



February 20, 2017

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

RE: ZRIN 1210-ZA26
Proposed Class Exemption for Insurance Intermediaries

To Whom It May Concern:

Ash Brokerage Corporation (“Ash” or “Ash Brokerage”) submits this letter in response to the Department of Labor’s (“DOL” or the “Department”) request for comments in connection with its proposed class exemption for insurance intermediaries to be “Financial Institutions” (the “Proposal”) related to the Conflicts of Interest Rule – Retirement Advice, 81-FR20946 (“Fiduciary Rule”). Ash Brokerage is a brokerage general agency (“BGA”)¹ that is considered an insurance intermediary as described in the preamble of the Proposal. The proposed class exemption provides an opportunity for Ash to become a Financial Institution and sign a best interest contract for BGAs, provided the company finds it desirable to add a retail component to its traditional wholesaling business² and meets the requirements as set by the Department. Ash did not submit a request for an individual exemption like twenty-two other BGAs (“Applicants”). However, company representatives met with the Department on October 25, 2016 as part of a group organized by the Association for Advanced Life Underwriting (“AALU”) and discussed issues concerning BGAs acting as Financial Institutions.

¹ Also commonly referred to as an insurance marketing organization or field marketing organization.

² For the purposes of this comment letter, Ash defines “retail” as a proposed business model where a BGA has a direct contractual relationship with a retirement investor.

I. Briefly About Ash Brokerage

Ash has been a family-operated insurance brokerage firm since 1971. We work with approximately 80 insurance companies distributing their insurance products such as life, disability, long-term care, fixed annuities and fixed indexed annuities. Ash has grown to become the largest independently owned BGA in the United States, serving over 10,000 financial professionals and employing 368 people nationwide. In 2016, we placed in excess of:

- \$1.16 billion in annuity premium
- \$17.8 billion in life insurance death benefit
- \$53.3 million in premium for disability, long-term care and linked-benefit

From a revenue perspective, Ash derives 73% of income from sales of protection products (i.e. life, disability and long-term care) and 27% from annuities.³

Ash technically is a wholesaler that distributes insurance products on behalf of insurance carriers. Practically, however, Ash has built a service model supporting advisors, brokers and insurance agents (collectively “advisors”)⁴ with their sales of insurance products for their clients. Services include providing platforms of insurance products, assisting advisors with their appointments with insurance carriers, developing solutions that meet the needs of advisors’ clients, processing insurance applications and underwriting, and enhancing advisors’ practices.

The advisors who work with Ash play an important role in protecting families’ lives and providing advice and financial planning to consumers across America. Their advice and recommendations help clients save and invest for retirement and children’s education, build retirement income streams so they do not outlive their assets, and identify protection solutions in the event of unexpected loss of life, disability or other tragedies. In 2016 alone, we assisted advisors with more than 30,000 American families meet retirement income and protection needs and objectives.

II. Summary of Position on Insurance Intermediary Class Exemption

Ash agrees with the Department’s goal of helping retirement investors receive advice that is in their best interest. Ash also believes that some regulation is needed so that retirement investors are reasonably assured of receiving such advice. Nonetheless, Ash did not support the Department’s initial proposal on conflicted advice and believe the Fiduciary Rule as it exists today is fraught with complications and unintended consequences that will harm

³ For annuities, “premium” is the full amount deposited (or invested) by a purchaser. Consequently, premium is not “sales” or “revenue” to a BGA.

