The COMMITTEE
of
ANNUITY
INSURERS

1455 Pennsylvania Avenue NW, Suite 1200, Washington, DC 20004

April 17, 2017

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attention: Fiduciary Rule Examination (RIN 1210-AB79)
U.S. Department of Labor
200 Constitution Avenue, N.W.
Room N-5655
Washington, DC 20210

Re: Fiduciary Rule Examination

On behalf of the Committee of Annuity Insurers (the "Committee"), we write to provide input to the Department of Labor ("the Department") as it reexamines the Fiduciary Rule[1] to determine whether the Fiduciary Rule will adversely impact Americans' retirement security. As we lay out below, the answer is unequivocally yes – the Fiduciary Rule in its current form already has and will continue to adversely impact retirement security **by reducing access to, and use of, guaranteed lifetime income options**. This means less guaranteed income in retirement, more uncertainty for retirees, and more reliance on government safety nets.

The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal policy with respect to annuities. The Committee's 29 member companies represent more than 80% of the annuity business in the United States and are among the largest issuers of annuity contracts to IRAs and employer-sponsored retirement plans. A list of the Committee's member companies is attached.

As we said in our March 16, 2017, comment letter supporting the Department's proposed delay of the Fiduciary Rule, the issues surrounding the Fiduciary Rule have the potential to impact the retirement security of millions of American workers and retirees, and the Department needs to get this issue right from the very first day that the Fiduciary Rule becomes applicable. As the Department only provided 30 days between the first and second comment periods, our

[1] For purposes of this letter, the term "Fiduciary Rule" refers to 29 C.F.R. § 2510.3-21 as currently set to become applicable on June 9, 2017, and the new and amended class exemptions released by the Department on April 8, 2016, as corrected by 81 Fed. Reg. 44,773 (July 11, 2016), and as set to become applicable pursuant to the extension published in the Federal Register at 82 Fed. Reg. 16,902 (Apr. 7, 2017).

goal in this letter is to identify the ways that the Fiduciary Rule will result in the negative effects contemplated by the President's February 3, 2017, Fiduciary Duty Rule Memorandum ("the President's Memorandum"). We are confident that the input the Department will receive from those who are working to implement the Fiduciary Rule, including issuers of annuities, will lead the Department to conclude that a revision of the Fiduciary Rule is not only warranted but necessary. We stand ready to assist the Department in that revision.

I. Introduction

A. The organization of our letter.

Our letter is organized primarily by the types of annuities that are typically held in IRAs and qualified plans. Throughout each section we highlight the ways that, with respect to each type of annuity, the Fiduciary Rule is causing and will continue to cause the adverse effects identified by the President's Memorandum:

- *Variable annuities* are regulated by the Best Interest Contract Exemption (the "BICE"). As we explain in **Section II**, the BICE includes a number of features that reduce access to annuities when an annuity would be in an individual's best interest, increases costs for savers, and substantially increases litigation risk.

- *Fixed rate annuities* are regulated by Prohibited Transaction Exemption ("PTE") 84-24. As we explain in **Section III**, the amendments to PTE 84-24 have so narrowed the exemption's coverage, the remaining exemption effectively prohibits ordinary forms of compensation.

- *Indexed annuities*, as we explain in **Section IV**, can no longer be sold through the independent distribution channel because the Department removed indexed annuities from PTE 84-24, while imposing requirements through the BICE (supervision by a limited subset of financial institutions) that cannot be met.

- With respect to *annuities in general*, in **Section V** of our letter, we discuss other ways that the Fiduciary Rule creates the adverse effects contemplated by the President's Memorandum.

Our letter concludes by advocating that the Department should further delay the applicability date of the Fiduciary Rule to ensure that the Department has enough time to address all of the concerns that have been raised, not just about the conditions of the BICE that go into effect on January 1, 2018, but the entire structure and treatment of annuities under the Fiduciary Rule. We also urge that, in connection with any new proposal, PTE 84-24 should cover all annuities, as the Department has provided on a temporary basis through the end of 2017.

B. The importance of annuities and the data showing the adverse effect of the Fiduciary Rule.

In our letters and testimony to the Department on its Proposed Fiduciary Rule, we have repeatedly praised the Department for its recent efforts, outside of this rulemaking, to facilitate better access to, and more use of, arrangements designed to provide a stream of income that is guaranteed to continue as long as an individual lives. It is without question that annuities play a critical role in the private retirement system:

1. Annuities are vital to the retirement security of millions of Americans. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to ***guarantee*** they will not outlive their retirement income.[2]

2. Annuities provide **insurance protection against longevity risk** by pooling that risk among a large group of individuals. That protection alone makes them vital components of an individual's retirement security. However, annuity contracts also pool and protect against other significant risks to which individuals are exposed in retirement, including inflation risk, investment risk, interest rate risk, mortality risk, and liquidity risk, thereby allowing middle class individuals to acquire, in a single integrated holding, insurance against a number of different risks to their retirement security.[3]

3. Because annuity insurers make long-term commitments to their policyholders to shield them from numerous forms of risk, they are subject to **stringent regulation by the states**. The state regulatory structure is directed squarely at policyholder protection, including requiring insurers to maintain significant reserves to back the prolonged and financially-critical benefit promises they make and regulating annuity sales agents and practices.[4]

Because the Fiduciary Rule is not yet applicable, and most firms have been singularly focused on getting ready for the Fiduciary Rule's applicability date, rather than collecting data, there is little data on the adverse effects that the rule will have on investors and retirees. The data that are available, however, suggest that there will be severe adverse consequences to Americans' retirement security.

- Data from the LIMRA Secure Retirement Institute shows that variable annuity sales in 2016, in anticipation of the Fiduciary Rule, declined by more than 25%.[5]

---

[2] *See generally*, J. BROWN, O. MITCHELL, J. POTERBA, AND M. WARSHAWSKY, THE ROLE OF ANNUITY MARKETS IN FINANCING RETIREMENT (MIT Press 2001).

[3] *See, e.g.*, KENNETH BLACK, JR. & HAROLD D. SKIPPER, JR., LIFE INSURANCE 162, 946-964 (13th ed. 2000) (summarizing the risk pooling attributes of annuities and the state regulation of annuities, respectively).

