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February 17, 2017

Submitted Electronically to e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11926
U.S. Department of Labor
200 Constitution Avenue, Suite 400
Washington, DC 20210

Re: Proposed Best Interest Contract Exemption for Insurance Intermediaries (ZRIN 1210-ZA26)

Dear Acting Secretary Hugler:

We write on behalf of Market Synergy Group, Inc. ("Market Synergy") to offer comment on the Department of Labor's ("Department") above-referenced proposed class prohibited transaction exemption ("Proposal"). The Proposal's stated intention is to grant an exemption that "would allow certain insurance intermediaries, and the insurance agents and insurance companies with whom they contract, to receive compensation in connection with certain fixed annuity transactions that may otherwise give rise to prohibited transactions as a result of the provision of investment advice to plan participants and beneficiaries, IRA owners and certain plan fiduciaries."

Market Synergy supports the idea that insurance intermediaries should be permitted to continue supporting the tens of thousands of independent insurance agents who sell life insurance products, especially fixed indexed annuities, for third-party compensation. As set forth more fully below, however, the Proposal would not meaningfully or feasibly accomplish that goal. Further, the Proposal is incompatible with the new presidential Administration's stated policies of: (i) increasing, not reducing, Retirement Investors' access to certain retirement savings offerings, retirement product structures, retirement savings information, and related financial advice; (ii) minimizing, not causing, dislocations or disruptions within the retirement services industry that may adversely affect Retirement Investors; and (iii) lowering, not raising, the prices that Retirement

Investors must pay to gain access to retirement services. Moreover, the Proposal irrationally imposes conditions on insurance intermediaries that Prohibited Transaction Exemption ("PTE") 2016-01, the Best Interest Contract Exemption ("BICE"), does not impose on other Financial Institutions.

Developments in a new presidential administration's regulatory philosophy can and should form the basis for shifts in policy. Market Synergy therefore recommends that the Department rescind its entire conflict of interest regulatory package, returning the financial industry to its pre-April 2016 position. In the alternative, Market Synergy recommends that, rather than adopting the Proposal, the Department should permit transactions involving fixed indexed annuity contracts to occur under the same conditions of PTE 84-24 that apply to "Fixed Rate Annuity Contracts," as that term is defined in that exemption. Together with existing state-based regulation, PTE 84-24's conditions, including the Impartial Conduct Standards, can protect Retirement Investors equally well with regard to fixed indexed annuities as they can for other fixed annuities.

Market Synergy adopts and incorporates herein by reference comments submitted by the members of its network of independent marketing organizations ("IMOs").

BACKGROUND

I. Fixed And Variable Annuities.

Annuities are retirement savings and income vehicles sold by life insurance companies. All annuities have one feature in common that distinguishes them from other financial products: with an annuity, the insurer promises to pay income on a regular basis for a chosen period of time, including the annuitant's lifetime.

Annuities may provide for immediate or deferred payments. In contrast to immediate annuities, deferred annuities characteristically have two phases of operation: (i) an "accumulation" or "deferral" phase in which the contract accrues value through payment of premiums and credited interest, and (ii) a "payout" phase in which the purchaser receives a predetermined stream of payments. The most common types of deferred annuities are variable annuities and fixed annuities, which include Fixed Rate Annuities and fixed indexed annuities.

Recognition should be given to the differences between state-regulated insurance products (e.g., fixed indexed annuities), on the one hand, and federally-regulated securities products (*e.g.*, variable annuities and mutual funds), on the other hand, with respect to three critical characteristics: (i) product guarantees (or lack thereof, in the case of investments like variable annuities); (ii) distribution channels associated with the respective products; and (iii) regulatory and disclosure regimes.

A. Fixed Annuity Contracts.

With a Fixed Rate Annuity, the owner is guaranteed a minimum crediting rate during the accumulation phase. The insurer, normally on an annual basis, declares in advance a specific crediting rate, which may be above a guaranteed minimum rate. The insurer bears the investment risk associated with the declared rate, which is guaranteed for that upcoming year (or another declared period). When the annuity reaches the payout phase, the payments' amounts are based on rates guaranteed at the time of issuance (or the insurer's current rates, if higher) and are guaranteed for the payout duration.

A fixed indexed annuity is a Fixed Annuity Contract that operates just like a Fixed Rate Annuity Contract with a minimum guaranteed interest rate. The only significant difference between fixed indexed annuities and Fixed Rate Annuity Contracts is the method for computing interest earnings credited. A fixed indexed annuity earns credited interest based on positive changes in a market index, such as the S&P 500. Premiums are not invested in index funds. The index's performance is simply used as a reference to determine the amount of credited interest in accordance with the specified index crediting method. The crediting rate is guaranteed to never be less than zero, even if the market declines and the index is net negative for the crediting period. Thus, as with Fixed Annuity Contracts, principal and prior credited interest are always protected from market downturns. Further, fixed indexed annuities typically allow the contract owner to elect to switch the chosen reference index or computation method from year-to-year or, alternatively, to select a fixed rate for the year.

Fixed indexed annuities are typically sold as retirement savings and income vehicles through guaranteed lifetime income rider benefits. According to the LIMRA Secure Retirement Institute, the top three stated reasons Retirement Investors purchase fixed indexed annuities are to: (i) supplement Social Security or pension income (46 percent); (ii) accumulate assets for retirement (34 percent); and (iii) receive guaranteed lifetime income (27 percent). According to data from analytics firm Wink's, Inc. (available at), and actuarial tables, in 2015, the average fixed indexed annuity consumer was 62 years old, married, and had a joint life expectancy of one of the two of them living to age 93. Therefore, most fixed indexed annuity sales are made to persons who will hold their contract through the surrender charge period and exercise the guaranteed retirement income privileges throughout their remaining lives.

B. Variable Annuity Contracts.

In contrast to the principal protection and guarantees associated with Fixed Rate Annuities, including fixed indexed annuities, variable annuities (like mutual funds) do not have guaranteed returns. They are securities whose investment returns vary in accordance with the value of the assets in which funds are invested. Unlike Fixed Annuity Contracts, variable annuities are thus exposed to losses of principal based on the investments' performance. And, unlike Fixed Annuity Contracts, variable annuities are regulated by federal and state securities law.

Variable annuities differ from Fixed Annuity Contracts, including fixed indexed annuities, in other ways. For example, variable annuities are not subject to state standard nonforfeiture laws and therefore insurers are not required to guarantee a minimum contract value or rate of return. Moreover, Fixed Annuity Contracts, including fixed indexed annuities, are subject to state guaranty fund laws that provide protections for purchasers if insurers become insolvent; variable annuities' separate accounts are not.

II. Distribution Of Fixed Annuity Contracts.

A. Independent Insurance Agent Distribution Channels.

Independent insurance agents, also known as "producers," typically sell a variety of insurance and other financial products, including life insurance and annuities. Nationwide, about 80,000 independent agents are engaged in fixed indexed annuity sales. Most life insurers do not recruit independent insurance agents to sell their products. Rather, independent agents are recruited by IMOs to offer, when appropriate, fixed indexed annuities and other types of insurance products to the agents' clients. Their sale of variable annuities, by contrast, is negligible.

In general, an IMO works with agents and insurers, providing economies of scale for producer recruitment, product education, wholesaling, marketing, processing business, and licensing and contract support. This service model allows insurers to reduce their overhead costs while facilitating the sale of products by independent agents, as opposed to their "captive" or career insurance agent counterparts. IMOs are generally compensated for their services by the insurers with which they have relationships based upon a percentage of agent sales volume. Formal data appears to be unavailable, but it is Market Synergy's understanding that the number of IMOs in today's marketplace likely exceeds 340 in total. *See* Cyril Tuohy, *Executive Sees IMOs Entering An Age Of Consolidation*, InsuranceNewsNet (Feb. 7, 2017), *at* ("Perry estimates that there are between 200 and 400 IMOs eligible to do business with insurers. Other independent estimates peg the number of IMOs in the U.S. at about 350. No public database exists to track the size and number of IMOs.").

Insurers have expended substantial money and resources in acquiring, investing in, or otherwise identifying, cultivating, and maintaining relationships with these insurance intermediaries. Many of these relationships are longstanding in nature.

