August 7, 2017

TO:
The Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11933
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Submitted Electronically -- EBSA.FiduciaryRuleExamination@dol.gov

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

Ladies and Gentlemen:

The Association for Advanced Life Underwriting ("AALU") appreciates the opportunity to respond to the Department of Labor's ("Department") Request for Information ("RFI")[1] regarding the Department's regulation redefining fiduciary investment advice and its related prohibited transaction exemptions (collectively, the "Fiduciary Rule" or "Rule").[2] This letter responds to the remaining issues in the RFI not addressed in our previous letter of July 21, 2017.

As we explained in our comment letter dated April 17, 2017, millions of Americans could have been spared unnecessary costs, confusion, and loss of access to retirement savings products and services had the Department delayed the applicability date of the Rule until it had completed the review ordered by President Trump in his February Memorandum.[3] Instead, the Department has imposed most of the Rule's provisions during the Transition Period from June 9, 2017 to December 31, 2017, with full implementation scheduled for January 1, 2018.

Had the Department completed its review and then acted, it would have been necessary to undergo only one round of regulatory change, avoiding the cost and confusion resulting from multiple rounds of change. Indeed, in justifying the limited delay of 60 days from April 10 to June 9, the Department itself recognized as much, writing:

> *"if the examination [resulting from the President's Memorandum] prompts the Department to propose rescinding or revising the rule, affected advisers, retirement investors and other stakeholders might face two major changes in the regulatory environment rather than one. This could unnecessarily disrupt the marketplace, producing frictional costs that are not offset by commensurate benefits."*[4]

1 82 Fed. Reg. 31,278 (Jul. 6, 2017).
2 81 Fed. Reg. 20,945 – 21,221 (Apr. 8, 2016).
3 President's Memorandum, 82 Fed. Reg. 9,675 (Feb 7, 2017).
4 82 Fed. Reg. at 12,320.

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This same mistake will be repeated if the Transition Period is not extended enough to permit the current review represented by the RFI to be completed. Accordingly, we reiterate our request that the Department extend the Transition Period by at least one year, to January 1, 2019. Only such an extension will provide the Department the time its needs to analyze the issues addressed by the current RFI, and to coordinate with the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), state insurance commissioners, the U.S. Congress, and other Federal and State regulatory entities.

We do appreciate that the Department has begun a process with this RFI that may still lead to a resolution that is in the best interest of retirement savers. While our members remain convinced that the best course of action would be to rescind the Rule, we recognize that the Department may ultimately decide to significantly modify the Rule instead. Accordingly, in order to give the Department the full benefit of our members' experience, we offer our comments below addressing a number of significant issues relating both to the prohibited transaction exemptions and to the text of the fiduciary definition. Refer to our comment letter dated July 21, 2017, for an explanation of both the flaws in the DOL process during the promulgation of this Rule and the real-world harm to retirement savers since implementation began in April 2016.

Our Members Put Our Clients First to Help Guarantee Their Retirement Security

AALU is the leading organization of life insurance professionals who are a trusted voice on policy issues impacting Americans' financial security and retirement savings. Our 2,200 members are primarily engaged in providing life insurance planning solutions for individuals, families, and businesses nationwide.

The role of life insurance and annuity products has never been as crucial to the long-term retirement security of average savers as it is today—with insurance-based solutions providing protection against very serious risks that can devastate retirees and their families. Longevity risk, market loss risk, and distribution timing risks are very real, and can cause retirement savers to be left without a secure retirement when they are at their most vulnerable. Our members play a crucial role by helping retirement investors understand and guard against these risks with life insurance products that provide security. Outside of defined benefits plans, only annuities can offer a guaranteed income stream for your entire life.

Yet the Fiduciary Rule, with its misplaced bias against commission-based compensation, is fundamentally at odds with how most life insurance and annuity products are structured, and has already caused a material reduction in usage of these vital products in retirement planning.

According to the Life Insurance and Market Research Association Secure Retirement Institute's First Quarter 2017 U.S. Retail Annuity Sales Survey, annuities sales were down 12 percent in the first quarter of 2017 compared to the year before, the fourth consecutive quarter of decline. Todd Giesing, assistant research director for the Institute, wrote, "Despite an improvement in the equities market and interest rate environment, uncertainty around the DOL rule overwhelmed any impact it may have had on annuity sales."[5] This is just one example of the reduction of choice and access for American savers.