[4] *Id.*

[5] Greg Iacurci, *Department of Labor's fiduciary rule blamed for insurers' massive hit on variable annuity sales*, INVESTMENT NEWS (Mar. 28, 2017),

Importantly, the decline occurred for all major variable annuity issuers. LIMRA is forecasting another decrease in the sales of variable annuities by 10-15%, and if the Fiduciary Rule goes into effect, by 20-25%.[6]

- Todd Geising, Assistant Research Director at the LIMRA Secure Retirement Institute, explained that "[t]he DOL fiduciary rule 'brought some tentativeness from advisers' in terms of using variable annuities with clients. . . It's not a particular product or company's strategic decision moving the industry itself,' he added. *'It truly is the forces specifically with the DOL rule.'"*[7] (Emphasis added.)

- LIMRA data also shows that, in the first three quarters of 2016, before the Fiduciary Rule began to impact the industry, sales of fixed annuity sales hit a record-breaking $117.4 billion, 14 percent higher than 2015 levels and nearly $7 billion higher than 2009 (when sales were last at their highest). But then, in the fourth quarter of 2016, fixed annuity sales fell 13 percent from the prior year.[8]

- "Some advisers backed off of sales until receiving more concrete information on their compensation for product sales, said Mr. [Bernie] Gacona of Wells Fargo. Some advisers were hesitant after hearing they may not receive trailing-commission dollars due to broker-dealers' potential compliance treatment of the rule, he added."[9]

- "U.S. variable annuity and fixed indexed annuity sales are expected to decline by at least 10% through 2018 as the industry struggles to adapt to upcoming regulations put forth by the Department of Labor, according to Cerulli Associates. The Boston-based global research and consulting firm states in its research that while insurers are trying to grow their businesses in the face of obstacles regarding 'benefit hedging, product derisking, and the sustained low-interest-rate environment,' *Cerulli sees the biggest challenge for the foreseeable future is DOL's fiduciary rule*, formally called the conflict of interest rule."[10] (Emphasis added.)

---

http://www.investmentnews.com/article/20170328/FREE/170329922/department-of-labors-fiduciary-rule-blamed-for-insurers-massive-hit?utm_source=Morning-20170329&utm_campaign=investmentnews&utm_medium=email&utm_visit=24334.

[6] *Id.*

[7] *Id.*

[8] LIMRA News Release, *LIMRA Secure Retirement Institute: Fixed Annuity Sales Hit Record $117.4 billion in 2016* (Feb. 21. 2017), http://www.limra.com/Posts/PR/News_Releases/LIMRA_Secure_Retirement_Institute__Fixed_Annuity_Sales_Hit_Record_$117_4_billion_in_2016.aspx.

[9] Iacurci, *supra* note 5.

[10] Melanie Waddell, *Annuity Sales to Plunge Under DOL Fiduciary Rule: Cerulli*, THINKADVISOR (Dec. 15, 2016), http://www.thinkadvisor.com/2016/12/15/annuity-sales-to-plunge-under-dol-fiduciary-rule-c?slreturn=1491340535.

- "The Insured Retirement Institute found that industrywide annuity sales in the third quarter [of 2016] totaled $51.3 billion, an 8.2% drop from sales of $55.9 billion during the second quarter of 2016, and a 12.3% decline from $58.5 billion in the third quarter of 2015."[11]

- "About a third (32%) [of a group of 552 U.S. financial advisers] believe shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule."[12]

- "Certain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule."[13]

Some who blindly support the Fiduciary Rule might believe that this is a good result. But anyone who actually helps Americans secure guaranteed income in retirement – or supports access to lifetime income – must conclude that these developments are exactly the adverse effects contemplated by the President's Memorandum.

We provide more detail below, but based on our conversations with Committee members, we believe that the current and expected future decline in annuity sales is attributable to three primary factors:

1. The significant increase in individual and class action litigation that the Fiduciary Rule not only causes, but is designed to create.

2. The Fiduciary Rule's imposition of major burdens on current compensation models, particularly commissions, which are an accepted and appropriate compensation model for annuities that align inherently with the nature of the product.

3. The gaps in the Fiduciary Rule, particularly the absence of any workable exemption for the sale of indexed annuities through the independent distribution channel.

Finally, we think it is critical for the Department to focus on the fact that, while any new regulation causes disruptions, the nature of the **disruptions** caused by the Fiduciary Rule are unique in comparison to other major regulatory efforts, because the hallmark of the Fiduciary Rule is that any product sold with commissions will be sold **under the threat of class action fiduciary litigation**.

---

[11] *Id.*

[12] CoreData Research UK, *The Fiduciary Rule: Sailing Through the Fiduciary Fog* (Nov. 2016), 21.

[13] A.T. Kearney Study: *The $20 billion impact of the new fiduciary rule on the U.S. wealth management industry* (October 2016), https://www.atkearney.com/documents/10192/7041991/DOL+Perspective+-+August+2016.pdf/b2a2176b-c821-41d9-b12e-d3d2b0807d69.

II. <u>Variable Annuities</u>: The existing BICE eliminates common forms of compensation, forces investors into fee-based products, requires costly compliance systems, and increases litigation risk.

The BICE, in its current form, will cause the adverse consequence that the President's Memorandum contemplates. It essentially forces insurance companies and agents that sell annuities into a "one size fits all" approach that ignores existing regulatory protections and increases litigation costs that will ultimately be paid for by increased fees, reduced rates of return, and lower retirement income.

A. The BICE's compensation requirements make it nearly impossible to maintain traditional incentive-based compensation, e.g., commissions, even when that compensation structure is in the client's best interest.

In order to satisfy the BICE, a financial institution must agree by contract not to "use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor." The Department's regulatory analysis essentially concludes that this requirement eliminates conflicts while preserving commissions when in the client's best interest. But that analysis ignores the reality that any difference in compensation among different products or investments, even when based on so-called "neutral factors" leaves a financial institution open to a class action lawsuit. What we have observed among Committee members since the finalization of the rule is deep concern about relying on "neutral factors" to justify ordinary differences in compensation.

