August 6, 2020

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

RE: ZRIN 1210-ZA29 – Improving Investment Advice for Workers & Retirees
Notification of Proposed Class Exemption
Docket ID No.: EBSA-2020-0003

Dear Secretary Scalia and Acting Assistant Secretary Wilson:

On behalf of NAFA, the National Association for Fixed Annuities, I write today with respect to the Department of Labor’s (“the Department”) Notification of Proposed Class Exemption, “Improving Investment Advice for Workers and Retirees” (the “Proposed Exemption”).

Founded in 1998, NAFA is the premier trade association in the financial and retirement services industry dedicated exclusively to fixed annuities. Our association’s mission is to promote the awareness and understanding of fixed annuities and to educate and inform state and federal regulators, legislators, industry personnel, media, and consumers about the value of fixed annuities and their benefits to Americans in financial and retirement planning. NAFA’s membership represents every aspect of the fixed annuity marketplace and every channel of distribution, including insurance companies, independent and field marketing organizations, and independent producers, advisors, brokers, and general agents.


2 Fixed annuities play a critical role in helping shape the collective retirement future of our country. There is approximately $500 billion of in-force annuity premium serving roughly 4.25 million Americans, with middle class consumers comprising the lion’s share of the annuity market; the average fixed annuity contract is valued at $117,000. In 2018, life insurance companies paid $83 billion in annuity benefits payments to annuity contract holders, and data consistently demonstrates that annuity ownership contributes to higher levels of retirement confidence.
I write to share information about our products and distribution arrangements, as well as comments on how we believe the exemption can be improved. Because fixed annuities are distributed through many different arrangements between insurers, intermediaries, agents, brokers and others, we appreciate the Department’s recognition that the Proposed Exemption may not apply as intended. We also appreciate the Department’s recognition that existing prohibited transaction class exemptions must remain available, providing several paths for efficient compliance.

As a preliminary matter, NAFA acknowledges the Department’s technical amendment and final rule, \(^3\) issued on July 7, 2020 and effective immediately, which implements the vacatur of the Department’s 2016 Conflict of Interest Rule (the “2016 fiduciary rule”),\(^4\) pursuant to the judgement and vacatur mandate issued by the U.S. Court of Appeals for the Fifth Circuit on June 21, 2018.\(^5\) This final rule conforms the regulatory text in the Code of Federal Regulations to the 1975 regulation, thereby reinstating the 1975 five-part test for determining fiduciary status under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code (“the Code”)\(^6\) and returning to the pre-2016 rulemaking the previously granted prohibited transaction exemptions, including PTE 84-24.\(^7\) As a litigant in a concurrent legal challenge to the Department’s 2016 fiduciary rule, NAFA is pleased to have regulatory finality in this regard and to have the 2006 PTE 84-24 available for exemptive relief.

NAFA further commends the Department’s stated interest in aligning the new Proposed Exemption with the enhanced standards of conduct now required by other regulators, in particular the Securities and Exchange Commission (“SEC”) Regulation Best Interest (“Reg. BI”)\(^8\) and the recent revisions to the National Association of Insurance Commissioner’s (“NAIC”) Suitability in Annuity Transactions Model Regulation (“Model Regulation 275”),\(^9\) and its desire to promote regulatory efficiencies for investment advice fiduciaries through such alignment. In its efforts to

\(^6\) 25 CFR 2510.3-21(c)(1), 40 FR 50842 (October 31, 1975); 26 CFR 54.4975-9(c), 40 FR 50840 (October 31, 1975).
\(^8\) Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 FR 33318 (July 12, 2019) (Regulation Best Interest Release).
\(^9\) NAIC Suitability in Annuity Transactions Model Regulation (#275). The NAIC joint Executive/Plenary Committee formally adopted revisions to the model regulation on February 13, 2020, including a new requirement that insurance producers act in the best interest of the consumer when making an annuity recommendation. The 2020 revised model is available at https://www.naic.org/store/free/MDL-275.pdf.
enhance the standard of care and conduct for annuity transactions and to require insurers to establish and maintain a robust supervisory system so that the insurance needs and financial objectives of annuity consumers are effectively addressed, the NAIC was mindful to harmonize the model regulation’s new best interest standard with other best interest regulations governing the financial services industry, while still ensuring that the model regulation maintains its insurance scope and focus. NAFA believes that the NAIC struck the correct balance in this regard.

Unfortunately, we don’t believe the same can be said of the Department’s efforts here. In fact, NAFA believes that the proposed class exemption – and especially the Department’s new interpretation of the five-part test as articulated in the preamble to the new exemption – may actually cause a misalignment amongst the various regulatory bodies and, of particular concern for NAFA members, create unnecessary disruption and uncertainty for insurance professionals and the products they offer.

Harmonizing the Department’s new class exemption with the SEC’s Regulation Best Interest (“Reg. BI”) may make some sense in the securities realm, but the same cannot be said for the insurance industry: insurance agents and financial professionals who sell fixed annuities – which are state-regulated insurance contracts, not security investments – are not investment advice fiduciaries as historically understood under ERISA and the Code. As we will explain in greater detail in this comment letter, the nature of the client contact and the services provided as part of an annuity transaction does not create the special conditions of trust, confidence, control and authority that is contemplated in the fiduciary setting. An insurance salesperson is paid on the sale of the insurance product; he or she is not paid for providing investment advice to a retirement investor. Moreover, financial professionals who sell these insurance products are subject to a comprehensive framework of state-based regulations, including standards of care in the recommendation and sale of annuity products, which under the revised NAIC model regulation requires annuity sellers to act in the best interest of their clients.

