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VIA EMAIL
Employee Benefits Security Administration
Office of Exemptions
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210
EBSA.FiduciaryRuleExamination@dol.gov (Subject: RIN 1210-AB82)

RE: Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (RIN 1210-AB82)

Ladies and Gentlemen:

On July 6, 2017, the Department of Labor ("Department") published its Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (the "RFI").[1] The RFI included 18 questions relating to the final *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice*[2] and associated prohibited transaction exemptions (collectively, the "Fiduciary Regulation"), including the Best Interest Contract Exemption ("BICE")[3] and PTE 84-24,[4] among others. On behalf of Western & Southern Financial Group, Inc. ("W&SFG")[5] and its subsidiaries, we appreciate the opportunity to offer responses to the RFI. W&SFG is a member of, and generally supports the comment letters regarding the Fiduciary Regulation of, the American Council of Life Insurers ("ACLI"), the Financial Services Roundtable ("FSR"), the Financial Services Institute, and the Insured Retirement Institute ("IRI"). We provide our comments to the Fiduciary Regulation to emphasize issues of particular concern to W&SFG's businesses and their customers.

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[1] U.S. Department of Labor, Request for Information, Definition of the Term Fiduciary, 82 Fed. Reg. 31,278 (July 6, 2017).
[2] Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice, 81 Fed. Reg. 20,946 (April 8, 2016).
[3] Best Interest Contract Exemption, 81 Fed. Reg. 21,002 (April 8, 2016).
[4] Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters, 81 Fed. Reg. 21,147 (April 8, 2016).
[5] W&SFG is wholly-owned by Western & Southern Mutual Holding Company, a mutual insurance holding company. W&SFG is a Fortune 500, diversified, and customer-oriented family of companies, as well as a nationally recognized leader in consumer and business financial services. W&SFG and its subsidiaries manufacture a diverse array of products, including a variety of life insurance products, annuities, mutual funds, and private funds. In addition, our companies distribute these products to consumers through a variety of distribution models, including a captive sales force, intermediaries such as banks, broker-dealers, and insurance marketing organizations, and independent agents that are often small business owners.

As an initial matter, we reassert the positions set forth in our April 17, 2017, comment letter[6] – the Fiduciary Regulation will result in reduced retirement investor access to guaranteed lifetime income products, increased litigation, and increased prices for retirement investors. As a result, the entire Fiduciary Regulation should be rescinded. Further, any new regulation should be guided by the following principles:

- The definition of the term "fiduciary" should include a requirement of mutuality.
- A broad prohibited transaction exemption should be satisfied by development and maintenance of policies and procedures reasonably designed to ensure that advisers satisfy fiduciary duties.
- Prohibited transaction exemptions should not prohibit specific material conflicts of interest.
- A single prohibited transaction exemption should be provided for all types of annuities.
- Prohibited transaction exemptions should provide meaningful grandfathering.

The questions posed in the RFI seem to suggest that additional, product-specific exemptions are being considered by the Department. We believe this is the *wrong* approach. A hornet's nest of exemptions for specific products, specific compensation structures, or specific business models is impractical and will result in governmentally-determined winners and losers, to the detriment of retirement investors. If the Department decides to keep its very broad definition of the term "fiduciary," it should propose a single, broad exemption that is agnostic to product, compensation, and business model and coordinate that exemption with any rulemaking by the Securities and Exchange Commission (the "SEC") regarding standard of care issues.

In response to specific questions posed in the RFI, we will show how the Fiduciary Regulation will or already is resulting in harm to retirement investors. Then, we will discuss how a product-by-product approach will only compound these issues in response to the RFI's question regarding fee-based annuities. Finally, in response to the RFI's question regarding model policies and procedures and a potential exemption based on future rulemaking by other regulators, we will explain how a single, broad exemption is the appropriate approach for a broad definition of the term "fiduciary," along with coordination with other regulators.

[6] *See* letter of Western & Southern Financial Group, Inc. dated April 17, 2017, *available at* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01403.pdf.

I. The Fiduciary Regulation is Harming Retirement Investors.

The Fiduciary Regulation is already producing unintended, negative consequences and this will be compounded if the remaining conditions of BICE and PTE 84-24 become applicable on January 1, 2018. These negative consequences for retirement investors include the decreased availability of fixed-indexed annuities, the decreased availability of a wide variety of annuities generally, increased costs to consumers as a result of class action litigation, and decreased availability of advice regarding previously purchased annuity products.