This means **fewer choices** for savers. Because of the litigation risk associated with the BICE, financial institutions that sell annuities have a strong incentive for clients to hold assets in a fee-based account, i.e., an account which charges an annual fee based on assets. As one analyst expressed it:

> "Adoption of the fee-based model has been mostly overlooked by the industry. *However, what was once considered an opportunity is now a necessity.*"[14] – Donnie Ethier, Associate Director, Cerulli Associates

A fee-based account can be an excellent choice for an individual that needs ongoing services and investment advice, including some annuity owners. However, while all annuities are long-term investments, not all annuity owners need ongoing investment advice with respect to their annuity; some simply need advice at the time of purchase or occasionally thereafter. It is not appropriate to compensate an adviser using an annual advisory fee unless there is a need for ongoing and regular services in connection with the sale. In fact, the SEC has expressed

---

[14] Waddell, *supra* note 10.

significant concern about charging asset-based fees when an account, like a long term IRA investment, does not require ongoing services (a practice called "reverse churning").[15]

Further, financial institutions are extremely nervous about differences in compensation even when there is ample support for the differences based on the additional time or expertise required to sell the product or determine whether a product is in the client's best interest. This concern readily flows into **reduced availability** of annuities:

> Since the Fiduciary Rule was finalized, "[s]ome advisers backed off of sales until receiving more concrete information on their compensation for product sales, said Mr. [Bernie] Gacona of Wells Fargo. Some advisers were hesitant after hearing they may not receive trailing-commission dollars due to broker-dealers' potential compliance treatment of the rule, he added."[16]

The Department stated in the preamble to the final BICE that "the neutral factors must be neutral in application as well as in selection. Differentials based on neutral factors that operate in practice to encourage Advisers to violate the Impartial Conduct Standards are not permissible." This description of the rule is vague and hard to decipher. Therefore, to avoid costly litigation, many organizations will **reduce choice and access,** as discussed in the next section.

One effect of the BICE's push to eliminate any differences in compensation is that some large distributors of annuities have begun asking Committee members to alter the commission on their products to a particular level set by the distributor. In some cases, the new commission level is *more than* the life insurance company currently pays brokers and agents for the sale of some of its products. Walking away from a large distributor is not a viable option in many cases, with the result that a higher commission will increase the cost of the annuity to some extent. In other words, while experience is still limited, the Fiduciary Rule has not led as the Department's economic analysis predicts, to a "race to the bottom" in terms of adviser compensation. Instead, in some cases it has led to a "race to the same level," which reduces competition on price.

B. The BICE significantly increases litigation risk.

The President's Memorandum asks the Department to determine if the Fiduciary Rule "is likely to cause an increase in litigation." The answer is unequivocally yes – this is perhaps the key issue for the BICE – in computer parlance, increased litigation is "not a bug but a feature." The BICE requires a financial institution to: (a) agree to a new cause of action that does not apply under current law in connection with IRAs; (b) refrain from including any provision in the contract that would restrict or limit the financial institution's liability; and (c) refrain from requiring clients to bring class actions through arbitration.

[15] U.S. Securities and Exchange Commission, Press Release, SEC Announces 2016 Examination Priorities (Jan. 11, 2016), https://www.sec.gov/news/pressrelease/2016-4.html.

[16] Iacurci, *supra* note 5.

The litigation risk created by the BICE is particularly acute, unfortunately, for financial institutions that distribute variable annuities.[17] Variable annuities provide a variety of guarantees, e.g., guaranteed lifetime income, guaranteed death benefits, and the option of various forms of principal and investment return guarantees. These guarantees have costs. And as stated above, a commission is often the compensation model that makes the most sense because the need for ongoing advice can be limited. We appreciate the statements from the Department indicating that the lowest cost investment is not necessarily the best, but as a practical matter, the features of the annuity market that reflect basic economic principles will be the same features that will attract frivolous class action litigation.

On this point, the Department's economic analysis simply misunderstands the current state of class action fiduciary litigation. The Department's analysis states the following regarding increased litigation cost:

> Commenters on the 2015 Proposal said that some insurance policies cannot be used to pay for penalties, and some do not cover litigation costs if the covered individual loses their case. The commenters cite these situations to suggest that the cost from claims is not fully captured by the increased cost of the insurance premiums. For those fiduciaries that are accused of wrong doing and successfully defend against the claim, the insurance coverage pays for the litigation. These costs should be captured in this analysis and are discussed below. The costs that are not quantified in the following analysis are penalties paid by the advisers who lose their cases.[18]

This analysis assumes that cases are simply won or lost based on their merits, and that the only costs for a firm that has not committed a breach is the litigation cost covered by insurance. It further assumes that cases end in judgements for or against defendants, and that settlements only result from wrongdoing. **This misses the entire point of litigation risk**: Because fiduciary litigation is fact-intensive, even frivolous cases can result in large settlements.[19] This phenomenon has been amply demonstrated in the explosive growth of litigation targeting 401(k) and 403(b) plans. Class action plaintiff firms will sue multiple employers on a single day with copy-cat complaints. These cases drag on for years, even though class action firms have been largely unsuccessful in winning cases at trial. They have, however, been able to extract large

---

[17] The proposed Best Interest Contract Exemption for Insurance Intermediaries would present the same litigation risk for independent marketing organizations ("IMOs") that distribute indexed annuities because it is a clone of the BICE in this regard.

[18] Department of Labor, *Regulating Advice Markets: Regulatory Impact Analysis for Final Rule and Exemptions* (April 2016), 239.

[19] For instance, based on 2016 data, 62.5 percent of class actions were resolved by settlement, and 72.2 percent of all settlements will require affirmative claims for money. Carlton Fields Jorden Burt, *The 2017 Carlton Fields Class Action Survey: Best Practices in Reducing Costs and Managing Risk in Class Action Litigation* (2017), 25, 27. Conversely, just 2.1 percent of cases go to trial. *Id*. at 25.

settlements by avoiding motions to dismiss because the cases cannot be dismissed before expensive discovery. And there is no reason to conclude the same will not occur with the BICE. As an exemption, the BICE is an affirmative defense that depends on the facts of the case and cannot be asserted on a motion to dismiss.[20] This is because the BICE contains a variety of conditions that can only be shown to have been satisfied during a trial, including that a firm's policies and procedures meet the conditions of the BICE.