AALU Members Have Invested Havily in Compliance with the Rule

As life insurance professionals, we work in the best interest of retirement savers every day, enabling individuals and families from all economic brackets to maintain independence in the face of potential financial catastrophe, and to build and guarantee retirement income.

5 "LIMRA Secure Retirement Institute: First Quarter 2017 Annuity Sales Decline," press release, May 18, 2017.

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In Question 2, the RFI asks what has been done to comply with the Rule. AALU members have devoted a considerable amount of time and resources to educate and train insurance professionals to ensure compliance with the Rule. Since June 9th, our members have focused on the Impartial Conduct Standards, working to ensure that a prudent, thorough, and well-documented process taking into account all relevant factors is employed in making recommendations to clients. Insurance carriers, insurance intermediaries, insurance brokers and insurance agents have all worked diligently and in good faith to meet the requirements of the Rule in the Transition Period.

Unfortunately, as we noted in our previous letter of July 21, 2017, unless the Transition Period is extended to allow time for the Department to complete its review and rescind or make fundamental changes to the "full" Best Interest Contract Exemption ("BIC Exemption") and the revised Prohibited Transaction Exemption 84-24 ("PTE 84-24"), the January 1, 2018 applicability date will severely disrupt these efforts.

In Question 4 of the RFI, the Department asks about the costs and benefits of implementing the remaining exemption requirements. The end of the Transition Period will usher in even more restrictions, reducing access to advice from life insurance professionals.

- Independent Insurance Professionals are Prevented from Serving Customers

Unless the "full" Best Interest Contract Exemption ("BIC Exemption") and the limited Prohibited Transaction Exemption 84-24 ("PTE 84-24") scheduled to become applicable on January 1, 2018 are rescinded or substantially modified, independent life insurance agents will be effectively prohibited from recommending certain types of annuities under any circumstances.

As we explain in more detail below in response to Question 17, the revised PTE 84-24 would no longer apply to all types of annuities, and the "full" BIC Exemption would require a financial institution to accept fiduciary liability for independent agents they do not directly supervise (which they are unlikely to do). The result is that a large number of skilled life insurance professionals literally will be unable to recommend some annuity products—no matter how much those products are in the best interest of retirement savers—because no exemption would permit them to receive compensation in the form of a commission. This "gag on advice" is despite the fact that those life insurance professionals are already operating under a fiduciary standard of care to act in the best interest of their clients, and must already ensure that their compensation is reasonable.

It is hard to discern any benefits resulting from implementing the deferred portions of the BIC Exemption or PTE 84-24. As the Department itself concluded in its April 7, 2017 regulation establishing the Transition Period, the Rule's benefits to retirement investors come from the Impartial Conduct Standards.[6] As life insurance professionals are complying with these standards already, there are few benefits if the deferred requirements were to be applicable. There are, however, substantial costs.

An Improper Balance—the Rule Results in a Loss of Choice and Access to a Wide Range of Retirement Savings Products Meeting their Individual Needs

RFI Question 3 asks whether the Rule has properly balanced the need of access and protection to "allow Advisers to provide a wide range of products that can meet each investor's particular needs?"[7] The answer is clearly "No."

6 *See*, 82 Fed. Reg. 16,907 and 16,909-10 (Apr. 7, 2017).
7 82 Fed. Reg. at 31,279.

One of the key reasons is that the Department has decided that so-called "level" fees are preferable to commissions where compensation may vary, resulting in a Rule that is heavily biased in favor of fee-based compensation. The reality, though, is that life insurance and annuity products have always been largely commission-based, a system developed through decades of regulation and supervision by State and Federal regulatory entities. In fact, many states review and approve the commissions that can legally be charged for certain insurance-based products. As a result, the Department's Rule requiring level compensation can conflict with the rules and regulations governing compensation enforced by other regulators.

This imbalance also makes it difficult to serve the needs of small employer plans, such as SIMPLE IRA plans. While these are ERISA plans, each participant's account is funded through an IRA in the name of that individual. These plan designs were created expressly to make it easier for small employers to offer their employees a plan, but the Rule makes it very difficult to reasonably charge fees in the best interest of participants if the "full" BIC Exemption applies after January 1, 2018. This is because the Rule generally will not allow advisors to receive differential compensation, such as from different classes of mutual funds. The reality, though, is that for new SIMPLE IRAs and those that do not yet have enough assets to qualify for NAV pricing on an aggregated plan level, the most efficient way to assess plan fees in the best interest of participants is through a choice between A or C share classes in each IRA. The bias against commissions makes it very difficult to do so after January 1.