A. Unintended, Negative Consequence: Decreased Availability of Fixed-Indexed Annuities

In question 17, the Department asks whether PTE 84-24 should be available for all annuity types, whether a BICE-like exemption for insurance intermediaries would facilitate advice, and the relative advantages of either approach. Based on this question, the Department appears to acknowledge what annuity manufacturers such as W&SFG have known since the Fiduciary Regulation was promulgated – the rule will substantially decrease the availability of fixed-indexed annuities and advice related to these products to the detriment of retirement investors. This negative impact must be avoided by permitting all annuities to use PTE 84-24, eliminating the Financial Institution requirement of BICE, or otherwise adopting a more principles-based exemption as discussed in Part III below.

As W&SFG has addressed in two prior comment letters,[7] the Fiduciary Regulation amends PTE 84-24 to remove coverage for variable annuities and fixed-indexed annuities sold to IRA owners and plan participants. Compensation relating to recommendations of these products must be received pursuant to BICE, while PTE 84-24 remains available only for "Fixed Rate Annuities."[8] This is problematic with respect to fixed-indexed annuities, which are often sold by independent insurance agents who are not affiliated with a "Financial Institution," a requirement of BICE. Independent agents may or may not be affiliated with an independent marketing organization ("IMO"), but are typically appointed as independent agents with multiple insurance companies, and thus can offer retirement investors more product choice. These agents are usually state insurance-only licensed and thus cannot easily affiliate with a registered investment adviser, broker-dealer, or bank. In these circumstances, the only potential Financial Institution in the current transaction model may be the insurance company that manufactures the fixed-indexed annuity.

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[7] *See id.* and letter of Western & Southern Financial Group, Inc. dated July 21, 2017, *available at* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00733.pdf

[8] *See supra* note 4.

But, BICE has several requirements that are very difficult for the issuing insurance company to satisfy as Financial Institution for independent agents. Among other requirements, BICE requires that the Financial Institution: (i) identify, mitigate, supervise and disclose the adviser's material conflicts of interests; (ii) treat the sale of the Financial Institution's own products as a proprietary sale with additional requirements; and (iii) make broad disclosures about the Financial Institution's business practices and compensation schemes on a publicly-available web site. Each of these requirements assumes that the Financial Institution has broad authority to dictate the adviser's product offerings and sales practices – authority an insurance company does not have, contractually or otherwise, with respect to independent agents. Increasing this difficulty is the Department's statement that "the Financial Institution exercising supervisory authority must adhere to the conditions of the exemption, including the policies and procedures requirement and the obligation to insulate the Adviser from incentives to violate the Best Interest Standard, *including incentives created by any other Financial Institution.*"[9]

In a non-binding FAQ, the Department attempted to clarify that the insurance company does not need to exercise supervisory responsibility with respect to the practices of unrelated and unaffiliated insurance companies.[10] However, under BICE, an insurance company still must ensure (and warrant to the retirement investor in the best interest contract) that the independent agent is providing a recommendation that is in the best interest of the retirement investor *without regard* to the adviser's interests and presumably would have to take steps to ensure that the independent agent is appropriately disclosing his or her material conflicts of interest. This task is extremely difficult, as the insurance company does not have full information regarding an agent's available products or control of the agent's sales process. Considering these practical difficulties and the substantial third-party litigation risk associated with BICE, W&SFG believes that few, if any, insurance companies will assume this challenging responsibility.

Without a Financial Institution and with no other available exemption, independent agents will be unable to recommend fixed-indexed annuities to their clients. This will undoubtedly result in a "reduction of Americans' access" to this "retirement product structure"[11] and a reduction in related advice, as it appears that consumers receive a majority of recommendations relating to these products from independent agents.[12]

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[9] *See* 81 Fed. Reg. at 21,067 (April 8, 2016) (emphasis added).
[10] Conflict of Interest Exemptions FAQs, Q22, p. 18 (Oct. 27, 2016), *available at* https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf.
[11] Presidential Memorandum on Fiduciary Duty Rule – Memorandum for the Secretary of Labor, § 1(a)(i), 82 Fed. Reg. 9,675 (Feb. 7, 2017).
[12] Approximately 60% of fixed-indexed annuity sales are effected by independent insurance agents. *See* Greg Iacurci, *Broker-dealers could see higher share of fixed indexed annuity sales thanks to DOL fiduciary rule,* INVESTMENT NEWS (May 5, 2016) *available at*

Notably, PTE 84-24 has been available for all annuity products for over thirty years. More recently, in delaying the applicability of some requirements of the Fiduciary Regulation, the Department determined it was appropriate to permit sales of fixed-indexed annuities pursuant to PTE 84-24 through the end of this year.[13] The Department should reverse course on the requirement that variable and, in particular, fixed-indexed annuities be sold pursuant to BICE and instead continue to make PTE 84-24 available for all annuities.