Fixed indexed annuities represent a significant portion of a typical IMO's independent insurance agents' sales. IMOs and their agent networks constitute the largest overall distribution channel for fixed indexed annuities. The great majority of fixed indexed annuities are sold by independent agents not affiliated with a broker-dealer, with the large majority of that percentage within IRAs. According to LIMRA (available at), nearly two-thirds of fixed indexed annuity sales in 2015 ($34 billion) were funded through IRAs or rollovers from retirement accounts (qualified assets). Some 63 percent of all fixed indexed annuity sales were sold through the independent insurance agent distribution channel. The next largest distribution channel was banks, which sold only 16 percent of fixed indexed annuities.

Those in the independent distribution channel are compensated almost exclusively through commissions. Commission rates for fixed indexed annuities have declined markedly over the past decade. They are on par with commission rates for Fixed Rate Annuities. According to Wink's (available at):

> [T]he average street level compensation for indexed annuities as of 2Q2016 was 4.60%. The is is the lowest this figure has been in over a decade. Moore Market Intelligence, a firm that consults on indexed insurance products, tracks product features for every indexed annuity available in the country. According to the firm's research, commissions on indexed annuities range from 2.00% to 12.00%, but the majority of products pay a commission in the 7.00% – 7.99% range. This commission is generally 50% lower for older-aged annuitants.

And even if average commissions on fixed indexed annuities were formerly higher, that does not mean that commissions paid on every such product were higher than commissions paid on all variable and Fixed Rate Annuity Contracts.

With a *one-time* commission of, for example, 4 or 5 percent paid by the insurer to the producer for a Fixed Annuity Contract that can be expected to be held for 25 to 30 years, the total compensation paid is far less than other financial products. By way of comparison, a fee-based Adviser might suggest a diversified portfolio of investments and charge 1.5 percent *annually* to manage assets. The Retirement Investor will pay the Adviser fees each year, regardless of whether the investments decline in value.

B. Market Synergy

Market Synergy is a licensed insurance agency that works with insurers to develop proprietary fixed indexed annuities and other insurance products for exclusive distribution. It partners with select IMOs in distributing those products. Market Synergy also conducts market research and provides training and product support for IMO network members and independent insurance agents. Its business derives from, and is dependent upon, the viability of the IMO/independent agent distribution channel for sales of fixed indexed annuities and other fixed insurance products.

Market Synergy distributes insurance products through eleven IMO network members located around the country. The network members are independently-owned insurance wholesalers focused on assisting agents increase their life insurance and annuity business. Although these IMOs have partnered for some purposes with Market Synergy, they compete aggressively with each other, and with non-network IMOs.

There are approximately 20,000 agents affiliated among the IMOs in the Market Synergy network. In 2015, Market Synergy and its network members collectively were responsible for approximately $15 billion of fixed indexed annuity sales, measured by premium paid. Historically, fixed indexed annuities represent more than 90 percent of Market Synergy's total sales. Essentially all of Market Synergy's revenue is attributable in some way to developing, marketing, or distributing fixed indexed annuities.

As the Department is aware, Market Synergy is the plaintiff in a lawsuit against the Department pending in the United States District Court for the District of Kansas. The suit is captioned *Market Synergy Group, Inc. v. United States Department of Labor*, No. 5:16-CV-04083, and was filed on June 8, 2016.

III. Existing State-Based Regulation Of Fixed Indexed Annuities.

Since their introduction to the marketplace, fixed indexed annuities have been regulated solely by the states as fixed insurance products. Virtually all fixed indexed annuities are *not* registered with the Securities and Exchange Commission ("SEC") as securities. This treatment was confirmed in the Harkin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989J, 124 Stat. 1376 (2010). Among other things, the Harkin Amendment requires the SEC to treat as "exempt" under federal securities law annuity contracts meeting the following requirements: (i) the contract's value does not vary according to the performance of a separate account; (ii) the contract satisfies applicable state standard nonforfeiture laws or, if applicable state law lacks such a provision, the requirements of the National Association of Insurance Commissioner's ("NAIC") model standard nonforfeiture law; and (iii) the contract is subject to suitability requirements that duplicate or substantially meet or exceed the requirements of the NAIC model suitability regulation or, alternatively, the insurer has implemented practices on a nationwide basis that meet or exceed the NAIC standards and sales are subject to state monitoring for compliance.

The insurance industry is one of the most heavily regulated industries in the United States. A comprehensive range of state insurance and consumer protection laws apply to: (i) the insurers that offer fixed indexed annuities; (ii) the licensed insurance agents who sell them; (iii) the annuity products themselves; and (iv) the sales transactions through which Retirement Investors procure them.

A. Regulation Of Insurers That Offer Fixed Indexed Annuities.

An insurer must be licensed in any state in which it desires to conduct business, including the sale of fixed indexed annuities. State licensing procedures are comprehensive, and include provisions regarding capital requirements, surplus requirements, and overall financial health. In addition, states scrutinize the investments insurers make in their general accounts, and often limit risky investments and prescribe other requirements to ensure solvency and overall financial health. States frequently audit insurers' financial health, and exercise broad authority to intervene to protect policyholders should an insurer become financially troubled. States also frequently conduct market conduct examinations of insurers and agents to ensure compliance with applicable laws and regulations.

Each state also maintains a guaranty association to protect policyholders in the event an insurer is unable to satisfy its obligations. State guaranty associations are funded by mandatory contributions from insurers, and generally provide an additional bulwark against unexpected losses or other adverse financial conditions. In particular, if an insurer becomes insolvent or is otherwise unable to satisfy its obligations, the insured's state guaranty association will ensure full payment of the annuity claim, up to the applicable benefits cap. According to the National Organization of Life & Health Insurance Guaranty Associations (available at), in most states, the coverage level for a fixed annuity is $250,000 in present value of annuity benefits, including net cash surrender/net withdrawal values. With respect to fixed indexed annuities particularly, most states: (i) exclude from coverage most indexed-linked interest or value that has not been credited to, or which is subject to forfeiture; (ii) permit the guaranty association to provide coverage through an alternative form of annuity that provides for a fixed or other means of calculating interest in lieu of the index mechanism in the original contract; and (iii) adjust the amount of index-linked value or interest eligible for coverage if it exceeds specified maximum rates. Coverage of fixed indexed annuities with respect to who is covered and the maximum benefit levels is otherwise consistent with coverage of fixed annuities.

B. Regulation Of Licensed Agents Who Sell Fixed Indexed Annuities.

Like insurers, insurance agents must be licensed in each state in which they sell fixed indexed annuities or other insurance products. Agent licensing requirements vary from state to state, but most states require prospective agents seeking to sell life insurance or fixed annuities to complete rigorous pre-licensing classes specific to license they seek. After completing the required coursework, prospective agents must pass the state's licensing examination. Many states also require licensed agents to take continuing education courses after becoming licensed. After obtaining a license, an agent must be appointed by an insurer to sell its products. "Captive" or career agents are contractually obligated to sell only one company's products, while independent agents often are appointed by multiple companies. Many insurers also require additional education and training, including product-specific instruction, before appointing agents.

In addition to maintaining their own mechanism for customers to submit complaints about agents, states require insurers to record and retain complaints about agent conduct. According to NAIC data (available at), complaints about fixed indexed annuities in 2016 (totaling 142) constituted a small fraction of complaints about life insurance products (totaling 9,699), and an even tinier fraction of complaints about insurance products generally (totaling 134,369).

C. Regulation Of Annuity Products.

Fixed indexed annuity products themselves must pass regulatory scrutiny before being offered to Retirement Investors. Fixed Annuity Contracts, like other insurance products, must be filed with and approved by state insurance regulators in most states before being offered for sale. This review ensures that contractual terms such as guarantees, indexing methods, participation rates, annuitization options, spreads, vesting periods, free look periods and cap rates both comply with state requirements and are fair to the Retirement Investor. In addition, state review processes assess an annuity contract's "readability" to ensure that it is understandable by the ordinary consumer.

A significant component of state oversight of fixed indexed annuities are nonforfeiture laws, which require a guaranteed minimum value for each annuity contract. Nonforfeiture laws remove the risk of principal loss from fixed indexed annuities. If the linked index goes up, excess interest is credited based on the participation rate. If the linked index declines, the annuity does not share in the loss, but still receives state-mandated minimum interest crediting. The Standard Nonforfeiture Law for Individual Deferred Annuities, NAIC Model Regulation 805, provides a comprehensive framework states can use to enact their own nonforfeiture laws.

