redefining / standards®

Nick Lane
Senior Executive Director and Head of U.S. Life and Retirement at AXA[1]
& Chairman, President and Chief Executive Officer of AXA Distributors, LLC
1290 Avenue of the Americas
15th Floor
New York NY 10104

September 24, 2015

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Room N-5655
Washington, DC 20210

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Suite 400
Washington, DC 20210

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

Dear Sir or Madam,

We appreciate the opportunity to supplement our initial July 21 submission and provide additional comments on the Conflict of Interest Proposed Rule and related exemptions (the Proposed Rule) released by the Department of Labor (the Department) on April 20, 2015.

In this supplemental letter, we discuss two additional concerns we have regarding the Proposed Rule:

- Issue #1: The Proposed Rule could be construed to conflict with tax laws under the Internal Revenue Code governing "Full-Time Life Insurance Salesman" (FTLIS) status, which would not only contravene Executive Orders 12866 and 13563, but could cause FTLIS agents who sell to retirement investors to lose valuable benefits provided to those agents and their families by their associated insurance companies; and

- Issue #2: Although the Department acknowledges that the Proposed Rule may result in a greater market share for passive investments,[2] it has not, as required by Executive Order

[1] "AXA" is the brand name of AXA Equitable Financial Services, LLC and its family of companies, including AXA Equitable Life Insurance Company (NY, NY), MONY Life Insurance Company of America (AZ stock company, administrative office: Jersey City, NJ), AXA Advisors, LLC (NY, NY) and AXA Distributors, LLC (NY, NY).
[2] Fiduciary Investment Advice, Regulatory Impact Analysis, April 14, 2015.

12866 and Office of Management and Budget (OMB) Circular A-4, considered the increased societal cost (i.e., systemic risk caused by reduced liquidity and higher market volatility) that would be created by this bias.

Accordingly, we respectfully request that the Department:

- Revise the Proposed Rule to eliminate the potential conflict between it and long-standing federal law; and
- Conduct an analysis of the Proposed Rule's costs and risks and then re-examine the Proposed Rule based on the findings of that analysis.

I. The Proposed Rule can be construed to conflict with existing federal law, in contravention of Executive Orders 12866 and 13563

A. Background

Federal rulemaking policy disfavors regulatory conflict. Thus, Executive Order 12866 provides that federal agencies "shall avoid regulations that are inconsistent, incompatible, or duplicative with its other regulations or those of other Federal agencies." Similarly, Executive Order 13563 states that "[i]n developing regulatory actions and identifying appropriate approaches, each agency shall attempt to promote . . . coordination, simplification, and harmonization."

Two provisions of the Proposed Rule: (i) the Best Interest Contract Exemption (BICE) and (ii) PTE 84-24 could be construed to preclude life insurance companies from providing their FTLIS agents who sell to retirement investors with important benefits, in conflict with the Internal Revenue Code. Specifically, life insurance companies rely on the FTLIS rules, which have been in place for over 60 years, to provide health, welfare, and retirement benefits to their FTLIS agents and FTLIS agents rely on the FTLIS rules to receive such benefits. If the Proposed Rule were construed to conflict with the FTLIS rules, it would not only be inconsistent with the Department's regulatory imperatives for rulemaking, but it would also run counter to established public policy in favor of quality, affordable health care for all Americans as set forth in the Patient Protection and Affordable Care Act.

Treasury Regulations define a FTLIS agent as an independent contractor "whose entire or principal business activity is devoted to the solicitation of life insurance or annuity contracts, or both, primarily for one life insurance company." [3] Internal Revenue Service guidance provides that an insurance agent will be deemed to be a FTLIS agent when, "pursuant to the terms and conditions of his arrangement with the life insurance company or its general agent, it is mutually agreed or clearly contemplated by the parties that the salesman's <u>entire or principal business activity</u> is the solicitation of application for life insurance or annuity contracts...for the life

[3] See Treasury Regulation Section 31.3121(d)-1

insurance company." (emphasis added).[4] Life insurance companies making a determination as to whether an agent meets the FTLIS requirements will look to the terms of his or her agreement with the company as well as the amount of the agent's sales of the company's proprietary products (including such sales to retirement investors) to confirm that the agent is, in fact, acting in accordance with that agreement.