First, annuities have common features that argue in favor of a single prohibited transaction exemption. For example, variable annuities, fixed-indexed annuities and fixed annuities may all include fixed options with interest guarantees, mortality-based investment guarantees, and retirement income guarantees, including the ability for retirement investors and other consumers to annuitize the product and receive a stream of guaranteed lifetime income. Second, the bifurcated prohibited transaction exemption approach creates an unnecessary level of complication for advisers who offer a variety of annuity types and for retirement investors who purchase multiple types of annuities. Third, retirement investors will still have the numerous protections afforded them under the impartial conduct standards, which are incorporated into revised PTE 84-24.

Inclusion of all annuities within one exemption is preferable to an expansion of the types of entities that qualify as Financial Institutions under BICE. First, an IMO practically cannot or will choose not to seek compliance with the proposed Best Interest Contract Exemption for Insurance Intermediaries ("IMO BICE").[14] Most cannot comply with the very stringent financial and sales requirements and those that can comply likely have other alternatives (e.g., an affiliated broker-dealer) that could use BICE, which has fewer requirements than IMO BICE. Second, many insurance-only agents are currently unaffiliated with an IMO.[15] These agents should be able to continue to sell fixed-indexed annuities without the Department requiring that they affiliate with an IMO, which generally performs centralized marketing and sales support functions, or a broker-dealer, registered investment adviser, or bank.

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http://www.investmentnews.com/article/20160505/FREE/160509950/broker-dealers-could-see-higher-share-of-fixed-indexed-annuity-sales (citing Wink, Inc. market research). W&SFG has three businesses that market fixed-indexed annuities through independent agents. These businesses estimate that independent agent sales of fixed-indexed annuities comprise 25-50%, 25-50%, and 75-100% of total sales, respectively.

[13] *See* 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, 83-1, 84-24 and 86-128, 82 Fed. Reg. 16,902 (April 7, 2017).

[14] *See* Proposed Best Interest Contract Exemption for Insurance Intermediaries, 82 Fed. Reg. 7,336 (Jan. 19, 2017).

[15] For example, one of our businesses estimates that 75-100% of its indexed annuities are sold by independent agents unaffiliated with an IMO.

As an alternative to expanding the types of entities that can qualify as a Financial Institution, the Department should consider completely eliminating the Financial Institution requirement. The preferable approach to help ensure that retirement investors continue to have access to advice and products, however, is to promulgate a new principles-based exemption that is agnostic to product type, compensation structure, and business model and is appropriately coordinated with other regulators. This approach is discussed further in Part III below.

B. Unintended, Negative Consequence: Decreased Annuity Variety, Decreased Innovation, and Increased Costs to Consumers

In the RFI, the Department asks whether the Fiduciary Regulation appropriately balances the interests of consumers in receiving broad-based investment advice while protecting them from conflicts of interest, whether the rule allows advisers to provide a wide range of products that can meet each investor's particular needs, and whether the warranty and contract requirements of BICE are necessary to incentivize compliance with the impartial conduct standards.[16] The Fiduciary Regulation does not strike an appropriate balance and the warranty and contract requirements are not necessary to incentivize compliance. Rather, these requirements will result in less variation among annuity products and their benefits and features, decreased innovation in the annuity marketplace generally, and increased costs to consumers as a result of, among other things, class action litigation.

Unless delayed,[17] BICE will require in most situations an enforceable written contract between the Financial Institution and retirement investor that includes, among other provisions, a warranty that the Financial Institution does not rely on differential compensation that is intended or would reasonably be expected to cause advisers to make recommendations that are not in the retirement investor's best interest. Notwithstanding that broad warranty, differential compensation is permitted to the extent "that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries (such compensation practices can include differential compensation based on neutral factors tied to the differences in the services delivered to the Retirement Investor with respect to *the different types of investments*, as opposed to the differences in the amounts of Third Party Payments the Financial Institution receives in connection with particular investment recommendations."[18]

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[16] 82 Fed. Reg. at 31,279-31,280 (July 6, 2017) at questions 3, 5, and 6.
[17] W&SFG reiterates its strong support of a further delay of the remaining conditions within BICE that will become effective on January 1, 2018. *See* letter of Western and Southern Financial Group, Inc. dated July 19, 2017, *supra* note 7.
[18] 81 Fed. Reg. at 21,077 (April 8, 2016) (emphasis added).