⁴ Approximately 90% of the advisors Ash works with regarding annuities are associated with a broker-dealer (“BD”), registered investment advisor (“RIA”) or bank. Only 10% of advisors are “independent,” holding only a life and health insurance license (hereinafter referred to as “independent agents”).

retirement investors. The Department appears to believe that compensation models dictate all advisor behavior, and without a Fiduciary Rule consumers will continue to overpay for financial advice. While it is true that there is some abuse, most advisors put their clients' interest first regardless of the way they are paid. And, the trend at the institutional level has been to expand fiduciary services as a way of doing business, managing conflicted incentives from an advisor's consideration. Further, cost of financial advice has been and is getting cheaper, as, among other things, brokerage firms reduce commissions, robo advisors gain ground, and investment advisor fees compress.⁵

Ash does not advocate that the marketplace alone gives consumers protection. Some regulation is necessary. However, Ash believes that a best interest standard can exist under current compensation models without the onerous requirements of the best interest contract exemption and the changes to PTE 84-24. Any regulation should address the actual problems, implemented appropriately to address those problems and overseen by a regulator that can enforce the regulation. Key to effective regulation is defining unified standards and imposing compliance requirements for Financial Institutions to meet the standards. In other words, institutions need to know what and how to police themselves, the liability for failing to do so, and regulatory oversight to ensure advisors and their organizations follow the rules. We believe the Fiduciary Rule misses the mark with respect to these objectives. And, within this framework, we do not believe the Proposal meets these objectives either. There are significant compliance gaps for BGAs acting as Financial Institutions. The Department's idea that institutional size is a proxy for compliance is misguided and does not solve the need of protecting retirement investors.

Aside from Ash's perspective on the Fiduciary Rule, Ash generally believes the DOL correctly identified the entities that should be Financial Institutions – i.e. banks, broker-dealers, investment advisors and insurance companies. Each of these businesses is designed to serve the retail consumer directly and, as a result, are regulated by state and federal governments to protect the public. Contrarily, BGAs are at their core wholesaling organizations and regulated accordingly. For BGAs wanting to take on a direct consumer relationship under a best interest contract exemption, the regulatory framework for such BGAs needs to change. However, the requirements set forth in the Proposal are far from the standards retail organizations face. They simply are not enough to protect consumers if a BGA wants to add a retail component to its business.

Ash recognizes the Proposal is intended to fill a gap caused by the Fiduciary Rule for the distribution of insurance products by independent agents. Ash could support the expansion of the definition of Financial Institution to include BGAs with significant changes to the Proposal. As further described below, if the Department decides to offer a class exemption to BGAs, we

⁵ Many broker-dealers have required clients to change their commission-based IRAs to fee-based investment advisory accounts because of the Fiduciary Rule. This may cause buy and hold investors to pay significantly more over time, as clients are charged annually instead of a one time commission for a transaction.

believe the Proposal should be revised as follows for those BGAs wanting to be Financial Institutions:

- With respect to retirement assets, level the playing field so that BGAs' retail business are equivalently regulated as the retail business of BDs, RIAs, banks and insurance carriers.
- Establish regulatory oversight for BGAs' retail business similar to the Financial Industry Regulatory Authority ("FINRA"), the Securities and Exchange Commission ("SEC") and/or the Office of the Comptroller of the Currency ("OCC").
- Replace the financial thresholds based on annuities premium with required levels of minimum capital and liquidity.
- Remove the requirement of fiduciary liability insurance as an alternative to setting aside one percent of annuities premium as a result of requiring minimum capital and liquidity.
- Require an independent third party audit of operations and data protection such as SSAE 16 (data points do exist).

With these substantive changes, the Department will better ensure the protection of Americans who receive advice from independent agents and their sponsoring BGAs. Without such changes, retirement investors would not be protected, whereby Ash could not support BGAs being Financial Institutions. This is not to say that Ash does not support independent agents without a Financial Institution to sign the best interest contract. Independent agents need an ability to continue working with retirement investors. Fortunately, there are other solutions. Broker-dealers are offering affiliations so that a Financial Institution can sign a best interest contract for insurance transactions between independent agents and their clients.⁶

III. Suggested Changes to the Proposal

Ash Brokerage appreciates the Department's attempt to solve a gap for the distribution of annuities, particularly fixed indexed annuities, caused by the Fiduciary Rule. Without a solution, independent agents would be without the ability to serve clients' retirement needs with insurance products. The Proposal, however, falls short of balancing the needs of independent agents, the retirement investor and the Department. Allowing wholesalers to add retail business as set forth in the Proposal, without more, is not a viable solution.

