February 18, 2017

By Email: e-OED@dol.gov

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

Re: **Proposed Best Interest Contract Exemption for Insurance Intermediaries, ZRIN 1210-ZA26**

Dear Sir or Madam:

InForce Solutions, LLC ("IFS")[1] appreciates the opportunity to provide comments on the Department of Labor (the "Department") class exemption to allow certain insurance intermediaries to act as Financial Institutions[2], thus permitting them and the insurance agents and insurance companies they contract with to receive compensation in connection with Fixed Annuity Contract transactions (the "Proposal") under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").

IFS is one of the 22 insurance intermediaries identified in the Proposal that applied to the Department for an individual exemption to act as a Financial Institution under the Best Interest Contract Exemption. IFS commends the Department for issuing the Proposal and for recognizing the role and value of insurance intermediaries in the sale of Fixed Annuity Contracts. Nonetheless, we are concerned that many of the conditions in the Proposal will be difficult, if not impossible, to meet by a large majority of insurance intermediaries. As a result, the proposal does not provide a workable way for the large majority of insurance intermediaries and independent agents to continue serving their clients who depend on them for service and retirement security products. Additionally, we would like to address the Department's concern about fixed indexed annuity (FIA) contracts and provide further information and perspective on the safety and value of these products. Following are our specific comments.

1. <u>A premium threshold is not an effective measure of an insurance intermediary's compliance and conflict mitigation capability.</u>

The Department puts too much emphasis on sales volume as an indicator of whether an insurance intermediary is capable of minimizing or eliminating an insurance agent's conflicts of interest in choosing between insurance companies and products. While the Department indicates that the size of this premium threshold is based on a variety of factors, it would seem that the predominant factor is the size of the insurance intermediaries that sought the Department's approval to act as a Financial Institution under the Best Interest Contract Exemption. The Department should not misconstrue the fact that only larger insurance intermediaries applied for individual exemptions to mean that smaller insurance intermediaries would be unable to effectively put into place an appropriate compliance program. Indeed, we are aware of other insurance intermediaries with sales below the premium threshold that deliberately chose to wait for further guidance anticipated from the Department instead

[1] IFS is a wholly-owned subsidiary of Allianz Individual Insurance Group, LLC ("AIIG"), which is a wholly-owned subsidiary of Allianz Life Insurance Company of North America, Inc.
[2] Any capitalized terms not defined herein will have the meaning set forth in the Proposal.

of applying for individual exemptive relief. The $1.5 billion premium threshold would be very disruptive to the marketplace because it unnecessarily excludes the vast majority of insurance intermediaries in operation today. We believe that fewer than 5% of all insurance intermediaries would be able to meet this threshold.

We do not share the Department's belief that economies of scale alone are likely to yield advantages in efficiently carrying out the compliance responsibilities under the Proposal. Instead, we believe that a more meaningful indicator of an insurance intermediary's ability to mitigate conflicts is the background and experience of management operating the insurance intermediary, including the chief compliance officer. A disclosure by the insurance intermediary about the background and experience of its management required to be made to the Department could allow the Department to better assess whether the insurance intermediary will be able to carry out the compliance responsibilities under the Proposal.

The Department also should consider that the Proposal's premium threshold creates a potential conflict for the insurance intermediary; namely, the insurance intermediary must generate and maintain a minimum sales volume to retain its status as a financial institution. Essentially, the Department is imposing a sales quota on the insurance intermediary, which is in direct conflict with what the Department's Fiduciary Duty Rule is designed to eliminate. For this very reason, the Department should reconsider requiring that insurance intermediaries meet a premium threshold to qualify as a financial institution.

For the reasons stated above, we believe that a premium threshold is unnecessary. A disclosure requirement about the insurance intermediary's management could allow the Department to better assess whether the insurance intermediary will be able to carry out the compliance responsibilities under the Proposal. This, combined with a reasonable amount of assets set aside to satisfy any excise tax or litigation liability, should be sufficient to address any compliance or conflict mitigation deficiencies. Nevertheless, if the Department believes that a premium threshold is necessary, we strongly believe that a three-year average of $1.5 billion is too high and should be lowered to an amount that could still be significant and would permit a higher percentage of insurance intermediaries to act as Financial Institutions. In addition, the Department should provide a more practical set of parameters that would allow insurance intermediaries to effectively operate year-to-year without the fear of suddenly losing the ability to rely on the exemption just because of a single lower sales year. We also believe a lower premium threshold should be available during the transition period of the Proposal.