D. Regulation Of Fixed Indexed Annuity Sales Transactions.

In addition to rigorous oversight of insurers, insurance producers, and fixed annuity products, the sale of an annuity is a heavily regulated transaction. States disclosure laws, most of which have adopted or are based on the Annuity Disclosure Model Regulation, NAIC Model Regulation 245, require that a prospective producer be provided a comprehensive suite of information including, among other things, a specific description of applicable charges and fees, the guaranteed and non-guaranteed elements of the contract, and explanation of how the index-based interest is determined, how to assess the value of the annuity contract, and a summary of the federal tax status, including any potential penalties, of the annuity contract. The NAIC also requires that its Annuity Buyer's Guide (available at) be provided to prospective purchasers.

States also regulate the materials used to advertise annuity contracts. Again, the NAIC has issued an Advertisements of Life Insurance and Annuities Model Regulation, the purpose of which "is to set forth minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of ... annuity contracts." The NAIC model regulation, which either has been adopted by or serves as the basis for much of the state-specific advertisement regulation, requires that advertisements be truthful and not misleading, sufficiently complete and clear so that they are not deceptive, and give the state regulator discretion to determine whether an advertisement has "the capacity or tendency to mislead or deceive." Advertisements must not refer to fixed annuities as "investments," or use similar terms that would suggest the possibility of investment gains.

State suitability requirements require insurers, in the words of the Suitability in Annuity Transactions Model Regulation, NAIC Model Regulation 275, to "establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that result in transactions involving annuity products so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed." In addition, an insurer is prohibited from issuing an annuity recommended to a customer "unless there is a reasonable basis to believe that the annuity is suitable based on the customer's suitability information." The model regulation also requires that producers be trained before selling annuities, and has been adopted by the majority of states.

Other state laws and regulations designed to protect consumers in annuity transactions include regulations requiring a "free-look" period, whereby an annuity purchaser has the right to cancel an annuity contract for any reason and receive a full refund within a defined period from the date of purchase (often 30 days); regulations governing the replacement of existing annuities with other annuities; limitations and requirements governing the sale of annuities to senior citizens; and state unfair insurance practices laws, which generally regulate unfair and deceptive practices in connection with the sale of insurance products, including annuity contracts.

IV. Insurance Intermediaries' Present Dilemma.

Since their introduction to the marketplace in 1995, fixed indexed annuities have helped enable and protect the retirements of millions of Americans. These products, including their sale, are extensively regulated by state insurance departments and are primarily offered through independent life insurance agents, who perform an essential role in educating clients about their choices in retirement savings vehicles and in evaluating whether a fixed indexed annuity might be a suitable choice given each client's unique financial circumstances. Independent agents often have longstanding relationships with their clients and familiarity with clients' retirement goals and resources.

Recent regulatory actions by the Department, however, threaten to obliterate these relationships and the independent insurance agent business and service model. Citing concerns over supposed conflicts of interest associated with the sale of retail financial products in the individual retirement market, the Department issued a final rule redefining the activities it deems to be fiduciary "investment advice" under the

Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code"). In most instances, this rule will make independent agents and other sellers of retail financial products fiduciaries to the products' purchasers. At the same time, the Department amended and partially revoked PTE 84-24, which provides exemptive relief to insurance agents and others who, under the Department's new definition, would become fiduciaries in connection with transactions involving ERISA plans or IRAs. Absent an exemption like PTE 84-24, ERISA and the Code prohibit fiduciaries from receiving third-party compensation, *e.g.*, commissions.

Reversing course from what it had proposed to do, the Department revoked PTE 84-24 as it applies to plan and IRA purchases of annuities that do not satisfy the Department's new definition of a "Fixed Rate Annuity Contract," thereby excluding fixed indexed annuities from PTE 84-24's scope. That exclusion leaves independent agents without a workable exemption under which to sell fixed indexed annuities. Fixed Rate Annuity Contracts will continue to enjoy exemptive relief under PTE 84-24.

Because PTE 84-24 is now unavailable to fixed indexed annuity sellers, to continue receiving third-party compensation, they must attempt to operate under the BICE, the only available PTE. To do that, they need a qualifying sponsoring Financial Institution. Neither Market Synergy nor IMOs themselves qualify as Financial Institutions under the BICE. In promulgating that PTE, the Department specifically declined to expand the categories of Financial Institutions to "marketing or distribution affiliates or intermediaries." The Department instead limited the definition of Financial Institution to certain entities "which are subject to well-established regulatory conditions and oversight," *viz.*, registered securities broker-dealers, registered investment advisers, banks, and, if certain conditions are met, insurers.

Although the Department allowed that it might grant individual exemptions to IMOs, it indicated that any such exemption would depend upon the IMO's ability to "effectively supervise" individual Advisers' compliance with the BICE. Because they serve *independent* agents, however, Market Synergy and IMOs are not configured to "effectively supervise" individual BICE compliance without significantly expanding their operations at an impractical cost. IMOs are not structured to, and do not: (i) control the type or degree of interaction independent agents have with their clients; or (ii) direct agents' day-to-day activities. Moreover, independent insurance-only agents do not and cannot legally work with securities broker-dealers and registered investment advisers. Many do not want to become securities-licensed; they are uninterested in selling securities. The customary relationships with securities brokerage and advisory firms are incompatible with the independent nature of these insurance professionals' businesses.

It is also doubtful whether any insurers will agree to serve as Financial Institutions for purposes of supervising independent insurance agents under the BICE. As of today, to Market Synergy's knowledge, no fixed indexed annuity carrier has publicly affirmed that they are willing to serve as the agent's approved Financial Institution. Indeed, in other litigation with the Department, the carriers, through their trade associations, have confirmed that they will not sponsor independent agents. *See* Pl.'s Memo. in Support of Mot. for Summ. Judg., *Chamber of Commerce of the United States v. Perez*, No. 3:16-CV-1476, ECF No. 59 at 25 (N.D. Tex. filed July 18, 2016), 2016 WL 4190833; Pl.'s Reply in Support of Mot. for Prelim. Inj., *Nat'l Ass'n for Fixed Annuities v. Perez*, No. 1:16-CV-1035, ECF No. 27 at 44 (D.D.C. filed July 22, 2016), 2016 WL 4497565. The reason is obvious: *independent* sales forces exist to avoid having insurers assume responsibility for, or control of, *independent* agents. Insurers must consider the risk of being held legally liable under the Best Interest Contract for the agents' acts and omissions, as well as having to establish the supervisory apparatus required under the BICE. And insurers cannot reasonably know what recommendations agents make using other insurers' products, yet the BICE presumes that they must. Rather than continuing to distribute fixed indexed annuities through independent channels, insurers will attempt to shift their distribution to career or captive agents, banks, registered investment advisers, and broker-dealers, or simply exit the fixed indexed annuity space completely.

This Department-created predicament has sent shockwaves through the independent distribution channel. According to a survey of 126 insurance intermediaries conducted just prior to the 2016 presidential election, 3 in 4 respondents expect a serious impact from the Department's actions on their business. *See* Laura Murach, LIMRA Secure Retirement Institute, *The DOL Fiduciary Rule: Independent Distribution Networks' Perspectives* (Jan. 16, 2017), *at* . Almost 7 in 10 anticipate that their organization's fixed indexed annuity sales will decrease. Furthermore, in 2017, sales of fixed indexed annuities are expected to drop 25 percent to 30 percent as a direct result of the Department's regulatory package. *See* Joseph Montminy, LIMRA Secure Retirement Institute, *How the DOL Fiduciary Rule Will Affect Individual Annuity Sales* (Nov. 2016), *at* .

V. Prevailing Federal Policy Considerations.

A. Congressional Deference To The States On Insurance Regulation.

Before the Department's recent regulatory actions, the states, not the federal government, had exclusively regulated Fixed Annuity Contracts, an important and thriving segment of the insurance industry. Congress has repeatedly affirmed the primary role of state regulators over the business of insurance through various legislative acts, including the McCarran-Ferguson Act, the Harkin Amendment, and a (vetoed) Joint Resolution of Disapproval (H.J. Res. 88).

