to flat fee or assets-under-management fee contracts, most preferring to serve those with assets over £100,000–£150,000 ($150,000–$230,000). Thus, those who were believed to be the most in need of regulatory protection fell into the "advice gap," closed out of the financial advice market, either cut loose by their advisors (so-called "orphans"), or not engaged with any advisors because they cannot afford or do not want to pay the higher up-front advisory fees.

The UK Financial Control Authority suggested that investors who cannot be served in the new RDR world (i) currently have some access to financial information on the ever-increasing internet platforms, and (ii) will be served more fully once a segment of the advisory industry figures out how to make serving them profitable. But, studies have also shown that investors, when faced with un-advised choices, will often choose more risky equities in up markets or fail to diversify adequately. It takes an advisor to help them say "no." Advisors provide value for

their fees. According to a recent study by Oliver Wyman, adults between the ages of 35 and 49 who make less than $100,000 per year who receive advice have 51% more assets than the same group of people who receive no advice.

Unfortunately, the DOL's proposal is similar to the UK in terms of the practical impact of its proposed requirements. Protecting consumers cannot come at the expense of the less wealthy. If wealthy investors are not already fee-based, they can afford the transition while the less wealthy cannot. Although transparency in insurance and securities sales is a laudable objective, but it must be accomplished equally for all consumers, with increasing access to honest advice and useful products as well. Improving professionalism by changing compensation schemes must be driven and measured by improving actual consumer outcomes, not just regulating behavior through prohibited compensation schemes, and it must serve both wealthy clients and smaller investors.

The Definition of "Fiduciary"as it Relates to Investment Advice is Impractical and Overly Broad.

Under the proposed definition, any time a person provides investment recommendations or appraisals for a fee to a retirement plan customer (plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner), such advice would qualify as a fiduciary investment advice so long as it is "individualized to" or "specifically directed to" to the customer for consideration. This definition is so broad that it would capture all manners of communication, including, marketing and sales efforts to sell a qualified retirement product, ongoing product servicing, and providing educational information regarding rollover and distribution. Further, it is broad enough to apply to insurance agents, broker dealers, and even call center employees so long as their communication is individualized to or directed to a retirement plan customer.

By a way of illustration, consider an example where an agent is interested in marketing an annuity product to a potential customer. By providing information regarding the annuity, including the underlying asset allocation options, the agent can become a fiduciary under the current proposal. This can be true even if the customer initiates the inquiry and the agent merely provides printouts and other marketing materials "directed to" the potential customer. Further, should the customer purchase that product and later contact the customer service representative to discuss the current value of the contract and the options available for distribution, that customer service representative can also become a fiduciary. Based on the above example, it will be difficult, if not impossible, for the product issuer of an annuity to make a sale and continue to service that product without exposing itself to fiduciary standards of conduct under ERISA. Although there are seven carve outs from the fiduciary definition, some of which are discussed in this letter, many only apply in very limited circumstances, and do not protect small plans and individual IRA customers. In practical terms, this is likely to force product issuers to reevaluate the overall cost of offering retirement vehicles which will result in less product options and reduced competition in the market place for the end customer. Ohio National strongly urges DOL to reconsider narrowing the scope of the fiduciary advice so that meaningful distinction can be preserved between advice that truly influences the underlying retirement decision and a routine communication that is essential for marketing, servicing, and ongoing education efforts.

The "Best Interest Contract Exemption" will not result in furthering the DOL's goal of providing adequate financial security for consumers.

The biggest challenges with the BIC Exemption, rendering it unworkable and in fact detrimental to the majority of consumers, are as follows:

1. A contract requirement that forces advisor and financial institutions to enter into a complex contract even before a sale is made. A contract is not necessary for compliance with and enforcement of the proposed requirements, and at best should be reduced to a concise disclosure upon completion of the transaction.

2. Disclosure requirements of several types (transactional, annual and web) that are unworkable since they requires cost projections without providing any assumptions that the insurer can use. The web disclosure also requires direct and indirect cost calculations down to an account level which is not readily available, and must be updated at reasonable intervals not less than quarterly while at the same time being readily accessible to the general public.

3. Reasonable compensation" is not defined, and various state courts faced with the question of "what is reasonable" would rule differently and quite possibly inconsistently.

4. Whether "best interests" have been violated will be subject to the vagaries of litigation and state law. Moreover, the "legal list" of assets regarding which advice may be provided under the BIC Exemption will require the advisor to avoid superior investments not on the list and instead direct the customer to an inferior product, which runs counter to what is in the customer's best interest.

5. The immense cost of compliance. The Proposal estimates the first year compliance cost to broker dealers to be $53,000. This is not mentioned solely in the context of the BIC Exemption, so actual first year compliance costs may be even greater. Additionally, advisors will have to make a business decision if the BIC Exemption offers enough total compensation promise to even consider utilizing it, and may decide against it, which again would work against the middle class which traditionally has operated under a commission-based framework. In addition, the BIC Exemption itself, as a contractual matter, will invite costly litigation, including class action litigation, as the agreement must expressly preserve a private cause of action, including class action, at the state level. This increased exposure to claims and litigation will naturally increase the liability insurance costs of financial advisors and firms, which costs will be passed along to consumers.

6. Undue focus on high net worth consumers. Some investment advisers, to lessen the compliance costs of and risks attendant to the BIC Exemption, may choose to lessen the fiduciary standard fulfillment challenges by concentrating only on flat fee compensation business to high net worth customers. Others may attempt to serve the middle class by

offering flat low fee products or services to a larger volume of customers at the risk of spending less time providing individualized advice with each of them. Some investment advisers may even gravitate to different, lower paying jobs within the retirement investment industry or will leave the industry altogether. We believe this exodus will leave individual retirement investors with fewer effective ways to consider retirement investment options that are most appropriate for their particular situation.

The DOL presumably would agree that the success of its fiduciary proposal, if ultimately enacted in its present form, would be partly measured not only by all retirement investors receiving investment advice that is only in their best interest, but also in products still being available that collectively meet the investment sensibilities of each retirement investor. Two insurance products that are disadvantaged by the DOL proposal, which have been demonstrated as valuable to customers for many years, and which have had strong sales over a variety of economic environments (particularly after the 2008 financial crisis), are annuities in general, and variable annuities in particular. Annuities provide the highest guaranteed monthly income available for those wishing to use retirement savings primarily for retirement living expenses, and in the process keep the funds from being used for less desirable purposes. Variable annuities are also associated with guaranteed retirement income, but additionally allow retirees to benefit from market gains, yet with downside protection. Each of these two investments meet the "investment objectives, risk tolerance, financial circumstances and needs" of many retirement investors, and the DOL proposal should be modified to improve their accessibility. The small business market would be better served with a rule that doesn't result in a disparate impact on that particular—and very large—segment of the American economy.

Ohio National very much appreciates the opportunity to provide this consumer and financial services perspective to assist with the Department of Labor's efforts to improve the Proposal. We view this as very much a public-private partnership to protect, and at the same time, further assist Americans with their retirement needs. Thank you for your consideration.

Sincerely,

Elizabeth F. Martini
Vice President & Counsel