The Department's analysis also fails to account for how litigation that is **disruptive or causes dislocations** will affect behavior. Financial firms do not want the reputation risk or distractions for senior business leaders that necessarily accompany litigation. Accordingly, firms are highly incented to **restrict consumer choice** and avoid innovation.

C. The BICE grandfather is too narrow, and as a result savers will lose access to advice.

The grandfather rule in the BICE is very limited. It provides relief for products sold before the applicability date of the regulation, but only if no further purchase recommendations are made, and no rebalancing advice is given if it affects the adviser's or financial institution's compensation. It is not workable for a financial institution to restrict advisers to only making "hold" recommendations – either an adviser is going to provide comprehensive advice or not. This leaves financial institutions with only two choices – cut off advisers from assisting clients (including in times of market stress) or apply the full BICE compliance structure to grandfathered products.

Applying the full BICE compliance structure to grandfathered products, however, may not be workable without significant **dislocations**. Contracts that have already been sold already have built into them the compensation that is paid for distribution of the product, including to the agent and to the firm or agencies that supervise the agent and provide for compliance with applicable rules. This distribution compensation, however, cannot as a general matter be changed after the fact. But any further advice with respect to the product (other than "hold"

---

[20] Generally, an affirmative defense cannot be raised in a motion to dismiss. As one civil procedure treatise explains "Numerous cases . . . state that the affirmative defenses specifically listed in Federal Rule 8(c), as well as those captured by the catchall clause . . . must be asserted in the defendant's answer." 5 FED. PRAC. & PROC. CIV. § 1277 (3d ed.). The rationale behind this rule is "based on the view that motions to dismiss or to strike cannot be used to resolve disputed fact questions . . . . Since the facts necessary to establish an affirmative defense generally must be shown by matter outside the complaint, the defense technically cannot be adjudicated on a motion under Rule 12." *Id*.

This circumstance is problematic for firms that intend to rely on the BICE because prohibited transaction exemptions are generally considered to be an affirmative defense by courts. Most recently, the Seventh Circuit held that "[A]n ERISA plaintiff need not plead the absence of exemptions to prohibited exemptions. . . . We now hold squarely that the section 408 exemptions are affirmative defenses for pleading purposes." Allen v. GreatBanc Trust Co., 835 F.3d 670, 676 (7th Cir. 2016). Five other circuits also agree that section 408 exemptions are affirmative defenses, or that the defendant bears the burden of proof, or both. *See* Harris v. Amgen, Inc., 788 F.3d 916, 943 (9th Cir. 2015), *rev'd on other grounds*, 136 S. Ct. 758 (2016); Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 601 n.10 (8th Cir. 2009); Elmore v. Cone Mills Corp., 23 F.3d 855, 864 (4th Cir. 1994); Lowen v. Tower Asset Mgmt., Inc., 829 F.2d 1209, 1215 (2d Cir. 1987); Donovan v. Cunningham, 716 F.2d 1455, 1467-68 (5th Cir. 1983).

advice, which is not complete advice) must be done under an expensive compliance system demanded by the BICE. This cost, including the additional litigation risk, was not part of the original distribution compensation for the product, which is too low to support the cost of the BICE.

The inadequacy of the grandfather is particularly acute for annuities, which have a long tail and are generally held for many years by savers.[21] As a result, for Americans like Baby Boomers who have already largely saved for retirement, including through the purchase of an annuity, the Fiduciary Rule **reduces access to financial advice** at the most critical time.

III. Fixed Rate Annuities: The amendments to PTE 84-24 have so narrowed its coverage as to prohibit ordinary compensation, causing disruption and dislocation in the fixed rate annuity market.

The Fiduciary Rule included significant changes to PTE 84-24, which have not been the topic of as much focus, simply because the disruptions associated with the BICE and other parts of the Fiduciary Rule have generated more attention. PTE 84-24 was amended in three significant ways. First, the Department provided that the *only* annuities that can be sold under PTE 84-24 are fixed rate annuities. Second, the Department significantly restricted the kinds of compensation that can be paid to an agent under PTE 84-24 by creating a new defined term, "Insurance Commission." Third, the Department imposed what are commonly known as the "Impartial Conduct Standards."

It has been the position of the Committee from the beginning of the rulemaking process that PTE 84-24 should be available for all annuities. We do not believe limiting the availability of PTE 84-24 only to fixed rate annuities makes analytical sense in light of the importance that annuities play in the retirement system. PTE 84-24 is designed, and has for years worked successfully, to provide that the simple act of a retirement plan or IRA purchasing an annuity or other insurance product does not create a prohibited transaction. All annuities *provide longevity insurance protection* and only annuities can provide guaranteed income for life – a paycheck for retirement. This unique *insurance* feature of all annuities is analytically far more significant in the context of the Fiduciary Rule than the differences in the manner in which earnings may be determined under a particular form of annuity. We have made very clear, however, that the solution to this problem should not be moving some annuities into the BICE, which has all the issues we laid out above.

PTE 84-24, as amended, has still caused **disruptions that adversely affect investors and retirees.** The Department's amendment to PTE 84-24 restricts compensation in connection with the sale of an annuity to an "Insurance Commission," which is defined to mean "a sales commission paid by the insurance company to the insurance agent or broker or pension consultant for the service of effecting the purchase of a Fixed Rate Annuity Contract or insurance contract, including renewal fees and trailers, but not revenue sharing payments,

[21] *See* Matthew Drinkwater, *Deferred Annuity Persistency* (LIMRA International 2006), 12 (describing the substantial persistency of deferred annuity contracts purchased in IRAs and employer plans).

administrative fees, or marketing payments."[22] The Department also seems to have intended some payments to supervising general agents and others to be treated as an Insurance Commission, because it requires the separate disclosure "of the amount of the Insurance Commission that will be paid to any other person as a gross dealer concession, override, or similar payment."[23]

This definition, however, is vague because it circularly uses the term "sales commission" in the definition, and while the term is in common usage in the industry, it can cover a range of means of compensating general and selling agents. It is also restrictive because it could be read to **prohibit ways of compensating agents that benefit consumers**.