The Department asks in Questions 7, 8, and 9 whether new innovations in the marketplace, such as fee-based annuities or mutual fund clean shares and T-shares, should be the subject of new exemptions, and how such products and the potential exemptions would be structured. While we do not object in principle to such product-specific exemptions and likely would support workable exemptions with reasonable conditions, we think there are several reasons why a broad-based exemption modeled on the Transition BIC Exemption and focused on reasonable fees, rather than a level fee, is needed as well. One problem is that those exemptions would capture "a moment in time" in regulatory text, rather than establishing a flexible exemption that can accommodate these and future innovations that might better serve consumers.

Another is that these exemptions, again, focus on level compensation and on eliminating commissions, rather than on reasonable compensation. The issue should not be the form of payment, but its reasonableness.

- Reasonable vs. Level—Amortizing Fees Over the Duration of the Investment

The Department has struck the wrong balance in its focus on the structure of compensation. Rather than trying to force all retirement products into one type of fee-based compensation model, the Department should instead focus on whether the compensation—by whatever method received—is reasonable. Arbitrarily limiting access to investments that have reasonable fees just because they are paid as a commission is harming the retirement saver and reducing access to a wide array of products and advisors.

The Rule is biased against commissions in part because it does not properly view the true cost to savers amortized over the life of an investment. The issue is not whether compensation in year one is higher or lower than another type of investment—the issue is whether the cost to the retirement saver is reasonable over the duration of that investment. Retirement savers are typically investing for the long-term whether in life insurance products or other investments, making this the proper analysis. Here is a simple example:

- A fee-based advisor receives a 1% level fee every year advising on a $100,000 investment. Over 10 years, that is $10,000 in fees (assuming no gains or losses in the account).
- A commission-based advisor receives a 5% commission in year one, and a 1/4% trailing commission in subsequent years. Over 10 years, that is $7,250 ($5,000 in year one and $250 in each of the following nine years).

As this example shows, a larger upfront commission can be more affordable than a fee-based structure—it is simply a different way to charge a fee. The total fee received by the commissioned agent is actually less than the fee received by the level fee advisor. By focusing on the fee differential in the first year, the Rule's bias is actually reducing access to lower-cost investment in this example. The Rule's preference for level fees rather than reasonable fees will limit access and choice.

- Reverse Churning

The SEC clearly recognizes the value of commission-based accounts for retirement savers. In 2014, the Commission listed combatting reverse churning—putting clients that aren't actively trading into fee-based accounts when a commission-based account would be a better, more affordable option—as an important priority. Many investors execute buy and hold strategies, with little to no trading over a number of years. For these savers, a fee-based account would mean paying an annual fee despite not needing or receiving any advice or services. A commission-based account would be more appropriate, only charging them when they need service from their advisor. The Rule's bias in favor of fee-based advisory accounts could effectively force savers into less affordable arrangements.

The Department Should Make Permanent the Transition Version of PTE 84-24

In Question 17, the RFI seeks information about the best means to facilitate advice regarding annuities, whether through changes to PTE 84-24 or to the BIC Exemption. It also asks whether such changes would result in any competitive advantages for annuities relative to other products, such as mutual funds, that may only be eligible for the BIC Exemption.

The reality is that the ability to give annuity advice has been significantly impaired under the Rule. The revised version of PTE 84-24 that will go into effect on January 1, 2018 reverses decades of consistent treatment of annuities, and will only be available for fixed-rate annuities. Other types of annuities, such as variable and fixed indexed annuities, would have to use the BIC Exemption. This causes several significant problems that will disadvantage retirement savers.