In an FAQ, the Department provided this additional explanation: "[F]irms can pay different commission amounts for different *broad categories of investments* based on neutral factors. Under this approach, the firm eliminates variations in commissions within reasonably designed investment categories, but variation is permitted between these categories based on neutral factors, such as the time and complexity associated with recommending investments within different product categories. *Thus, for example, a firm might adopt one commission structure for mutual fund investments, while providing a different structure for annuities, assuming there is a neutral basis for the distinction.*"[19] Thus, this warranty essentially requires financial services companies to levelize commissions *within* "types of investments" and justify any differences in commissions *between* "types of investments" based on differences in services delivered to the retirement investor, not differences in revenue to the Financial Institution.

First, we believe this is an inordinate and counter-productive regulatory intrusion into private business. W&SFG assesses numerous factors to determine commissions on each product as both a manufacturer and as a distributor of financial services products. In lieu of interfering in that process, compliance with the impartial conduct standards should address the Department's concerns in this area. Second, W&SFG believes this requirement will result in decreased choice of investments generally and, in our experience, annuities specifically. If annuities with all of their variations and differing structures are considered one "type of investment," as suggested in the FAQ, levelization is practically impossible. Even if one considers each of fixed annuities, fixed-indexed annuities, and variable annuities as different "types of investments" levelization is extremely difficult, because variations in product design usually require commensurate variation in commission rates. The end result is that products within a type of investment will become less varied with respect to features and benefits enjoyed by retirement investors and therefore less likely to meet the differing needs, financial circumstances, risk tolerances, and objectives of those retirement investors.

At W&SFG, we are already seeing a decrease in retirement investor choice, even though the warranty and best interest contract are not required until January 1, 2018. One of our insurers manufactures a variable annuity specifically designed for the retirement market with subaccounts that invest in exchange-traded funds instead of mutual funds. This product has a lower all-in cost to the retirement investor and a lower commission to the agent. This product is no longer being offered by several of our distribution partners because the commission is *too low* to meet the partner's levelized commission rate for variable annuities. Unfortunately this *decrease* in product variation and *increase* in commission rate is an inevitable negative impact to retirement investors as a result of the Fiduciary Regulation.

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[19] Conflict of Interest Exemptions FAQs, Q9, p. 7 (Oct. 27, 2016), *available at* https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf (emphasis added).

The annuity marketplace is replete with product innovations intended to meet customer needs. The exact same product is often offered with multiple surrender charge options. For example, all of our fixed-indexed annuity products offer both a 7-year and a 10-year surrender charge period. The 7-year version provides the agent with a lower commission because the insurance company will have a shorter investment horizon. In addition, the marketplace provides different methods of paying these commissions. An annuity may offer an all up-front commission, a partial up-front plus trail commission, or a level commission throughout the surrender charge period. These commission payment options are intended to provide the agent with the same total commission (taking into account the time value of money), paid at different times. Annuities may also offer living benefit riders, death benefit riders, and a variety of other features that meet certain retirement investor needs.

Notably and importantly, in all of these instances, the commission is paid by the insurance company to the agent. This is *not* like mutual funds where a sales charge is paid by the consumer and deducted from the amount actually invested in the fund. These annuity commissions are priced as part of the product design so that most if not all of the retirement investor's premium is credited to the annuity contract value. A change in the commission affects either the benefit to the consumer (i.e. the credited interest rate) or the profit/loss to the insurance company, or both. Returning to the above-referenced variable annuity, when distributors indicated that they wanted to levelize variable annuities at a higher commission than currently paid by our insurer, we were unable to increase the commission on this variable annuity, retain a competitive benefit to the customer, and make a reasonable profit. So, consumers lost the option of a lower cost variable annuity directly as a result of the levelization requirement.