For the reasons explained below, the Department’s new and expansive interpretation of the 1975 five-part test for determining fiduciary status under ERISA and the Code is flawed on both procedural and substantive grounds. We also believe that the Department’s interpretation is inconsistent with the June 21, 2018 ruling in the U.S. District Court of Appeals for the Fifth Circuit vacating the Department’s 2016 fiduciary rule. We will also address specific concerns regarding the Proposed Exemption itself and will provide potential alternatives for exemptive relief. On behalf of NAFA’s membership, thank you in advance for your consideration.
The Department’s new interpretation of the 5-part fiduciary test is opaque and disproportionately harmful to insurance professionals

In his October 2019 Executive Order 13892 – Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication, President Trump ordered federal agencies to act transparently and fairly with respect to all affected parties, requiring them to apply only those standards of conduct that have been publicly stated in such a manner that would not cause unfair surprise to a person for whom a transgression of those standards may have legal consequences or administrative enforcement or adjudication. “Unfair Surprise” is defined in the executive order as meaning a “lack of reasonable certainty or fair warning of what a legal standard administered by an agency requires.” The executive order goes on to further require agencies to avoid unfair surprise not only when it imposes penalties but also whenever it adjudges past conduct to have violated the law. NAFA agrees with President Trump that “[t]he rule of law requires transparency” and that “[r]egulated parties must know in advance the rules by which the Federal Government will judge their actions.” Since 1975, parties regulated under ERISA have understood the rules by which the Department will judge their actions.

Under section 3(21)(A) of ERISA, a person is a fiduciary with respect to a Plan to the extent that, inter alia, the person “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such Plan or has any authority or responsibility to do so.” A year after Congress passed ERISA in 1974, the Department established a five-part test to define “investment advice” as the term is used in ERISA section 3(21) in order to determine fiduciary status. Accordingly, a person is deemed to be rendering investment advice to a Plan (or IRA) only if such person (1) renders such advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the Plan or a fiduciary with respect to the Plan or IRA, (4) that such services will serve as a primary basis for investment decisions with respect to Plan or IRA assets, (5) and that such person will render individualized

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10 Executive Order 13892, 84 Fed. Reg. 55239 (October 15, 2019). On the same date, the President issued a companion order, Executive Order 13891, Promoting the Rule of Law Through Improved Agency Guidance Documents, 84 Fed. Reg. 55,235 (October 15, 2019), in which he expressed as general policy the requirement that administrative agencies of the executive branch treat guidance documents as non-binding both in law and practice – thus disfavoring rulemaking through guidance documents.

11 Id. Pursuant to the executive order, the meaning of unfair surprise is informed by the examples of lack of fair notice discussed by the Supreme Court in Christopher v. SmithKline Beecham Corp., 567 U.S. 142, 156 & n15 (2012).

12 Id.

13 See 85 Fed. Reg. 40834, discussing the background for its Proposed Exemption. The Department notes that the Code includes a parallel provision defining a fiduciary of an IRA. See also Department of Labor Advisory Opinion 2005-11A (May 11, 2005).
investment advice to the Plan or IRA based on the particular needs of the Plan or IRA regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

Aside from the short detour in the regulatory landscape during 2016 – 2018 with the promulgation of the 2016 fiduciary rule and its subsequent vacatur, for 45 years the above articulation of fiduciary status has governed the activities of and attendant obligations on financial professionals in their relationships with clients. If, as a financial professional, you rendered investment advice for a fee or other compensation and met all five factors of the five-part test, you were an investment advice fiduciary under ERISA and the Code; if you did not meet all of these requirements under ERISA and the Code, you were not deemed a fiduciary. And, for the vast majority of insurance professionals doing business with respect to ERISA plan rollovers and IRA transactions, the sale of an annuity did not give rise to fiduciary status.

However, in the preamble of its rulemaking notice, the Department sets forth its re-interpretation of the 1975 five-part test and provides the Department’s views on when advice to roll over Plan assets to an IRA could be considered fiduciary investment advice under ERISA and the Code.\(^\text{14}\) This new guidance effectively sweeps away nearly five decades of Department fiduciary governance resulting in a significant shift in the regulatory landscape, particularly – and disproportionately – for the insurance industry.

**Renders investment advice**

Discussing what could now be considered the rendering of investment advice, the Department announces its decision to no longer apply the analysis contained in Advisory Opinion 2005-23A (the “Deseret Letter”),\(^\text{15}\) reversing course on its longstanding guidance, because it now believes that analysis to be incorrect. In the Deseret Letter, the Department took the view that a rollover recommendation by someone who is otherwise not a fiduciary does not constitute investment advice with respect to Plan assets – even when that advice is combined with a recommendation as to how the rollover distribution should be invested.