Because the definition of "Insurance Commission" is so vague, but critical to receiving relief under PTE 84-24, insurance companies have been cutting back on forms of support for agents that benefit consumers. For example, in the past, many insurance companies have provided funds to agents to set up their office, obtain strong administrative support, and engage in continuing education. Second, insurance companies provide loans and similar funds to allow new agents to get started and build up a base of clients. These payments increase competition and expand access to financial professionals. Third, many insurance agencies split commissions and have other arrangements to incentivize agents and their supervising general agents to work as a team to serve clients.

It is possible that many or all of these arrangements fall under the restrictive definition of "Insurance Commission." But as a practical matter, there is significant uncertainty, and many insurance companies are now unwilling to provide this support for products sold under PTE 84-24. That means that the **disruptions** caused by the restrictive definition of "Insurance Commission" will **adversely affect investors and retirees and their access to lifetime income**.

With respect to the final change made by the amendments to PTE 84-24, the Committee of Annuity Insurers has supported incorporating the Impartial Conduct Standards into PTE 84-24. The Impartial Conduct Standards are straightforward: when an adviser acts as fiduciary and will receive compensation in connection with investment advice, (a) the adviser must act with appropriate prudence and care and in the client's sole interest (called "Best Interest" in the Fiduciary Rule); (b) the adviser may not make misleading statements; and (c) the adviser must disclose conflicts of interest. This, coupled with the disclosure of commissions under PTE 84-24, makes PTE 84-24 a workable exemption, except for the unnecessary restriction of the scope of annuities covered and the types of compensation covered.

The addition of the **Impartial Conduct Standards** to PTE 84-24 has certainly caused disruptions among issuers of fixed rate annuities. These disruptions have been heightened by the extremely short implementation period. But we believe that, unlike other disruptions caused by the Fiduciary Rule, imposing **these standards will *not* adversely affect investors and retirees**.

[22] PTE 84-24, Section VI(f).

[23] PTE 84-24, Section IV(b)(1)(B).

IV. Indexed Annuities: The Fiduciary Rule has significantly reduced access to unregistered annuities, particularly indexed annuities, which provide guarantees but include the potential to capture market gains.

A fixed indexed annuity provides for interest that is credited based on the positive performance of one or more market indexes, such as the S&P 500. The crediting of only positive indexed interest provides assurance against any investment losses due to a decline in the market index but also access to market returns greater than the interest typically credited on fixed rate annuity contracts. Such features are attractive to many middle-class investors and contribute greatly to their overall retirement security.

A. The Department's proposed exemption for insurance intermediaries fails to close a huge gap in the regulation.

The Department's proposed Best Interest Contract Exemption for Insurance Intermediaries ("the IMO BICE") attempts to resolve a very significant problem the Department created in the final Fiduciary Rule, namely that the Fiduciary Rule as issued would effectively prohibit the sale of fixed indexed annuities by IMOs to plans or IRAs when the Fiduciary Rule goes into effect.

The final Fiduciary Rule removed fixed indexed annuities from PTE 84-24 without prior notice and without soliciting public input. The BICE, which is the sole exemption under which fixed indexed annuities can be sold, did not provide a feasible exemption for fixed indexed annuities currently being sold through the independent agent channel.[24] Had the industry been able to anticipate the removal of fixed indexed annuities from PTE 84-24 when the Department proposed its Fiduciary Rule, the industry could have provided meaningful comments on the problems created by the Department's changes, namely that fixed indexed annuities are commonly sold through an entity that cannot qualify as a Financial Institution. Instead, as the Department recognizes, the Fiduciary Rule will prohibit independent agents from selling fixed indexed annuities to retirement investors if the Rule, as currently constructed, becomes applicable on January 1, 2018.

The Department overlooked these serious consequences when promulgating its final regulation and, while the proposed IMO BICE is undoubtedly a good faith attempt to remedy a serious omission, that omission should not be addressed through a patchwork measure that would add even more conditions and requirements to the already tortuously complex BICE exemption.

[24] The existing BICE conditions relief upon a "Financial Institution" entering into a contract with the purchaser of an annuity and agreeing to accept certain new legal obligations outlined by the exemption. For purposes of the existing BICE, a Financial Institution can only be a bank, broker-dealer, insurance company, registered investment adviser, or any entity that is described as a Financial Institution in an individual exemption granted by the Department. IMOs are not typically organized as one of those enumerated entities and DOL has not yet granted any individual exemptions. This means that insurance intermediaries, like IMOs, cannot serve as a Financial Institution for purposes of the existing BICE and are not eligible for any exemption that would permit the sale of fixed indexed annuities through the independent distribution channel, unless some third-party entity agrees to serve as a Financial Institution.

We made the foregoing points in our February 21, 2017, comment letter on the IMO BICE. But the salient point here, for purposes of the review that the President has ordered, is that the Fiduciary Rule, in the words of the President's Memorandum, has resulted in a "**reduction of Americans' access to certain retirement savings offerings**." It is self-evident that the Fiduciary Rule did not adequately preserve access to indexed annuities – otherwise the Department would not have received dozens of requests for individual exemptions and the proposed IMO BICE would not have been needed.

The proposed IMO BICE, in its current form, will not fill the gap the Fiduciary Rule created or restore access to indexed annuities. For example, the proposed IMO BICE would condition relief upon an IMO (a) having transacted sales of fixed annuity contracts averaging at least $1.5 billion in premiums per fiscal year over its prior three fiscal years, and (b) having fiduciary insurance or reserves of at least 1% of the average amount of premium sales by the IMO over the prior three fiscal years. We understand that only a small number of IMOs would meet these requirements.

