creativeOne

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Submitted by Fedex

February 21, 2017

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: ZRIN 1210-ZA26 – Proposed Best Interest Contract Exemption for Insurance Intermediaries

Dear Acting Secretary Hugler:

I am the President of Creative One Marketing Corporation ("CreativeOne"), a national life insurance and annuity brokerage organization, which is commonly known as an independent marketing organization ("IMO"). CreativeOne supports the idea that insurance intermediaries should be allowed to keep supporting the tens of thousands of independent insurance agents who sell life insurance products, especially fixed indexed annuities. However, in our review of the Proposed Best Interest Contract Exemption for Insurance Intermediaries ("Proposed Exemption"), we are very troubled by many of the overly onerous requirements and confusing standards that make compliance with the exemption impossible. We adamantly believe that without any further analysis and meaningful changes to the Proposed Exemption, a great majority of 80,000 independent agents selling fixed annuities will be forced to irreversibly exit this consumer-critical market. This will cause massive upheaval for the agent, distributor, insurance carrier, and most importantly, consumers of these valuable, guaranteed retirement income insurance products.

We understand that the Prohibited Transaction Exemption ("PTE") 2016-01, the Best Interest Contract Exemption ("BICE"), and the Proposed Exemption was developed and written under a previous administration and previous regulatory regime. That being said, we feel it is extremely important to comment on the areas of the Proposed Exemption where it failed to consider the practical impact to the fixed annuity industry and irrationally imposed conditions in comparison to other compliance requirements through BICE. We maintain that the Administration should undertake a more thorough analysis in crafting a fair and reasonable rule that recognizes the uniqueness and nuances of the fixed annuity marketplace. The

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Proposed Exemption is inconsistent with the new 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.

This comment will focus on three key areas. First, we believe that Department of Labor (the "Department") misunderstands the function and purpose of the IMO and the fixed annuity product. As such, we will focus exactly on what we do and the value that independent distribution has for consumers. Second, we will address the overly burdensome requirements that IMOs will face to comply and the impossible window of remaining time to implement yet-to-be finalized standards. Third, this comment will make the case that the 1% premium requirement for capital or insurance is unbalanced and inequitable due to the associated risk involved in the IMO space compared with other similarly situated "Financial Institution" firms in the retirement and securities space such as broker-dealers or registered investment advisors.

Ultimately, our recommendation is for the Department to delay the implementation of the rule to review the necessity of the rule and to craft requirements that account for the uniqueness of the industry, rather than rely on arbitrary, unsupported, and unreasonable conclusions. We believe the fixed annuity industry and consumers would substantially benefit from a more comprehensive study of the Proposed Exemption and also a delay of the applicability dates under the BICE and this Proposed Exemption. The fixed annuity industry currently and will continue to operate under a robust regime of state insurance regulatory safeguards that has consistently proven to offer strong consumer protection. No consumer harm has been demonstrated by the DOL or others within the fixed annuity industry, so delaying the BICE and this Proposed Exemption will not cause any harm.

## I. A strong, sound, and competitive independent distribution channel for fixed annuities is exceptionally beneficial to consumers—the Proposed Exemption will devastate the current distribution model

### *a. The uniqueness of IMO annuity distribution model is beneficial to consumers*

Both the preamble and the language of the Proposed Exemption make it clear that the Department does not fully understand the nuts and bolts of the IMO independent distribution channel. Nowhere in the preamble did the Department indicate that they did any investigation or analysis into the distinctiveness of the model, but instead focused almost exclusively on securities distribution models via registered advisory firms, banks or broker-dealers. Therefore, we believe it is important to explain to the Department who we

are, what we do, and the value we and other IMOs provide to American retirees and small businesses around the country. We believe a thorough and careful consideration of the fixed annuity market is required in order to reach any conclusions about the workability of the BICE or this Proposed Exemption.

Since 1985, CreativeOne has worked with insurance carriers and independent agents to assist in the sale of fixed annuities and other insurance products. We are contracted with over 20 insurance carriers. Last year, CreativeOne served as the marketing organization for approximately 3,500 agents selling fixed indexed annuities or other type of fixed annuities. These independent agents operate their own small business. While CreativeOne supports and services billions of dollars in premium from independent agents, CreativeOne remains a dedicated small business located in the heart of America. We are committed to helping these 3,500 small agents/insurance agency businesses understand and provide annuity products to those in need of safe accumulation and guaranteed income plans in their retirement years.