Instead, in withdrawing the Deseret Letter effective as of June 29, 2020, the Department asserts its new belief that advice to take a distribution of assets from an ERISA-covered plan or IRA is actually investment advice within the meaning of the first factor of the five-part test. This is a significant departure from the way that the financial services industry has long understood the treatment of IRA rollovers.

\(^{14}\) *Id.* at 40835 (internal citation omitted).

\(^{15}\) *Id.* at 40839.
In other words and by way of example, an insurance professional who recommends an IRA rollover to purchase a fixed annuity would now seemingly satisfy the first prong of the fiduciary test: the rendering of investment advice. The hypothetical agent is one-fifth of the way to being an ERISA fiduciary.

On a regular basis

The Department goes on to offer interpretive guidance concerning the next three prongs of the 1975 test, beginning with the “regular basis” factor. Analyzing this second requirement in determining fiduciary status, the Department acknowledges that advice to take a distribution from a Plan and roll over the assets may be an isolated and independent sales transaction that would fail to meet the regular basis prong, but nevertheless opines that such advice can occur as part of an ongoing relationship – or even an anticipated ongoing relationship – that an individual enjoys with his or her advice provider. To illustrate this, the Department provides a very broad example of such a circumstance: for instance, where an advice provider has been giving financial advice to an individual about investing in, purchasing, or selling securities or other financial instruments, the advice to roll assets out of a Plan would, in fact, satisfy the “regular basis” requirement.

Such a wide-ranging example appears to encompass nearly all circumstances and relationships that exist between most financial professionals and their clients – or, in the Department’s interpretation, relationships that might exist in the future, if the distribution transaction occurs early in the relationship. For an independent producer who sells life insurance policies or other insurance line products to a client – a very typical situation – a one-time sales transaction involving an IRA rollover purchase of a fixed annuity might easily be deemed to create an ERISA ongoing advice relationship, satisfying the regular basis prong. At this point in the analysis to determine investment advice fiduciary status, our hypothetical insurance agent has satisfied the first two prongs of the test.

Pursuant to a mutual agreement, arrangement, or understanding

The Department’s guidance regarding the determination of whether there is a mutual agreement, arrangement or understanding to provide fiduciary advice under ERISA and the Code (the third prong) suggests that such a determination is based on the “reasonable” understanding of “each” of the parties (emphasis in the original). The Department goes on to note that contract terms explaining that the parties mutually understand fiduciary advice is not being provided “are not determinative” though they are “appropriately considered” in trying to discern the understanding of each of the parties. We find this standard very confusing. It is not clear what the Department means by emphasizing the word “reasonable” in the guidance relating to “each” of the parties—if the contract clearly and unambiguously provides that both parties understand fiduciary advice in not being provided, is there any other “reasonable” interpretation? Further, it is not clear why the
Department believes the terms of a contract between two willing private parties would not be “determinative” of their intentions.

Finally, we fail to see how the terms of such a contract are “appropriately considered” if they are not considered to be binding terms—why does the Department believe that its guidance can determine whether the terms of a private contract can be ignored, especially where such contracts are regulated and approved by state insurance authorities? The guidance is sufficiently confusing that our hypothetical insurance agent may have satisfied the third prong of the test simply because the Department suggests contrary understandings can be read out of the mutual agreement.

**The advice will serve as a primary basis for the investment decision**

Regarding the fourth prong – the “primary basis” prong – the Department emphasizes that the investment advice need only serve as “a” primary basis for the investment decision, not “the” primary basis—a distinction that, while technically correct, semantically dilutes the import of this prong of the five-part test, which is intended to draw a critical and logical line between the investment advice and the investment decision. Generally, “primary” is understood to mean the first in order, or of chief importance. Essentially, the Department’s broad interpretative guidance regarding the primary basis prong means that there could be any number of “primary” bases or reasons that contribute to the decision made by the Retirement Investor – in effect, mooting this factor in the fiduciary status test and rendering it a four-part test.

The Department goes on to state that where a financial service professional is making investment advice recommendations pursuant to a best interest standard (or some other requirement to provide advice based on the individualized needs of the Retirement Investor), a reasonable understanding is that the advice will serve as, at least, a primary basis for the investment decision – and thus, would satisfy this prong of the five-part test. Here the Department gives the example of a financial services professional making a recommendation pursuant to a best interest standard such as the one in the SEC’s Regulation Best Interest, but a financial services professional who provides a recommendation in an individual’s best interest could certainly encompass an insurance professional adhering to the best interest obligations set forth in the revised NAIC Model Regulation 275.

The Department’s interpretation of this component of the fiduciary status test puts agents and brokers in a difficult quandary: by virtue of providing “a” recommendation that is in a consumer’s “best interest” under either Reg. BI or the revised NAIC model regulation, the “primary basis” prong would be automatically satisfied – no matter that they did not intend or expect to create a fiduciary relationship. It is remarkable that the Department would view a financial professional’s compliance with regulations that explicitly disclaim the creation of a fiduciary relationship as
confirmation, under this new regulatory interpretation, as implicit satisfaction of one of the factors in the five-part test establishing fiduciary status.

At this point in the preamble, the Department contrasts its example of the financial service professional who is complying with the SEC’s Reg. BI with that of a one-time sales transaction – such as the one-time sale of an insurance product. Here the Department distinguishes a recommendation to purchase an insurance product – a one-time sales transaction – as generally not conferring fiduciary status under ERISA or the Code, even if the sale is accompanied by a recommendation to the Retirement Investor that the insurance product would be a well-suited and valuable purchase.