2. <u>The fiduciary insurance/ asset reserve requirement is too high and the required insurance coverage is not currently available in the insurance market.</u>

The fiduciary insurance/asset reserve requirement is too high and is not a realistic reflection of an insurance intermediary's potential liability. Tying the requirement to premium misconstrues the role of the insurance intermediary, which is to market the product and facilitate its purchase. The insurance intermediary does not have custody of the premium. Rather, the premium is held by the insurer that issued the FIA contract, and is used to support the guarantees of principal and a minimum rate of return. We suggest that the Department consider the capital requirements broker-dealers and registered investment advisers are subject to under state and federal securities laws, which require that lower capital amounts be maintained when no assets are held in custody.[3]

[3] Under Rule 15c3-1(a)(2)(v) of the Securities Exchange Act of 1934, the net capital requirement is not less than $25,000, instead of a minimum of $250,000 for firms carrying customer accounts.

The Department should also be aware that no fiduciary insurance exists in the marketplace today that meets the requirements set out in the Proposal. Even if it did, with so few insurance intermediaries anticipated to qualify as a Financial Institution under the Proposal, the risk pool would not be of sufficient size and comprised of a broad enough cross section of risk to determine affordable premium and/or any deductible requirements. This, in turn, would not make insurance a viable option for this purpose.

3. <u>Audited financial statements do not necessarily demonstrate sound business practices, and it is not possible to have audited financial statements by the Applicability Date.</u>

We note that the Proposal seeks to confirm that the insurance intermediary has sound business practices that have been reviewed by an independent entity. We question the utility of audited financial statements as demonstrating sound business practices. While we agree that periodic financial audits would provide reasonable assurances of an entity's financial health, we do not share the Department's view that the audited financial statements will indeed confirm that an insurance intermediary has sound business practices. Simply put, a financial statement will show where an entity's money came from, where it went, and where it is now. An entity can have unsound business practices that audit testing may not discover because audit testing only focuses on an entity's reporting measures to avoid financial misstatement risk. We support adhering to an auditing standard to demonstrate that it has sound business practices. However, we believe that the Proposal's audited financial statements requirement would fall short. We would support the development of an SSAE16-like report that reflects the appropriate data points for this purpose for an insurance intermediary. Not only would this prove to be more relevant, but we anecdotally note that the current cost range for an SSAE 16 audit is $15,000 to $50,000. This is compared to audited financial statements, which can cost upwards of $100,000.

We also note that firms that previously have not had audited financial statements would be unable comply with this requirement by the Applicability Date. Based on our own review, a minimum period of three months is a reasonable approximation of the time needed to obtain audited financial statements.

4. <u>Requiring an illustration in the sale of an FIA may violate several states' annuity disclosure laws.</u>

Many states have enacted the Annuity Disclosure Model Regulation (the "Disclosure Model") adopted by the National Association of Insurance Commissioners (NAIC)[4], which, in some states, includes standards for annuity illustrations. These standards permit, but do not require an illustration in the sale of an FIA contract. They also require that both guaranteed and nonguaranteed index-based values be illustrated. These standards, however, prohibit illustrating any index that has not been in existence for at least ten calendar years.[5] Further, the Department's suggestion that retirement investors be provided a chart comparing pure index returns to the index-based interest credited to the FIA contract would violate state annuity disclosure laws. Both the Disclosure Model and the NAIC's Advertisements of Life Insurance and Annuities Model Regulation[6] (adopted by several states) only permit index returns

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[4] NAIC Annuity Disclosure Model Regulation, MDL 245. The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight.
[5] Section 6F(9)(b) of the Disclosure Model.
[6] NAIC Advertisements of Life Insurance and Annuities Model Regulation, MDL-570.

to be illustrated when they reflect the current caps, spreads and rates declared by the insurance company.[7]

Notwithstanding, IFS fully supports the Proposal's requirement to provide annuity-specific disclosure consistent with the state disclosure laws for FIAs. Regardless of whether an illustration is utilized, most states have adopted disclosure regulations that require delivery of both a disclosure document and the Buyer's Guide[8] in connection with the initial sale of an FIA contract. We believe that the requirements of the state disclosure laws for FIAs are sufficient to protect consumers and foster consumer education. We question, however, the value in the Department requiring these disclosures to be repeated whenever additional premiums are paid. State annuity disclosure laws generally require that these disclosures only be provided in connection with the sale. Moreover, we note that the Department's own disclosures under the Best Interest Contract Exemption are not required with every single advice recommendation.