Clearly the BICE warranty requirement is a significant impediment to advisers' continued ability to provide a wide range of products to meet the also wide range of retirement investor needs. Similarly, the BICE contract requirement and resultant litigation risk does not appropriately balance the needs of retirement investors to have access to and receive investment advice against the Department's stated goal to protect retirement investors from perceived conflicts of interest. Given that BICE appears to be intended to be enforced primarily through class-action litigation,[20] the great majority of lawsuits that are filed will likely not involve discrete, individual situations where an agent truly failed to act in a retirement investor's best interest, thereby causing real harm and identifiable damages. Rather the conflicts created by the class action enforcement mechanism will result in lawsuits surrounding technical compliance with the detailed requirements of the exemption. For example, a three-day website outage could be a failure to meet BICE's requirement that a retirement investor have on-line access to his best interest contract, resulting in a class action lawsuit, or a plaintiff's attorney could

[20] *See, e.g.* 81 Fed. Reg. at 21,043 (April 8, 2016) ("[T]he option to pursue class actions in court is an important enforcement mechanism for Retirement Investors.").

challenge the sufficiency of a description of third-party payments through class action litigation. Unfortunately, the only individuals who will really benefit in these types of scenarios are class action plaintiffs' attorneys.

The inevitable increased expenses firms will incur due to BICE class action litigation will be passed on to retirement and other investors, leading to higher costs for retirement products and services. A Morningstar analysis predicted annual *settlement* costs of up to $150 million for the financial services industry.[21] This annual cost number does not include the associated legal and business expenses borne in connection with those settlements, which could increase the actual costs by multiples.

Notably and importantly, the industry is now complying with the impartial conduct standards without the best interest contract and its warranty requirements. The financial services industry is already highly regulated and all of the qualified sales covered by the Fiduciary Regulation are already covered by state sales practice statutes, state insurance regulations, state securities regulations, and/or federal securities regulations and self regulatory industry rules. As noted by industry trade organizations,[22] with respect to annuity sales, a robust regulatory framework already exists, now bolstered for retirement investors by the impartial conduct standards. Leveraging this existing framework or, at the very least, modeling an enforcement mechanism off of the existing framework is preferable to an enforcement mechanism that will benefit class action plaintiff's attorneys far more than consumers.

C. Unintended, Negative Consequence: Decreased Advice on Existing Annuity Contracts

Yet another unintended, negative consequence of the Fiduciary Regulation is a decrease in the availability of investment advice regarding existing financial services products, accounts, and relationships. In particular, we have already seen a decrease in the availability of investment advice for retirement investors with existing annuity contracts. The RFI again tacitly acknowledges the problem by asking "To what extent are firms and advisers relying on the existing grandfather provision? How has the provision affected the availability of advice to investors? Are there changes to the provision that would enhance its ability to minimize undue disruption and facilitate valuable advice?"[23]

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[21] Michael Wong, *Fiduciary Rule Lawsuits Could Spur Industry Reform*, MORNINGSTAR (April 3, 2017), *available at* http://www.morningstar.com/cover/videocenter.aspx?id=801452.

[22] For a good overview of the regulations relating to annuity sales, please see the comment letter with respect to the initial Fiduciary Regulation proposal of ACLI (July 21, 2015) *available at* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00621.pdf. *See* page 50 and Appendix.

[23] *See* 82 Fed. Reg. at 31,278 (July 6, 2017) at question 16.

As both a manufacturer and distributor of flexible premium annuities, W&SFG is well aware of the difficulties that the Fiduciary Regulation's grandfathering approach presents. These prior sales are, in fact, contractual relationships directly between the insurer and the annuity owner that permit the annuity owner to make additional deposits. In addition, the insurer has a contractual relationship with the applicable agent to pay additional commissions on subsequent deposits for that annuity. Pursuant to these contracts, when a consumer sends one of the W&SFG insurance companies a subsequent annuity premium, the W&SFG insurer has an obligation to deposit the funds and send compensation to the agent and, if applicable, the agent's firm. The agent could have: (i) specifically recommended the deposit; (ii) previously recommended systematic deposits; or (iii) not made any recommendation or had any involvement in the deposit at all. Under the Fiduciary Regulation, the first scenario would require a new exemption, the second scenario could be eligible for grandfathering under BICE, and the third scenario would not require an exemption at all.

In any event, the insurance company will often not know which scenario applies, and the agent's firm (if any) may not have practical methods to ensure that its agents are complying with an exemption or the grandfathering provisions, as applicable. This creates yet another unnecessary breeding ground for class action litigation that will likely provide little or no substantive benefit to retirement investors. Moreover, levelizing compensation on these existing contracts requires either: (i) an intermediary that can artificially levelize to the agent, which is not available in the independent agent channel, or (ii) changes to existing contracts, which is impracticable.