NAFA is pleased that the Department recognizes that a one-time insurance annuity sales transaction – even when the financial professional is operating pursuant to suitability or best interest conduct standards – does not itself give rise to a fiduciary relationship. However, the Department muddies the water when it then states in footnote 41 that insurance agents may have or may contemplate an ongoing advice relationship with a customer when, for example, the agent receives a trailing commission on the annuity transaction and that such a commission structure may mean that the agent provides ongoing recommendations or service with respect to the annuity.16

NAFA takes exception to the Department’s analysis: in the first instance, payment of trailing commissions does not create or imply an ongoing (or regular basis) relationship. Trailing commissions are paid directly by the insurer to the insurance agent (they are not paid by the consumer), and it is still just commission paid by the insurance company to the agent for a one-time annuity sale. It is merely another type of commission payment structure; the form and timing of the payments from the insurance company to the agent have nothing to do with whether that agent is functioning as an investment advice fiduciary to the consumer. For the consumer, the payment of a trailing commission does not trigger a different type of relationship with the insurance professional, and, for the insurance professional, the receipt of a trailing commission does not trigger different or additional obligations to the consumer; it is a commission arrangement strictly between the insurance salesperson and the insurance company, which does not create or imply fiduciary status.

But, fiduciary status will be determined by the “surrounding facts and circumstances”

Noting that all prongs of the five-part test must be satisfied for the investment advice provider to be a fiduciary within the meaning of the regulatory definition, just how the Department will view satisfaction of those five prongs will be informed by the surrounding facts and circumstances. As

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it relates more specifically to whether advice to roll over Plan assets to an IRA satisfies the regular basis prong of the five part test, the Department states that, too, would depend on the facts and circumstances. And, for an investment advice provider who establishes a new relationship with a Plan participant and advises a rollover of assets from the Plan to an IRA, the rollover recommendation may be seen as the first step in an ongoing advice relationship – the start of an advice relationship – that could satisfy the regular basis prong of the five-part test … again, depending on the facts and circumstances.

Thus, a determination as to whether a person is a fiduciary of a Plan or IRA under ERISA or the Code under a broad new interpretation of the 1975 five-part test will ultimately be established by largely undefined surrounding facts and circumstances – an overarching regulatory framework that, functionally, can only be truly tested after the fact.

For the reasons stated above, NAFA believes that the expansive interpretive guidance that the Department articulates in the preamble to the Proposed Exemption is inconsistent with the President’s executive orders requiring transparency and fairness in agency rulemaking and disfavoring rulemaking through guidance documents in that it (a) upends Department advice that the financial services industry has relied upon for the past fifteen years with the withdrawal of the Deseret Letter; (b) reinterprets the common and long-held understanding of the 1975 five-part fiduciary test, and, in doing so, arguably collapses two of the five prongs (rendering it now a four-part test); and (c) posits that, ultimately, the determination of whether or not one is an investment advice fiduciary will rise or fall on opaque and largely unspecified “facts and circumstances” test that, by necessity, will be adjudicated after the fact.

As the President stated last October, regulated parties must know in advance the rules by which the federal government will judge their actions. Advisory Opinion 2005-23A provided regulated parties with a bright line rule. The Department’s new guidance providing for the assessment of “facts and circumstances” does not provide brokers and agents with a bright line rule. How can a financial professional determine where the line is between sales activity and the establishment of a fiduciary relationship, especially where such a relationship may spring up prospectively, sometime after the initial sales transaction? The Department’s reinterpretation of the fiduciary test creates an opaque standard that would unfairly place regulated parties in the impossible position of not knowing, in advance, the rules by which their actions will be judged.

We encourage the Department to confirm that, as noted in its discussion of rollover transactions, the “regular basis” requirement can only be met with respect to a recommendation to roll over assets when, at the time of the recommendation, there is an agreement that the “advice provider will be regularly giving financial advice regarding the IRA in the course of a more lengthy financial
relationship.” Absent such assurance from the Department, compliance could go overbroad as a protection measure, thereby creating, out of fear of regulatory consequences, fiduciary relationships which were never intended and where they don’t or shouldn’t exist.

For nearly half a century the financial services industry has looked to the Department’s definition of a fiduciary and the five-part test defining investment advice as a reliable proxy in determining fiduciary status. The vague new fiduciary standard expressed in the preamble would make it impossible for financial professionals to have reasonable certainty about what they need to do to comply and, as such, is contrary to the President’s executive order to have transparent and fair enforcement and adjudication of administrative rules.

**The Department’s interpretation of the 5-part test is inconsistent with the Fifth Circuit Opinion**

In addition to being contrary to the President’s expressed directives regarding agency rulemaking, NAFA also believes that the Department’s reinterpretation of the fiduciary standard and what it suggests might now be considered fiduciary activity are out of line with the opinion of the Fifth Circuit in overturning the 2016 fiduciary rule.