The main content of the Proposal provides a definition for BGAs to be "Financial Institutions" and conditions for transactions similar to the best interest contract exemption. Lacking from the Proposal is any regulatory regime on how the DOL will oversee BGAs acting as Financial Institutions. The Department references in the Proposal that the Applicants intend to

⁶ Ash has discussed with four broker-dealers that would allow independent agents to affiliate with them in a non-registered capacity in order to fulfill the best interest contract exemption.

establish a compliance infrastructure, but there is no mention on what such infrastructure would be, what it would contain and how it will be overseen. As much as such a lack of clarity and open field could benefit Ash, we find giving such latitude questionable to protect consumers. Moreover, it would establish an unfair playing field in favor of BGAs compared to broker-dealers, RIAs and banks. The Proposal needs to include (a) content on how BGAs should operate compliantly for retail business, and (b) mechanisms on how BGAs will be overseen by the DOL (or another regulator).

Ash also believes the definition of “Financial Institution” under the Proposal needs to be revised. Under the Proposal, a BGA meeting the following five elements is a Financial Institution:

1. Maintains written contracts between:
 - a. The BGA and insurance companies regarding the distribution of fixed annuity contracts, and
 - b. The BGA and each Advisor or another intermediary (sub-intermediary).
2. Maintains applicable state insurance licenses.
3. Maintains sound business practices, including financial statements that are audited annually by an independent CPA.
4. Sets aside one percent (1%) of annual annuities premium, or, alternatively, maintains fiduciary liability insurance to cover such amount.
5. Has transacted sales of fixed annuity contracts over the last three years of at least \$1.5 billion of premium.

We agree that BGAs should maintain written contracts with insurance carriers regarding the distribution of fixed annuity contracts. We also agree that BGAs should maintain contracts with Advisors or another intermediary.⁷ We do think that the contracts requirement is incomplete and should provide greater detail when there is more than one intermediary. There should be a contractual chain from the insurance carrier to the Advisor. The Proposal as written leaves a gap between the primary BGA and the Advisor when there is/are sub-intermediary/ies in between. The Proposal should be revised to address this gap.

Ash also agrees with the requirements that BGAs should be properly state licensed and maintain sound business practices, which includes audited financial statements conducted by an independent third party CPA. However, we believe sound business should also include audit of internal controls and procedures, particularly data protection. *Please see below.*

⁷ Ash understands the requirements for the content of contracts generally are mandated by the terms of the best interest contract exemption. As such, Ash does not comment on this portion of these requirements since they are established by existing rule and other Financial Institutions must adhere to them. Regarding the new content requirements for BGAs, Ash has no objection at this time.

Ash does not believe the financial requirements based on annuities premium are wise or meaningful. The amount of premium means nothing if a company is inefficient financially and operationally. A company with smaller sales can have just as much financial strength as a larger one if it runs its business efficiently. Accordingly, any financial requirements should be based on financial principles demonstrating stability and not on assumptions that bigger institutions have financial wherewithal. We find requirements of minimum capital and liquidity that banks and broker-dealers must follow as better protection for consumers. *Please see below.*

A. BGAs as “Financial Institutions” Should Be Regulated as Retailers

If BGAs want to enter the retail space, the playing field should be level for all who give advice to retirement investors. Accordingly, the Proposal needs to be revised so when BGAs take on a retail capacity, they are equivalently regulated as broker-dealers, investment advisors, banks and insurance carriers. Absent from the Proposal are the stringent compliance requirements that retail financial firms must follow, including how the DOL will oversee BGAs similar to the oversight FINRA has over broker-dealers, the SEC has over investment advisors and the OCC has over banks.⁸ These gaps in the Proposal need to be addressed before BGAs have the same standing as other Financial Institutions.