Besides **restricting access** to products because of the limited number of IMOs that can meet the proposed IMO BICE conditions, the IMO exemption is also very **disruptive** because it serves as a "barrier to entry." An IMO that does not currently meet the high sales threshold of $1.5 billion in average premiums over its prior three fiscal years will be prohibited from serving as an intermediary for any IRA annuity sales. However, IRAs represent more than half of all indexed annuity sales outside of institutional markets.[25] As a result, an IMO that is not currently eligible for the IMO BICE will find it extremely difficult to ever become eligible. In fact, it is hard to imagine any condition that would be more **harmful** to market competition than a barrier to entry that prevents any market participant other than the very largest from participating in the market. (Imagine trying to open a new pharmacy if the FDA were to allow only pharmacies with 500 locations to sell prescriptions.)

In sum, the IMO BICE would cause just the **dislocations and disruptions** the President's Memorandum references. If finalized, the proposed exemption would create **adverse consequences** for Americans who will find the market for fixed indexed annuities severely constricted because the Department has offered an exemption for only a small number of insurance intermediaries and created a very high barrier to entry.

B. The BICE is unworkable for unregistered annuities and other securities not sold through a broker-dealer.

The Department's BICE contemplates that an insurance company would be willing to serve as the "Financial Institution" when its unregistered annuity products are sold by independent agents that are not associated with a broker-dealer. In Part I of the Department's Fiduciary Rule FAQs released on October 26, 2016, the Department suggested that the

[25] LIMRA Secure Retirement Institute, *Presentation to Federal Advisory Committee on Insurance* (2015), available at: https://www.treasury.gov/initiatives/fio/Documents/LIMRA8.6.15.pdf.

requirement to sign on to the BICE contract is similar to the suitability analysis insurance companies undertake.[26] This is obviously not correct, as the entire Fiduciary Rule is premised on the need for a significant increase in the standard of care that applies to financial advisers. The fiduciary oversight, monitoring, and compliance policies and procedures contemplated by the BICE are not workable for distribution through independent agents, and accordingly the Fiduciary Rule has caused major **disruptions** in the industry.

Even if an insurance company is willing to use the BICE for the distribution of unregistered annuities (or has no choice because of the gap the Fiduciary Regulation has created), the insurance company opens itself up to significant **litigation risk** that is worse than that faced by a broker-dealer or registered investment adviser ("RIA"). A broker-dealer can place limits on the securities that its representatives sell and already supervises their activities. An insurance company, on the other hand, does not know about and cannot control an agent's sale of another provider's products. Q&A-22 in Part I of the Fiduciary Rule FAQs asserts that the "BIC Exemption does not require insurance companies to exercise supervisory responsibility with respect to the practices of unrelated and unaffiliated insurance companies." Even if such a statement could deter costly class actions – which it cannot – the terms of the BICE require that any compensation paid in connection with a sale be no more than "reasonable" compensation and any differences must be based on "neutral factors" – which requires supervision of other similar products the agent sells.

As a practical matter, the entire rule is built around the assumption that an agent will have a *single* financial institution that supervises his or her activities. That is just not true with respect to the sale of fixed rate and fixed indexed annuities. The Department's economic analysis did not account for the **dislocations and disruptions** that have been caused for independent insurance agents because the Department essentially required most investments to be sold through an exemption – the BICE – that is designed for broker-dealers and registered investment advisers.

In addition, since the release of the BICE, there has been significant confusion among broker-dealers about the manner in which, and even for some broker-dealers, whether it is possible, to meaningfully supervise the sale of unregistered annuities. While FINRA's rules and interpretive guidance provide limited guidance on the manner in which non-securities business of its member firms must be supervised, and how a registered person's outside business activities must be supervised under FINRA Rule 3270, neither FINRA nor the SEC has issued guidance on this point, particularly in the context of a broker-dealer supervising non-securities business as it might be required to ensure compliance with the Fiduciary Rule. Even if a broker-dealer is willing to act as the financial institution under the BICE in connection with the sale of fixed and indexed annuities, the broker-dealer is going to impose a charge, which may be very significant, because of the need to monitor transactions and build systems for a product that is not sold as a

[26] "As under the 'suitability' rules that apply to insurance companies under many states' laws, the insurer or financial institution responsible for overseeing the agent's recommendations is responsible for adopting appropriate supervisory mechanisms to ensure the agent's (including independent agent's) compliance with its legal obligations to customers." Department of Labor, Conflict of Interest FAQs (Part I – Exemptions), Q&A-22 (Oct. 26, 2016).

security but will create significant litigation risk. This means **an increase in the prices that investors and retirees must pay to gain access** to these annuities.

V. <u>Annuities in General</u>: A number of other features of the Fiduciary Rule have caused disruptions that will harm investors and retirees and increase prices.

In this Section V, we discuss additional features of the Fiduciary Rule that meet the criteria that the President laid out in his February 3 memorandum.

A. The lack of a workable seller's carve-out restricts options for individual investors and retirees.

In our July 21, 2015, comment letter responding to the Department's proposed Fiduciary Rule, the Committee pointed out that the Fiduciary Rule's "wide net" means that "incidental advice" in connection with the sale of a product will now be fiduciary in nature. The Fiduciary Rule treats essentially any "suggestion" for an individual to take a course of action or not take a course of action as a "recommendation." In other words, the definition of "investment advice" conflates selling and impartial investment advice. And this effect of treating sales as advice was intentional. The Department's economic analysis essentially concludes that, because individuals have a hard time distinguishing between different standards of care, it is better to treat all retail recommendations as fiduciary activity and subject them to the highest duty know to the law.

The effect, however, of conflating sales and impartial advice is to **increase price and take away consumer choice.** Under the final rule, large plan fiduciaries, because of the carve-out for "independent fiduciaries," can decide what services they will receive from financial professionals, and what they will pay for advice. But individuals do not have that choice – they cannot engage with an agent without paying for the entire compliance structure behind the BICE or another exemption, including the cost of paying for the possibility of expensive litigation.

While we support a fiduciary standard of care, prudence, and loyalty when a financial professional chooses to provide impartial investment advice, as a practical matter, the Fiduciary Rule no longer makes this a choice. This means that the entire annuity industry, both manufacturers and distributors, must be ready for class action litigation associated with the sale of annuity products based on a "Best Interest" standard. The problem is that the central risk pooling feature of annuities, by its nature, embeds trade-offs and insuring against contingencies that may not come to pass for any one particular individual.