Explaining its decision to vacate the rule, the Fifth Circuit majority remarked that, unlike the 2016 fiduciary rule, the Department of Labor’s 1975 regulation “captured the essence of a fiduciary relationship known to the common law as a special relationship of trust and confidence between the fiduciary and his client,” calling this relationship of trust and confidence the “cornerstone of fiduciary status.” The Court further described the hallmarks of an investment advice fiduciary under ERISA and the Code as someone whose business it is to provide investment advice on a “regular basis” and where the client’s reliance on that advice serves as the “primary basis” for the investment decision.

The Court noted that the definition of “regular basis” and “primary basis” criteria in the 2016 fiduciary rule was contrary to how the Department’s regulation had been understood for the prior forty years, consequently encompassing virtually all financial and insurance professionals who do business with ERISA plans and IRA holders. This, the Court said, did not comport with common law, nor the structure of the financial services industry: at the time Congress enacted ERISA in

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17 Id. at 40839.
18 Chamber of Commerce, 885 F.3d 365, 376.
19 Id. at 380.
20 Id. at 366.
1974, it was well aware that investment advisers who rendered investment advice for a fee were fiduciaries and that brokers and insurance agents who sold products to their clients were not.\textsuperscript{21}

Examining the language defining a fiduciary, the Court emphasized the preposition “for” in the ERISA statute: a fiduciary is a person who renders investment advice \textit{for} a fee or other compensation, thus tying the fee or other compensation directly to the rendering of investment advice; in short, the purpose of the fee under the ERISA definition of a fiduciary is for advice, not sales.\textsuperscript{22} For the financial services industry, this distinction was critical: investment advisers are paid fees because they render investment advice, while brokers and agents are compensated only for their completed sales, not on the basis of their “pitch to the client;” accordingly, “[t]ransforming sales pitches into the recommendation of a trusted adviser mixes apples and oranges.”\textsuperscript{23}

To further illustrate why stockbrokers and insurance salespeople are generally not considered fiduciaries, the Court pointed out that the 2016 fiduciary rule improperly included one-time IRA rollover and annuity transactions, situations “where it is ordinarily inconceivable that financial salespeople or insurance agents will have an intimate relationship of trust and confidence with prospective purchasers.”\textsuperscript{24}

And, the Court further stated that under the three subsections defining who is a fiduciary under ERISA and the Code, the “renders investment advice for a fee or other compensation” subsection or prong is bookended by two other prongs, both of which are related to the financial professional's ability to exercise discretionary authority or control with respect to a Plan: an individual is a fiduciary to the extent he or she exercises any discretionary authority or control over the management of the Plan (or the management or disposition of its assets) or has any discretionary authority or responsibility in the Plan’s administration.\textsuperscript{25} Thus, a fiduciary is defined in \textit{functional} terms of control and authority, which, the Court said, necessarily implies a special relationship beyond that of an ordinary buyer and seller.\textsuperscript{26} In short, salespeople and insurance brokers do not have the ‘authority’ or ‘control’ to ‘render investment advice.’\textsuperscript{27}

\textsuperscript{21} Id. at 372.
\textsuperscript{22} Id. at 372.
\textsuperscript{23} Id. at 373, 382.
\textsuperscript{24} Id. at 380.
\textsuperscript{25} Id. at 376, citing 29 U.S.C. § 1001(21)(A)(iii); 26 U.S.C. § 4975(e)(3)(C).
\textsuperscript{26} Id. at 376, 377. Here the Court cites the U.S. Supreme Court decision in \textit{Mertens v. Hewitt Assocs.}, 508 U.S. 248, 262, 113 S.Ct. 2063, 124 L.Ed.2d 161 (1993).
\textsuperscript{27} Id. at 373.
The published Technical Amendment and Final Rule repeatedly affirms the Department’s intent to conform its regulatory posture with the Fifth Circuit’s vacatur of the 2016 fiduciary rule – and the (welcome) return to the actual language of the 1975 rule is in keeping with the Court’s mandate. But, the Department’s new guidance regarding the five-part test changes the meaning of the 1975 rule as long understood by the financial services industry and does not, in fact, conform with the Court’s opinion.

The Department states that, “In addition to satisfying the five-part test, a person must receive a fee or other compensation to be an investment adviser.”28 In the rollover context, the Department provides the example of broker-dealer who (1) satisfies the five-part test; (2) advises the retirement client to move assets from a Plan to an IRA; and (3) receives any fees or compensation incident to the distribution of those assets as being an ERISA (and section 404) fiduciary. Here, the Department is making the same error that it did in the 2016 rule: transforming sales activity, for which the broker is paid compensation based on his or her sale of a product, into the compensation for investment advice rendered by a trusted adviser.

And, because the Department now opines that a one-time rollover recommendation can satisfy the “regular basis” prong of the five-part test if the parties have additional meetings (even if a future meeting concerns recommendations regarding non-qualified moneys) or if the broker or agent receives a trailing commission, brokers and insurance agents find themselves in what the Court said was the “ordinarily inconceivable” position of being deemed an investment advice fiduciary – and having the essential hallmarks trust and confidence with purchaser that the intimate and ongoing fiduciary relationship entails – based upon a one-time IRA rollover or annuity recommendation.