- Independent Life Insurance Professionals Must Be Able to Advise Clients on All Life Insurance and Annuity Products

First, as referenced above, this is effectively a "gag on advice" for independent life insurance agents because they will not have a financial institution willing to enter into a BIC Exemption arrangement on the their behalf, and will no longer be able to use PTE 84-24. The insurance intermediaries with which many independent agents work were excluded from the definition of financial institution in the BIC Exemption, leaving only insurance carriers. While the Department tried to argue that insurance carriers could act as financial institutions for independent agents, the reality is that insurance carriers are not likely to take on the risks and liabilities of the BIC Exemption for agents they do not directly supervise.[8]

8 See, e.g., Conflict of Interest FAQs, (Part I- Exemptions), Q21., October 27, 2016.

The Department proposed an insurance intermediary class exemption at the end of the Obama Administration that would allow a small number of insurance intermediaries to act as financial institutions through a parallel exemption modeled on the BIC Exemption.[9] However, this controversial proposed class exemption was rushed out by the Department and contained very restrictive conditions. There has been no additional discussion of this exemption from the Department since the end of the comment period, and the RFI does not make reference to it.

The Transition version of PTE 84-24 avoided these problems by retaining the original version of PTE 84-24 adopted in 2006, modifying it only to add the Impartial Conduct Standards. We strongly urge the Department to retain this approach, replacing the modified version of PTE 84-24 with the Transition version. Among the many benefits of this approach is that it does not result in wrenching regulatory change—advisors would be using the same exemption as they have been using historically, significantly reducing transition costs and confusion for retirement savers and advisors. The additional changes in the revised PTE 84-24 taking effect in January, such as revising the definition of commission, will serve only to cause additional confusion and difficulty, and are not necessary in light of the applicable Impartial Conduct Standards. The Transition version of PTE 84-24 builds on the familiar rules, ensuring access to advice in the best interest of retirement savers for a reasonable fee.

There is no competitive advantage to annuities resulting from PTE 84-24 compared to mutual funds. Just as PTE 84-24 has existed for decades, so too has PTE 77-4, providing an exemption for proprietary mutual fund advice. The BIC Exemption may provide an additional alternative exemption as it is not product specific, but that is true for mutual funds as well as for annuities. We also note that the terms of PTE 84-24 require specific disclosures and other conditions that differ from the BIC Exemption. These additional requirements were developed by the Department to address the specific issues relevant to annuities.

The "Full" BIC Exemption Should Be Replaced with a Streamlined Exemption Modeled on the Transition BIC Exemption

The class action lawsuit provisions of the BIC Exemption will be extremely damaging to retirement investors, siphoning money out of the retirement system and into the pockets of trial lawyers through frivolous litigation. The contract requirements, with one-size-fits-all warranties and representations, should be removed from the BIC Exemption as well. The disclosure requirements of the "full" BIC Exemption are confusing, and impose significant compliance burdens that will ultimately be borne as costs by retirement savers. None of these add protections beyond those already provided by the Impartial Conduct Standards—in fact, they will harm retirement savers.

The Department can serve retirement savers by replacing the "full" BIC Exemption with a streamlined exemption modeled on the Transition BIC Exemption that requires adherence to the Impartial Conduct Standards. The streamlined exemption would also provide clear and concise disclosure of the advisor's financial interests, based on SEC, FINRA, and state insurance disclosure requirements. Most significantly, it would rely on reasonable compensation, as does the Transition BIC Exemption, rather than trying to artificially impose a "level" compensation requirement that simply does not work with many life insurance and annuity products.

The Department Should Expand the Exclusion of Sales Activity from the Definition of Fiduciary Advice

Question 18 asks about additional changes to the Rule or exemptions to benefit retirement investors. One essential change is to expand the exclusion from fiduciary advice for sales activity. In every version of the Rule, since its initial proposal in 2010, the Department has recognized that not all information provided in connection with an investment should be fiduciary advice.

9 82 Fed. Reg. 7,336 (Jan. 19, 2017).

Specifically, the Department noted that throughout the history of financial regulation in the United States, there has been a distinction between sales activity and investment advice. SEC Commissioner Piwowar recently wrote the Department that Congress had created the distinction in securities regulation 70 years ago, and urged the Department to remember that "The substantive regulation of broker-dealers and the tailored regulation of 'selling' and 'advice' activities are core principles of our securities regulatory regime that should not be overlooked."[10] The same has been true of life insurance regulation for even longer.

The Department should expand its current sales exclusion to more closely resemble the version it proposed in 2010. In the 2010 proposal, the sales exclusion covered conversations in which the recipient should have known he or she was receiving sales information and not advice.[11] In the 2015 proposal, the sales exclusion applied to the fiduciaries of plans with more than 100 participants. In the 2016 final regulation, it applied to fiduciaries managing more than $50 million in assets.