In the McCarran-Ferguson Act, Congress "declare[d] that the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011. "Certainly," the Supreme Court has stated, the "selling and advertising of policies" is "part of this business." *SEC v. Nat'l Secs., Inc.*, 393 U.S. 453, 460 (1969). And while "Congress did not order the unqualified deferral to state law" in the McCarran-Ferguson Act and "ERISA leaves room for complementary or dual federal and state regulation," *John Hancock Mut. Life Ins. Co. v. Harris Trust & Savs. Bank*, 510 U.S. 86, 98 (1993), Congress nonetheless communicated a strong preference for existing state regulation over new federal regulation. After all, the McCarran-Ferguson Act was enacted to ensure "the supremacy of the States in the realm of insurance regulation." *Dep't of Treasury v. Fabe*, 508 U.S. 491, 500 (1993).

> Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is in the public interest and that the business and all who engage in it "shall be subject to" the laws of the several states in these respects.

Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 429-30 (1946); *see also Fabe*, 508 U.S. at 500.

> Moreover, in taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its

> purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations.

Benjamin, 328 U.S. at 430. In this way, "Congress intended to declare, and in effect declared, that uniformity of regulation, and of state taxation, are not required in reference to the business of insurance, by the national public interest, except in the specific respects otherwise expressly provided for." *Id.* at 431. The federal government's recent intrusion into the regulation of fixed indexed annuities is inconsistent with the stated congressional policy in favor of state-based regulation.

The Harkin Amendment confirms this "hands-off" approach to federal regulation of fixed indexed annuities specifically. In enacting that Amendment, Congress confirmed that fixed indexed annuities should not be federally regulated as securities, in contrast to variable annuities and other products. As noted above, the Harkin Amendment conditions the eligibility of fixed indexed annuities to be treated as insurance on their compliance with state insurance laws or their model regulation equivalent. Senator Harkin, the Amendment's sponsor, made several statements during congressional debate confirming an intent to regulate fixed indexed annuities at the state, not federal, level. For example, he stated: "This is the Amendment that basically provides that fixed index annuities be treated as insurance products, regulated by state insurance regulators." Senator Harkin explained that fixed indexed annuities are "basically an insurance product" and "ought to stay with the state insurance commissioners with the protections that were added in my amendment," referring to state insurance nonforfeiture laws and annuity suitability regulations. He added that "[t]his is a proper place for the insurance commissioners to regulate." C-Span Video Library, Conference Committee on Financial Regulatory Reform: Financial Regulations Bill, Day 5, Part 2 (June 22, 2010) (comments begin at the 3:41:50 mark), *at* .

And, invoking the Congressional Review Act, Congress enacted a Joint Resolution of Disapproval (H.J. Res. 88) stating that "Congress disapproves the rule submitted by the Department" and urging that "such rule shall have no force or effect." The prior administration vetoed this Joint Resolution.

Because it contravenes longstanding public policy, state insurance officials have condemned the Department's attempts to regulate transactions involving Fixed Annuity Contracts and those who market and sell them. The National Conference of Insurance Legislators ("NCOIL"), for example, formally resolved that the "state-based regulatory structure governing the manufacture, distribution, and sale of retirement related financial products is effective and proven" and "has in place on-going substantive procedures, processes and protocols to license, regulate and supervise insurance agents of retirement related financial products." NCOIL "strongly supports the States' rights to regulate their own insurance markets and products, including retirement related financial products" and decries the Department's actions, which "threaten the proven State-based legislative and regulatory structure by imposing a vague and burdensome fiduciary standard on non-fiduciary sales relationships, thereby upending the retirement savings marketplace." NCOIL, *Resolution in Opposition to the United States Department of Labor Fiduciary Rule* (Nov. 20, 2016), *at* .

Likewise, in litigation between Market Synergy and the Department, Kansas Insurance Commissioner Ken Selzer stated that he was "having some difficulty understanding the rationale" behind the Department's regulatory actions. Commissioner Selzer, like other state officials, finds it "difficult to justify the Department of Labor's differing regulatory treatment of substantially similar (and, for these purposes, materially indistinguishable) fixed insurance products, largely sold through the same distribution channels, that are already regulated from a consumer protection standpoint at the state level."

B. The Administration's Articulated Policies On Retirement Savings.

Most recently, the new presidential Administration has made known its policy preferences in formulating regulations relating to purported conflicts of interest in connection with retirement investment advice. In a document entitled "Presidential Memorandum on Fiduciary Duty Rule" (available at), the Administration directed the Department "to examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice." The Department was directed to prepare an "updated economic and legal analysis concerning the likely impact of the Fiduciary Duty Rule," which must consider, among other things, the following:

> (i) Whether the anticipated applicability of the Fiduciary Duty Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;
>
> (ii) Whether the anticipated applicability of the Fiduciary Duty Rule has resulted in dislocations or disruptions

within the retirement services industry that may adversely affect investors or retirees; and

(iii) Whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.

Market Synergy submits that the considerations that must govern the Department's analysis of the "Fiduciary Duty Rule" should also govern its analysis of the Proposal.

THE PROPOSAL SHOULD NOT BE ADOPTED

I. As With The BICE, The Proposal Does Not Provide A Meaningful Or Feasible Exemption To Insurance Intermediaries.

As the Department implicitly acknowledged by issuing the Proposal, the BICE leaves insurance intermediaries without a workable PTE. In an understatement that is not completely honest with itself or the public, the Proposal states that, in issuing the BICE, "the Department noted that compliance might be more burdensome for some industry segments than for others, that some insurers and some independent insurance agents might be among those needing to make more significant changes, and that this could impose some costs on affected Retirement Investors."

Rather than remedying the BICE's deficiencies, however, the Proposal would similarly strand nearly every insurance intermediary in today's marketplace. It has been poorly received by the life insurance industry. Experts and analysts quoted in recent press articles have characterized the Proposal as "virtually worthless," "unworkable," "unplayable," and even "crazy." *See, e.g.*, Cyril Tuohy, *IMOs Call DOL Fiduciary Exclusion Unworkable*, InsuranceNewsNet (Jan. 17, 2017), *at* ("Regulatory thresholds proposed for independent marketing organizations (IMOs) to participate in the sale of fixed indexed annuities are so high as to be virtually worthless and unworkable for the bulk of the IMO industry, industry experts said."); Nick Thornton, *Under proposed exemption, IMOs will need $15M in cash reserves*, BenefitsPro (Jan. 20, 2017), *at* ("Under the proposed sales and reserve requirements, it is possible that no IMOs would be able to qualify as a financial institution, says Sheryl Moore, CEO of Moore Market Intelligence, which provides analytics tools to the insurance industry. 'Given what the DOL knew about the revenues of the applicants, you can't tell me they didn't know the $1.5 billion sales threshold will obliterate the IMO distribution channel, said Moore."); Warren Hersch, *IMOs to DOL: Fiduciary rule class exemption sets too high a bar*, LifeHealthPro (Jan. 24, 2017), *at* ("Even for those IMOs that do meet the $1.5 billion bar, the outlook may not be sustainable. Forcing insurers and producers to consolidate sales around a smattering of distributors could prove enormously disruptive, if not altogether damaging to the FIA market, the proposal's critics say.").

A. The Premium Threshold Excludes Most Insurance Intermediaries.

The Proposal's dysfunction lies chiefly in its many onerous conditions. To begin with, to qualify as a Financial Institution, subsection (4) of the Proposal's definition of Financial Institution would require an insurance intermediary to have had annual Fixed Annuity Contract sales averaging at least $1.5 billion in premiums over each of the three prior fiscal years. It is unclear whether that refers to premium submitted to insurers or premium taken by insurers (as where applications are withdrawn or policies rejected before issuance). Regardless, this condition alone excludes the vast majority of IMOs operating today, as sales for nearly all such intermediaries do not even approach that threshold. One recent press article indicated that only eleven IMOs could potentially qualify. *See* Cyril Tuohy, *Super-IMOs Get 16 Months To Comply With DOL Rule for Exemption*, InsuranceNewsNet (Jan. 24, 2017), *at* . Market Synergy believes that even that number is optimistic and, depending on how the premium threshold is measured, only several IMOs could qualify.

The premium threshold appears to exclude Market Synergy itself. Although the Department has, during litigation with Market Synergy, opined that Market Synergy would be eligible for relief under the Proposal, the Department misunderstands Market Synergy's network business model. Market Synergy has limited Fixed Annuity Contract sales independent of its network member IMOs. The Proposal does not suggest that sales can be aggregated across independent companies within a consortium or competitor IMOs to meet the threshold.