Put simply, the Department cannot claim to be faithful to the Fifth Circuit decision by reinstating the text of the 1975 regulation when it has simultaneously offered a new interpretation of the words of that text that fundamentally changes their meaning. Not only has the Department offered what is tantamount to a new regulation without going through the proper notice and comment rulemaking process, but its new interpretation is at odds with the substance of what the Fifth Circuit cited as the reasons the 1975 five-part test properly embodies the statutory meaning of fiduciary investment advice.

For the reasons expressed above, it is NAFA’s opinion that the Department’s guidance is out of line with both the President’s executive orders and the ruling of the Fifth Circuit. We believe that the preamble guidance makes it impossible for insurance professionals to know when – or if – ERISA fiduciary status would apply to their sales activity in the qualified money marketplace.

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which is a disservice to the individuals who sell these critical retirement products, as well as to the clients they serve. NAFA urges the Department to rescind its reinterpretation of the 1975 rule and five-part test and to reissue the advisory guidance in Advisory Opinion 2005-23A.

The Proposed Exemption should be modified in several important respects

As it relates specifically to the new Proposed Exemption, NAFA agrees that the Department has attempted to create a broader and more flexible prohibited transaction exemption than is currently available for investment advice fiduciaries under ERISA and the Code, and that the principles-based approach of the new Proposed Exemption would promote some harmonization within the financial services industry, including an alignment with the Reg. BI as it applies to broker-dealers and registered investment advisers. To the extent that financial services professionals are already subject to the requirements of Reg. BI, the Department’s proposed new exemption should promote regulatory efficiencies for certain financial services providers.

However, as discussed above, insurance transactions not involving securities are unlikely to be subject to Regulation Best Interest requirements. As a result, using the new Proposed Exemption would necessitate significant adverse changes for many fixed annuity transactions, and thus may not be often utilized by the insurance sector of the financial services industry, as compared to PTE 84-24. Notwithstanding that, we do believe that it should be available as an option for these transactions, and therefore, respectfully offer the following suggestions to improve the Proposed Exemption.

Definition of a Financial Institution – Insurance Companies

As we stated earlier in this letter, NAFA’s membership represents all channels of fixed annuity distribution, but NAFA’s mission is particularly important in the independent agent channel. The independent distribution of fixed annuities represents over half of all fixed annuity sales (currently totaling over $100 billion annually), with approximately 60 – 65% attributed to qualified sales. And, over 50% of all fixed annuities are sold by independent agents who are insurance-only licensed and who have no employer or supervising entity; for the majority of these independent insurance agents sell insurance and annuity products for more than one insurance company.

NAFA would point out that having an agent sell insurance products for a number of different companies is a feature not a bug of the independent agent channel: an independent agent’s access to a wider array of products and multiple company’s offerings provides greater options for consumers and the likely outcome of a more tailored product recommendation by the agent that will effectively meet the individual consumer’s insurance needs and financial objectives.
Independent agents are just that: independent. And, the relationship between an independent agent and an insurance company for which the agent can sell its insurance products and annuities differs in fundamental ways from the adviser/seller-to-supervisor relationships that exist under the securities business model. Because the independent insurance professional has the ability to review, recommend, and sell the product offerings of multiple insurance companies, insurers do not have the ability to manage the independent agent’s “product shelf” in the same way that a financial institution in the securities realm can.

Yet, under the Proposed Exemption, an independent insurance agent – if he or she were deemed to be an investment advice fiduciary under ERISA or the Code – would need to rely on a Financial Institution in order to receive compensation on an IRA rollover, and, pursuant to the Department’s guidance, the most likely entity to serve in the capacity of the Financial Institution responsible for compliance and oversight would be an insurance company. In fact, the Department explicitly states in its preamble guidance that insurance companies can supervise independent agents. 29 But, in the independent agent channel, where agents sell for multiple insurance companies, it is impractical to think that any one insurance company can perform the supervisory and management functions required by the Proposed Exemption when the company cannot possibly know if another insurer’s annuity available to the agent might have been in the consumer’s best interest under the exemption’s Impartial Conduct Standards.

It is simply unreasonable to ask an insurance company to sign off as a Financial Institution for the recommendation of an independent agent when it is impossible for the company to know or evaluate what products of another insurer might be available for the insurance profession to recommend or what the compensation arrangements for another insurer’s products might be. As it relates to the critical requirements of oversight and supervision of the Investment Professional by a Financial Institution, the Proposed Exemption as it is currently laid out frankly doesn’t work under the independent agent distribution model that exists in the insurance industry. Furthermore, imposing these management and control requirements on insurance companies that are designed to work in the securities industry creates an unlevel playing field, putting the sale and distribution of insurance products at a competitive disadvantage.