To fulfill this commitment, CreativeOne acts as an outsourced service provider for the insurance companies to the independent insurance agent. CreativeOne provides product education, marketing assistance, and administrative support to independent agents for their sales of fixed annuities and other insurance products. CreativeOne also recruits independent agents, provides licensing support, and performs various other traditional insurance carrier functions akin to a third-party intermediary between the independent agents and the insurance companies whose products the agents are appointed to sell. We employ 126 employees to accomplish these broad range of tasks. CreativeOne is compensated directly by the insurance company for its recruiting, marketing support, and other services based on a percentage of agent sales volume. It is important to note that CreativeOne, like virtually every other IMO, has no relationship with the end-consumer who purchases annuities. Rather, the IMO business model provide a vital and cost-efficient role for insurance carriers and independent agents to operate. This independent distribution of fixed annuities, utilizing independent distributors such as IMO, creates substantial economic and operational efficiencies for the carriers, which in turn provides consumers with more competitive guarantees and crediting factors to their contracts. A great majority of fixed annuity products provided by insurance agents rely on the services provided by outsourced distributors (IMOs). We estimate that among the top 10 carriers who manufacture fixed indexed annuities, 75-80% of sales are through the IMO distribution channel.

It appears from the Proposed Exemption that the Department assumes that IMOs like CreativeOne perform tasks and operate as if they mirrored broker-dealers. This is simply incorrect. Specifically, CreativeOne does not interact directly with any consumer, but merely serve as the intermediary between the agent and the carrier, performing critical service and support functions for both. Correspondingly, CreativeOne, along with other IMOs, have never been organized to operate as a "supervisor" of independent agents, who

often conduct sales through multiple IMOs and carriers. IMOs are not structured operationally or legally as complaint resolution bodies and do not serve the role as complaint supervisor or disciplinarian. In fact, state insurance law provides for a mechanism and carrier requirements to handle all consumer complaints. And, to our knowledge, every carrier-independent agent producer contract describes the relationship between those parties in a principal-agent relationship, consistent with 100 years of state-based insurance statutory and case law. In the current distribution model, IMOs are not designed to be the supervisors of independent agents for the carriers.

The independent insurance agents CreativeOne works with are just that—independent. These agents are not employees of CreativeOne. They are independent contractors of the insurance companies whose products the agents are authorized to sell, as is CreativeOne. In fact, independent agents in contracting with a number of different insurance companies, may use a number of different IMOs. In general, there is not even a contractual relationship between the agent and the IMO; an agent is free to select an IMO suitable for his or her needs, then the insurance company designates the agent to the IMO. Independent agents decide how to develop and manage their client relationships, and they decide what financial products are appropriate to recommend to their clients. CreativeOne is contracted and remunerated by insurance carriers. Almost every independent agent is paid directly by insurance carrier, not by CreativeOne. IMOs do not have agent agreements with such independent agents since there is no principal-agent relationship nor duties to one another.

Each independent agent we work with is himself or herself a small business, either as a sole proprietorship or an LLC. Each of these businesses usually have between 1-5 employees. As insurance professionals, and small businessmen and women, independent agents do not make a salary. They rely primarily, if not exclusively, on sales commissions paid by insurance companies for their livelihoods and the livelihoods of their employees.

We refer to agents who do not have securities licenses as "insurance-only" agents. These independent agents are licensed with one or more state insurance departments to sell insurance products, including fixed indexed annuities and other types of fixed annuities. Fixed annuities sold by insurance-only agents are considered to be a type of life insurance product and are regulated extensively by state insurance departments. A characteristic of all fixed annuities, including fixed indexed annuities, is that contract owners do not bear any downside investment risk. Rather, they benefit from principal protection, guaranteed lifetime income options, and other contractual guarantees and benefits that are backed by the assets and reserves of the insurance carrier issuing the policy. All fixed annuities, unlike variable annuities, are covered by state guaranty funds which, in the case of a carrier insolvency, provides a valuable additional protection of contractual guarantees under the fixed annuity.

Sales of securities are subject to an entirely different regulatory regime, as well as difference licensing requirements on both the federal and state level. This is in part because securities-licensed broker-dealer representatives can sell investment products such as variable annuities and mutual funds in which, unlike fixed annuities, the investor bears all downside investment risk, and in theory, could even lose his or her entire principal investment.

Independent agents supported by CreativeOne sell to, assist, and service customers of all ages, but given the characteristic features of fixed annuities, generally customers fall into the range of 50 to 74. Fixed annuity customers' annual income and net worth varies, but typically have a net worth ranging from $250,000 - $750,000. Approximately two-thirds of all fixed indexed annuity sales include a guaranteed lifetime benefit rider, which offers predictable and certain guaranteed income the customer cannot outlive will maintaining flexibility and liquidity under the contract. Sales involved qualified and non-qualified funds, the former representing 64.5% of annuity sales that CreativeOne services.

The retirement income and savings needs of the independent agents' clients can be met, at least in part, with the purchase of fixed indexed annuities. They are versatile products that provide upside potential associated with the selected reference index (with any gains locked into the contract value each year or interest crediting period), complete downside investment risk protection as well as state mandated minimum guaranteed contract values, and traditional fixed interest rate account options. Indeed, our records indicated that approximately 93% of annuity premium sales by agents with work with CreativeOne have been from the sale of fixed indexed annuities, with 66% being purchased with tax-qualified funds, predominately Individual Retirement Accounts ("IRAs").