Retirement savers benefit from choice in the services they receive. AALU believes clear disclosure that information provided incident to a sale is not advice will protect retirement savers, and increase their access to appropriate information. A clearly defined and administrable sales exclusion will also eliminate many of the more difficult prohibited transaction problems created by the Rule as currently written, from commission fee structures to recommendations of proprietary products.

Ensuring Parity for Independent Agents in the Definition of Independent Fiduciary with Financial Expertise

Another necessary change it to fix a technical language problem harming independent life insurance agents. In its definition of fiduciary advice, the Rule excludes certain types of financial professionals—this ensures that investment product manufacturer sales representatives may explain their products to professional investment advisors without becoming fiduciaries themselves. To do otherwise would restrict the flow of information about products in the marketplace between financial professionals.

Unfortunately, the text of the regulation at §2510.3-21(c) is written in a manner that may not provide this same treatment to independent insurance agents. The text requires that the financial institution (bank, broker-dealer, insurance company, or registered investment adviser) for whom the advisor works be a fiduciary to the plan in order for the exclusion to apply to the advisor. Independent life insurance agents are agents of the insurance companies who products they recommend, but this does not necessarily establish a fiduciary relationship between those insurance companies and the client. The text must be amended to clearly apply to independent insurance agents to prevent inadvertent fiduciary status among financial professionals the Department never intended. AALU also would support a simplified solution in which recommendations made to licensed financial professionals are excluded from the definition of advice.

The Grandfather Provisions Need to Be Expanded and Updated

The Department should provide a new grandfathering provision related to the end of the Transition Period, and it should expand its application to provide greater utility. Specifically, the grandfather provision should provide that the terms of existing life insurance and annuity contracts entered into before the applicability date of the Rule continue to govern with respect to additional deposits into those accounts. Because such deposits may generate a commission, it is not practical to apply a new set of rules that may prevent the receipt of such a commission when the original agreement was lawful, valid, and agreed to by both parties.

10 "Comment Letter in Response to the Department of Labor's 'Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions,'" Securities and Exchange Commissioner Michael S. Piwowar, July 25, 2017.
11 75 Fed. Reg. at 65,276 (October 22, 2010).

A properly written grandfather provision would ensure that the Rule applies prospectively, but prevent it from reaching back to retroactively amend the terms of existing arrangements. It must also apply to the period after June 9th up to the adoption of any new version of the Rule.

Fiduciary Definition Should Exclude Recommendations to Invest Required Minimum Distribution ("RMD") Proceeds

The expanded definition of fiduciary investment advice includes, "recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA."[12]

The Department has taken the position that recommending how to invest the proceeds of a Required Minimum Distribution ("RMD") is fiduciary advice under this definition. The guidance uses the specific example of a life insurance sale in which the proceeds of an upcoming RMD are recommended as the source of funds to pay the premium.[13] This outcome should be beyond the scope of the Rule.

In an RMD situation, the Department concedes that the advisor has not recommended a distribution—the law compels the distribution. By continuing to apply the Rule to the reinvestment of the proceeds, the end result is a highly technical "booby-trap." If the producer recommends paying the premium with the proceeds before the distribution has happened, it is fiduciary advice. But the same recommendation made one day later after the distribution has been received, is not subject to the Rule. The application of the Rule should not turn on this technicality. Instead the Department should recognize that RMD's are a special case and exclude advice regarding the recommendation from the definition of advice.

Conclusion

Our members are committed to acting in the best interest of retirement savers, and have worked hard to comply with the Rule. While we believe rescinding the Rule is the best solution, and working with Congress to craft an appropriate approach, our comments here highlight important changes necessary to improve the Rule, should the Department retain it.

We appreciate the opportunity to comment, and look forward to working with the Department. We also believe that any changes to the Fiduciary Rule should be open to public comment before becoming final to ensure that retirement savers are not harmed. We would be happy to answer any questions you may have.

Sincerely,

David J. Stertzer
Chief Executive Officer
AALU

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12 29 CFR §2510.3-21(a)(1)(i)
13 *See,* Conflict of Interest FAQs (Part II -Rule), Q4., January 2017.

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