5. The insurance intermediary should have the latitude to select the person to conduct the required annual training.

We support the Proposal's annual training requirement, even though under the Best Interest Contract Exemption the Department does not impose a similar requirement on the other entities that can serve as a Financial Institution. We do, however, object to the Department imposing a qualification standard on the person who will conduct the training. Instead, we believe that the insurance intermediary should be responsible to determine the person who has appropriate qualifications to provide training.

6. State law and market forces already limit insurers' ability to change key terms of an FIA contract during the surrender period.

The Department questions the extent to which an insurer can change the participation rate, indexing method, cap, or relevant fees and charges, to directly affect its own compensation. FIAs are heavily regulated by each state insurance department where sold. State insurance law imposes requirements relating to annuity product design, administration and the investments that support the insurance guarantees, and permits the insurer to periodically declare renewal rates for the nonguaranteed values. In addition, state insurance law requires that the form of an FIA contract be filed with and approved by the insurance department before it can be made available for sale. The filing requirements can vary by state, but generally provide for the initial, minimum and maximum participation rates and caps for the indexing methods, the range of variability for any charges, and demonstrations of compliance with the Standard Nonforfeiture Law for Individual Deferred Annuities (the "Standard Nonforfeiture Law")[9], among other requirements.

The Standard Nonforfeiture Law establishes a formula to calculate the interest rate used to determine the minimum guaranteed surrender value required on an FIA contract. This formula does not permit insurer discretion, unlike the rates declared for the nonguaranteed, current rates of a fixed indexed annuity contract.[10] The current rates, however, are subject to the initial, minimum and maximum rates

[7] Section 6F(8) of the Disclosure Model; Section 5O(2) of the Advertisements of Life Insurance and Annuities Model Regulation.
[8] The NAIC's approved Buyer's Guide to Fixed Deferred Annuities, which for fixed indexed annuities, includes an appendix on equity-indexed annuities.
[9] NAIC Standard Nonforfeiture Law for Individual Deferred Annuities, MDL-806.
[10] Nonguaranteed current rates are typically declared and guaranteed for the following year or longer, according to the fixed indexed annuity contract.

included in the FIA contract form filings. Further, state insurance departments require the FIA contract form filings to include detailed demonstrations of compliance with the Standard Nonforfeiture Law.

IFS is troubled by the Department's suggestion of potentially further limiting the class exemption to annuity contracts that do not permit insurers to change key terms during the surrender charge period. We do not share the Department's view that because there are more moving parts with an FIA contract, then the insurer should be restricted from declaring renewal rates for the nonguaranteed values during the surrender charge period. It is important for the Department to recognize that insurers, whether issuing an FIA or other financial products, including even fixed rate annuities, need the flexibility to change nonguaranteed rates to ensure financial stability so they can meet the long-term promises they owe to purchasers of the contracts. An insurer that fails to administer the product features according to the contract provisions or applicable law could face administrative penalties imposed by state insurance departments. We could also face litigation risk with our customers and harm to our reputation.

Moreover, the Disclosure Model provides the disclosure standards for FIA contracts. These standards require delivery of both a product-specific disclosure document and the Buyer's Guide to the customer in connection with the sale. These disclosures describe both the guaranteed and nonguaranteed elements of the FIA contract and, for the nonguaranteed values, include clear notice that the current, declared rates are subject to change. Additionally, the fixed indexed annuity contract provides for both these values and makes clear that the rates declared for the current period are subject to change, but will never be less than the minimum rates stated in the contract.

7. The Proposal should be delayed consistent with any delay of the Department's Fiduciary Duty Rule.

We are aware that the Department has proposed to delay the applicability date of its Fiduciary Duty Rule in response to the President's Executive Memorandum directing the Department to review the Rule and consider whether to repeal or revise it. Because any actions the Department takes regarding the Rule could impact the Proposal, IFS requests that the Department delay the effective date of the Proposal consistent with any delay applicable to the Rule.

IFS appreciates the opportunity to provide comments on the Department's Proposal. Should the Department have any questions or desire to discuss our comments further, please contact James Nelson at james.nelson@allianzlife.com or (763) 765-7500.

Sincerely,

Brian B. Peterson
Chief Executive Officer and Chief Manager