Maintaining an independent distribution channel to retirees in need of guaranteed retirement products is critically important to consumers. Independent agents are free to contract with any number of different insurance carriers. Our average agent contracts with between 4-5 insurance carriers based on the needs of their customer base, the competitiveness of the products, and other factors such as carrier rating, quality of service, renewal rates, and rider benefits. This independence allows agents to choose from a variety of carriers and products to solve the wide variety of needs of their clients.

For example, an independent agent may have two clients: one aged 55 and the other aged 75. The independent agent and client would have the ability to consider products from a variety of carriers based on the individual needs and circumstances of the client. For example, the needs of the client aged 55 may include a product that would allow for better accumulation where immediate income may not be necessary. Conversely, the agent and client could also locate a much different annuity product for the 75 year old client who may be less concerned with accumulation and more concerned with immediate income and long term care benefits. Not all insurance carriers will carry products for every possible client's individual need. The independent agent has the benefit of being able to give the consumer

the best choice of available products. Insurance only agents are subject matter experts specializing in the aspects of this conservative safe insurance product. Many securities licensed salespeople may not have the subject matter expertise, because insurance may only be a small focus with a heavier concentration in sales of securities. The independent distribution channel also provides access to retirement income planning strategies for an underserved segment of the population: namely, hard-working, middle-income Americans who do not meet the asset thresholds of many securities broker-dealers and investment advisory firms.

*b. The Proposed Exemption will devastate small businesses and consumers*

It is with great urgency and concern that we wish to advise the Department that the Proposed Exemption would devastate the independent distribution of annuities channel. Unfortunately, the BICE offered no outlet for the tens of thousands of independent agents selling fixed indexed annuities today, and now this Proposed Exemption offers no solution either. The impacts would be felt at all levels: from the carrier to the IMO to the independent agent to the consumer. This Proposed Exemption puts the accessibility of guaranteed retirement products to middle-income Americans at severe risk.

There are significant costs associated with the rule even before the Proposed Exemption requirements enter the equation. Carriers, IMOs, and independent agents will have to spend a significant portion of their revenues on compliance and additional supervisory resources to comply. Once you add in the requirements reserved only for "insurance intermediaries" in the Proposed Exemption, the entire arrangement becomes absolutely unworkable. We estimate that we have spent over a million dollars at our IMO so far preparing to be compliant by the applicability date, even though we do not know if the Proposed Exemption will be finalized or what conditions will be required. These costs do not include the additional insurance or capital costs necessary to comply with the Proposed Exemption and do not include additional capital and human resources that are yet to come. We face 48 days until CreativeOne must have compliance pathway to meet the April 10 deadline but we still don't know what steps to implement. The Transition Period steps in the Proposed Exemption do not provide any meaningful transition help either, and as written, require compliance qualifications based on operations and requirements that occurred in the past such as the three-year minimum sales requirement. Creating a regulatory exemption relief rule with retroactive application of requirements may very well be illegal under ex post facto law. Regardless, this unsettled regulatory quagmire and the uncertain outcome of the four federal lawsuits challenging the Fiduciary Rule has and will continue to cause massive disruption for insurance agents and clients. IMOs face a Sisyphean task without knowing where we are supposed to be pushing the boulder.

These costs will be felt far and wide. At the carrier level, we have already seen commission rates drop among some carriers 1-2% in preparation of the annuity market

taking a downturn and higher cost of operations and costs associated with compliance with the fiduciary rule. This small number has a large impact across the industry. A cut in commission rates at this level could impact an independent agent's income by as much as 25% per year, putting independent agents on the ropes and trying to decide whether to shut down their business, undergo layoffs, or keep going in this arduous regulatory landscape.

We have also begun to see carriers discontinuing significant annuity products in anticipation of the applicability of the Fiduciary Rule, further limiting consumer choice of different annuities. Carriers will reduce the number of products in order to avoid what could appear to be conflicts within their own portfolios and conflicts on an IMO shelf versus other companies' products. There will be an irresistible urge to standardize and incentive to collude among carriers. Even these results will not resolve the presumed problem of significant commission differences leading to class action lawyer led allegations of conflicted advice. To give just one example, most contracts pay lower commissions at upper ages due to actuarial mortality effects and the annuity guarantees. However, the ages at which these breaks occur vary widely due to carrier risk acceptance and actuarial approaches yielding multiple percentage points of commission difference. Even if that could be surmounted by every company miraculously pricing the same, the result would not be positive for a competitive market for consumers. Other examples are by state approval differences, rider differences, and renewal differences.