The Department recognizes that the premium threshold would limit entities that could operate as the supervisory Financial Institution to larger intermediaries, but contends that the Proposal would not prevent smaller intermediaries from working with larger intermediaries. Rather than allowing smaller intermediaries to continue business functions, however, the predictable result of the Proposal is to render smaller intermediaries redundant. To act as Financial Institutions, larger intermediaries must satisfy the Proposal's many conditions, including acknowledging their fiduciary status and the fiduciary status of the Advisers with whom they contract in writing, adhering to enforceable standards of fiduciary conduct and fair dealing with respect to their advice, setting forth those standards in an enforceable contract with the Retirement Investor, adopting policies and procedures designed to mitigate any harmful impact of conflicts of interest, and disclosing information about their conflicts of interest, the recommended Fixed Annuity Contract and the cost of their advice. If larger intermediaries must ensure the satisfaction of these (and other) conditions for themselves, it leaves no room for smaller intermediaries to participate in the sales chain.

The Department also opined that smaller IMOs could be subcontracted to perform compliance work for Financial Institutions. But few Financial Institutions would contract with smaller IMOs for compliance work since IMOs are not structured to, and do not: (i) control the type or degree of interaction independent agents have with their clients; or (ii) direct agents' day-to-day activities. IMOs are "independent marketing organizations," not "independent compliance organizations." In fact, IMOs within Market Synergy's network have been informed by many insurers that they plan on significantly reducing the number of IMOs with whom they work due to these difficulties. The Proposal assumes that smaller IMOs can and will radically restructure their operations from sales *support* to sales *supervision*. It also raises the question of why a larger IMO would desire to subcontract with a smaller IMO with which it competes in the marketplace. Again, the Proposal's predictable effect is to render smaller intermediaries redundant.

This threatens IMOs' viability. In February 2017, an executive from a leading manufacturer of fixed indexed annuities publicly commented about the dire situation in which the Proposal leaves IMOs, and the anticompetitive "monopoly" it will create:

> It's certainly affecting the smaller firms, in that they can't – they don't have the infrastructure to be a financial institution, and when you look at the IMO exception, it's very, very few IMOs that will even qualify for the IMO exemption. So the way I look at it is that these smaller firms you know have to make a decision, either get out of the FIA business or consolidate with the larger IMOs out there that do have the infrastructure and that has a capability to be an FI. It's unfortunate in that the DOL rule is almost turning the FIA business into a monopoly because there's going to be fewer and fewer IMOs if the rule goes through that have the ability to be financial institution than currently exist today.

> We're going from hundreds of IMOs down to maybe, I don't know, 5 to 10 that could be an FI.

Transcript, Seeking Alpha, *American Equity Investment Life Holding Company Fourth Quarter 2016 Financial Inc. Earnings Call* (Feb. 9, 2017), *at* .

Another executive shared those views, publicly commenting that "sales of FIAs by independent agents may come under pressure later this year if the DOL fiduciary rule is not delayed or overturned through litigation. While the DOL's recently proposed Best Interest Contract Exemption for Insurance Intermediaries (the IMO Exemption) could facilitate continued sales of FIAs subject to the fiduciary rule by independent insurance agents, we believe the proposed requirements may arbitrarily and unnecessarily prevent some highly qualified insurance intermediaries from obtaining Financial Institution status and even if the proposed exemption is finalized prior to April 2017, the eligible insurance intermediaries may not have sufficient time to meet the proposed requirements." Press Release, American Equity Investment Life Holding Company, *American Equity Reports Fourth Quarter and Full Year 2016 Results* (Feb. 8, 2017), *at* .

Finally, the Proposal would collaterally damage independent insurance agents in particular. Most smaller IMOs likely could not find an IMO Financial Institution willing to assume responsibility for independent insurance agents it has never known, and that are agents of a competitor IMO. Due to the large fixed costs to supervise each agent and incremental potential fiduciary liability, IMO Financial Institutions likely would only agree to supervise agents with sales exceeding $1 million per year. That threshold would eliminate many independent agents from the marketplace as the few surviving IMOs would not desire to supervise less-profitable agents. Market Synergy projects that, under the Proposal, more than 70 percent of the 80,000 independent agents will never find an IMO that would agree to expend resources to supervise them.

B. Even The Few Intermediaries Meeting The Premium Threshold Will Be Unable Or Unwilling To Satisfy The Proposal's Other Onerous Conditions.

The Proposal's other conditions also virtually ensure that even the few insurance intermediaries capable of meeting the premium threshold nonetheless would be unable to operate profitably or would be unwilling to remain in business.

1. Reserving/Fiduciary Liability Insurance.

Subsection (3) of the Proposal's definition of Financial Institution would require the Financial Institution to maintain fiduciary liability insurance, or unencumbered cash, bonds, bank certificates of deposit, U.S. Treasury Obligations, or a combination of all of these, available to satisfy potential liability under ERISA or the Code as a result of the firm's failure to meet the terms of this exemption. The aggregate amount of these items must equal at least 1 percent of the average annual amount of premium sales of Fixed Annuity Contracts by the Financial Institution to Retirement Investors over the prior three fiscal years of the Financial Institution. In effect, that means Financial Institutions operating under the Proposal's conditions must maintain reserves and/or fiduciary liability insurance equaling *at least* $15 million.

To the extent this condition can be satisfied by maintaining adequate unencumbered reserves, even among those satisfying the premium threshold, few (if any) insurance intermediaries currently have, or will be able to maintain, reserves in the required amount. Fewer still would be willing to indefinitely tie up such significant capital amounts. The Department has misjudged the financial margins at which IMOs operate.

To the extent this condition can be satisfied by fiduciary liability insurance, coverage tailored to IMOs does not yet appear to exist in the insurance marketplace, and there is no certainty that a carrier will develop and offer to underwrite such coverage in the immediate future. Fiduciary liability insurance generally insures against losses caused by breaches of fiduciary responsibilities. Market Synergy believes that most large IMOs today maintain only $4 million to $5 million in standard (non-fiduciary) errors and omissions liability coverage, with aggregate limits of $10 million. Such coverage typically insures for the cost of defending against negligence claims, and does not cover alleged fiduciary breaches. Market Synergy recently contacted a leading errors and omissions brokerage, which stated that an adequate fiduciary liability insurance for IMOs does not exist and could only be procured, if at all, through a custom policy from Lloyds of London. Curiously, the Proposal acknowledges that some applicants for individual BICE exemptions "indicated uncertainty as to the current availability of insurance for liability under the exemption," but then ignores that point completely.

Worse, this requirement does not appear to be suspended under the Proposal's transition relief. Because the reserving/fiduciary liability insurance requirement is part of the definition of Financial Institution, such Institutions must obtain insurance or muster adequate unencumbered reserves by April 10, 2017. Since reserves and fiduciary liability insurance cannot be procured on such short notice, the transition relief offered would not assist *any* insurance intermediary.

2. Independent Annual Financial Audits.

The Proposal also requires IMOs to have financial statements that are audited annually by a certified public accountant. Audited financial statements must be made available on the IMO's website. While perhaps less onerous than the premium threshold and reserve/fiduciary liability insurance conditions, this requirement is an unnecessary and intrusive measure. According to the Proposal, it was based on the Department's understanding that insurers submit their financial statements on a quarterly basis to the NAIC, which collects these data on behalf of state insurance regulators. The NAIC data allows state insurance regulators to provide solvency oversight of insurers, helping to assist in preventing insolvencies for which liability is imposed on other operating insurers under state guaranty fund laws. This enables state regulators to perform asset stress tests on insurers and determine the impact of other insurer insolvencies or credit rating downgrades on the insurance market.

No similar concerns exist with respect to IMOs. IMOs are not backed by state guaranty funds and there are no conceivable systemic financial effects of an IMO's insolvency. Neither state nor federal regulators perform solvency oversight of IMOs. Publicly available financial audits would needlessly expose the confidential information of IMOs, most of which are closely held corporations, including sensitive data concerning profit, capital spending, headcount, and so forth. In short, the reasons the NAIC requires audited financial statements from insurers is not a reason applicable to IMOs.

3. Prior Approval Of Written Marketing Materials.

The Proposal also would require Financial Institutions to approve in advance all written marketing materials used by Advisers after determining that such materials provide a balanced description of the risks and features of the annuity contracts to be recommended. This requirement is equally unnecessary – states already require the issuing insurer to establish and maintain a system of control over the content, form, and method of dissemination of all advertisements of its policies. This is a requirement, for example, in NAIC Model Regulation 570, Advertisements of Life Insurance and Annuities Model Regulation, which sets forth minimum standards and guidelines to assure a full and truthful disclosure of all material information in the advertising of life insurance policies and annuity contracts. And, as a practical matter, because they operate across state borders, most insurers insist upon prior approval of written marketing materials regardless of whether any individual jurisdiction legally mandates it. The Proposal layers superfluous federal regulation over existing adequate state-based regulation.