Acknowledging these functional and operational differences between the insurance industry model and the securities industry was top of mind during the NAIC’s work to create a new best interest standard of conduct governing annuity transactions; the NAIC working group tasked with the

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29 Id. at 40837. Here the Department states, “While some insurance agents are employees of an insurance company, other insurance agents are independent, and work with multiple insurance companies. The proposed exemption would apply to either of these business models. Insurance companies can supervise independent insurance agents and they can also create oversight and compliance systems through contracts with intermediaries such as independent marketing organizations (IMOs), field marketing organizations (FMOs) or brokerage general agencies (BGAs).”
project had, as its predicate policy, the development of a standard that was more than suitability but not a fiduciary standard. The NAIC also recognized the inherent difficulties an insurance company faced in supervising annuity recommendations in the independent distribution channel and, therefore, limited the scope of the required supervisory role to only those annuities offered by that particular insurer and only the compensation relating to the annuities offered by the insurer. Importantly and sensibly, under the Model Regulation’s required supervision system insurers do not need to consider or compare the product options that are available to the producer from other insurance companies, nor are they required to consider or compare compensation related to those other options.\(^{30}\)

Under the Proposed Exemption, Financial Institutions are required to mitigate conflicts of interest in order to avoid misalignment between the Investment Professional and the Retirement Investor in connection with the covered fiduciary advice and transaction.\(^{31}\) As it relates to conflict of interest mitigation policies and procedures for insurance companies, NAFA appreciates that the Department does, in fact, recognize that an insurance company operating as a financial institution under the Proposed Exemption would only be responsible for the recommendation and sale of products that are offered by that insurance company – and not those offered by unrelated or unaffiliated insurers.\(^{32}\)

But, the Department’s guidance only gets us halfway there: unlike the NAIC’s approach, here the Department fails to exclude from an insurer’s scope of supervisory requirements the compensation available to the insurance professional related to products offered by other insurers. Failing to acknowledge this critical exclusion from what an insurance company is otherwise required to include in its supervision system makes it impossible for any insurance company to comply with the Exemption’s requirement to identify and mitigate potential conflicts of interest related to an independent agent’s commission or compensation arrangements.

The Department has stated its intent to align with other regulatory bodies across the financial services industry to promote a more uniform best interest conduct standard, including alignment with the SEC’s Reg. BI and the NAIC Model Regulation 275. Additionally, the Department states that the Proposed Exemption will advance regulatory efficiencies that might not otherwise exist for investment advice fiduciaries.\(^{33}\) In fact, the Department acknowledges that the conduct standards that apply to broker-dealers under Reg. BI are functionally identical to those set forth in

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\(^{30}\) NAIC Suitability in Annuity Transactions Model Regulation (#275). See Sec. 6.C.(4)(a), (b).

\(^{31}\) Id. at 40683, Sec. II(c)(2) of the Proposed Exemption.

\(^{32}\) Id. at 40846.

\(^{33}\) Id. at 40836.
the proposed exemption, and that the satisfaction of such standards would be deemed to be compliant with the similar standards of the Proposed Exemption. 34

In that regard, NAFA would note that the revised NAIC Model Regulation 275 – which requires insurance professionals to act in the best interest of the consumer when making an annuity recommendation and requires insurers to supervise those recommendations so that the insurance needs and financial objectives of the consumer are effectively met – establishes conduct standards for annuity transactions that align significantly with the conduct standards under the Proposed Exemption.35 To the extent that the NAIC’s standards under Model Regulation 275 overlap with the relevant standards under the Proposed Exemption, NAFA would encourage the Department to deem an insurance company’s satisfaction of the NAIC Model Regulation 275 standards as being compliant with the comparable standard in the Proposed Exemption. This, we believe, would relieve compliance burdens and be in keeping with the Department’s stated desire to promote important regulatory efficiencies.

**Definition of a Financial Institution – Insurance Intermediaries**

The Department goes on to suggest that insurance companies could contract with insurance intermediaries, such as IMOs and FMOs, to perform this oversight and compliance function, although intermediaries are currently not included in the Proposed Exemption’s definition of a financial institution. While NAFA would not wish to foreclose the opportunity for an insurance intermediary that would want to apply for financial institution status, we would note that IMOs and FMOs are not compliance organizations and generally are not easily adaptable to serve such a function.

Typically, IMOs and FMOs provide recruiting and marketing, in addition to performing certain administrative functions for insurance companies; they do not oversee independent agents’ activities, nor the insurer’s compliance requirements. In fact, the independent agents have appointments or contracts directly with the insurance company – there is no contract or implied contract between the intermediary and the agent. Moreover, insurance intermediaries do not direct the insurance professional’s recommendation to a consumer to purchase an insurance annuity and, consequently, would not satisfy multiple prongs of the five-part test in determining fiduciary status. And, as with the case for an insurance company’s supervisory role, independent agents are

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34 Id. at 40852.

35 For example, under the Model Regulation’s supervision system required of insurance companies, insurers must, among other obligations, establish and maintain procedures to: (1) determine whether a producer has provided to the consumer the disclosures and information required by the regulation; (2) identify and eliminate certain incentive-tied compensation based on the sale of specific annuities within a limited period of time; (3) detect recommendations that are not in the best interest of the consumer; and (4) ensure that an annuity recommendation would effectively address the particular consumer’s financial situation, insurance needs, and financial objectives.
often affiliated with multiple insurance intermediaries, which would present similar problems under the Proposed Exemption as currently written in terms of the IMO’s or FMO’s responsibility to ensure the agent’s compliance under the impartial conduct standards.

Accordingly, there would be significant challenges for an intermediary to serve in the capacity of a financial institution. Despite those challenges and because some intermediaries may wish to pursue such a function, NAFA is not opposed to including insurance intermediaries under the definition of a Financial Institution under the Proposed Exemption.