Consumers and small businesses will also be squeezed out of the market. Assuming some workable IMO Exemption were granted, as the cost of compliance increases, it will cost the IMO, as the supervising "financial institution", a fixed cost to maintain and support each and every independent agent. For each independent agent, the IMO will have to maintain the requisite amount of insurance and create compliance and supervisory capability to cover each agent and their sales. It has become clear that IMOs will not be able to support all of their agents with such increases and new role of supervisor. Many lower producing independent agents will be squeezed out of the market as their IMO will not be able to support their administrative costs. An agent with small production at one IMO, but more significant production at another IMO may be rejected by the former. This will result in single IMO agents, making independent distribution, less independent—a negative impact on consumers.

And while the DOL may have surmised that insurance carriers would serve as a supervising "financial institution" under the BICE, as of the date of this filing, no carrier has publicly announced it will sign a best interest contract with consumers. We are not surprised, since independent agents sell for multiple carriers and do not operate as gate-keeper supervisors like a broker-dealer. Fixed annuity carriers operate more like a variable annuity or mutual fund company- they manufacture financial products but do not serve as employer or supervisor. As a result, these independent agents will have nowhere to go and will be forced to end their business. With such a drastic decrease in revenue and increase in compliance costs for independent agents, we estimate as many as 60-70% could exit the

insurance marketplace as a whole. Many independent agents sell both fixed annuities and other insurance lines, such as life insurance, however many do not specialize in P&C, long term care, or disability insurance. It is completely impractical for independent agents to simply change their business model and client service proposition to sell other insurance lines. Most CreativeOne independent agents focus on selling fixed annuities and operate their small business to specialize in such retirement products for consumers. Eliminating access to fixed indexed annuities for tens of thousands of independent agents will result in agents losing their small business livelihood and their customers losing their trusted insurance salesperson.

The consumer will also face significant harm. As noted above, a consumer's local "mom-and-pop" insurance agent could possibly go out of business. The consumer could try to find another authorized insurance agent licensed and appointed to support their annuity, but this is highly unlikely. Many registered reps of broker-dealers do not have contracts to sell fixed indexed annuities, preferring to sell variable annuities. End even if a registered rep could obtain a license and appointment with the insurance carrier to service an indexed annuity customer, most customers would likely face the firm's minimum investable assets threshold that many broker-dealers impose to work with them—a level that many middle-income Americans won't reach. Registered investment advisors will similarly decline to support these annuity customers because most do not maintain high minimum investable asset thresholds and won't be able to charge a fee on the annuity purchased. Most RIA firms charge 1-1.5% for the average annuity customer ($250,000-$750,000 net worth), and simply do not want to serve Main Street customers because they make more money working with millionaires. Some RIA and BD firms have stated in their own industry conferences that the fee model does not work for a significant portion of the consumer base who are not millionaires. And a last theoretical BICE-approved "financial institution" are banks, yet to our knowledge no bank has agreed to serve as a "financial institution" for independent agents. Customers might also theoretically seek out a different independent agent properly appointed with their insurance carrier, but finding an authorized agent would prove impossibly cumbersome and expensive for the customer. Further, even if they located an authorized independent agent to service their annuity account, most agents would impose their own minimum investable asset thresholds and decline to serve those customers. The BICE rule and the Proposed Exemption will price out a great majority of middle-income Americans. Good retirement strategies and products will be reserved only for the rich.

## II. The $1.5 billion premium requirement—a perspective of an IMO who qualifies

As other commenters are likely to point out, of the hundreds of IMOs in the current marketplace, we believe as few as five to eight IMOs could potentially meet the onerous historical annuity sales requirements, including CreativeOne. While IMOs with annuity sales under $1.5 billion could theoretically partner or affiliate with those IMOs with

demonstrated $1.5 billion in annuity sales, such scenario is unrealistic as described below and hundreds of IMOs will simply go out of business. We estimate that approximately 300 IMOs do not meet the $1.5 billion requirement and that as much as 250 will not be able to recreate their business model. With each of these 250 IMOs employing an estimated 10 to 100 employees, it is entirely possible that as many as 25,000 employees will lose their job as a result of this rule's unintended impact on small business and individuals. Similarly, fixed annuity insurance carriers will be forced to lay off many employees with decreased or discontinued sales of fixed annuities. Many industry experts have predicted 2017 sales of fixed indexed annuities to decrease by 30-35% as a direct result of the BICE requirement for fixed indexed annuities[1]. As a result of less sales, insurance carriers will be forced to lay off many employees who support their fixed annuity lines. While detailed estimates are difficult, we believe that just a 10% reduction in the workforce among the top 10 fixed annuity carriers (which represent 2/3rds of all sales) will cause the elimination of 1,000 jobs. We believe that the BICE rule and the unworkable Proposed Exemption will have the direct and irreversible impact of eliminating what could very well be 25,000 jobs for individuals working at an IMO and 1,000 jobs for those working at the top 10 fixed annuity carriers. Given the devastating harm to the many employees of this industry, and the cascading negative impact to current and future annuity customers, we request the Department delay the applicability of the BICE rule to better assess the actual costs being borne and actual benefits likely to result with better information.