Facing these difficulties, many distributors of annuities have "orphaned" annuity contracts by cutting off advisers from providing advice on these existing contracts and refusing to accept or pay additional trail compensation relating to those contracts.[24] The insurance company that issued the contract is often left with a direct relationship with the annuity contract holder, but has not traditionally provided advice or recommendations to these contract holders. Rather, the insurance company has provided account and other administrative services.

We have previously recommended that, at least with respect to insurance products (including annuities), meaningful grandfathering needs to be *product-related*, not recommendation-related. All compensation relating to products sold prior to the effective date of the rulemaking should be grandfathered. Alternatively, a principles-based exemption (as discussed in Part III below) would also help address this issue. If a new exemption required policies and procedures reasonably designed to ensure that advisers

[24] One public example is State Farm Insurance Company, which is cutting off further advice with respect to mutual funds and variable annuities. *See* Greg Iacurci, *State Farm citing DOL fiduciary rule cuts agents from mutual fund and variable annuity sales*, INVESTMENTNEWS (Sept. 12, 2016) *available at* http://www.investmentnews.com/article/20160912/FREE/160919992/state-farm-citing-dol-fiduciary-rule-cuts-agents-from-mutual-fund.

satisfy fiduciary duties (as opposed to specific transactional requirements), these practical grandfathering issues would be significantly less problematic.

The problems with the Fiduciary Regulation are voluminous. Above are merely three primary examples of the unintended, negative consequences that are or will result if the Fiduciary Regulation is not revised or rescinded. Unfortunately, as addressed below in Part II, the RFI suggests the Department is contemplating an approach to solving these unintended, negative consequences that will unfortunately only compound them.

II. Additional Exemptions are Not the Answer.

In the RFI, the Department notes that it is continuing to review comments received in response to the March 2, 2017, request for comments on issues raised in the Presidential Memorandum,[25] but that it is also "interested in receiving additional input from the public about possible additional exemption approaches or changes" to the Fiduciary Regulation.[26] The Department continues by noting that "recent innovations in the financial services industry" may make new and more streamlined exemptions and compliance mechanisms a possibility, and indicates that mutual fund clean shares and fee-based annuities are examples of such innovations.

W&SFG is very concerned with the overall suggestion in the RFI that *more specialized* exemptions is a potential solution to the unintended, negative consequences resulting from the Fiduciary Regulation. As explained in the FSR comment letter submitted contemporaneous with this letter, streamlined exemptions for particular products could have the unintended consequence of compelling institutions to focus solely or excessively on such "favored" products, which may not be in the retirement investor's best interest. These favored products would have the practical effect of limiting choice and potentially affecting returns for retirement investors.

The Fiduciary Regulation already raises significant concerns regarding governmentally chosen winners and losers. First, BICE provides streamlined compliance and less litigation risk for the investment adviser model than the commission model of broker-dealers and insurance agents.[27] Second, the Department determined that fixed-indexed and variable annuities require more protections than fixed annuities and revoked PTE 84-24 for these annuities.[28] Third, BICE itself requires that a "Financial Institution"

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[25] *See, generally,* 82 Fed. Reg. 9,675 (Feb. 7, 2017).
[26] 82 Fed. Reg. at 31,279 (July 6, 2017).
[27] 81 Fed. Reg. at 21,083-21,084 (April 8, 2016); BICE § II(h) (making numerous requirements of BICE inapplicable to "Level Fee Fiduciaries", which is defined as an entity and adviser that only receives compensation that is "provided on the basis of a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee").
[28] *See* 81 Fed. Reg. at 21,157-21,158 (April 8, 2016) ("In light of the ways in which these products have developed, and the concerns articulated by other regulators and the commenters regarding the complexity,

sign-off on each transaction, which disfavors the independent agent distribution of fixed-indexed annuities (see Part I.A above). Even when the Department recognized this problem and proposed the IMO BICE, it imposed additional obligations on insurance intermediaries than is required of a bank, broker-dealer, registered invested adviser, or insurance company under BICE.[29]

The Department's questions regarding fee-based annuities show how the Department's current exemptive approach is needlessly complex and bound to fail.[30] First, "fee-based annuities" have been available for many years, so the Department's assertion that these have been developed in response to the Fiduciary Regulation is surprising. Fee-based annuities appear to be proliferating in the wake of the Fiduciary Regulation, but not because they will benefit retirement investors, but because they may be subject to fewer Fiduciary Rule-related regulatory burdens.