In addition to BDs, RIAs and banks meeting the Fiduciary Rule requirements when working with retirement investors, they also must comply with a multitude of requirements aimed towards protecting investors and the capital markets. These requirements include but are not limited to:

- State and federal privacy regulations
- Safeguarding customer Information
- Capital and liquidity requirements
- Anti-money laundering regulations
- Business continuity plans
- Supervisory controls and supervision of transactions
- Advertising standards
- Compensation
- Licensing
- Outsourcing key operational functions to third parties
- Books and recordkeeping requirements
- Gifts and entertainment
- Whistleblower protection
- Requiring a chief compliance officer
- Risk management

⁸ Ash wants to make it clear that it supports additional regulation of BGAs only when they act in a retail capacity and such regulation is limited to their retail business. BGAs serving only in the traditional wholesaling role should be regulated by state insurance departments.

- Regulatory reporting
- Regulator exams

BGAs may also be subject to some of these requirements by virtue of doing wholesaling insurance business in various states. However, the states are not consistent, nor do many have the resources to expand oversight of producer organizations. To avoid inconsistent application or no oversight at all, there needs to be a central authority responsible to ensure compliance with all rules and regulations like there are with FINRA (BDs), the SEC (RIAs) and banks (OCC).

BGAs may truly believe they can build compliance systems sufficient for investor protection. But, the differentiating factor between BGAs as Financial Institutions under the Proposal and other financial services firms is a central regulator. Ash realizes this puts the Department in a difficult spot of becoming the regulator of BGAs with retail business,⁹ notwithstanding insurance sales are not its area of expertise. Or, the Department must relinquish its authority to another regulator which can oversee BGAs that become Financial Institutions. Ash believes one of these two outcomes must happen to protect retirement investors and the capital markets. Otherwise, the better solution should be left to the marketplace without a class exemption. This has already happened with broker-dealers offering independent agents affiliations so that insurance transactions involving retirement assets fall under the best interest contract exemption.

B. Minimum Capital is a Better Financial Measurement Than Thresholds Based on Annuities Premium

Ash supports a financial requirement for BGAs to act as Financial Institutions under the Proposal. However, we do not believe that there should be a financial threshold based on annuities premium, whether it is the amount of premium (referring to the \$1.5 billion premium requirement) or the amount required to reserve (referring to the requirement to “set aside” unencumbered assets equaling 1% of annuities premium). Size of premium should not matter. What should be is that the structure of the organization is sufficient enough to meet regulatory requirements. A better way of ensuring financial stability is requiring minimum capital requirements similar to the way banking regulators require minimum capital and liquidity thresholds or the SEC requires minimum net capital for broker-dealers.

Premium is not the same thing as revenue to a BGA, where revenue is a small percentage of premium. Further, BGAs’ revenue vary widely, depending on the type of annuity, its benefits, its complexity, the insurance company, and volume. So, BGAs with the same levels of premium could experience very different levels of revenue as a result of these factors. If the Department hasn’t already done so, it needs to take these factors into account and the variance they would produce. The Department also needs to take into account the costs of producing

⁹ See footnote 8.

the sales. Some smaller BGAs may be much more efficient in managing its costs than larger organizations, whereby the smaller BGA may be much more financially sound.

Limiting a financial threshold just to annuities premium also does not account for revenue coming into the company from other sources. For example, Ash would not meet the Proposal's threshold, even though it sold \$1.16 billion in premium without aggregation for 2016, which such production probably is considered one of the larger in the industry.¹⁰ Ash's protection business represents 73% of its revenue. It is not clear why the Department would not take all business into consideration when determining the financial stability of a BGA. And, to be fair, this could cut both ways. The non-annuities business could be strong and provide the financial support the Department wants. Or, the non-annuity business could be such a strain on the company, no matter how much sales come from annuities, the company could be a risk to consumers.

Ash believes that the better financial requirement is minimum capital. This takes into account all of a company and not just a portion of it. The Department suggested something similar with an alternative of setting aside one percent (1%) of annuities premium or maintaining fiduciary liability insurance. However, the set aside amount is too much and fiduciary liability insurance does not address financial stability. It would take many years after paying expenses to generate enough "set aside" funds from the revenue resulting from annuities sales to achieve the one percent requirement. For example, the proposed set aside amount for \$1.5 billion premium would be \$15 million. Revenue from \$1.5 billion of premium probably would be somewhat greater than this amount, but a good portion of this revenue would need to cover costs, leaving a fraction of the amount needed to meet the one percent threshold. It would take years to organically grow to the one percent threshold, or a significant capital infusion would need to be made.