The Department suggested in the preamble to the Proposed Exemption that smaller IMOs could perhaps be "subcontracted" under a larger IMO to perform compliance work and serve as a qualifying "financial institution". But the reality of that business proposition is untenable for a larger IMO that might be able to qualify as a "financial institution". Larger IMOs are already undergoing massive business model change in a quick sand regulatory world and have little interest in contracting with smaller IMOs for that IMO's compliance work. We are direct competitors of all other IMOs, so helping a competitor IMO makes no business sense. As mentioned above, IMOs do not operate as supervisors controlling the interactions independent agents have with their clients. Further, the nature of the relationship between IMOs and independent agents does not include direct oversight of their day-to-day activities. IMOs, unlike broker-dealers or RIAs, are not required to, and indeed do not operate as, compliance supervisors.

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[1] "Fixed indexed annuity sales are projected to decline 30% to 35% next year due to a new Labor Department rule raising investment advice in retirement accounts, according to Limra, signaling the disruptive power the regulation will have on insurance companies and product distributors," *See* Greg Lacurci, *Indexed annuity sales projected to plummet 30% because of DOL fiduciary rule*, Investment News (August 2, 2016), *at* http://www.investmentnews.com/article/20160802/FREE/160809980/indexed-annuity-sales-projected-to-plummet-30-because-of-dol

A more likely scenario is that the handful of large qualifying IMOs will simply recruit the larger producing agents of the small IMPs and there will be consolidation resulting in the complete demise of hundreds of small IMOs. While as one of the qualifying large IMOs, this would appear to be a competitive advantage, on principal we, we view it as bad for the industry and retirees across America. Mass contraction, consolidation, and liquidation are not good for a competitive market and harms consumers.

An executive from a leading fixed annuity carriers publicly commented on an earnings call in February 2017 about how the Proposed Exemption forces out of business almost all 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.[2]

Also, another executive harkened that prediction, 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." [3]

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[2] Transcript, Seeking Alpha, *American Equity Investment Life Holding Company Fourth Quarter 2016 Financial Inc. Earnings Call* (Feb. 9, 2017), *at* http://tinyurl.com/jae2xll.

[3] Press Release, American Equity Investment Life Holding Company, *American Equity Reports Fourth Quarter and Full Year 2016 Results* (Feb. 8, 2017), *at* http://tinyurl.com/gsogncx.

## III. Timing of the Proposed Exemption unfeasible and unfair to IMOs

Since the Fiduciary Rule was published on April 8, 2016, the IMO industry has been in a hurricane of uncertainty that has not subsided. After the rule was published, IMOs voiced their opposition because the 1,023 page rule did not once mention the term "independent marketing organization"—effectively writing the industry out of existence. After applications for IMO exemptions began to pile in starting in May of 2016, many in the industry expected the Department to act swiftly to provide regulatory certainty for the industry. Lawsuits were also filed challenging the rule, further confounding IMOs, independent agents, carriers and annuity customers. Industry trade journalists have opined that the IMO industry might have a compliance track but then again might not, continuing our confusing and unpredictable pathway to adapt.[4]

Even the Department of Labor's attorney in a September 21, 2016 federal court hearing challenging the Fiduciary Rule indicated that IMOs would have clearer regulatory compliance guidance in the form of a to-be-issued IMO Exemption:

> MR. THORP: So the Department concluded that it would not categorically include these market intermediaries as financial institutions because it wasn't sure that they were all capable of providing the supervisory role that was needed for a financial institution under the exemption. But they gave an opportunity for basically the industry to make the showing. And you have 10 of the applications attempting to do so, and the Department **expects to rule on those applications well in advance of the April upcoming deadline.** If granted, each of those, the applicants, if they meet the terms, can serve as the financial institution and a lot of plaintiff's concerns about what the insurers would be willing to do directly is ameliorated and sort of leaves the market structure largely as it is now. So plaintiffs are asking the court to basically speculate that that's not available when it's a path that's clearly available to proceed under the regulation. So it is a path that could potentially be workable.
> ...
> THE COURT: Before you leave that last point -- I'm sorry -- what's the turnaround time on ruling on these applications for examination?
> MR. THORP: It varies, Your Honor, because the exemption process is in an application, and usually there's a back and

[4] *See* Kevin W. Mechtley, *DOL 101: The fiduciary rule's impact on IMOs* (July 12, 2016), *Life Health Pro, at* http://www.lifehealthpro.com/2016/07/12/dol-101-the-fiduciary-rules-impact-on-imos?t=life-sales-strategies

> forth between the applicant and the Department before a proposal is put out for notice. And then the final proceeds from there. **The Department expects that process to conclude well before.**
> THE COURT: **The effective date?**
> MR. THORP: **The April deadline.**
> (emphasis added.)[5]

Unfortunately, no guidance came until January 18, 2017 when the DOL released its proposed class exemption for insurance intermediaries, just 92 days before the April 10, 2017 deadline. We also take exception with the Department's statement that it considered the role of the insurance intermediary when it released the final BICE rule. Nowhere in the preamble or in the regulatory impact analysis to support the BICE can we identify any consideration of the IMO distribution model, despite that IMOs handle $37 billion of all fixed indexed annuity sales. Post-hoc rationalizations cannot replace the omitted analysis of 62% of the $60 billion fixed indexed annuity space. Nonetheless, IMOs alike all face even further legal and compliance uncertainty since we do not know what a final form of an IMO Exemption might entail. This leaves IMOs in the lurch while the April 10 deadline looms with unrelenting impact.