A "fee-based annuity" is not a defined term in the RFI or elsewhere. The Department could mean an annuity product in which the insurance company pays the agent a level commission during the surrender charge period or during the life of the annuity (e.g. 1.00% annually). In this arrangement, the commission is paid on the initial annuity premium, not a fluctuating value. This type of annuity is really an alternate way of paying what is otherwise an up-front commission and most in the industry would not refer to this as a "fee-based annuity." Alternatively, the Department could be referring to an annuity with no commission paid by the insurance company, but instead the *consumer* pays the agent a level fee during the life of the contract. This payment can be charged to a separate brokerage account held by the consumer, be paid separately by the consumer, or, in some instances, deducted from the annuity and paid to the adviser. The last option is less common because it results in lower benefits to the consumer.

In the latter scenario, the retirement investor will likely pay *more* for advice relating to the annuity than she would if the insurance company paid the agent a traditional up-front commission. While, the insurance company will increase the benefit

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risks, and enhanced conflicts of interest associated with them, the Department determined that the conditions of PTE 84-24 are insufficiently protective to safeguard the interests of plans and IRAs investment in these products").

[29] *See* 82 Fed. Reg. 7,336 (Jan. 19, 2017). Additional requirements under IMO BICE include (i) the IMO must approve all written marketing materials; (ii) the designated person responsible for ensuring adherence to the impartial conduct standards must approve each recommendation before it is transmitted to the insurance company; (iii) the contract between the IMO and adviser must contain certain provisions regarding marketing materials and compliance with IMO BICE; (iv) compensation must be paid in one of two ways; (v) the IMO must conduct annual training on specified topics; (vi) additional disclosures must be provided and reviewed orally with the client; and (vii) the IMO must maintain a copy of its audited financial statements on a website.

[30] 82 Fed. Reg. at 31,280 (July 6, 2017) at question 8 (Among others, the questions include,"How would advisers be compensated for selling fee-based annuities? Would all of the compensation come directly from the customer or would there also be payments from the insurance company?...Would payments vary depending on characteristics of the annuity?")

to the consumer because it is not paying an insurance commission, the client will either pay the commission separately or decrease his annuity contract value to pay the commission. In both situations, the never-ending commission could amount to a significantly higher amount than the increased benefit.

Ultimately, fee-based annuities have been unpopular because, among other things, annuities are typically long-term products. Once recommended and purchased, clients typically plan to hold the annuity over a long period of time. If an annuity is utilized for a guaranteed income stream, it may be held until the client and potentially his/her spouse passes away, which could be a still longer period. This is a far different scenario than an investment adviser making recommendations in a fee-based registered investment advisory wrap account.

Overall, fee-based annuities (however defined) may be in the best interest of retirement investors with certain needs or financial circumstances. But they and other products developed to meet certain retirement investor needs should not need or have a specific exemption. Moreover, the focus of product development should remain on meeting the varied needs of retirement investors and not be focused on avoiding regulatory burdens. As such, the Department should not go down a rabbit's hole of exemption drafting for a particular product type, a particular business model, or a particular compensation method.

III. The Solution is a Principles-Based Exemption and Coordination with Other Regulators.

In lieu of a quagmire of exemptions that vary based on the product, the compensation structure, or the business model, the Department should propose a simplified, principles-based exemption that is agnostic to the varying financial services entities, products and services, as well as differing methods of delivering those products and services. In addition, the Department should more closely coordinate with other financial services regulators, including the SEC. In two prior comment letters, W&SFG has argued that the existing exemptions should be scrapped and replaced with a "safe harbor" that will permit a fiduciary and its affiliates to develop and adhere to reasonably designed compliance procedures and processes to meet their respective fiduciary duties. This approach will better address the Department's stated goals, better preserve retirement investors' access to retirement products and advice, and build on and not conflict with current regulatory schemes and related requirements.

The Department gets closer to this approach by asking whether the Department could "base a streamlined exemption on a model set of policies and procedures, including policies and procedures suggested by firms to the Department."[31] W&SFG does not

[31] 82 Fed. Reg. 31,278 (July 6, 2017) at question 10. The Department continues, "Are there ways to structure such a streamlined exemption that would encourage firms to provide input regarding the design of

think that one set or multiple sets of "model" policies and procedures is the appropriate approach, as this would suffer the same problem as a product-based exemption – it would be an inappropriate level of government intrusion in how businesses operate, would stymie innovation, and would require endless tailoring for any innovation that did occur. However, a principles-based exemption that requires a fiduciary to develop and adhere to policies and procedures that are reasonably designed, based on its business model, to result in compliance with fiduciary duties would not limit product, business model, or compensation variety and would instead spur innovation of compliance structures and, as appropriate, related technologies, all to more effectively and efficiently ensure fiduciary duties and retirement investor needs are satisfied.