Annuities come in a wide variety of forms to meet varying consumer needs. Whether an annuity is in a client's best interest, which type of annuity is in the client's best interest, and which features or riders are in the client's best interest all depend on a prediction about the future. Annuities are subject to second-guessing later if the contingency does not occur. Consider the following simple example involving an individual who purchases a *deferred variable annuity*. The account value of such an annuity is typically invested in mutual funds or other securities, and reflects the investment gains and losses on those assets. The contract offers access to equity-based returns, which are subject to market risk and volatility, but which also provide the opportunity to accumulate more retirement savings over the long term. At the time the individual purchases the annuity he may desire the lifetime income protections that come with a guaranteed lifetime withdrawal benefit or GLWB. This benefit will require payment of an additional charge. The choice of a variable annuity with a GLWB protects against real risks and a consumer's desire to purchase protection against those risk. But it is not always obvious which choice is in an individual's "best" interest. Depending on market performance and how long the individual lives, he may or may not receive any payments as a result of the purchase of the GLWB even though he received the benefit of the longevity guarantee.

It is perfectly appropriate for a financial adviser that has agreed to serve as a fiduciary to make recommendations with the appropriate care, skill, and prudence. But the Fiduciary Rule imposes that standard of care on every sale, and in fact, because of the gaps in the Fiduciary Rule we described earlier, the Fiduciary Rule imposes that obligation on the annuity issuer or another financial institution that does not want **the litigation risks** associated with it. The Department's response to this problem is that the fiduciary standard is not judged in hindsight, but rather at the time of the sale. We agree that this is a correct statement of law, but that is not how the class action plaintiffs' bar will proceed. They will proceed with suits that cannot be dismissed quickly, to secure settlements.

Another unintended consequence of the Fiduciary Rule's severe litigation risk is the impractical nature of training agents to do their jobs within the confines of the final regulation. Insurance agents are not ERISA lawyers, but the Fiduciary Rule forces them to become one. We understand from Committee members that the training materials that have been developed in the short implementation period often stick closely to the actual words of the Fiduciary Rule and the BICE, including descriptions of the relevant standard of care. Committee members are afraid to deviate from the words of the Fiduciary Rule because they feel these materials will be used in litigation against them – which means it is difficult to provide training to agents that is practical and at the appropriate level. This problem of translating legal standards to common language is not unique. But what is unique about the Fiduciary Rule is that, by design, it is intended to **increase litigation** against the financial services industry. And that has **adverse consequences** for investors and retirees because compliance efforts and training must be viewed through the lens of litigation, not what is best for investors and retirees.

B. The Fiduciary Rule reduces access to advice for middle class Americans.

We expect that the Department will hear from many industry groups about the loss of access to advice. We agree that this will be an effect.

An independent study by CoreData Research UK, which is the London unit of a global financial services research and strategy consultancy, estimated that 71% of advisers will cut off advice to many small clients and will disengage with an average of 25% of their mass market clients (mass-market investors means those with less than $300,000 in net investable assets).[27] With respect to annuities in particular the study observed:

> About a third (32%) [of a group of 552 U.S. financial advisers] believe shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.[28]

Similar results have been seen in the U.K. because of its reforms – and in fact, the U.K. has decided to undertake a similar top-to-bottom review of its similar regulation because of concerns over the effects on smaller savers. The U.K.'s regulator has admitted that "at present, this high standard of advice is primarily accessible and affordable only for the more affluent in society."[29]

C. The Department's FAQs have caused significant disruption because they include new compliance rules that were not the subject of notice and comment.

The Department released two sets of Fiduciary Rule FAQs – Part I on October 27, 2016, and Part II on January 13, 2017. The latter set of FAQs was released less than three months before the Fiduciary Rule's anticipated April 10, 2017 applicability date. For a regulation with a normal sufficient implementation timeline, FAQs like these might be welcome. Unfortunately, both sets of FAQs came out after most firms had invested significant time and resources in preparing for the Fiduciary Rule, and their late release caused **disruptions.** These disruptions occurred because a number of the FAQs take positions that require changing policies and procedures and, in some cases, reversing reasonable interpretations. Some of these FAQs appear to contradict the Fiduciary Rule itself. We mention here the FAQs that we think particularly cause disruptions, increase costs, or limit choices.

Q&A-12 of Part I of the Fiduciary Rule FAQs includes a long discussion of adviser recruitment programs. These programs are part of the normal economic activity of the financial services industry. Just like other employees, advisers routinely change firms when, consistent with economic theory, their resources could be better deployed. Firms of all kinds pay recruitment bonuses and other incentives to bring new workers on board. For advisers, it is typical to provide incentives that are tied to an adviser's performance, and this is not unlike any performance compensation that any other employee might receive. The Department's response, however, suggests that *some* recruitment compensation structures satisfy the BICE, but many others do not. This simply results in confusion and disruption in the ordinary deployment of

---

[27] CoreData Research UK, *supra* note 12 at 3. This estimate move among advisers to affluent clients is consistent with an October 2016 report by management consultant A.T. Kearney, which recommends that advisers focus on accounts greater than $200,000 and focus on a fee-based model. A.T. Kearney Study, *supra* note 13 at 30.

[28] CoreData Research UK, *supra* note 12 at 21.

[29] Her Majesty's Treasury, *Financial Advice Market Review Final Report* (Mar. 2016), 13, https://www.fca.org.uk/publication/corporate/famr-final-report.pdf.

human resources in the economy. The Department also introduced a new quasi-grandfather rule with regard to recruitment bonuses, on which it received no public comment.

Q&A-9 of Part I of the Fiduciary Rule FAQs similarly has a complex set of rules for payment grids, none of which was fully considered in the Fiduciary Rule. Many of the statements the Department made are too vague to provide assurances that a firm has complied with the rule. For example a payment grid may not "disproportionately increase" compensation; a firm must "exercise special care" with differences in product categories, and should avoid retroactive application "[d]epending on the magnitude of past investments and the size of the percentage increase." Because these standards are all tied to compliance with the BICE, a firm simply does not know if it has complied with all the terms of the exemption.