The Proposed Exemption was released on the very last full day of the previous Administration, 286 days since the Fiduciary Rule was published. This Proposed Rule was published—less than 3 months from the applicability date of the Fiduciary Rule. In the short 30 days since this Proposed Exemption was published President Trump issued an executive memorandum directing the Department to review the rule. The Department also sent a proposed rule to the Office of Management and Budget set the groundwork to delay the rule. We applaud efforts to initiate a delay and further study of the real-world effects of the BICE and the Proposed Exemption.

IMOs do not know how to plan for the future because their path has been incredibly unstable and unclear and now seems cut off. With this changing landscape, IMOs are tasked with trying to solve the day-to-day business issues surrounding the rule including: Should we hire additional compliance staff? Should we invest in expensive technological solutions that are not even fully developed, yet? Should we lay off employees to prepare for the predicted downturn in industry sales and compensation? Should we cut back salaries? Should we remain in business? The uncertainty regarding the regulatory climate in the IMO arena have led to an uncertainty in answering these questions.

Furthermore, after this comment period ends, and assuming the Department makes a reasonable effort to hold hearings and put in the necessary amount of time to diligently consider all of the submitted comments, the earliest realistic date the Department could

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[5] Hearing Transcript on Motion for .Preliminary Injunction, *Market Synergy Group, Inc. v. United States Department of Labor*, No. 5:16-CV-04083, September 21, 2016

publish a revised final IMO Exemption rule is early to mid-March. The Department could realistically be asking IMOs to comply in less than 30 days with requirements they would be seeing for the first time. The Department certainly understands the level of effort it would take to make the necessary changes due to the complexities of this industry—it took 286 days to write this Proposed Rule. By comparison, the Department provided all other industries impacted by the Fiduciary Rule a full year to comply, which still many in the other financial services industries has indicated is too short. The Financial Services Roundtable has supported a delay of the Fiduciary Rule for two years thereby allowing more time for the Administration to consider a less bureaucratic "best interests" standard.[6]

While not deliberate, this rule deeply disadvantages IMOs compared to other competing Financial Institutions. The regulatory outlook for broker-dealers, RIAs, and banks has been clear since April 8 of last year. They have had ample time to make necessary adjustments to their business models, contract with their affiliates, and train their employees to ensure full compliance under the Fiduciary Rule. IMOs are still dangling in the wind. It will be impossible for IMOs to completely restructure themselves either by partnering or affiliating with other IMOs, finding appropriate insurance coverage that does not yet exist, or adapting to a compliance regime of a qualifying IMO, if they could find one to partner with.

The Department may claim that it is not picking winners and losers, it is certainly only allowing IMOs to start playing the game with two outs left in the ninth inning. The only equitable solution to save the independent distribution channel is to delay the rule to provide much needed stability to the industry and time to comply.

## IV. The 1% insurance/capital requirement creates a risk-obligation imbalance

The Proposed Exemption's insurance and capital requirement demonstrates a lack of understanding and examination of the industry to effectively craft a workable solution. Under the proposed exemption, for an IMO to qualify as a financial institution, the IMO must maintain aggregate amount of at least 1% of premium sales consisting of a combination of cash or cash equivalents or liability insurance. The purpose of this requirement was to seemingly satisfy potential unlimited liability under ERISA as a result of the IMO's failure to meet the terms of the exemption. However, the Department's lack of awareness of key differences between independent and captive distribution models as well as insurance versus securities industry are glaring in several significant areas including the availability of liability insurance, the risk associated with annuities as compared to other investment and insurance products, and how this Proposed Exemption compares to other similar regulatory requirements for other investment and insurance organizations.

When the Proposed Exemption was released, our first call was to the insurance specialist we work with for providing our errors and omissions coverage and directors and

[6] Press Statement, *FSR Statement on Rep. Wilson Fiduciary Rule Bill* (January 6, 2017), at http://fsroundtable.org/fsr-statement-on-rep-wilson-fiduciary-rule-bill/

officers coverage. He specializesin the IMO industry and has very specific knowledge about our needs. He found the insurance requirement shocking. It was evident to him that the rule was not crafted with any grace or knowledge of the industry. After conferring with other insurance providers, he concluded that no product meeting the Proposed Exemption exists on the market. He concluded that our only likely option would be to reach out to Lloyd's of London for the creation of a specialty policy, but the premiums Lloyd's would require would be astronomical. Certainly, the Department did not intend the requirement to be so onerous as to require Lloyd's of London to create a policy for 5-8 IMOs to purchase under this rule.