II. The Proposal Conflicts With The Administration's Articulated Policies.

The new Administration has expressed its view that the Department's regulatory package "is a solution in search of a problem. There are better ways to protect investors, and the Trump administration is taking action to do so." The package's "intent may be to have provided retirees and others with better financial advice, but in reality, its effect has been to limit the financial services that are available to them. President Trump does not intend to put unnecessary limits on economic opportunity. The Department of Labor exceeded its authority with this rule, and this is exactly the kind of government regulatory overreach the President was put into office to stop. We desperately need to overhaul how we approach financial regulation." Press Briefing by White House Press Secretary Sean Spicer (Feb. 3, 2017), *at* . Congress, too, agrees with the Administration that the Department's regulatory package "will have a detrimental impact on low- and middle-income Americans and small businesses." H.R. Rep. No. 114-527, at 19 (2016).

The Department's analysis of this Proposal should account for the new Administration's regulatory philosophy. After all, "an agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely on the incumbent administration's views of wise policy to inform its judgments." *Chevron USA Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 865 (1984). "A change in administration brought about by the people casting their votes is a perfectly reasonable basis for an executive agency's reappraisal of the costs and benefits of its programs and regulations. As long as the agency remains within the bounds established by Congress, it is entitled to assess administrative records and evaluate priorities in light of the philosophy of the administration." *Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1043 (D.C. Cir. 2012) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 59 (1983) (Rehnquist, J., concurring in part and dissenting in part)). "An agency's view of what is in the public interest may change, either with or without a change in circumstances," and the agency may change course on this basis so long as it "suppl[ies] a reasoned analysis." *Motor Vehicle Mfrs.*, 463 U.S. at 43. Indeed, an agency "must" consider "the wisdom of its policy on a continuing basis, for example, in response to changed factual circumstances, or a change in administrations." *Nat'l Cable & Telecommc'ns Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005).

As discussed more fully below, the Proposal is at odds with the incumbent Administration's stated policy preferences of: (i) increasing, not reducing, Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, and related financial advice; (ii) minimizing, not causing, dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and (iii) lowering, not raising, the prices that investors and retirees must pay to gain access to retirement services.

A. Without A Workable Insurance Intermediary Exemption, The Retirement Services Industry Will Experience Massive Dislocations And Disruptions.

The coming shift in how fixed indexed annuities are sold, and *who* will sell them, will radically alter the life insurance industry, to the overwhelming detriment of independent agents, IMOs, Market Synergy and the market for retirement savings.

Because their businesses are so heavily dependent upon their ability to receive compensation from the marketing and sale of fixed indexed annuities, it is expected that Market Synergy, its member IMOs, and their independent agents will experience revenue decreases easily exceeding 50 percent. Market Synergy itself could experience a revenue drop approaching 80 percent. This will necessarily result in thousands of layoffs for both Market Synergy and its member IMOs.

Across the entire independent distribution channel, IMOs not affiliated with a Financial Institution are completely disenfranchised by the new regulatory regime which, among other things, will likely prompt a shift in distribution to captive agents, broker-dealers, registered investment advisers, and banks. Moreover, insurance-licensed-only agents do not and cannot legally work with securities broker-dealers and registered investment advisers. Many do not want to become securities-licensed because they are not interested in selling securities. The customary relationships with securities brokerage and advisory firms are not compatible with the independent nature of these insurance professionals' businesses. The many thousands of these agents, in particular, are at risk of losing their hard-earned careers, professional autonomy, and financial livelihoods.

All this will cost insurance intermediaries and independent insurance agents their customers, market share, goodwill, and competitive position relative to broker-dealers, banks, registered investment advisers, and captive agent sales forces. It is expected that upwards of 20,000 to 50,000 independent agents will exit the marketplace. And, in this hostile environment, it will become exceedingly difficult to attract and recruit new independent agents – the lifeblood of any IMO.

B. Any Contraction Of The Independent Insurance Agent Distribution Channel Will Adversely Affect Retirement Investors.

The Proposal also would reduce Retirement Investors' access to retirement savings offerings, product structures, information, and financial advice. Retirement Investors will be adversely impacted because independent insurance agents offer, at no expense, financial advice tailored to each customer's needs, goals, and financial resources. For example, independent agents are required both by law and good business practice to ascertain whether a fixed indexed or other annuity is a suitable choice for the customer. By effectively eliminating third-party compensation for them, independent agents will be unable to offer financial advice to less affluent Retirement Investors. Many of their lower- and middle-income clients will likely go unserved because the modest assets of these would-be Retirement Investors are not desirable to large brokerage and investment advisory firms, most of which are not contracted with the various insurers.

Millions of fixed indexed annuities have been sold over the past decade, most of which of which remain in force today. Once independent insurance agents have exited the annuity marketplace, there will be a massive consumer servicing gap since the original annuity salesperson will no longer be licensed, authorized, or in business. Unlike other financial products, new Advisors cannot readily assume annuity accounts or clients, nor would insurers permit such activity due to privacy laws, business reasons, and contractual relations with its original salesperson. This would likely cause widespread service disruptions and costs borne by insurers to handle the many issues that would materialize without an agent field force.

In these ways, the Proposal would effectively raise the prices that Retirement Investors must pay to gain access to retirement services. Congress and the state insurance legislators both share this view. In connection with its Joint Resolution of Disapproval (H.J. Res. 88), Congress found that the Department's regulatory package "disrupts advisory relationships, contains a multitude of technical shortcomings, and brings about a number of unacceptable consequences. The final rule restricts access to affordable financial advice for lower- and middle-income Americans and makes it harder for employers – especially small businesses – to set up retirement plans." H.R. Rep. No. 114-527, at 15. "The final regulation will have the net effect of locking lower- and middle-income investors out of the advice market." *Id.* And, as it resolved in November 2016, "NCOIL believes in protecting the interests of consumers against excessive government regulation that will only hurt average working Americans trying to save for retirement." And NCOIL resolved that "the Rule will prevent consumer access to crucial retirement education and services, ultimately harming the very people it seeks to aid."

In short, because it does not offer a meaningful or feasible exemption to insurance intermediaries, the Proposal is just more the same bad medicine.

C. The Proposal Is Purposefully Intended To Increase Litigation And Will Impose Significant Litigation Costs.

The Administration also is concerned with whether the Proposal is likely to cause an increase in litigation. The Proposal was *specifically designed* to do just that, because it is intended to be privately enforceable by imposing contract- and fiduciary-based liability via the Best Interest Contract. It is a classic example of regulation through litigation.

As the Proposal explains in euphemistic vernacular, "Section II sets forth the requirements that establish the Retirement Investor's enforceable right to adherence to the Impartial Conduct Standards and related conditions." Although it carefully avoids using terms like "litigation," "lawsuit," or "class action," the Proposal explains that it seeks to ensure that "insurance intermediaries described in the definition are sufficiently large and established to stand behind their contractual and other commitments to Retirement Investors," and to "satisfy potential liabilities under the exemption," which is just bureaucratic doublespeak for "increased litigation." After the substantially similar BICE was announced, Congress passed Joint Resolution of Disapproval (H.J. Res. 88), finding in connection with that resolution that "the BIC exemption continues to envision class action litigation under state law. The costs associated with this litigation will drive costs up for those least able to bear it, namely low- and middle-income retirement savers." H.R. Rep. No. 114-527, at 17.

Nor is there any question that the litigation costs the Proposal and its sister PTE, the BICE, will inflict upon the financial industry will be enormous. A February 2017 stock analyst note from analytics firm Morningstar estimated a long-term *annual* range from resulting class action settlements alone of $70 million to $150 million. (Morningstar did not estimate the costs of non-class individual litigation.) In a bearish scenario, Morningstar wrote, the cost of class action settlements alone could decrease the operating margin on the advised, commission-based IRA assets of affected firms by 24 percent to 36 percent. Further, it warned, in the near-term, these cost could be exceeded by a multiple as firms learn how to become compliant. Notably, Morningstar also stated that the Department's own regulatory impact analysis for individual large firms is likely "off by a multiple" or, at a minimum, not representative of the largest wealth management firms. *See* Michael Wong, Morningstar, *Costs of Fiduciary Rule Underestimated* (Feb. 10, 2017), *at* .