The FTLIS rules provide that FTLIS agents are treated as if they were employees of their associated life insurance company for purposes of certain tax-qualified benefit plans including group-term life insurance plans, accident and health plans, pension and 401(k) plans, and cafeteria plans.[5] Accordingly, FTLIS agents are eligible for these benefits despite the fact that they are independent contractors and would not otherwise be permitted to participate in these plans.

B. The BICE

We are concerned that the BICE could be construed to preclude life insurance companies with FTLIS agents who sell to retirement investors from providing important health, welfare and retirement benefits to those agents and their families, in conflict with the FTLIS rules. As further described below, this concern derives from the exemption's formulation of "Best Interest," and the warranty and range of investment options requirements. We believe these requirements could be construed to fundamentally conflict with the FTLIS rules in various ways:

- The BICE requires that advisers affirmatively agree to provide investment advice that is in the "Best Interest of the Retirement Investor . . . without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." The phrase "without regard to" could be construed to preclude the sale by FTLIS agents of their associated life insurance companies' proprietary products to retirement investors.

- The BICE requires that the BIC include a warranty stating that the financial institution does not use "quotas...differential compensation or actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor." This warranty could be construed to preclude life insurance companies from: (a) using proprietary production tests which include sales to retirement investors when making a FTLIS determination and (b) providing benefit plan coverage based on proprietary sales to retirement investors.

- The BICE requires advisers to make available "a range of assets . . . broad enough to . . . make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor," which could be construed to preclude insurance agents selling to retirement investors from agreeing with a life insurance

[4] IRS Revenue Ruling 54-312
[5] Internal Revenue Code §7701(a)(20)

company – as required for FTLIS status – that their entire or principal business activity will be devoted to the solicitation of proprietary life insurance and annuity products.

In order to address this potential conflict, in addition to other changes discussed in our initial submission relating to the BIC itself, we suggest that the BICE be revised in two ways: [6]

- inclusion of an affirmative statement that it should not be construed to conflict with the ability of an agent to be deemed FTLIS in accordance with the Internal Revenue Code and to participate in his or her associated life insurance company's benefit plans, and

- the warranty as to quotas, appraisals, etc. should be revised as follows: "The use by ~~Neither~~ the Financial Institution, or ~~nor~~ (to the best of its knowledge) any Affiliate, ~~or Related Entity~~ of ~~uses~~ quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives ~~to the extent they would tend to encourage~~ has not caused nor will cause the individual Adviser to make recommendations of the Financial Institution's products or services that are not in the Best Interest of the Retirement Investor. For purposes of this warranty, the term "quota" does not include a threshold amount of proprietary sales used to determine whether an insurance agent meets the definition of a "Full-Time Life Insurance Salesman" under the Internal Revenue Code (a "FTLIS") and the term "incentives" does not include the provision of employee benefits to a FTLIS."

C. Prohibited Transaction Exemption (PTE) 84-24

As discussed in our initial submission, the Proposed Rule inexplicably excludes variable annuities from PTE 84-24 despite their similarity to fixed annuities, which are included in the exemption. This exclusion, in our view, not only denies retirement savers choice, it also frustrates federal policy promoting the availability of options for lifetime income – a key feature available with virtually all variable annuities. [7]

In this letter, we also bring to your attention that the Proposed Rule's amendments to PTE 84-24 may be construed to conflict with the FTLIS rules because, like the BICE, they require that advisers affirmatively agree to provide investment advice "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." As noted above, the phrase "without regard to" can be read to preclude the sale by FTLIS agents of their associated life insurance companies' proprietary products to retirement investors. In addition, the definition of "Insurance Commission" contained in the PTE 84-24 amendments may be construed to preclude the provision of employee benefits to FTLIS agents because it does not specifically include such benefits in the enumerated forms of compensation listed in the definition.

---

[6] We also wish to reiterate our concern that sponsors of small retirement plans will be unduly prejudiced under the Proposed Rule and renew our call for the BICE to be revised so as to include all retirement plans with less than 100 participants.

[7] See pp. 8-9, 13-14 of July 21, 2015 letter from Nick Lane of AXA to the Employee Benefits Security Administration commenting on the Proposed Rule.

Therefore, we also recommend that the definition of "Insurance Commission" in PTE 84-24 be revised as follows:

> "a sales commission paid by the insurance company or an Affiliate to the insurance agent or broker or pension consultant for the service of effecting the purchase or sale of an insurance or annuity contract, including, but not limited to, benefits under one or more employee benefit plans . . ."