Furthermore, the Proposed Exemptions 1% of premium for capital/insurance shows a fundamental misunderstanding of the entire industry when compared to other similarly situated firms like broker-dealers. Under this Proposed Exemption, IMOs must maintain insurance, cash, or cash equivalent of 1% of premium. For example, an IMO that meets the minimum premium threshold of $1.5 billion in premiums would have to maintain capital or an insurance policy amounting to $15 million to satisfy potential liability under the rule. In comparison, a broker-dealer is typically only required to maintain capital of between $5,000 and $250,000 depending on the firm[7]. This disparity in capital requirement is extremely egregious especially when considering the risk involved.

Broker-Dealers can sell incredibly risky products to clients such as non-traded real-estate investment trusts (REITs). Clients who purchase these products are in serious jeopardy of losing their principal. These products have no guarantee, no liquidity, allow for little to no control, and exhibit a lack of transparency. In contrast, a client purchasing a fixed indexed annuity from an insurance carrier will have a minimum guaranteed contract value and guaranteed income, no risk of losing their premium, with all guarantees backed by the insurance carrier as well as the appropriate state guaranty fund. Additionally, in order to purchase an annuity, the client is given exhaustive disclosure before the annuity is purchased to provide a clarity of understanding of return and timing and clear knowledge of all cost and fees associated. And, at time of annuity policy delivery, the customer has the right to receive a full refund under the "free look" provision, which typically lasts for 10 to 30 days.

It is our understanding that Registered Investment Advisors must maintain even less capital than Broker-Dealers by comparison. According to the National Association of Securities Administrators Association model rule, registered investment advisors need only maintain $10,000 to $35,000 of net worth (not reserved capital).[8] RIA firms, like Broker-Dealers, sell investment products and advisory services that can result in investment losses to the consumer. In contrast, fixed annuity customers are guaranteed to never have losses due to market declines and have guarantees backed by highly regulated insurance carriers

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[7] *See SEC Financial Responsibility Rules*, Appendix 11, at https://www.sec.gov/about/offices/oia/oia_market/key_rules.pdf

[8] See *NASAA Minimum Financial Requirements For Investment Advisers Model Rule 202(d)-1 at http://www.nasaa.org/wp-content/uploads/2011/07/IA-Model-Rule-Minimum-Financial-Requirements.pdf*

whose financials are analyzed rated and accessible by ratings companies such as S&P and Moody.

Despite the fact that the Broker-Dealers and RIAs preside over much riskier product sales, this Proposed Exemption will impose a capital/insurance requirement that dwarfs any similar requirement for a broker-dealer or registered investment advisor. Additionally, the Proposed Exemption missed a critical step in its evaluation and provision construction by not comparing the capital/insurance requirement to IMO revenue, instead just relying on premium. IMOs, like independent agents, never possess funds from customers, rather all premiums are paid directly to insurance carriers. Premium volume is not a fair indicator of the financial wherewithal of an IMO or its potential ability to maintain a compliance structure for independent agents. Based on the similar capital (or theoretical insurance) requirements, we estimate that larger IMOs who meet the $1.5 billion threshold will have to maintain $1 of reserved capital for every $2 in annual gross revenue to meet this requirement. Conversely, we similarly estimate that the largest broker dealers, who can sell risky and non-guaranteed products like non-traded REITs, has to maintain in reserve $1 in capital for every $17,000 of annual gross revenue. And for RIA firms needing to only maintain just $35,000, the largest firm by AUM size would only need to maintain $1 in net worth for every $2.8 million in AUM. This outcome is inequitable, unfair, and certainly demonstrates a lack of study into what would be similarly situated firms in the industry. Allowing the requirement to continue would be equivalent to picking winners and losers within the retirement investment space and destructive to the free enterprise system our country and its regulatory bodies have sought to protect.

This result demonstrates a clear lack of understanding by the previous administration, not only of the products themselves, but also of annuities compared to other products, like securities. The 1% of premium level is unreasonable and arbitrary. The comments did not mention how much of premium relates to revenue. Setting the level at 1% of premium would nearly reach a level where a significant portion of all revenue would have to be dedicated to the capital requirement or insurance policy.

## V. Information contained within the Department's "Supporting Statement for Paperwork Reduction Act of 1995" contains many inaccuracies—demonstrating the need for additional time for further review

We also wish to comment on the Supporting Statement for Paperwork reduction Act of 1995 Submissions the Department of Labor provided to the Office of Management and Budget dated January 9, 2017 as part of the Information Collection Review process for this Proposed Exemption.[9] We have grave concerns that this Supporting Statement woefully underestimates the costs to implement the exemption, the practical impact to the industry, and the impossible time to execute the compliance steps before April 10, 2017. This document illustrates that the Department failed to conduct a thorough analysis of the fixed annuity marketplace, and the impact to IMOs and independent agents.