III. The Proposal Discriminates Against Insurance Intermediaries By Imposing Conditions That The BICE Does Not Impose On Other Financial Institutions.

Insurance intermediaries like Market Synergy cannot help but feel that the Department has singled them out for discriminatory adverse treatment. While the Proposal's stated goal is to put qualifying insurance intermediaries on par with other Financial Institutions, registered investment advisers are not subject to many of the same conditions, whether under the BICE or under other laws. This is arbitrary and capricious. "The treatment of cases A and B, where the two cases are functionally indistinguishable, must be consistent. That is the very meaning of the arbitrary and capricious standard." *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1260 (D.C. Cir. 1996).

As noted above, the Proposal's definition of Financial Institution would require an IMO Financial Institution to maintain fiduciary liability insurance, unencumbered reserves, or a combination of these, in an aggregate amount equaling at least 1 percent of the average annual amount of premium sales of Fixed Annuity Contracts by the Financial Institution to Retirement Investors over the prior three fiscal years. The Proposal explains that this provision "seeks to ensure that the Financial Institution can stand behind its commitments to retirement investors and satisfy potential liabilities under the exemption." Yet while it has defined all registered investment advisers as Financial Institutions under the BICE, the Department has not imposed a similar reserving/fiduciary liability insurance condition on *them*. That is true notwithstanding that IMO Financial Institutions face the very same "potential liabilities" under the Proposal that registered investment advisers face under the substantively identical BICE.

As reflected in the Department's Field Assistance Bulletin No. 2008-04, registered investment advisers are not required by ERISA to obtain fiduciary liability insurance. Registered investment advisers may maintain reserves or fiduciary liability insurance in any amount, or not at all. And a registered investment adviser's solvency is not backed by the guarantee of government-sponsored depositor insurance or a state guaranty fund. The Department has thus irrationally endeavored "to ensure that the [IMO] Financial Institution can stand behind its commitments to retirement investors" without ensuring the same with respect to registered investment adviser Financial Institutions.

That same uneven treatment also taints the Proposal's requirement that independent annual financial audits be made publicly available on an IMO's website. The Department proposed this requirement under the belief that "the periodic financial audits would provide reasonable assurance of the entity's financial health." But no such assurances are required of registered investment advisers, whose "financial health" is never assured. Registered investment advisers are not immune from bankruptcy, but they are not subject to this condition or anything like it.

IV. The Department Is Disjointedly Restructuring The Entire Fixed Annuity Industry.

Perhaps the flawed Proposal could have been overhauled if it were proposed months before it was. As it is, the Department has offered an ill-conceived "midnight rule" in the last hours of the prior presidential administration. The Proposal has a rushed feeling: it asks scores of questions highlighting its lack of familiarity with insurance intermediaries, annuity products, and the life insurance industry in general; it allows interested persons only a 30-day comment period to respond to these numerous, complicated, and consequential questions; and, when it does state the Department's factual assumptions for the Proposal, those assumptions are frequently wide of the mark. Worse, it was unveiled less than three months before the fast-approaching April 10, 2017 applicability date, with meaningless transition relief offered.

Frustratingly, the Department was not honest with itself or the public as to why the Proposal was even offered, *viz.*, because the BICE is unworkable for the independent insurance agent distribution channel. In excluding fixed indexed annuities from PTE 84-24 in favor of the BICE, the Department deferred considering possible solutions to the conundrum in which it put Market Synergy and others in the independent distribution channel: Financial Institutions like insurers will not sponsor independent agents, and neither the agents nor IMOs themselves qualify as Financial Institutions. The Department expressly *declined* to expand the categories of Financial Institutions to "marketing or distribution affiliates and intermediaries," leaving for another day the question of whether such intermediaries *might* be given individual or class exemptions.

This incremental approach to rulemaking is unreasoned. "[A]n agency does not act rationally when it chooses and implements one policy and decides to consider the merits of a potentially inconsistent policy in the very near future." *ITT World Commc'ns, Inc. v. FCC*, 725 F.2d 732, 754 (D.C. Cir. 1984). Agencies may not enact "a rule that utterly fails to consider how the likely future resolution of crucial issues will affect the rule's rationale." *Nat'l Ass'n of Broadcasters v. FCC*, 740 F.2d 1190, 1210 (D.C. Cir. 1984). Of course, agencies have always been permitted "to resolve some issues and to defer resolution of other issues when the issues decided were not inextricably related to the issues deferred." *ITT World Commc'ns*, 725 F.2d at 754. But here, the Department "has attempted to restructure the entire industry on a piecemeal basis." *Id.* It finalized an unworkable exemption (the BICE) while kicking down the road the crucial question of whether it could actually propose and finalize workable "insurance intermediary" exemptions in the form of individual or class exemptions. It left such concerns to a separate rulemaking, showing that the Department impermissibly "resolve[d] some issues" and "defer[red] resolution of other issues when the issues decided" were "inextricably related to the issues deferred." *Id.* (agency acted irrationally when it "established a policy of promoting intermodal competition without considering issues which concern directly the likelihood of intermodal competition"); *see also Nat'l Fed'n of Indep. Bus. v. Perez*, 2016 WL 3766121, at *38 (N.D. Tex. June 27, 2016) (the Department acted irrationally when it "failed to consider the ramifications that its New Rule would have on consultants" and "left such concerns to a separate rulemaking").

The Department's regulation-in-installments methodology is particularly disturbing because, in this circumstance, its "small errors in predictive judgments can have catastrophic effects on the public welfare," *Nat'l Ass'n of Broadcasters*, 740 F.2d at 1211. If adopted without significant other regulatory changes, the Proposal would ensure the destruction of the 80,000-plus member fixed annuity industry. Put bluntly, the Department has done too little, too late.

THE DEPARTMENT HAS NOT CONSIDERED ALL THE EVIDENCE

The Department does not appear to have considered much of the evidence identified in this comment. The Proposal makes no reference to the evidence or the evidence did not exist at the time of the Proposal's issuance. For convenience, in Appendix 1, attached hereto, Market Synergy enumerates by category both the relevant evidence the Department overlooked in the Proposal, as well as new post-Proposal evidence.

COUNTEPROPOSALS

The Proposal is unacceptable. The Department should take a different approach.

I. The Department Should Rollback Its Entire Regulatory Package.

"Administrative agencies have an inherent authority to reconsider their own decisions, since the power to decide in the first instance carries with it the power to reconsider." *Trujillo v. Gen. Elec. Co.*, 621 F.2d 1084, 1086 (10th Cir. 1980). As noted above, the Administration recognizes that the Department's regulatory package is "a solution in search of a problem" and that there are better ways to protect Retirement Investors. It has already begun the work of curbing the Department's "regulatory overreach." Congress, too, has opposed the entire regulatory package.

And the states support deregulation at the federal level. For example, as noted above, NCOIL has formally resolved that "the Rule promulgated by the DOL would threaten the proven State-based legislative and regulatory structure by imposing a vague and burdensome fiduciary standard on non-fiduciary sales relationships, thereby upending the retirement savings marketplace." While the Department professes that its Proposal lacks federalism implications "because it has no substantial direct effect on the States, on the relationship between the national government and the States," the states themselves strongly disagree.

Market Synergy supports the incumbent Administration's, Congress's, and NCOIL's articulated policies in this regard. It urges the Department to return the financial industry (and the insurance industry in particular) to the position it occupied before the Department's regulatory package was unveiled in the prior presidential administration. The Department should rescind that package in its entirety. In accomplishing this, the Department should delay the Proposal's notice of pendency and keep the comment period open indefinitely until there is clarity to the larger regulatory picture.

II. PTE 84-24 Should Be Amended To Again Encompass Fixed Indexed Annuities.

If the Department does not rollback its regulatory package in its entirety, it should at least amend PTE 84-24 so that it no longer excludes fixed indexed annuities. This would put such annuities on equal footing with other Fixed Annuity Contracts.

Some commenters have maligned fixed indexed annuities as uniquely risky, complex, and conflict-laden financial products. These commenters cite no studies or data to support their misguided views. That is unsurprising – there is simply no evidence of an epidemic of sales abuses or product maladies associated with fixed indexed annuities. Hardly anybody complains to state insurance regulators about them, and Congress and state officials have long recognized their value and suitability for many Retirement Investors. Unfortunately, in amending PTE 84-24 to exclude fixed indexed annuities from its scope, and again in the Proposal, the Department uncritically accepted these commenters' views. The Department should take this opportunity to correct its error.