In sum, we submit that the Department should adopt the changes proposed in this section in order to prevent a possible conflict between the Proposed Rule and the long-standing FTLIS laws.

II. The Department has not analyzed all costs and risks of the Proposed Rule, as required by Executive Order 12866 and OMB Circular A-4

A. Background

Federal rulemaking policy requires that federal agencies, in deciding whether and how to regulate, conduct a thorough analysis of all of the costs and benefits of proposed regulations, including any indirect costs. To this end, Executive Order 12866 requires federal agencies to

> ... assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless essential to consider.

Where, as here, a regulatory action is anticipated to have an annual effect on the economy of $100 million or more, agencies are required to conduct "[a]n assessment, including the underlying analysis, of costs anticipated from the regulatory action such as, but not limited to, . . . any adverse effects on the efficient functioning of the economy, private markets . . . together with, to the extent feasible, a quantification of those costs."

In addition, OMB Circular A-4 requires consideration of countervailing risk, defined as "an adverse economic, health, safety, or environmental consequence that occurs due to a rule and is not already accounted for in the direct cost of the rule." Analysis of such risks is subject to the same standards as direct costs of the rule, which must be "based on the best reasonably obtainable scientific, technical, and economic information available" including "peer-reviewed literature." In short, federal agencies must "propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify the costs."

B. The Proposed Rule creates a government-sanctioned bias in favor of passively-managed investments

The Department acknowledges that the Proposed Rule creates a bias in favor of passively-managed investments, stating in its Regulatory Impact Analysis that the Proposed Rule "will affect the demand for financial products and financial services beyond advice... . Passive and other lower cost investments may gain market share." A number of commenters – including AXA – and other interested parties have expressed concerns consistent with the Department's acknowledgement that the Proposed Rule is biased in favor of, and will cause a flight towards, passive investments. For example, John Hailer, CEO of Natixis Global Asset Management recently stated that the Proposed Rule is likely to establish passive investments as a "class of 'preferred' investment choices," and to "steer[] investors to only one investment approach."[8] In addition, several comment letters submitted to the Department also cited the Proposed Rule's potential "low-fee" exemption as creating a bias in favor of passively-managed investments.[9]

Despite the Department's acknowledgement of this bias, the record is devoid of any analysis by the Department of the costs and risks this bias may cause, such as societal costs in the form of increased systemic risk.

C. The Proposed Rule's bias towards passive investments will likely create societal costs, in the form of increased systemic risk, which the Department has not analyzed

The Proposed Rule's bias towards passive investments will likely create societal costs by increasing the systemic risk in the market in two primary ways:

- Elevated levels of overall market volatility driven by increased correlations of stock returns and a reduction of active investors who are willing to take "opposite views," leading to higher market risk premiums as investors demand compensation for increased volatility.

- Failure to detect and remedy deviations in security prices from fair market value (e.g. price bubbles), resulting in inefficient markets and ultimately lower returns or even losses for investors.

With respect to the first point, passive investors allocate investment flows to/from the same stocks in equal proportion to their index weight. An increase in the proportion of passive investors with common allocation methods would lead to increased correlation of individual stocks and higher market volatility as buy (or sell) orders come in at the same time (e.g. as stocks rebalance or are added/deleted from the index). The likelihood of this outcome is supported by a study by the International Monetary Fund of 40 markets which demonstrated that upon addition

---

[8] "Natixis CEO: Why the Gov't Shouldn't Meddle In Your Investments," accessed via http://wealthmanagement.com/industry/natixis-ceo-why-govt-shouldn-t-meddle-your-investments

[9] For example, see comment letters to the Proposed Rule submitted by Ameriprise Financial, OppenheimerFunds, Inc., Dodge & Cox, and Fidelity Investments.

of a stock to an index, the stock's return reflected a much higher correlation with the index in each studied market, thereby increasing market volatility.[10] The same study also indicated that the phenomenon has increased in magnitude over the last decade, which coincides with the steady increase in passive investing.

Exacerbating this concern is the fact that index funds and ETFs are particularly vulnerable in times of high market volatility, when prices of many stocks in a benchmark index may be rapidly rising or falling in a short period of time. Recent stock market volatility caused this precise problem – trading halts in individual stocks "cascaded into ETFs" with "[d]ozens of ETFs trad[ing] at sharp discounts to the sum of their holdings, worsening losses for many fundholders who sold during the panic."[11] The result is dramatically reduced liquidity in the market as a result of reduced trading volumes, both in the ETF itself as well as the underlying individual stocks, and increased overall volatility.