We would, however, strongly encourage the Department to engage in meaningful dialogue with interested intermediaries prior to the release of any final rule to ensure that compliance with the exemption appropriately recognizes the business role played by IMOs and FMOs in the independent insurance agent distribution channel and does not place impracticable or burdensome conditions on them as compared to banks, broker-dealers, or registered investment advisors. To that end, NAFA would also urge the Department to clarify that insurance intermediaries would not generally be deemed fiduciaries under ERISA or the Code and would, therefore, not be required to rely upon the new Proposed Exemption.

**Disclosure Requirements**

Under the Section II(b) disclosure requirements in the Proposed Exemption, the Department requires the financial institution to provide written acknowledgment to the retirement investor that the financial institution and the investment professionals are fiduciaries under ERISA and the Code. This disclosure must be made prior to engaging in a transaction pursuant to the proposed exemption. NAFA would note that in some circumstances the financial institution may not be an investment advice fiduciary at all. Moreover, for reasons discussed previously, an investment professional may not be a fiduciary at the time of the initial transaction – but he or she may become a fiduciary at some later point by dint of future meetings with the retirement investor. Accordingly, it may be impossible to know if either the financial institution or the investment professional is, or might become, a fiduciary prior to engaging in the subject transaction. To avoid potential unintentional non-compliance with this subsection of the Proposed Exemption, NAFA requests that this requirement be removed.

**Commission-based compensation arrangements**

In its guidance, the Department discusses conflict of interest mitigation strategies and points out the minimization of compensation incentives for selling one type of product over another as one such strategy.\(^{36}\) NAFA would note that the NAIC, in addressing material conflicts of interest under...
the revisions to Model Regulation 275, tied such compensation incentives to the sale of a specific annuity product within a limited period of time, being careful not to create an overly broad presumption that general product types – a type or kind of fixed annuity product, for instance – would, in itself, suggest incentive-related conflicts. NAFA urges the Department to identify a commission-based incentive as one where the incentive is tied to the sale of a specific financial or insurance product within a limited period of time.

**Evaluating a potential rollover from an ERISA-covered Plan**

In evaluating a potential rollover from an ERISA-covered Plan, if the Plan participant is unwilling to provide information regarding the assets in the existing Plan and the information is not otherwise readily available, the Department’s guidance requires the investment professional – which, of course, may now include an insurance-only licensed agent – to evaluate the rollover by using publicly-available information to make a reasonable estimation of expenses, asset values, and risks and returns of an existing Plan and then explain to the Plan participant (i.e., the Retirement Investor) how such an evaluation was made and any limitations there might be to the Retirement Investor. The Department acknowledges that this required Plan evaluation may, in fact, overlap or conflict with existing regulatory requirements. NAFA believes that they do conflict. Insurance professionals cannot offer securities advice and are proscribed from acting in the capacity of a securities professional. An insurance-only agent could not – or, rather, should not – undertake the kind of securities-based analysis suggested here by the Department; accordingly the Department must clarify the requirements related to evaluating a potential rollover.

**Proprietary products and limited menus of investment products**

A similar problem arises as it relates to providing investment advice on proprietary products or where such advice is based on a limited menu of investment products. In these situations, the Department is requiring investment professionals to “prudently determine” that those proprietary products or limited menu products are in the best interest of the Retirement Investor when compared with other investment alternatives available in the marketplace. Accordingly, the guidance states that the Proposed Exemption would only be available if the Financial Institution “prudently concludes” that its offering would not cause a misalignment of interest. Leaving aside that fixed annuities are insurance products and are not securities investment products, the Department is requiring an insurance-only agent to compare an insurance annuity against a universe of product alternatives – i.e., security investments – that they are not licensed to advise on or sell, putting them in the crosshair of state securities regulators. We urge the Department to

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37 *Id.* at 40845.
38 *Id.* at 40847.
39 *Id.*
clarify these requirements by noting that investment professionals and financial institutions are not required to take into account products and investment strategies that they are not licensed to recommend.

**Ongoing monitoring**

Ongoing monitoring should not be required, and the Department should remove the language suggesting that monitoring is required in relation to “investments that possess unusual complexity and risk.”

That definition is too vague to apply, and we presume the Department will not wish to produce and maintain a list of specific investments that require monitoring. However, if it is retained, we ask that the Department clarify that fixed annuities are not considered unusually complex or risky.

**Annual retrospective review and certification**

Finally, the retrospective review and certification required in Section II(d) should not be required. Class exemptions typically do not employ such a requirement, and it is not necessary for the exemption to function as intended; in fact the Proposed Exemption sets forth in great detail the possible repercussions should a financial institution or investment professional not satisfy the conditions of the exemption. NAFA requests removal of Section II(d) of the Proposed Exemption.

**Conclusion**

On behalf of NAFA’s member companies and the insurance professionals operating in the fixed annuity independent distribution channel, I appreciate the opportunity to submit these comments. We urge the Department to rescind its new guidance related to defining fiduciary status and the five-part test and restore Advisory Opinion 2005-23A. We also ask the Department to consider the modifications we have suggested, which, we believe, would improve the Proposed Exemption.

I look forward to continuing our engagement with the Department. Please do not hesitate to contact me if additional information or clarification is needed.

Sincerely,

Charles J. DiVencenzo,
NAFA President & CEO
414-332-9305, ext. 1

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40 Id. at 40843.