In the Proposal, the Department disregards the true record concerning fixed indexed annuities. As discussed above, fixed indexed annuities and Fixed Rate Annuity Contracts are identical insurance products except for the method of calculating interest credited to the contract. Fixed indexed annuities are treated the same as other fixed annuities under state insurance law and federal securities law. They can offer the same income, insurance, and contractual guarantees as other fixed annuities; significant investment risk is borne by the insurer and there is no risk of principal loss; and they are no more complex than other fixed annuities. Moreover, commission rates for fixed indexed annuities are on par with rates for Fixed Rate Annuity Contracts; in concluding otherwise, the Department relied on outdated and irrelevant data and ignored the decade-long downward trend in commission rates. Finally, the NAIC and NCOIL have repeatedly denied the charge of "abuse" associated with fixed indexed annuity sales. *See, e.g.*, Brief for Petitioners NAIC and NCOIL at 13, *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010) (No. 09-1021), *at* .

In the context of a rule addressing purportedly conflicted sales advice, the only salient distinction between fixed indexed annuities and other Fixed Annuity Contracts – the different method for computing interest credited to policies accounts – is immaterial. That difference does not affect the manner in which fixed indexed annuities are sold, or the incentives to sell them. Nor does it make fixed indexed annuities any riskier. To the contrary, as state officials have emphasized, "the investment risks associated with fixed indexed annuities are borne by the insurance company, not the consumer" and "the primary feature of fixed indexed annuities is the safety of principal, not the allure of investments inherent with variable products, mutual funds, and other securities products." *See* NCOIL, *Resolution in Support of State Insurance Commissioner Authority Over Fixed Indexed Annuity Products* (Nov. 23, 2008), *at* ; *see also* Letter from NAIC to Congressman Gregory Meeks (May 1, 2009), *at* ("Though poor index performance may reduce payments beyond the minimum rate of return, the fundamental risk lies with the company, not the consumer."); Letter from NAIC to Christopher Cox, Chairman, SEC (Sept. 10, 2008), *at* ("Whereas variable annuities are in separate accounts, the indexed annuity is typically in the general account of a carrier as are standard fixed annuities. The insurance carrier bears the investment risk, not the owner."). As Commissioner Selzer recently attested, "fixed indexed annuities, like other types of fixed annuities, have none of the risk characteristics of those non-guaranteed investment products for which purchasers assume all investment risk and risk of loss of principal."

These views by knowledgeable state regulators contradict the Proposal, which ominously "cautions Financial Institutions and Advisers to avoid inaccurate or misleading statements regarding the risk characteristics of fixed indexed annuity contracts, particularly statements that inaccurately suggest these products have only upside potential and no risk of loss of principal." Market Synergy remains troubled that the Department – which maintains no expertise in or experience with life insurance products that have traditionally been regulated by the states – has taken it upon itself to (mis)regulate these products at the federal level.

In mischaracterizing fixed indexed annuities, the Proposal relied largely, if not exclusively, on earlier publications from the SEC, the Financial Industry Regulatory Authority ("FINRA"), and the North American Securities Administrators ("NASAA"), none of which profess or maintain expertise in or experience regulating fixed indexed annuities. The SEC and FINRA have described fixed indexed annuities as "complex" and "risky," (if they are surrendered prematurely), not that their sale involves purported conflicts of interest. Any such supposed inherent complexity or risk can and has been mitigated through disclosure and suitability requirements *that already exist at the state level*. State-mandated disclosure requirements, for example, already respond to the SEC's concern that Retirement Investors may have to pay surrender charges or tax penalties if they prematurely cancel the annuity contract. Subjecting sales transactions to a fiduciary standard is an unnecessary "solution." For its part, NASAA's tendentious, barebones statement that fixed indexed annuities are "instruments of fraud and abuse" is unaccompanied by any study or data supporting that charge and, in light of the NAIC's and NCOIL's vigorous defense against this charge, should be rejected as faulty.

Furthermore, the Impartial Conduct Standards that apply to Fixed Rate Annuity Contracts currently exempted under PTE 84-24 would equally assuage any conflicts of interest associated with fixed indexed annuities. Generally stated, the Standards require that when insurance agents (and others) provide fiduciary investment advice, they act in the plan's or IRA's best interest, and not make misleading statements to the plan or IRA about recommended transactions. Together with existing state-based regulation, PTE 84-24's Impartial Conduct Standards would adequately protect against any purported conflicts of interest in fixed indexed annuity transactions.

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On behalf of Market Synergy, we thank the Department for its consideration of these comments. We welcome the opportunity to discuss these comments and engage in a productive dialogue on its Proposal and Market Synergy's alternative recommendations.

Respectfully submitted,

CARLTON FIELDS JORDEN BURT, P.A.

By: ______________________ James F. Jorden

By: ______________________ Brian P. Perryman

APPENDIX 1

SELECT EVIDENCE THE DEPARTMENT HAS NOT CONSIDERED

Evidence The Proposal Overlooked

- State insurance and consumer protection laws applicable to insurers, producers, annuity products, and annuity transactions
- Annuity commission rate trends from Wink's, Inc. (available at)
- Laura Murach, LIMRA Secure Retirement Institute, *The DOL Fiduciary Rule: Independent Distribution Networks' Perspectives* (Jan. 16, 2017), *at*
- Joseph Montminy, LIMRA Secure Retirement Institute, *How the DOL Fiduciary Rule Will Affect Individual Annuity Sales* (Nov. 2016), *at*
- NAIC Annuity Buyer's Guide (available at)
- Joint Resolution of Disapproval (H.J. Res. 88)
- H.R. Rep. No. 114-527 (2016)
- Evidence of legislative intent of the Harkin Amendment, C-Span Video Library, Conference Committee on Financial Regulatory Reform: Financial Regulations Bill, Day 5, Part 2 (June 22, 2010) (comments begin at the 3:41:50 mark), *at*
- NCOIL, *Resolution in Opposition to the United States Department of Labor Fiduciary Rule* (Nov. 20, 2016), *at*
- NCOIL, *Resolution in Support of State Insurance Commissioner Authority Over Fixed Indexed Annuity Products* (Nov. 23, 2008), *at*
- Letter from NAIC to Congressman Gregory Meeks (May 1, 2009), *at*
- Letter from NAIC to Christopher Cox, Chairman, SEC (Sept. 10, 2008), *at*
- Brief for Petitioners NAIC and NCOIL, *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010) (No. 09-1021), *at*
- Department Field Assistance Bulletin No. 2008-04

Post-Proposal Evidence

- Presidential Memorandum on Fiduciary Duty Rule (available at)
- Press Briefing by White House Press Secretary Sean Spicer (Feb. 3, 2017), *at*
- 2016 NAIC insurance complaint data (available at)
- Press articles:
    - Cyril Tuohy, *FIA Distribution Could Turn into "Monopoly"*, InsuranceNewsNet (Feb. 10, 2017), *at*
    - Cyril Tuohy, *Executive Sees IMOs Entering An Age Of Consolidation*, InsuranceNewsNet (Feb. 7, 2017), *at*
    - Cyril Tuohy, *Super-IMOs Get 16 Months To Comply With DOL Rule for Exemption*, InsuranceNewsNet (Jan. 24, 2017), *at*
    - Warren Hersch, *IMOs to DOL: Fiduciary rule class exemption sets too high a bar*, LifeHealthPro (Jan. 24, 2017), *at*
    - Nick Thornton, *Under proposed exemption, IMOs will need $15M in cash reserves*, BenefitsPro (Jan. 20, 2017), *at*
    - Cyril Tuohy, *IMOs Call DOL Fiduciary Exclusion Unworkable*, InsuranceNewsNet (Jan. 17, 2017), *at*
- Transcript, Seeking Alpha, *American Equity Investment Life Holding Company Fourth Quarter 2016 Financial Inc. Earnings Call* (Feb. 9, 2017), *at*
- Press Release, American Equity Investment Life Holding Company, *American Equity Reports Fourth Quarter and Full Year 2016 Results* (Feb. 8, 2017), *at*
- Michael Wong, Morningstar, *Costs of Fiduciary Rule Underestimated* (Feb. 10, 2017), *at*