Q&A-17 of Part II of the Fiduciary Rule FAQs introduced a new concept of a "free-meal seminar," concluding that a "free-meal seminar" is not a "widely attended" gathering, but provided no guidance about when a seminar is large enough to be considered widely attended.

Finally, Q&A-4 of Part II of the Fiduciary Rule FAQs takes the hard-to-believe position that an adviser that *does not recommend a distribution at all from an IRA*, but simply advises a client who is taking a distribution required by the law to invest the distribution in life insurance, is making a fiduciary investment recommendation.[30] This guidance is so surprising and inconsistent with the proposal that no commenter could have even guessed that it is something that should be addressed in their comments. The FAQ suggests that any funds that were ever in an IRA or plan are forever subject to fiduciary obligations. For purposes of the President's Memorandum, however, the key point is that this answer **restricts access to a financial product.** For individuals who are forced to take required minimum distributions ("RMDs"), but who have no need for the funds, the purchase of whole life insurance with RMD distributions is a longstanding straightforward financial tool. No life insurance company is set up to comply with the Fiduciary Rule for sales completely outside of IRAs and plans; even if the Department's interpretation is correct, this would take years to implement. Firms have no choice but to restrict the marketing of this straightforward financial tool.

[30] Department of Labor, Conflict of Interest FAQs (Part II – Rule), FAQ-4 (Jan. 13, 2017).

VI. The Department should further delay the Fiduciary Rule and should not let the expanded definition of fiduciary investment advice go into effect without a complete review of the Fiduciary Rule as ordered by the President's Memorandum.

A. More time is needed to complete a full review of the Fiduciary Rule.

We fully expect that, once the Department has all the input from the regulated community on the questions the Department has asked, it will make an "affirmative determination" on the considerations the President outlined in his Memorandum. Accordingly, the Department will be required to "publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate and as consistent with law."

On April 7, the Department published a final rule delaying the applicability date of the Fiduciary Rule and making changes to the BICE and PTE 84-24 (the "Delay Rule"). We very much appreciate that delay. Unfortunately, the Delay Rule appears to conclude that *no review* of the overall structure of the Fiduciary Rule is needed, and that the only aspects of the Fiduciary Rule that could be affected by the review that the President has ordered are the requirements of the BICE that are applicable on January 1, 2018.

The President's Memorandum requires the Department to rescind or revise the *entire* Fiduciary Rule, not just the BICE. Accordingly, the Department will need to address (a) the expanded definition of "investment advice fiduciary;" (b) the exceptions to the new definition, including the new definition of financial education; (c) all of the conditions of the BICE and Principal Transaction Exemption; and (d) the changes to existing PTEs, including PTE 84-24.

We believe that the Department cannot both review the comments it will receive, and if any of the conditions in the President's Memorandum are met, make decisions about any proposal to rescind or revise the Fiduciary Rule, by June 9. Accordingly, we urge the Department to publish a further delay as soon as possible.

B. In connection with any new proposal, PTE 84-24 should cover all annuities, as the Delay Rule already provides on a temporary basis.

As we have noted above, the Fiduciary Rule in its current form will operate to reduce access to, and use of, guaranteed lifetime income options that annuity products provide. A paramount consideration of a revised Fiduciary Rule should be to preserve access and use of the guaranteed lifetime income solutions that all forms of annuity products uniquely provide. In connection with the issuance of a proposal to rescind or revise the Fiduciary Rule, we stand ready to provide input on how to ensure that Americans do not lose access to products that provided guaranteed income in retirement.

As a preliminary suggestion, we urge the Department to make permanent a change already made on a temporary basis by the Delay Rule – ensuring that all annuities can be sold under PTE 84-24. During the period from June 9, 2017 to January 1, 2018, PTE 84-24 as in effect before the Fiduciary Rule will be available for any recommendations regarding annuities or insurance made by someone acting as a fiduciary, as long as the Impartial Conduct Standards are met. The Impartial Conduct Standards require:

- Recommendations are in the individual's "Best Interest", as defined by the Fiduciary Rule.
- Compensation paid to the selling agent or broker does not exceed reasonable compensation.[31]
- No misleading statements are made regarding recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to the investment decision.

This structure, which makes PTE 84-24 available for all annuities, but appropriately requires compliance with the Impartial Conduct Standards, is a workable exemption. In addition, PTE 84-24 should not be limited to narrowly defined "Insurance Commissions;" rather, PTE 84-24 should provide relief for a range of compensation types. Of course, whatever compensation will be paid in connection with the sale of the annuity, it should be disclosed.

* * * *

As we hope we have made clear in our comment letters and testimony, the Committee fully supports a regulatory regime that requires financial professionals who provide investment advice to act in the best interest of their clients. We applaud Department staff for opening up this review, particularly when we know how hard staff worked on the Fiduciary Rule. Our goal is the same – protect savers and retirees without restricting access to or use of guaranteed income products. We appreciate this opportunity to offer input. If you have any questions, or if we can be of any assistance in your consideration of the issues summarized above, please do not hesitate to contact either of the undersigned at 202-347-2230.

Counsel to the Committee of Annuity Insurers

Joseph F. McKeever, III
Partner, Davis & Harman LLP
jfmckeever@davis-harman.com

Michael L. Hadley
Partner, Davis & Harman LLP
mlhadley@davis-harman.com

Attachment

[31] The condition was already contained in PTE 84-24, but in other exemptions is included in the Impartial Conduct Standards.

THE Committee OF Annuity Insurers
www.annuity-insurers.org

AIG Life & Retirement, Los Angeles, CA
Allianz Life Insurance Company, Minneapolis, MN
Allstate Financial, Northbrook, IL
Ameriprise Financial, Minneapolis, MN
Athene Annuity & Life Company, Des Moines, IA
AXA Equitable Life Insurance Company, New York, NY
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Global Atlantic Life and Annuity Companies, Southborough, MA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc., New York, NY
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Life Insurance Company of the Southwest, Dallas, TX
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
Symetra Financial, Bellevue, WA
The Transamerica companies, Cedar Rapids, IA
TIAA, New York, NY
USAA Life Insurance Company, San Antonio, TX
Voya Financial, Inc., Atlanta, GA

The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.