Out of broker-dealers, banks and investment advisors, BGAs are more akin to independent BDs, where client assets are held away from the firms (i.e. "direct" at an insurance company).¹¹ Larger independent BDs generally have to maintain net capital under the SEC Net Capital Rule (Rule 15c3-1), which requires the minimum net capital to be the greater of \$250,000 or two percent (2%) of aggregate debit items computed under Rule 15c-3 reserve requirements. These amounts are designed to protect the broker-dealer from material adverse effects to the business.

BGAs (as retailers) would not be subject to the same risks as broker-dealers. Generally, the risks from sales practice violations would be markedly different. BDs and BGAs would both have similar suitability and best interest obligations. However, losses stemming from claims of

¹⁰ Data about BGA production is not readily available, and it is difficult to discern because many BGAs aggregate production by sub-intermediaries.

¹¹ Independent broker-dealers are generally referred to as introducing brokers, where client assets are held at a clearing firm or "direct" at product manufacturers (e.g. mutual funds or insurance companies).

unsuitably would be very different. For unsuitable securities investments, the remedy usually is rescission or recovery of “net out of pocket losses.” For unsuitable annuities, it is rare that fixed and indexed annuities themselves lose money, because they are contracts with fixed values plus the credited rate of return promised by insurance companies. The only true loss that could happen is if an insurance company can no longer pay (i.e. its claims paying ability). Rather, the main risks of unsuitable fixed and index annuities relate to “losses” from early surrender of contracts where a client could experience a surrender charge or a negative market value adjustment.¹²

Ash would be amenable to a net capital requirement like broker-dealers, but adjusted for the nature of insurance business. Or, Ash would be fine with a flexible minimum capital that is adjusted for certain factors and risks. Either approach should take into consideration the following:

- The concentration of business a BGA does with one carrier,
- The concentration of lower rated carriers on a BGA’s platform (e.g. less than A- according to A.M. Best)
- The nature of possible losses or damages (as mentioned above),
- The likelihood of lawsuits,
- The types of annuities a BGA sells and the percentages of each,
- The number of staff devoted to oversight,
- The amount of annuities transactions conducted by a firm,
- The average value of a firm’s annuities transactions, and
- The percentage of “large” transactions conducted by a BGA.

Another factor for the Department to consider is the decline of fixed indexed annuity complaints since state insurance commissioners required more stringent suitability thresholds to protect client interests. Closed complaints for fixed indexed annuity sales were under 100 for years 2011 (50), 2012 (54), 2013 (46) and 2014 (77).¹³ In 2008, there was one complaint for every \$100 million of issued premium.¹⁴ In 2014, there was only one complaint for every \$633 million of issued premium.¹⁵ FINRA reported complaints were less than 10 per year in 2013 and 2014.¹⁶ Clearly, significant improvements have taken place since 2008-2010.

In any event, the amount of minimum capital should be no more than what broker-dealers are required to maintain.

¹² Surrender charges and market value adjustments may be appropriate when the circumstances of the client changes.

¹³ Koco, Linda. “FIA Complaints Rise Unexpectedly.” *InsuranceNewsNet*. 11 March 2015. Web. 20 February 2017.

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.

Ash also does not support fiduciary liability insurance as a substitute for meeting a financial threshold.¹⁷ Maintaining minimum capital should stand alone and be separate from insurance coverage. BGAs should have some skin in the game that minimum capital provides and fiduciary liability insurance does not.