With respect to the second point, there is also increased risk that markets are unable to detect and remedy when the "herding" behavior of passive investments that may lead to market inefficiencies has gone too far. As allocation to passive investments increases, inefficiencies caused by the shift would normally be "traded away" by active investors. However, if there are fewer active investors in the market due to the Proposed Rule, this natural corrective mechanism may never materialize, and price bubbles are likely to occur in the "herded" securities. This inefficiency could ultimately lower returns for passive investments, whose managers may be forced to buy into or sell out of these mispriced securities in order to track their benchmark index.

Taken together, we believe the likelihood of increased societal costs outlined above and the directives in Executive Order 12866 and OMB Circular A-4 require the Department to analyze the societal costs created by the Proposed Rule's bias in favor of passive investments and re-examine the Proposed Rule as appropriate based on that analysis. We respectfully request that the Department conduct such an analysis and proceed accordingly.

In conclusion, we agree that "[t]he American people deserve a regulatory system that works for them, not against them."[12] We submit that in promulgating the Proposed Rule, the Department has not "identif[ied] and consider[ed] regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public."[13]

Accordingly, the Department should: (1) revise the Proposed Rule as discussed in Section I of this letter in order to ensure that it does not conflict with existing federal law, and (2) conduct the required analysis of the societal costs that will likely be created by the Proposed Rule's bias in favor of passive investments.

---

[10] "Additions to Market Indices and the Comovement of Stock Returns Around the World," Stijn Claessens and Yishay Yafeh, March 2011. Accessed via https://www.imf.org/external/pubs/ft/wp/2011/wp1147.pdf

[11] http://www.wsj.com/articles/wild-trading-exposed-flaws-in-etfs-1442174925

[12] Executive Order 12866

[13] Executive Order 13563

AXA redefining / standards®

Respectfully submitted,

Nick Lane

cc: Senator Richard Shelby, Chairman, Senate Banking, Housing & Urban Affairs Committee
Senator Sherrod Brown, Ranking Member, Senate Banking, Housing & Urban Affairs Committee
Senator Orrin G. Hatch, Chairman, Senate Finance Committee
Senator Ron Wyden, Ranking Member, Senate Finance Committee
Senator Lamar Alexander, Chairman, Senate Health, Education, Labor & Pensions Committee
Senator Patty Murray, Ranking Member, Senate Health, Education, Labor & Pensions Committee
Representative John Kline, Chairman, House Education and the Workforce Committee
Representative Robert C. "Bobby" Scott, Ranking Member, House Education and the Workforce Committee
Representative Jeb Hensarling, Chairman, House Committee on Financial Services
Representative Maxine Waters, Ranking Member, House Committee on Financial Services

Senator Charles E. Schumer, New York
Senator Kirsten E. Gillibrand, New York
Representative Lee N. Zeldin, New York 1st District
Representative Peter T. King, New York 2nd District
Representative Steve Israel, New York 3rd District
Representative Kathleen M. Rice, New York 4th District
Representative Gregory W. Meeks, New York 5th District
Representative Grace Meng, New York 6th District
Representative Nydia M. Velazquez, New York 7th District
Representative Hakeem S. Jeffries, New York 8th District
Representative Yvette D. Clark, New York 9th District
Representative Jerrold Nadler, New York 10th District
Representative Daniel M. Donovan, Jr., New York 11th District
Representative Carolyn B. Maloney, New York 12th District
Representative Charles B. Rangel, New York 13th District
Representative Joseph Crowley, New York 14th District
Representative Jose E. Serrano, New York 15th District
Representative Eliot L. Engel, New York 16th District
Representative Nita M. Lowey, New York 17th District
Representative Sean Patrick Maloney, New York 18th District
Representative Christopher P. Gibson, New York 19th District
Representative Paul Tonko, New York 20th District

Representative Elise M. Stefanik, New York 21st District
Representative Richard L. Hanna, New York 22nd District
Representative Tom Reed, New York 23rd District
Representative John Katko, New York 24th District
Representative Louise McIntosh Slaughter, New York 25th District
Representative Brian Higgins, New York 26th District
Representative Chris Collins, New York 27th District