This approach could be enforced with a requirement of internal and/or third-party examinations of the effectiveness of policies and procedures and related controls with reporting to the Department of material weaknesses and/or when appropriate imposition of excise taxes in accordance with the Internal Revenue Code. But, if an adviser or firm generally adopts and adheres to reasonable policies and procedures to mitigate and disclose conflicts of interest, otherwise acts in a client's best interest, and charge reasonable fees, inadvertent failures should not result in excise taxes or other liability. A fiduciary is generally expected to have a reasonable process for determination of the reasonableness of compensation for engaging a third party to provide a product or service to a plan, such as requiring multiple bids. A principles-based exemption, unlike BICE, would permit similar reliance on reasonable processes related to meeting the best interest standard, managing conflicts of interest, and determining reasonableness of compensation – all to the benefit of retirement investors without unintended, negative impacts to access to retirement advice, products and services.

Furthermore, such a principles-based exemption should be coordinated with other regulators. The Department asked whether a streamlined exemption could be developed for advisers that comply with or are subject to standards adopted by the SEC or other regulators.[32] While the Department should not adopt a streamlined exemption that favors one business model over another, the Department should coordinate closely with the SEC and other regulators, including the National Association of Insurance Commissioners and the Financial Industry Regulatory Authority. As noted by IRI in its comment letter submitted contemporaneously with this letter, these regulators have valuable expertise regulating certain segments of the financial services industry impacted by the Fiduciary Regulation. We are encouraged by recent public comments from Secretary Acosta, other Department officials, SEC Chairman Jay Clayton, and SEC Commissioner Michael

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such a model set of policies and procedures? How likely would individual firms be to submit policies and procedures suggestions to the Department? How could the Department ensure compliance with approved model policies and procedures?"

[32] 82 Fed. Reg. 31,278 (July 6, 2017) at question 11.

Piwowar regarding the need for regulatory coordination.[33] This coordination should focus on a uniform standard of conduct that will apply to all recommendations made by financial professionals with respect to any securities or insurance product with businesses free to meet that uniform standard through adoption and adherence to reasonable policies and procedures.

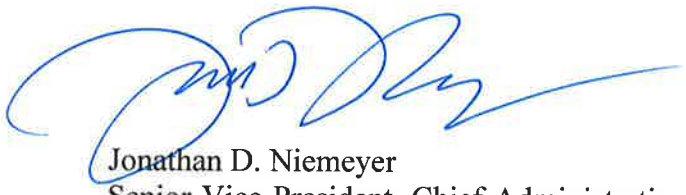
As discussed in this letter, a patchwork of prohibited transaction exemptions is already depriving retirement investors of varied financial services products, will further stifle innovation, and will continue to result in less investment advice and increased costs. A patchwork approach implicitly, and sometimes explicitly, indicates that certain products, business models, and compensation structures are more conflicted, more problematic, and requiring of more restrictions – which is simply not the case. Accordingly, if the Department retains the current very broad definition of fiduciary, then it must provide an equally broad exemption that accounts for the various ways that retirement investors can receive and have access to investment advice and products, both today and in the future.

America is, and should continue to be, a leader in financial product and service innovation. American retirement investors of all types and across the economic and geographic spectrum should have access to and benefit from our robust marketplace for financial advice and investment options. But, if the federal government takes a proscriptive approach about how these products are sold to retirement investors and, worse, imposes different restrictions based on who the seller is, what the product is, how the seller is compensated, or how the sale is otherwise regulated, we are concerned that today's robust marketplace, and retirement investor choice and access to advice will be significantly diminished.

[33] *See, e.g.*, comment letter of Michael S. Piwowar (July 25, 2017), *available at* https://www.sec.gov/news/public-statement/piwowar-comment-dol-fiduciary-rule-prohibited-transaction-exemptions. *See also* public statement of SEC Chairperson Jay Clayton (June 1, 2017), *available at* Available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.

Once again, W&SFG appreciates the opportunity to comment on the Fiduciary Duty Rule and its potential impacts to retirement investors, as well as on the questions raised in the President's Memorandum. If you have any questions regarding our comments or if we can be of any assistance in your consideration of the issues discussed above, please contact Sarah Sparks Herron at 513-357-4055 or sarah.herron@westernsouthernlife.com or me. Thank you.

Sincerely,



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