[9] See *IMO Exemption Supporting Statement 1-9-17-clean.docx, OMB Control Number 1210-NEW, at* https://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201701-1210-005.

A workable exemption allowing independent insurance agents to continue selling fixed indexed annuities is imperative to avoid the impending disaster that will ensue without an exemption. As mentioned earlier, no insurance carrier has publicly stated that they will sign a best interest contract for independent agents. As a result, some IMOs had filed for individual PTEs which appears to have been converted by the Department into a proposed class-wide exemption for IMOs to serve as an approved Financial Institution for independent agents. We agree that a workable exemption must be fashioned for independent agents, which represent 62% of the $61 billion[10] in fixed indexed annuity sales in 2016. However, the Proposed Exemption and Supporting Statement demonstrate the Department should undertake a more exhaustive review and open consideration from stakeholders to properly create a workable exemption for agents.

There seems to be a fundamental misunderstanding by the Department of what role an IMO serves in the marketplace. As further described above, IMOs do not have any contact or relationship with annuity customers, rather we serve the critical role of offering intermediary services for the insurance carriers and the independent agents. As such, IMOs are "fiduciaries" under the BICE since IMOs do not render advice to consumers. Further, the payment of remuneration for such intermediary services by the insurance carriers is no different than a variable annuity company paying its internal wholesaler distribution team or a third-party administrator for advertising or processing new business. IMOs do not operate as agent compliance organizations, yet are the lifeblood of indexed annuity business for cost-efficiency and independence reasons.

In addition, we take exception with the conclusory statement from the Supporting Statement stating "the exemption would allow IMOs, independent insurance agents, and insurance companies to receive compensation and other consideration in conjunction with the purchase of fixed annuities that, in the absence of an exemption, would not be permitted under ERISA and the Code."[11] This statement is simply inaccurate since insurance carriers and IMOs are able to earn compensation and other consideration under the BICE and without the BICE without violating ERISA or the Code. Insurance carriers and IMOs who do not agree to serve as "fiduciaries" under the BICE are still free to earn compensation since they do not satisfy the conditions regulating their compensation.

If IMOs were forced to convert into a supervisory compliance organization to satisfy some of the Department's concerns of independent agents, then a much more thorough analysis and dialogue than the limited feedback from the cited 19 IMOs is justified. These 19 IMOs only represent an estimated 6% of the IMO marketplace of 300 IMOs and the short 30-day window for comments is unduly short. As of the last date of the comment period for this Proposed Exemption, only 15 comments were submitted, according to the DOL's website[12]. This pales in comparison to the over 3,000 comments

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[10] See *LIMRA Secure Retirement Institute U.S. Individual Annuity Sales Survey* (2016, 4th Quarter).

[11] See *IMO Exemption Supporting Statement 1-9-17-clean.docx, OMB Control Number 1210-NEW, at* https://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201701-1210-005, page 2.

[12] See https://www.regulations.gov/docket?D=EBSA-2016-0026.

the Department received with the BICE rule. A hasty rule with little input from stakeholders will lead to an unworkable exemption for independent agents. As a result, the Department should immediately consider a delay of the applicability date of the BICE and this Proposed Exemption.

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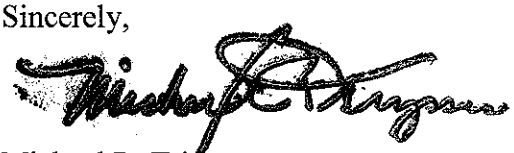
We understand that these requirements enumerated within the Proposed Exemption are not without purpose. We believe in the general concept of a "best interest" standard, but unfortunately, the BICE rule and the Proposed Exemption are written in such an unworkable and burdensome manner as to put the entire fixed annuity industry at risk. We believe there are alternative methods to accomplish the goals of a "best interest" standard without devastating small businesses and consumers. The Department should delay the applicability date and work with our industry, which knows best what potential effects will be, to conduct an adequate review of the entire rule and the Proposed Exemption in order devise to a practical solution that protects consumers and preserves the viability of this desperately needed guaranteed retirement income industry. Such a delay is fully warranted based on the demonstrated dislocation for the industry and harm that will occur to the consumer. Robust regulatory consumer protections will continue to be applied and enforced during the Administration's review, justifying a thoughtful reconsideration of the Proposed Exemption and the Fiduciary Rule in its entirety. The fixed annuity industry and the fixed annuity customers deserve more time to engage in meaningful dialogue with policyholders and other stakeholders to avoid a cataclysmic impact.

Thank you in advance for considering these comments. If you have any questions or if we can be of assistance, please feel free to contact me.

Sincerely,



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