C. Sound Business Practices Should Include Audits Financials and Internal Controls

The Department requested comment on the utility of audited financial statements and alternatives as protection to retirement investors. Ash believes that having an independent audit conducted by a certified public accountant is a sound business practice. Financial audits provide reasonable assurance of a company's financial health. We do not believe, however, that financial statements need to be published on a Financial Institution's website. Most BGAs are private companies and disclosure could cause a competitive disadvantage. Not all financial services firms are required to disclose their financial health on their website. More importantly, the changes recommended herein obviate the need for financial statement disclosure by BGAs. With BGAs meeting a minimum capital requirement, retirement investors can be assured that BGAs acting in a retail capacity are relatively sound. Ash would be amenable to filing financial statements with the Department as another means of protecting retirement investors.¹⁸

Ash also believes that audit of internal controls and procedures should be a regular part of a BGA's business, particularly controls around privacy and information security. For the last several years, Ash has had an independent audit of its operations and systems, resulting in a SSAE 16 report. Ash believes it is important to show its business partners operational and data protection strength. This also demonstrates auditors have the data points necessary to test BGAs, contrary to the representations made by some Applicants to the Department. Data protection and efficient processes are a vital part of retail financial services. Firms need sound privacy, confidentiality and information security practices and they need these practices tested. We see no reason why BGAs cannot have a third party audit internal controls and procedures.

D. Unintended Consequences: Lack of Choice and Competition

The Proposal as written would essentially limit the number of BGAs to about five to seven that could meet all of the proposed requirements.¹⁹ This would put a number of BGAs out of business, a race for aggregation, and the distribution of insurance products in the hands

¹⁷ Ash could support a requirement of BGAs maintaining fiduciary liability insurance, but it would not be from the perspective of ensuring financial stability. Any Financial Institution in the fiduciary advice business should have fiduciary coverage as a best practice from a practical business perspective through its E&O carrier.

¹⁸ Assuming Ash pursues Financial Institution status.

¹⁹ Iacurci, Greg. "DOL proposes allowing some insurance intermediaries to use a BICE under fiduciary rule." *InvestmentNews*. 18 January 2017. Web. 20 February 2017. Tuohy, Cyril. "IMOs Decry the DOL's 'Exclusive Club' Approach." *InsuranceNewsNet*. 19 January 2017. Web. 20 February 2017.

of a select few.²⁰ The natural consequence of such limited choice of BGAs could impose risks of less consumer options and increased costs of those options. Moreover, most advisors work with more than one BGA. Many utilize one BGA for annuities, another for life insurance, another for long-term care, etc. Some Applicants admit that to comply with a class exemption they would require exclusivity of advisors in order to manage fiduciary responsibilities.²¹ It is not clear from the Proposal whether the Department understood this as exclusivity of annuities sales only or all insurance business. Ash would like to submit that based on industry dialogue it is the latter and not the former. If so, the Proposal would severely limit advisor choice for annuities and particularly protection products (i.e. life, disability, and long-term care). We don't think this is the Department's intent, but that appears to be the intent of several BGAs.

IV. Conclusion

Ash appreciates the opportunity to comment on the proposed class exemption for BGAs. In sum, we do not support a class exemption for BGAs at this time. The Proposal fails to protect retirement investors and does not provide a level playing field for retail financial services firms. If the Department moves forward with a class exemption, stronger compliance requirements and consistent oversight by a central regulator are needed. Financial thresholds based on annuities premium should be replaced with requirements of minimum capital. Independent audits should cover financials and internal controls and procedures (e.g. SSAE 16).

We hope our comments are useful to the Department, notwithstanding the constant flux surrounding the Fiduciary Rule. Ash would welcome the opportunity to expand on its comments at the request of the Department. We are willing to provide additional information, meet with the Department, or attend a hearing at your convenience.

If you have any questions or if we can be of further assistance, please do not hesitate to contact me at 260-434-9724.

Sincerely,

/s/ Jeffrey V. Gery

Jeffrey V. Gery
Chief Legal Officer
Ash Brokerage Corporation

²⁰ *Id.*

²¹ See Proposal at **Background Regarding Fixed-Indexed Annuities and IMOs**, *Common Characteristics of IMO Individual Exemption Applicants* and footnote 70.